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ACCA Paper F3

Financial Accounting (INT)

Class Notes

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Contents

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Introduction to the paper

AIM OF THE PAPER

The aim of the paper is to develop a knowledge and understanding of the underlying principles and concepts relating to financial accounting and technical proficiency in the use of double-entry accounting techniques including the preparation of basic financial statements.

MAIN CAPABILITIES

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

A Explain the context and purpose of financial reporting

B Define the qualitative characteristics of financial information and the fundamental bases of accounting

C Demonstrate the use of double-entry and accounting systems

D Record transactions and events

E Prepare a trial balance (including identifying and correcting errors)

F Prepare basic financial statements for incorporated and unincorporated entities

EXAMINER

The examiner for paper F3 is Nicola Ventress. Nicola wrote the F3 pilot paper (in your study manual, revision kit and available to download via the ACCA website). This gives us a good indication of how the syllabus areas will be examined.

FORMAT OF THE EXAM

This exam can be sat as a written or computer based exam.

The exam is 2 hours long with no reading time.

50 questions with 90 marks available.

These 90 marks are split down as 40 two mark questions and 10 one mark questions.

Both computational and non-computational questions.

Questions can be tested as multiple choice, multiple response, multiple response matching, or (most commonly) number entry.

All questions are compulsory.

Pass mark is 50%.

INTERNATIONAL AND UK STREAMS

The following notes are suitable for both the International and UK streams. There is some terminology differences between the two streams. These are summarised below:

International	**UK**
Statement of comprehensive income	Profit and loss account
Statement of financial position	Balance sheet
Non-current assets	Fixed assets
Inventory	Stock
Trade receivables	Debtors
Non-current liabilities	Long term liabilities
Trade payables	Creditors
Irrecoverable debts	Bad debts

Chapter 1

Introduction to financial reporting

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WHAT IS FINANCIAL REPORTING?

Recording:

Daybooks

Ledgers

→

Presenting:

Statement of Comprehensive Income

Statement of Financial Position

Statement in Changes in Equity

Statement of Cash Flow

What is a business?

Sole trader

This is a business that is owned and operated by one person. The sole trader and the business are legally the same entity and therefore the sole trader is personally liable for any business debts.

Partnership

This is a business that is owned by two or more people, some of which will be actively involved in the business. The partners and the business are legally the same entity and therefore the partners are jointly liable for any business debts.

Limited liability company

This type of business is owned by shareholders and run by a board of appointed directors. A company is a legal entity in its own right, and therefore the shareholders only have limited liability for any business debts.

TYPES OF ACCOUNTS AND THEIR USERS

Larger businesses have many transactions; these transactions can be recorded in two main types of accounts management accounts and financial accounts.

Management accounts

- Frequency
- Legal requirement
- Format
- Users

Financial accounts

- Frequency
- Legal requirement
- Format
- Users

Chapter 2

Financial statements

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STATEMENT OF COMPREHENSIVE INCOME (SOCI)

The statement of comprehensive income shows a summary of all income and expenses for a period of time (usually over a year).

Statement of Comprehensive Income for the year ended 31 December 2009

	$000	$000
Revenue		233,000
Less: Cost of sales		
Opening inventory	12,332	
Purchases	119,098	
Carriage inwards	1,009	
	132,439	
Closing inventory	-13,777	
		(118,662)
Gross Profit		114,338
Discounts received		5,111
Other income		4,000
		123,449
Less: Expenses		
Discounts allowed	3,444	
Depreciation	10,710	
Gas and electricity	14,122	
Irrecoverable debts	7,134	
Loan interest	4,000	
Carriage outwards	5,666	
Water rates	8,444	
Advertising	15,000	
Other expenses	3,142	
		(71,662)
Profit for the year		51,787

STATEMENT OF FINANCIAL POSITION (SFP)

This financial statement lists the assets, liabilities and capital at a point in time. It is a snapshot of a business position at a particular date (usually the year end date).

Statement of Financial Position as at 31 December 2009

	Cost $000	Accumulated Depreciation $000	Carrying Value $000
Non–current assets			
Property	150,000	(12,000)	138,000
Plant and machinery	45,000	(11,250)	33,750
Motor vehicles	26,000	(13,260)	12,740
	221,000	(36,510)	184,490
Current assets			
Inventory		13,777	
Trade receivables		12,775	
Prepayments		2,800	
Cash at bank		3,400	
			32,752
Total assets			217,242
Capital			
Opening capital		152,465	
Profit		51,787	
Drawings		(35,900)	
			168,352
Non–current liabilities			
Loan			20,000
Current liabilities			
Trade payables		12,445	
Accruals		16,445	
			28,890
Total capital and liabilities			217,242

Note: The statement of cash flows and the statement in changes in equity complete the full set of financial statements, these will be covered in detail in later chapters.

ACCOUNTING EQUATION

The accounting equation is a simple expression of the fact that at any point in time the assets of a business will be equal to its liabilities plus capital of the business.

ASSETS = CAPITAL + LIABILTIES

Dual effect and business entity principles

Dual effect

Every business transaction has an equal and opposite effect.

Business entity

For the purpose of accounting for business transactions the owner of the business is a separate entity for the business itself.

Example 1

Katy P is a sole trader and commences business on 1 July 2009. The following transactions took place in her first week of trading:

1.7.2009 Katy put $20,000 cash into the business.

3.7.2009 Katy purchased a motor vehicle for use within the business for $9,500.

7.7.2009 Katy takes out a five-year loan from the bank for $5,000.

Required:

Show the accounting equation for Katy P at the end of the week.

UNDERLYING ASSUMPTIONS

- Going concern

  Accounts are normally prepared on the going concern basis. This means that they are prepared on the assumption that a business will continue for the foreseeable future, assumed to be a year.

  Non-current assets and liabilities can only be included in financial statements which are prepared on the going concern basis.

- Accruals

  The financial statements are prepared on the accruals basis, meaning that transactions are reported in the period to which they relate, regardless of when cash is received or paid.

Chapter 3

Double entry bookkeeping

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INTRODUCTION

In chapter 2 we looked at two principles of recording transactions, the dual effect and separate entity principles. We used these principles to help us prepare the accounting equation. In reality, re-writing the accounting equation each time a transaction occurs is time consuming. What we use instead is double entry bookkeeping and ledger accounts to record the dual effect of each transaction.

Double entry bookkeeping is "the recording of monetary transactions" of a business.

Double entry bookkeeping is the fundamental concept underlying accountancy. All accounting transactions should be recorded using the double entry system.

Ledger accounts

In order to assist us with the preparation of the financial statements we use ledger accounts for simplicity. There is a ledger account for each asset, liability, income and expense item.

Each ledger account has two sides, the debit side (on the left) and the credit side (on the right)

Debit (Dr) | Name of account e.g. bank, capital | **Credit (Cr)**

Date	Narrative	$	Date	Narrative	$

The principles of ledger accounts are:

- Each transaction must have an EQUAL and OPPOSITE effect.
- To record this dual effect a DEBIT entry must have a corresponding CREDIT entry.
- A ledger account will be created for each item that appears in the statement of comprehensive income and statement of financial position.

You must learn what a **DEBIT** entry is and what a **CREDIT** entry is:

Debit	(Increasing)	**C**redit	(Increasing)
Expenses	(Comprehensive Income)	**L**iabilities	(Financial Position)
Assets	(Financial Position)	**I**ncome	(Comprehensive Income)
Drawings	(Financial Position)	**C**apital	(Financial Position)

NOTE: To decrease these types of account the debits and credits will be reversed.

Example 1

George commences business on 1 April 2009. The following transactions take place in his first two weeks of trading.

1.4.2009	He invests $50,000 into a business.
2.4.2009	He purchases $5,000 worth of goods on credit.
3.4.2009	He sells half of the inventory for $6,000 cash.
4.4.2009	He issues a cheque to pay for the goods he received on credit.
5.4.2009	He pays his rent for April of $450 by cheque.
6.4.2009	He sells his remaining inventory for $6,000 on credit.
7.4.2009	He purchased goods on credit for $7,000.
8.4.2009	He purchases a delivery van for $7,000 cash.

Required:

For the first two weeks of trading prepare:

1. The journal entries (recording the dual effect) for each transaction
2. The ledger accounts
3. The trial balance
4. The statement of comprehensive income
5. The statement of financial position

Example 1 Solution

Journal

1.4.2009

2.4.2009

3.4.2009

4.4.2009

5.4.2009

6.4.2009

7.4.2009

8.4.2009

Example 1 Solution

Main Ledger

Example 1 Solution

Example 1 Solution

Example 1 Solution

Trial balance

Account name	Financial Statement	$	$
Bank			
Capital			
Purchases			
Trade payables			
Sales			
Rent			
Trade receivables			
Motor vehicles			
Total			

Closing Inventory Journal

Example 1 Solution

George Statement of Comprehensive Income for the two weeks ended 14 April 2009

	$	$
Sales		
Less: Cost of sales		
Opening inventory		
Purchases		
Closing inventory		
Gross profit		
Other income		
Less: expenses		
Rent		
Profit for the year		

Example 1 Solution

George Statement of Financial Position as at 14 April 2009

	Cost $	Accumulated Depreciation $	Carrying Value $
Non–current assets			
Motor vehicles			
Current assets			
Inventory			
Trade receivables			
Cash at bank			
Total assets			
Capital			
Opening capital			
Profit			
Drawings			
Non–current liabilities			
Current liabilities			
Trade payables			
Total capital and liabilities			

Example 2

Tina starts business on 1 January 2010. The following transactions take place in her first month of trading.

1.1.2010	She invests $65,000 into a business.
2.1.2010	She purchases $8,000 worth of goods on credit.
7.1.2010	She sells a quarter of the inventory for $4,000 cash.
8.1.2010	She issues a cheque to pay for half of the goods she received on credit.
14.1.2010	She pays her insurance for January by issuing a cheque for $75.
15.1.2010	She sells her remaining inventory for $12,000 on credit.
16.1.2010	She purchased goods on credit for $10,000.
18.1.2010	She purchases some computer equipment for $3,000 cash.
20.1.2010	She pays her rent for January by cheque for $150.
21.1.2010	She sells half her inventory for $10,000 cash.
25.1.2010	She withdraws $100 from the bank and put it into the petty cash tin (this is cash in hand).
31.1.2010	She purchases some stationery worth $30 taking money from the petty cash tin.

Required:

For the first month of trading prepare:

1. The journal entries (recording the dual effect) for each transaction.
2. The ledger accounts.
3. The trial balance.
4. The statement of comprehensive income.
5. The statement of financial position.

Example 2 Solution

Journal

1.1.2010

2.1.2010

7.1.2010

8.1.2010

14.1.2010

15.1.2010

16.1.2010

18.1.2010

20.1.2010

Example 2 Solution

21.1.2010

25.1.2010

31.1.2010

Main Ledger

Example 2 Solution

Example 2 Solution

Example 2 Solution

Example 2 Solution

Trial balance

Account name	Financial Statement	$	$
Bank			
Capital			
Purchases			
Trade payables			
Sales			
Insurance			
Trade receivables			
Computer equipment			
Rent			
Petty cash			
Stationery			
Total			

Closing Inventory Journal

Example 2 Solution

Tina Statement of Comprehensive Income for the month ended 31 January 2010

	$	$
Sales		
Less: Cost of sales		
Opening inventory		
Purchases		
Closing inventory		
Gross profit		
Other income		
Less: expenses		
Insurance		
Rent		
Stationery		
Profit for the year		

Example 2 Solution

Tina Statement of Financial Position as at 31 January 2010

	Cost $	Accumulated Depreciation $	Carrying Value $
Non–current assets			
Computer equipment			
Current assets			
Inventory			
Trade receivables			
Cash at bank			
Petty cash			
Total assets			
Capital			
Opening capital			
Profit			
Drawings			
Non–current liabilities			
Current liabilities			
Trade payables			
Total capital and liabilities			

Chapter 4

Inventory

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INTRODUCTION

Inventory is the product we purchase and sell in the business.

In a business it is unlikely that all of the inventory will be sold at the end of an accounting period, this inventory left over is known as closing inventory.

Closing inventory is an asset and appears in the statement of financial position under the heading current assets.

Statement of Financial Position (extract) as at 31 December 2009

Current Assets	$000
Inventory	**13,777**

Closing inventory also forms part of cost of sales in the statement of comprehensive income.

Statement of Comprehensive Income (extract) for the year ended 31 December 2009

	$000	$000
Revenue		233,000
Less: Cost of sales		
Opening inventory	12,332	
Purchases	119,098	
Carriage inwards	1,009	
	132,439	
Closing inventory	-13,777	
		(118,662)
Gross Profit		114,338

By deducting closing inventory from cost of sales at the end of the period it is an application of the accruals concept.

Accruals concept

This is sometimes referred to as the 'matching' concept because we aim to match all income earned in the period with the expenditure incurred in generating that income.

In other words, we must recognise income and expenditure on an earned/incurred basis, irrespective of when cash is received or paid.

Example 1

Shay, a sole trader starts the year with inventory of $50,000. During the year Shay makes sales of $300,000 and purchases goods for resale of $180,000. Shay has inventory of $84,000 at the end of the year.

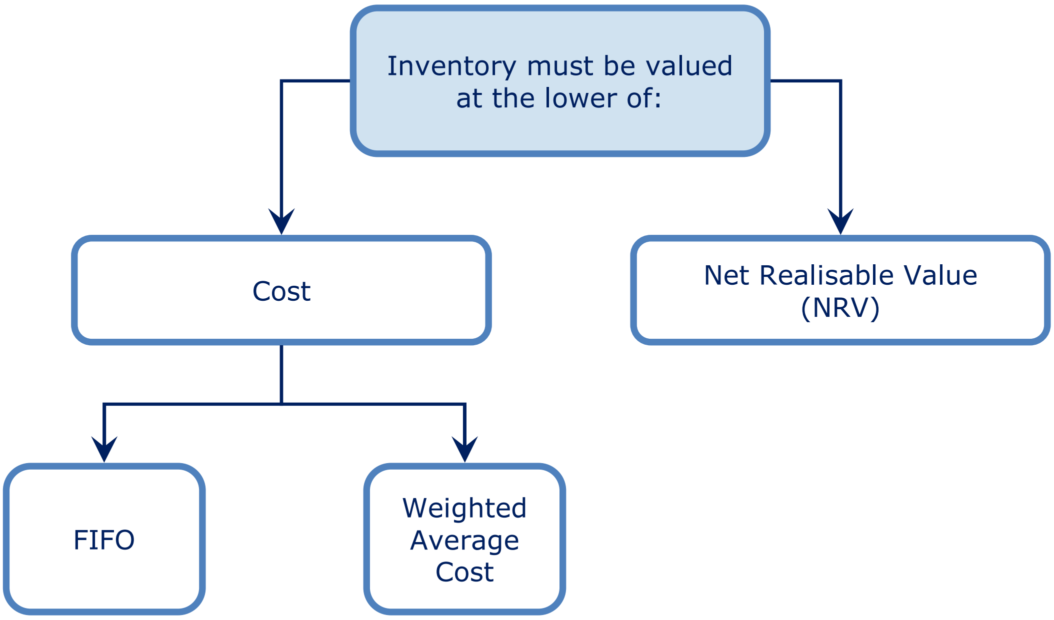
Shay also incurred carriage inwards costs of $20,000, carriage outwards costs of $9,000 and other expenses of $68,000.

Required:

Prepare the statement of comprehensive income for Shay for the year.

VALUING CLOSING INVENTORY

IAS 2 is the accounting standard that gives detailed guidance on how to value closing inventory.



First in first out (FIFO)

This method of inventory assumes that the closing inventory left at the end of the period is the newest inventory at its latest prices, as it assumes that items purchased first will be sold first.

In time of rising prices (e.g. in periods of positive inflation), closing inventory will have a higher cost and therefore a higher valuation in the financial statements.

Weighted average cost

Under this method assume all units are issued at the current weighted average cost per unit which is recalculated each time more items are purchased. There are two methods of calculating this, the periodic and continuous methods. Later examples show how these are calculated.

Last in first out (LIFO)

Under international accounting standards this is not an acceptable method of inventory valuation.

Accounting for closing inventory

Once the value of closing inventory has been calculated it should be entered into the accounts through the journal.

The journal entry for closing inventory is:

Dr	Inventory (Asset)	(Statement of financial position)
Cr	Inventory (Cost of sales)	(Statement of comprehensive income)

Example 2

Navigator Office Supplies made the following purchases and sales in January:

Purchases

Date	Pens	Unit cost	Total
3rd	500	$4.00	$2,000
12th	500	$4.60	$2,300
16th	400	$4.75	$1,900
22nd	700	$5.25	$3,675
31st	900	$5.40	$4,860
	3,000		$14,735

Sales

Date	Pens	Unit price	Total
7th	300	$10.00	$3,000
13th	400	$10.00	$4,000
17th	300	$10.00	$3,000
29th	700	$10.00	$7,000
	1,700		$17,000

Required:

Assuming there is no opening inventories prepare the statement of comprehensive income using the following methods:

- FIFO.
- Weighted Average Cost.

Net realisable value (NRV)

The net realisable value is the amount of proceeds we can receive from selling inventory less any costs to sell.

Usually this is higher than cost if the business wants to make a profit. However, it may be the case that inventory cannot be sold for a profit because it may have become damaged or obsolete.

Example 3

Radiance Kitchenware has the following items in their financial statements for the year ended 31 December 2009:

Inventory at 1 January 2009	$45,678
Purchases	$98,000
Inventory at 31 December 2009	$42,800

Closing inventory includes the following damaged items:

- A table was purchased for $500. Due to fire damage the maximum it can be sold for is $200 after a wax product costing $50 has been applied.
- Four chairs costing $100 each were also damaged in the fire. They can be sold for $20 each.

Required:

Calculate the cost of sales for inclusion in the statement of comprehensive income for the year ended 31 December 2009.

Chapter 5

Non-current assets

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INTRODUCTION

An asset can be defined as:

- A resource controlled by the entity as a result of past events
- where future economic benefits are expected to flow.

A non-current asset is an asset that is intended for continued use in a business (generally for more than one accounting period). They are shown at the top of the statement of financial position.

Tangible non-current assets are assets that have a physical substance. Examples include:

- Land
- Buildings
- Plant and machinery
- Motor vehicles
- Computer equipment
- Fixtures and fittings.

CAPITAL AND REVENUE EXPENDITURE

Capital expenditure

Capital expenditure is the costs of acquiring non-current assets. Per I.A.S. 16 the following costs may be capitalised in the statement of financial position on acquisition of a non-current asset:

- Initial cost
- Delivery costs
- Non-refundable import taxes
- Installation costs
- Any costs incurred in bringing the asset into intended use.

Capital expenditure may also be subsequent expenditure that enhances the performance of the asset, therefore increasing the economic benefits that asset brings.

Revenue expenditure

Revenue expenditure is expenditure on maintaining the earning capacity of non-current assets. Costs that are regarded as revenue expenditure and shown as an expense in the statement of comprehensive income and may not be capitalised per I.A.S. 16 are:

- Insurance costs
- Repairs
- Maintenance

Example 1

Classify the following costs as capital or revenue expenditure:

	Capital	**Revenue**
Purchase of a new motor vehicle		
Purchase of a tax disc		
Fuel		
Insurance		
CD Player		
Alloy wheels		
New tyre		

DEPRECIATION

Depreciation is the charge to the statement of comprehensive income to reflect the consumption of an asset in a period.

By applying depreciation charges, we are consistent with the ACCRUALS CONCEPT i.e. applying the cost of using the asset to the statement of comprehensive income for the same period.

All tangible non-current assets should be depreciated on a systematic basis per I.A.S. 16, with the exception of land. This is because land is seen to appreciate in value.

Accounting for depreciation

Once the depreciation charge has been calculated it should be entered into the accounts through the journal.

The journal entry for depreciation is:

Dr	Depreciation expense	(Statement of comprehensive income)
Cr	Accumulated depreciation	(Statement of financial position)

Non-current assets are shown at their carrying value in the statement of financial position.

Statement of Financial Position (extract) as at 31 December 2009

	Cost	Accumulated Depreciation	Carrying Value
	$000	$000	$000
Non–current assets			
Property	150,000	(12,000)	138,000
Plant and machinery	45,000	(11,250)	33,750
Motor vehicles	26,000	(13,260)	12,740
	221,000	(36,510)	184,490

Methods of depreciation

Calculating depreciation in a given period are common questions in this exam. There are two main methods of depreciation. These are straight line and reducing balance.

Straight line depreciation

Depreciation is charged on a straight-line basis over the life of the non-current asset. This means an equal amount is charged in every accounting period over the life of the asset.

To calculate the depreciation charge the following formula is used:

$$\text{Depreciation per annum} = \frac{\text{Original cost} - \text{estimated residual value}}{\text{Estimated useful Life}}$$

Alternatively the examiner may choose to give you a straight-line depreciation percentage; this percentage must be applied to the cost of the asset.

$$\text{Depreciation per annum} = \% \times \text{cost}$$

Example 2

Mr Bubble purchased a building on 31 July 2005 for $150,000. The building has an expected useful life of five years and a residual value of $20,000.

Calculate the depreciation charges for each of the five years ended 31 December on the basis:

1. It is Mr Bubble's policy to depreciate on a straight-line basis with a full year's charge made in the year of acquisition and none in the year of disposal.
2. It is Mr Bubble's policy to depreciate on a straight-line basis with proportionate depreciation in the year of purchase.

Reducing balance depreciation

This method of depreciation is generally used for assets that tend to lose more value in the initial years and require greater maintenance in the later years.

A fixed percentage is charged to the carrying value on an annual basis. Hence, as the book value of an asset reduces, the depreciation charge reduces accordingly.

Depreciation per annum = % x carrying value

Example 3

Mr Jazzy purchased a motor vehicle for $25,000 on 1 October 2006. The estimated useful life is three years.

Required:

Calculate the depreciation charges for each of the three years ended 31 December on the basis:

1. It is Mr Jazzy's policy to charge depreciation at 25% per annum on a reducing balance basis, with a full year's charge in the year of acquisition and none in the year of disposal.
2. It is Mr Jazzy's policy to charge depreciation at 25% per annum on a reducing balance basis, with proportionate depreciation in the year of purchase.

DISPOSAL OF NON-CURRENT ASSETS

When a business disposes of an asset it is unlikely that the sale proceeds will agree with the carrying value of the asset at the date of disposal. A profit or loss on disposal will arise which will need to be calculated and accounted for:

	$
Sale proceeds	X
Carrying value of asset at the date of disposal	(X)
Difference = Profit / (Loss) on disposal	X/(X)

Accounting for a disposal

- Step 1: Remove the cost

Dr Disposals

Cr Non-current asset cost

- Step 2: Remove the accumulated depreciation

Dr Non-current asset accumulated depreciation

Cr Disposals

- Step 3: Deal with the sale proceeds

Dr Bank (Cash proceeds)

Cr Disposals

- Alternative step 3: part-exchange proceeds

Dr Asset cost

Cr Bank

Cr Disposals (with part-exchange allowance)

Example 4

Mrs Kemp purchased a motor vehicle on 1 April 2005 costing $22,000 and depreciates the asset 20% reducing balance basis with proportionate depreciation in the years of purchase and disposal. Mrs Kemp sold the motor vehicle for $8,000 on 1 July 2009.

Mrs Kemp has a year-end of 31 December each year.

Required:

Show the journal entries to record the disposal and complete the disposals ledger account.

Calculate the profit / loss arising on the disposal.

Example 5

Lesley bought a van costing $15,000 several years ago. On 1 March 2010 the van was exchanged for the latest model.

At the date of exchange the old van's carrying value was $3,400 and the dealership gave a part-exchange allowance of $1,500. The new van has a list price of $18,000.

Required:

Show the journal entries to record the disposal and complete the disposals ledger account.

Calculate the profit / loss arising on the disposal.

REVALUATIONS

When a non-current asset is purchased we record them at their initial cost. However, over time these values may materially differ from their market value.

For example, if a company purchased a property 20 years ago and therefore subsequently charged depreciation for 20 years, it would be safe to assume that the carrying value of the asset would be significantly different from today's market value.

In order to overcome this issue I.A.S. 16 permits companies to reflect the market value in the statement of financial position.

This policy may be adopted (i.e. the business has a choice), and if so the following rules must be applied per the standard:

- If a company chooses to revalue an asset they must revalue all assets in that category.
- Revaluations must be regular.
- Subsequent depreciation must be based on the revalued amounts.
- Gains from revaluations are not taken to the statement of comprehensive income, as no gain has been realised.

	$
Valuation (revalued amount)	X
Carrying value of asset at the date of revaluation	(X)
Difference = Revaluation gain / (loss)	X/(X)

Accounting for revaluations

To account for a revaluation gain you must increase the asset value and create a revaluation reserve.

Dr	Asset cost	(Statement of financial position)
Dr	Accumulated depreciation	(Statement of financial position)
Cr	Revaluation reserve	(Statement of financial position)

Example 6

Chris Lebowski purchased a building at a cost of $45,000 on 1 January 1994 with a useful life of 50 years. Chris's policy is to depreciate buildings 2% per annum straight-line basis with a full's years charge in the year of acquisition and none in the year of disposal.

On 1 January 2009 the building had been valued by a qualified valuer, the valuation given was $150,000. Chris would like to incorporate this valuation in the financial statements for the year ended 31 December 2009.

Chris has stated that the useful life of the asset will remain at fifty years.

Required:

(a) Calculate the revaluation gain or loss to be shown in Chris's financial statements for the year to 31 December 2009.

(b) Complete the necessary journals and ledger accounts to record the revaluation.

(c) Calculate the depreciation charge for the year ended 31 December 2009.

NON-CURRENT ASSET REGISTER

The majority of companies will own a number of non-current assets, and it is imperative that effective control is kept over them. In order to ensure management is aware exactly where each item is located and that they are adequately maintained and serviced, a non-current asset register is maintained.

A non-current asset register is generally maintained in the finance department. Companies can purchase specifically designed packages or a register can simply be maintained on an Excel spreadsheet.

Here is what a typical non-current asset register would look like:

Motor Vehicles

Asset type	Date purchased	Description	Cost	Depreciation	Carrying Value	Disposal proceeds	Disposal date
Motor Vehicles	1 Jun 2005	Purple Ford Fiesta	8,000				
	Year ended 31 Dec 2005			2,000	6,000		
	Year ended 31 Dec 2006			1,500	4,500		
	Year ended 31 Dec 2007			1,125	3,375		
	Year ended 31 Dec 2008					1,500	Nov-08

INTANGIBLE ASSETS

Intangible assets are used in a business on an ongoing basis and do not have physical substance.

Examples of intangibles:

- Goodwill
- Patents
- Brands / trademarks
- Copyrights.

These can only be capitalised on the statement of financial position if they have been purchased. This is because the cost can be reliably measured.

Research and development

Research – No expectation of future economic benefits

Always written off to the statement of comprehensive income as incurred.

Development – Can capitalise if meets six criteria and amortised once brought into production.

1. Technically feasible
2. Ability to use or sell
3. Probable that future economic benefits to flow
4. Intention to complete
5. Resources available to complete
6. Costs can be reliably measured

Subsequent treatment

Intangible assets are amortised over their useful lives on a systematic basis. If it has indefinite useful life it is reviewed for impairment instead.

Dr	Amortisation expense	(Statement of comprehensive income)
Cr	Accumulated amortisation	(Statement of financial position)

Chapter 6

Irrecoverable debts and the allowance for receivables

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INTRODUCTION

The majority of companies sell their products on credit. The length of credit will vary between companies, but the most common length of credit is 30 days. It is the responsibility of the credit control department of a business to ensure that any outstanding receivables balances are promptly paid by the customer.

If however, a customer fails to pay we need to be able to account for this is our ledgers. It would not be prudent to hold a receivable in our statement of financial position if we were aware that they are unlikely to pay.

IRRECOVERABLE DEBTS

This is a debt that you consider to be uncollectable. Circumstances where this would occur are if the customer has been fraudulent, gone bankrupt or disappeared. This would mean that it is unlikely that we will receive the money due to us.

If this is the case we should not have this balance in our receivables, and would therefore write the debt off.

Accounting for irrecoverable debts

Once the amount to be written off has been established, it should be entered into the accounts through the journal.

The journal entry for irrecoverable debts is:

Dr	Irrecoverable debts	(Statement of comprehensive income)
Cr	Trade receivables	(Statement of financial position)

Example 1

George has a small antiques business and at the end of the financial year ended 30 April 2007 has a receivables balance of $42,500. Included in the year-end balance is $4,000 that is owed by Zippy Traders. George has heard that they have been closed down due to financial irregularities and that all the directors have disappeared.

Also included in the amount is $500 owed by Bungle who is George's brother-in-law. Bungle has left George's sister and George is not sure if he will pay his debt which is due in 2 weeks time.

Required:

How should George account for these items?

Recovering irrecoverable debts

If a debt that has previously been written off is subsequently recovered, we will need to adjust the ledgers to reflect this.

The journal entry for this is:

Dr	Bank	(Statement of financial position)
Cr	Irrecoverable debts	(Statement of comprehensive income)

ALLOWANCE FOR RECEIVABLES

Doubtful debts are those which have not yet been paid within the credit terms offered, yet are not considered to be irrecoverable. There is uncertainty as to whether they are collectable because:

- The customer may be temporarily unable to pay
- The customer is disputing or querying an invoice.

As the customer could still pay the business so it is inappropriate to cancel the receivable; instead, to be prudent, we create an allowance for receivables account to reflect the uncertainty and to show the receivables in the statement of financial position net of this allowance:

Statement of Financial Position (extract) as at 31 December 2009

Current Assets	$000
Trade receivables	15,000
Less: allowance for receivables	(2,500)
	$12,500

Calculation of the allowance

The allowance for receivables is normally made up of:

- Specific allowance

  This is calculated first and is specific to an individual doubtful debt.

- General allowance

  This is a general percentage of all receivables after irrecoverable debts have been written off and any specific allowances have been provided for. This is to reflect general uncertainty over all receivables, whether late paying or not.

Example 2

At 31 December 2009 trade receivables were $152,000. The following information is given for the year to 31 December 2009:

- Irrecoverable debts of $6,000 are to be written off.
- Specific allowances are to be made against two invoices for $4,600 and $1,400.
- A general allowance of 6% is to be maintained.
- The opening balance on the allowance for receivables account is $8,000.

Required:

Prepare the following accounts for the year to 31 December 2009:

(a) Irrecoverable debt expense;

(b) Allowance for receivables;

(c) Trade receivables.

Accounting for the allowance

The allowance for receivables is a liability which is carried forward and brought forward each year. We must therefore only account for the movement in the allowance for receivable account. The double entry will depend on whether it is an increase or decrease in allowance.

Journal for an increase in allowance:

Dr Irrecoverable debts	(Statement of comprehensive income)
Cr Allowance for receivables	(Statement of financial position)

Journal for a decrease in allowance:

Dr Allowance for receivables	(Statement of financial position)
Cr Irrecoverable debts	(Statement of comprehensive income)

Example 3

Jen's year-end receivables balance was $114,000. However, following review of receivables she realised that she must write off an irrecoverable debt of $4,000 and establish an allowance against a specific doubtful debt of $10,000. She wishes to maintain her allowance against receivables at 3%. The opening balance on the allowance for receivables account is $4,400.

Required:

Complete the ledger accounts for irrecoverable debts, the allowance for receivables and the trade receivables account.

Recovery of a doubtful debt

Where a debt which is considered doubtful has been allowed is recovered, this is recorded in the normal way:

Dr Bank

Cr Trade receivables

When the new allowance is then calculated at the year-end, the debt will no longer form part of it.

Example 4

Benny has a year-end of 31 December each year. At 31 December 2008 Benny had a balance on the allowance for receivables account (in respect of customer Longhine) for $100.

During the year to 31 December 2009 Longhine settled the debt.

Required:

Show how you would account for this transaction using journal entries.

Chapter 7

Accruals and prepayments

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INTRODUCTION

The accruals concept states that we must recognise transactions as they occur, irrespective of when cash is received or paid. We have seen this in action in previous sessions, for instance when we account for credit sales and purchases.

In this session we will focus on year-end adjustments to other income and expenses which are accruals and prepayments.

ACCRUED EXPENSES

An accrual is an expense due but not yet paid or invoiced for. We must adjust our financial accounts for that expense even though we have no bill for it yet.

The double entry journal to record an accrual is:

Dr Expense	(Statement of comprehensive income)
Cr Accruals	(Statement of financial position)

Let's consider the following example:

Example 1

Mrs Nelly is a sole trader specialising in selling yummy cup cakes; she set up her business on 1 February 2009. She receives her gas bills quarterly in arrears. In the period ended 31 December 2009 the following bills were received and paid:

30 April 2009	$300
31 July 2009	$310
31 October 2009	$300

Required:

What is the amount for the gas expense to be shown in the statement of comprehensive income for the period ended 31 December 2009, Mrs Nelly's first year of trading?

Example 2

Julia is a sole trader who has been in business for a number of years. At 1 March 2008 she had an accrual brought forward of $1,200 in relation to rent.

Rent is paid as follows:

7 April 2008	$1,500 (for the quarter ended 31 March 2008)
9 July 2008	$1,950 (for the quarter ended 30 June 2008)
6 October 2008	$2,250 (for the quarter ended 30 September 2008)
9 January 2009	$1,650 (for the quarter ended 31 December 2008)

Required:

Prepare the rent ledger account showing the rent expense to be included in the statement of comprehensive income for the year ended 28 February 2009.

PREPAID EXPENSES

A prepayment adjustment is necessary where a business has paid for an expense now, which relates to the next accounting period.

The double entry journal to record a prepayment is:

Dr Prepayments	(Statement of financial position)
Cr Expense	(Statement of comprehensive income)

Example 3

Mariah starts her business on 1 August 2008, and pays her insurance for the year to 31 July 2009 totaling $1,800. Her year-end is 31 December each year.

Required:

What is the amount for the insurance expense to be shown in the statement of comprehensive income for the year ended 31 December 2008?

Example 4

Continuing the previous example, on 1 August 2009 Mariah pays her insurance for the year to 31 July 2010 totaling $2,200.

Required:

What is the amount for the insurance expense to be shown in the statement of comprehensive income for the year ended 31 December 2009?

ACCRUED INCOME

Accrued income is sundry income earned, but not yet received.

The double entry journal to record accrued income is:

Dr Accrued income	(Statement of financial position)
Cr Income	(Statement of comprehensive income)

Example 5

Jen has been sub-letting one of her properties to a tenant for many years. She receives rent quarterly in arrears. At 30 November 2008 she had a balance of rent in arrears of $27,600. The total amount of rent received during the year ended 30 November 2009 was $718,050. At 30 November 2009 there was still rent in arrears of $31,800.

Required:

What is the amount of rental income to be shown in the statement of comprehensive income for the year ended 30 November 2009?

DEFERRED INCOME

Deferred income is income which has been received but which relates to the following accounting period.

The double entry journal to record deferred income is:

Dr Income	(Statement of comprehensive income)
Cr Deferred income	(Statement of financial position)

Example 6

Mandy receives rent quarterly in advance; her financial year-end is 30 April each year. She has a balance on deferred income at 1 May 2009 of $200.

Rent is received as follows:

1 June 2009	$600 (covering the quarter ended 31 August 2009)
1 September 2009	$450 (covering the quarter ended 30 November 2009)
1 December 2009	$500 (covering the quarter ended 28 February 2010)
1 March 2010	$600 (covering the quarter ended 31 May 2010)

Required:

What is the amount of rental income to be shown in the statement of comprehensive income for the year ended 30 April 2010?

Chapter 8

Sales tax

CHAPTER CONTENTS

WHAT IS SALES TAX?

Sales tax is a tax on the final consumer of a product, which is collected on behalf of the tax authorities by the business.

A business that is registered for sales tax charges sales tax on products it sells and can recover sales tax it suffers on purchases.

Example 1

A table manufacturer sells tables to a wholesaler who then sells them on to a retailer. Finally the retailer sells to the final consumer.

The manufacturer sells the tables to a wholesaler for $100.

The wholesaler sells the tables to the retailer for $160.

The retailer then sells the tables to the consumer for $300.

The rate of sales tax is 15%.

Required:

Calculate the amount of sales tax that will be payable to the local authority by each business.

Calculating sales tax

	$000
List price	200
Trade discount @ 10%	(20)
Net amount	180
Sales tax @ 15%	27
Gross amount	207

Accounting for sales tax

A ledger account is created for sales tax to record the sales tax on sales and purchases.

Double entry for sales

Dr Bank / trade receivables
Cr Sales
Cr Sales tax control account

Double entry for purchases

Dr Purchases
Dr Sales tax control account
Cr Bank / trade payables

Double entry for payments to tax authorities

Dr Sales tax control account
Cr Bank

Example 2

A business sells goods on credit for a list price of $2,000 and gives a 5% trade discount.

The business then purchases goods for cash from a supplier paying $1,150 inclusive of sales tax. The business also pays $20 cash net of sales tax for stationery. The rate of sales tax is 15%

Required:

Calculate the net sales tax payable in the sales tax ledger control account and the double entry for each transaction.

Chapter 9

Books of prime entry

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INTRODUCTION TO BOOKS OF PRIME ENTRY

Main business transactions are summarised into books of prime entry for later posting to the ledgers.

The common books of prime entry and the types of transaction recorded in them are:

Sales Day Book (SDB)	Records credit sales to customers
Sales Returns Day Book (SRDB)	Records the return of credit sales
Purchases Day Book (PDB)	Records credit purchases from suppliers
Purchases Returns Day Book (PRDB)	Records the return of credit purchases
Cash Payments Book (CPB)	Records all payments made at the bank
Cash Receipts Book (CRB)	Records all receipts made at the bank
Petty Cash Book	Records all receipts and payments of cash in hand
Journal	Other transactions (Depreciation etc)

Sales day book

Records credit sales transactions to then be recorded to the Receivables Ledger Control Account and the Receivables Ledger (individual customer accounts).

Date	Invoice no.	Customer	Net	Sales Tax	Gross
01-Dec	1,596	Chris	250	37.50	287.50
02-Dec	1,597	Neil	300	45	345
05-Dec	1,598	Carly	100	15	115
07-Dec	1,599	Amy	50	7.50	57.50
		TOTAL	700	105	805

Purchases day book

Records credit purchase transactions to then be recorded in the Payables Ledger Control Account and the Payables ledger (individual supplier accounts).

Date	Invoice no.	Supplier	Net	Sales Tax	Gross
02-Dec	1,456	Paul	75	11.25	86.25
04-Dec	952	Joanne	160	24	184
05-Dec	632	Billy	50	7.50	57.50
06-Dec	1,1475	Ann	350	52.50	402.50
		TOTAL	635	95.25	730.25

Returns day books

Sales Returns Day Book

Date	Credit note	Customer	Net	Sales Tax	Gross
08-Dec	12	Chris	50	7.50	57.50

Purchase Returns Day Book

Date	Credit note	Supplier	Net	Sales Tax	Gross
12-Dec	2500	Ann	100	15	115

Discounts

Trade Discounts

These are discounts that are pre-agreed with the customer or supplier and the list price on the invoice is amended.

Early settlement discounts

Discounts Allowed

Double entry
Dr Discounts Allowed
Cr Trade Receivables Control Account

Discounts Received

Double entry
Dr Trade Payables Control Account
Cr Discounts Received

Contras

Where another business is both a customer and a supplier the balances on the receivables and payables accounts may be netted off against each other to show one balance which is receivables or payable.

Double entry
Dr Trade Payables Control Account
Cr Trade Receivables Control Account

Cash receipts book

This is one half of the cashbook; it records all receipts in the bank.

Date	Narrative	Bank	Receivables	Cash sales	Bank interest received	Discount Allowed
01-Dec	Cash sales	1,000		1,000		
05-Dec	Interest received	15			15	
07-Dec	Chris	217.50	217.50			12.50
08-Dec	Neil	330	330			15
10-Dec	Cash sales	1,500		1,500		
	TOTAL	3,062.50	547.50	2,500	15	27.50

Cash payments book

This is the other half of the cashbook; it records all payments out of the bank.

Date	Narrative	Bank	Payables	Wages	Utilities	Discount Received
01-Dec	Wages	1,500		1,500		
05-Dec	Water rates	50			50	
07-Dec	Paul	80	80			6.25
08-Dec	Joanne	170	170			14
10-Dec	Electricity	70			70	
	TOTAL	1,870	250	1,500	120	20.25

Petty cash book

A separate cashbook is kept for petty cash, which is used to cover sundry expenses.

Receipt	Date	Narrative	Cash	Postage	Refreshments
100	01-Dec	Bank			
	02-Dec	Tea & coffee	5		5
	03-Dec	Stamps	10	10	
	04-Dec	Biscuits	2		2
		TOTAL	17	10	7

Imprest system

CONTROL ACCOUNTS

Dr | **Receivables Ledger Control Account** | **Cr**

Narrative	**$**	**Narrative**	**$**
Balance b/f	X	Cash received	X
Credit sales	X	Discount allowed	X
Returned cheques	X	Sales returns	X
Interest on overdue accounts	X	Contra with payables ledger	X
Refunds given to customers	X	Irrecoverable debt w/off	X
		Balance c/f	X
	X		X
Balance b/f	X		

Dr | **Payables Ledger Control Account** | **Cr**

Narrative	**$**	**Narrative**	**$**
Cash payments	X	Balance b/f	X
Discount received	X	Credit purchases	X
Purchase returns	X	Refunds received from suppliers	X
Contra with receivables ledger	X		
Balance c/f	X		
	X		X
		Balance b/f	X

Example 1

The following are the balances on Gary's ledger accounts in the month of March:

Opening payables balance	$12,785
Purchase day book	$44,999
Returns outwards day book	$3,950
Returns inwards day book	$2,300
Cheques paid to suppliers	$37,500
Discounts received	$1,400
Sales ledger contras	$900

Required:

Calculate the closing balance for the payables account at the end of March.

Example 2

Paris had the following balances on her payables / receivables for the financial year ended 30 June 2009.

Sales made on credit	$450,000
Cash sales	$22,000
Credit purchases	$300,000
Cash purchases	$4,500
Sales returns	$17,000
Purchase returns	$14,000
Discounts allowed	$11,000
Discounts received	$12,000
Irrecoverable debts written off	$2,500
Payments made to credit suppliers	$263,100
Receipts from credit customers	$438,580
Contra	$17,500
Balance on trade payables control at 1 July 2008	$53,500
Balance on trade receivables control at 1 July 2008	$51,500
Balance on allowance for receivables at 1 July 2008	$3,400

The allowance for receivables is to be maintained @ 1.5% of the remaining receivables balance.

Required:

Prepare the receivables and payables control accounts for the year ended 30 June 2009.

Chapter 10

Control account reconciliations

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INTRODUCTION

Normally at the end of each month we check to ensure our control accounts reconcile to the individual balances on our ledger accounts. We do this by checking our list of individual balances tie into the control account balance.

If there is an imbalance then it must be investigated. The main discrepancies are due to:

1. Casting error in the day books.
2. Posting error.
3. A one sided contra.
4. An entry that has been made in the individual account but not in the control accounts.
5. An entry being omitted from the control account.

EXAMPLES

Example 1

At the financial year-end 31 December 2007 Explorer Rain Wear had a balance on the payables control account of $22,550. The balance on their payables ledger was $20,650. The accountant found the following discrepancies:

1. An invoice of $1,200 had been omitted from the control account.
2. The purchase day book total was overstated by $1,000.
3. Goods returned of $1,590 had not been recorded in the control account.
4. Discounts received of $10 had not been posted in the control account.
5. Contra entries of $500 need to be recorded in the control account.

Required:

After adjusting for these errors, what is the adjusted control account balance and adjusted list of balances?

Example 2

Benji has a debit balance of $72,266 on the trade receivables control account, which does not agree with the list of receivables balances figure of $70,659. The accountant found the following discrepancies:

1. A contra of $7,296 with the trade payables control account was entered on the wrong side of the trade receivables control account.
2. The sales day book was overcast by $2,500.
3. Discounts totaling $36,015 have been omitted from the control account.
4. A debt of $3,000 needs to written off and an allowance for receivables needs to be adjusted to 2% of the remaining receivables balance.
5. A cash receipt for $20,000 has been omitted from the individual customers account.
6. A customer invoice of $3,500 was entered into the ledger account as $35,000.

Required:

Reconcile the control account to the list of receivables balances.

Example 3

Gaga Co. receives a supplier statement from Rihanna Co. The balance on Rihanna Co's account in the books of Gaga Co shows an amount outstanding of $118,000. However, according the supplier statement it shows an amount outstanding of $138,000.

The accountant has investigated into the difference and has found the following issues:

1. Goods returned to the supplier worth $15,000 have not been reflected in the supplier statement.
2. Discounts of $500 have been disallowed by Rihanna Co.
3. Rihanna has made an agreed contra entry of $5,000 with the amounts owed by Gaga Co. Gaga Co has not recorded this entry in its books.
4. A payment made to Rihanna Co. of $9,500 has not been reflected in the supplier statement.

Required:

What is the correct amount owed to Rihanna Co. after adjusting for the above issues?

Example 4

Michael's receivables ledger control account does not agree with the list of receivables balances.

Upon investigation Michael discovered the following errors:

1. The sales returns day book was under cast by $4,000.
2. A credit note has been entered into the sales returns day book as $530 instead of $350.
3. An irrecoverable debt has only been written off in the individual customer account.
4. A contra entry has only been entered into the control account.
5. The total of the discounts allowed column in the cash receipts book has been overcast by $250.
6. The total of the receivables column in the cash receipts book has been entered into the wrong side of the control account.

Required:

Which of the above errors would cause a difference between the control account balance and the total of the list of receivables balances?

Chapter 11

Correction of errors and suspense accounts

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TYPES OF ERROR

In earlier sessions we prepared a trial balance that lists all the main ledger account balances. We did this to check that all the debit balances equaled the total of the credit balances. The main reason we do this is to check for errors.

However, there may be situations where there are errors that are not detected by extracting a trial balance resulting in the total of the debit column equalling the credit column.

Errors that can arise that do not result in an imbalance of the trial balance are:

1. Omission of entire transaction

2. Commission

3. Principle

4. Reversal

5. Original entry

6. Compensating error

CORRECTING ERRORS

When correcting errors through a full double entry journal it is useful to consider the following steps:

Step 1 – What did happen?

Step 2 – What should have happened?

Step 3 – What correction is required?

Example 1

The following errors were discovered:

1. A purchase of stationery for $500 cash has not been recorded in the ledger accounts.
2. Computer repairs worth $400 were posted on the debit side of the computer equipment account.
3. Commission received of $60 was posted to the credit side of the discount received account.
4. Cash paid of $5,500 for property maintenance has been entered into the property maintenance account and cash account as $550.
5. A contra between the receivables control account and the payables control account of $1,000 has been posted to both accounts on the wrong side.

Required:

Prepare the journal entries to correct each error.

TRIAL BALANCE

If there is an imbalance of the trial balance a temporary ledger account known as the suspense account will be opened to force the trial balance to balance:

Account name	DR $	CR $
Bank	71,675	
Capital		65,000
Purchases	18,000	
Trade payables		14,000
Sales		26,000
Insurance	75	
Trade receivables	12,000	
Computer equipment	3,000	
Rent	150	
Petty cash	70	
Total	104,970	105,000

Account name	DR $	CR $
Bank	71,675	
Capital		65,000
Purchases	18,000	
Trade payables		14,000
Sales		26,000
Insurance	75	
Trade receivables	12,000	
Computer equipment	3,000	
Rent	150	
Petty cash	70	
Suspense	**30**	
Total	105,000	105,000

Errors that can arise from a trial balance that does not balance are:

1. Addition errors
2. One-sided posting errors
3. Trial balance errors
4. Single entry
5. Transposition errors (on one side).

Example 2

After investigation into the imbalance of the trial balance (above) it was discovered that stationery purchased for $30 was credited to the bank account but no other entry had been made.

Required:

Record the journal entry to correct this error and clear the suspense account.

Example 3

Shayla has prepared her trial balance for the year ended 31 May 2010 that does not balance. A suspense account was opened for the difference of $2,812 credit.

On further investigation the following issues were discovered:

1. A computer purchased on 1 October 2009 for $3,500 was entered into the bank and computer equipment ledgers as $350.
2. At the year-end Shayla had not yet depreciated her computer equipment. Her policy is to depreciate equipment 25% reducing balance with a proportionate charge in the year of acquisition.
3. A payment for stationery for cash of $440 was debited to the stationery account as $780.
4. Inventory purchased for $1,000 on credit had been posted to rent and rates.
5. Discounts given to credit customers as a reward for early payment of $1,310 have been recorded on the wrong side of the discounts allowed ledger account.
6. Commission received of $125 has been recorded as a debit in the commission received account.
7. Rental income of $3,742 has only been recorded in the bank ledger account.
8. The debit side of the utilities ledger account has been undercast by $600.
9. Shayla made cash drawings of $400 in the year; this has been recorded on the credit side of the purchases account but correctly posted to the cash account.
10. A contra made between the trade payables and trade receivables control accounts of $1,250 has been debited to both accounts.

Required:

Prepare the journals to correct these issues and enter any relevant entries into the suspense account to clear it.

ADJUSTMENTS TO PROFIT

To correct an error you posted a double entry journal as seen in the last example. These journal debits and credits may result in a change in profit for the year, depending on whether the journal effects a statement of comprehensive income account.

Dr SFP account Cr SFP account	No impact on profit for the year
Dr SOCI account Cr SOCI account	No impact on profit for the year
Dr SOCI account Cr SFP account	Profit for the year will decrease
Dr SFP account Cr SOCI account	Profit for the year will increase

Example 4

Continuing with the previous example, Shayla's draft profit for the year ended 31 May 2010 prior to the posting of the journal corrections was $199,871.

Required:

Calculate the revised profit figure.

Chapter 12

Bank reconciliations

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INTRODUCTION

Within the ledger account is a bank account ledger, and it is important that the balance in the ledger reconciles to the balance on the actual bank statement. We call this exercise a bank reconciliation.

Dependant on the size of the company, this can be done on a weekly or monthly basis, and in some larger companies even daily.

Preparing a bank reconciliation has many advantages. They include:

- Provides a check on accuracy of recordings in the cash book.
- Highlights any errors.
- Assists in the day to day cash management.
- Any differences can be identified quickly.

THE BANK'S PERSPECTIVE

On a bank statement the balances will be from the perspective of the bank not that of the business. Therefore, if a bank statement shows a credit balance, the bank has a payable. In other words the bank owes the business money and is therefore in a positive position.

If the bank statement shows a debit balance this indicates the business is overdrawn, i.e. it is an asset from the bank's point of view.

RECONCILING ITEMS

It is extremely unlikely that the balance on the ledger account and the balance on the bank statement will agree. This can be due to the following reasons:

- Cheques issued by the company are immediately entered into the cashbook, but they will not appear on the bank statement until they are presented to the bank. These are called unpresented cheques.
- Receipts by the business are immediately entered in the cashbook and then banked. This can take a number of days to clear. These are called outstanding lodgements.
- There may be items in the bank statement that have not been processed through the cash book e.g. BACS transfer, standing orders, direct debits, dishonoured cheques, bank interest and bank charges.

Proforma bank reconciliation

	$
Balance per bank statement	X
Less: Unpresented cheques	(X)
Add: Outstanding lodgements	X
Balance per adjusted cash book	X

Preparation process

1. Compare the cashbook and bank statement and tick matching items
2. Post corrections to the cash book i.e. items on the bank statement that have not been processed through the ledger
3. Put in items that are in the cashbook that have yet to be presented to the bank as a reconciling item.

Unless otherwise told, assume figures on the bank statement are correct.

Example 1

Mary Kay has prepared her cashbook for the month of April 2010:

Cash Book

Dr Date	Narrative	$	Date	Narrative	Cr $
1 April	Balance b/f	14,500	1 April	Cheque 1437	450
3 April	Cheque 345	3,650	1 April	Cheque 1438	600
5 April	Cheque 95464	1,200	1 April	Cheque 1439	750
12 April	Cheque 741	1,100	1 April	Cheque 1440	150
29 April	Cheque 6532	3,000	12 April	Cheque 1441	250
			12 April	Cheque 1442	350
			27 April	Cheque 1443	395
			27 April	Cheque 1444	165
			27 April	Cheque 1445	245
			30 April	Balance c/f	20,095
		23,450			23,450
1 May	Balance b/f	20,095			

Mary Kay received her bank statement on 26 April 2010:

High Street Bank Plc
54 The Bank,
London,
LL3 9WR

To: Mary Kay   Account No. 34563244   26 April 2010

STATEMENT OF ACCOUNT

Date	**Details**	**Paid out**	**Paid in**	**Balance**
2010		$	$	$
1 April	Opening balance			14,500 C
4 April	1437	450		14,050 C
5 April	1438	600		13,450 C
8 April	345		3,650	17,100 C
10 April	95464		1,200	18,300 C
11 April	Standing order - L.S.F	750		17,550 C
12 April	1439	750		16,800 C
14 April	Direct debit - D Gravity	750		16,050 C
17 April	1441	250		15,800 C
18 April	BACS transfer		3,500	19,300 C
20 April	1442	350		18,950 C
20 April	741		1,100	20,050 C
24 April	Bank charges	500		19,550 C

D = Debit   C = Credit

Required:

Prepare for Mary Kay a bank reconciliation for the month of April and update the cash book as necessary.

Example 2

You have been asked to prepare a bank reconciliation as at 30 November 2009 for Rose. The cashbook has a credit balance of $2,400 and the bank statement at that date has an overdrawn balance of $1,550.

Upon investigation you find the following discrepancies:

1. A cheque issued by Rose has been entered into the cash book twice for $459.
2. A direct debit of $225 has been taken from the account and not been entered into the cash book.
3. There are unpresented cheques totaling $5,840.
4. There are outstanding lodgements of $8,390.
5. A cheque receipt for $1,450 has been dishonoured by the bank.
6. Bank charges of $1,400 have been charged by the bank.
7. A BACS transfer of $6,196 has been received by the bank and not been accounted for in the cash book.
8. She has entered cheque payment number 100600 into the cash book as $1,680, when the correct amount is $1,860.

Required:

Correct the cash book with the above and prepare a bank reconciliation.

Chapter 13

Limited company accounts

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LIMITED LIABILITY COMPANY

This type of business is owned by shareholders and run by a board of appointed directors. A company is a legal entity in its own right, and therefore the shareholders only have limited liability for any business debts.

Limited company financial statements

The format of limited company financial statements is slightly different to those of sole traders, but the principles are still the same. IAS 1 lays out the proforma financial statements, including a new financial statement, the statement in changes in equity (SOCIE) which we will see at the end of this session.

Statement of comprehensive income

Julius Ltd Statement of Comprehensive Income for the year ended 31 December 2009

	$000
Revenue	385,000
Cost of sales	(188,000)
Gross profit	197,000
Other income	2,000
Distribution costs	(38,500)
Administration expenses	(37,700)
Profit before interest and tax	122,800
Finance costs	(8,000)
Profit before tax	114,800
Income tax expense	(53,000)
Profit for the year	61,800
Other comprehensive income:	
Gains on property revaluations	38,000
Total comprehensive income for the year	99,800

Statement of financial position

Julius Ltd Statement of Financial Position as at 31 December 2009

	$000	$000
Non-current assets		
Property plant and equipment		200,000
Intangible assets		187,999
		387,999
Current assets		
Inventory	88,432	
Trade receivables	97,455	
Bank	13,400	
		199,287
Total assets		587,286
Equity and liabilities		
Equity		
Share capital	50,000	
Share premium	50,000	
Revaluation reserve	38,000	
Retained earnings	220,497	
		358,497
Non-current liabilities		
8% loan note	75,000	
Redeemable preference shares	25,000	
		100,000
Current liabilities		
Trade payables	77,789	
Taxation	51,000	
		128,789
Total equity and liabilities		587,286

CAPITAL STRUCTURE

The main difference between sole trader and limited company financial statements is the way the equity capital of the business is structured. Because of this, we need to consider some key terms:

Issued share capital

This is the nominal (par) value of shares issued to shareholders. Shares can be issued at a price equal to or greater than the nominal (par) value. Any amounts of issued shares over and above the par value is held in the share premium account

Ordinary and preference shares

Ordinary share capital

- Standard shares with no special rights or restrictions.
- Receive discretionary dividend determined by the company's directors.

Preference share capital

- Preferred shares that usually carry no voting rights.
- A fixed dividend is paid (% of share par value) in priority to ordinary shares.

Redeemable

Irredeemable

Example 1

Big Boss Ltd issues 150,000 25c shares at par value.

Required:

Show the double entry journal to record the share issue.

Example 2

Big Boss Ltd issues a further 50,000 ordinary shares at $1.25 per share.

Required:

Show the double entry journal to record the share issue.

Example 3

Big Boss Ltd now issues 25,000 6% 2014 preference shares for 25c each. Big Boss Ltd also decides to pay a dividend of 5c per share to ordinary shareholders.

Required:

(a) Show the journal entry to record the share issue.

(b) Calculate how much dividend will be payable at the year end and the journal entries.

Bonus issue

A bonus issue is the issue of new shares to existing shareholders in the same proportion as their existing holding (i.e. a 1 for 4 bonus issue). The key fact here is that these shares are issued for free and no cash is received. A bonus issue can be used by a company to restructure its equity and reserves.

Example 4

Banana Bread Ltd has issued ordinary share capital of 50,000 shares with a par value of 50c each. Banana Bread Ltd has an opening balance on its share premium account of $50,000.

On 1 January 2009 the company makes a 1 for 2 bonus issue to its existing shareholders funded from the share premium account.

Required:

Show the double entry journal to account for the issue

Rights issue

A rights issue is the issue of new shares to existing shareholders in the same proportion to their existing holding at a price equal to or above its par value (usually at a discount compared to its market value). A rights issue can be used by a company to raise cash in the business.

Example 5

Continuing with the previous example, on 1 May 2009 Banana Bread Ltd made a 1 for 3 rights issue to existing shareholders for $1.50 per share when shares were trading at $1.75 per share. The issue was fully subscribed.

On 31 December 2009 (Banana Bread Ltd's year end) the directors decided to pay a dividend of 5 cents per share to all ordinary shareholders.

Note: The opening balance on Banana Bread's retained earnings was $100,000 and profit for the year was $15,000.

Required:

(a) Show the double entry journal to account for the rights issue

(b) Show the double entry for the dividend payment

(c) Show the balances at 31 December 2009 on the following accounts:

- Share capital
- Share premium
- Retained earnings.

STATEMENT OF CHANGES IN EQUITY (SOCIE)

As per IAS 1 a complete set of financial statements for the a limited company are made up not only of the SFP and SOCI but also the statement of cash flows (session 17) and the statement of changes in equity.

A statement of changes in equity is just a reconciliation of the movements between the company's opening and closing balances of share capital and reserves.

Julius Ltd Statement of Changes in Equity for the year ended 31 December 2009

	Share capital	**Share premium**	**Revaluation reserve**	**Retained earnings**	**Total**
	$000	$000	$000	$000	$000
Opening balance at 1 January 2009	25,000	0	38,000	188,697	251,697
Share issue	25,000	50,000			75,000
Gains/(losses) on revaluations			0		0
Profit for the year				61,800	61,800
Dividend paid/payable				(30,000)	(30,000)
Closing balance at 31 December 2009	50,000	50,000	38,000	220,497	358,497

Example 6

Required:

Using the information given and your answer to example 5, prepare the statement of changes in equity for Banana Bread Ltd for the year ended 31 December 2009.

LOAN STOCK/BONDS

To fund a company's operations or expansion the directors may choose to issue debt finance by way of loan notes rather than issuing shares.

These loan notes may have a set nominal issue value which will be repaid by the company at a specified time.

Interest will be payable to the loan note holder on the nominal value.

In the exam you may be asked to calculate the interest expense for the year to be shown as finance costs in the SOCI.

Example 7

Moodle Ltd issues 30,000 $150 10% loan notes on 1 July 2009. Interest is paid annually in arrears on the 30 June each year.

Required:

Assuming Moodle Ltd has a year end of 31 December 2009 what is the double entry required to fully account for the loan notes.

TAXATION

All companies have to pay tax on taxable profits. The tax charge is normally ESTIMATED at the end of the financial year and charged to the statement of comprehensive income, and paid in the following year.

The double entry for taxation would be:

Dr	Taxation expense	(Statement of comprehensive income)
Cr	Taxation liability	(Statement of financial position)

The double entry for when the tax is paid a few months later:

Dr	Taxation liability	(Statement of financial position)
Cr	Bank	(Statement of financial position)

Since the amount paid is likely to differ from the estimated tax charge originally recognised, a balance will be left on the taxation liability account being an **under or over provision** of the tax charge.

Example 8

The City Ltd estimated last year's tax charge to be $250,000 at 31 December 2008. On 1 October 2009, The City Ltd settled their income tax bill and paid cash to the tax authorities of $255,000.

At 31 December 2009 The City Ltd estimated that this year's income tax charge to be $270,000.

Required:

Show how this should be accounted for in the books of The City Ltd, showing clearly the journal entries required and the taxation liability account.

Chapter 14

From trial balance to financial statements

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CHAPTER CONTENTS

TRIAL BALANCE

Example 1

The trial balance of Jewel Limited as at 31 March 2010 is as follows:

	Dr	Cr
	$	$
Ordinary share capital (50c)		100,000
6% Preference shares ($1)		50,000
Retained earnings at 1 April 2009		234,666
10% Loan notes		100,000
Inventory at 1 April 2009	32,000	
Trade receivables	45,987	
Allowance for receivables 1 April 2009		5,987
Trade payables		39,945
Bank	73,958	
Buildings cost	150,000	
Plant and machinery carrying value	422,987	
Loan note interest paid	5,000	
Admin expenses	48,000	
Distribution costs	49,000	
Profit on disposal		1,000
Purchases	69,666	
Revenue		365,000
Total	896,598	896,598

Notes:

1. Depreciation on buildings is to be charged at 2% straight line
2. Depreciation on plant and machinery is to be charged at 10% reducing balance
3. Closing inventory was valued at $28,990
4. A general allowance of 5% of receivables is to be maintained
5. Tax charge is estimated at $25,000
6. A final dividend of 15c per share has been declared before the year end.

Required:

Prepare the statement of comprehensive income, statement of changes in equity and the statement of financial position for Jewel Limited for the year ended 31 March 2010.

Example 2

The trial balance of Miranda Limited as at 31 December 2009 is as follows:

	Dr	Cr
	$	$
Ordinary share capital ($1)		52,500
Share premium		18,000
Retained earnings at 1 January 2009		731,955
Revenue		193,500
Inventory at 1 January 2009	33,000	
Trade receivables	130,867	
Allowance for receivables 1 January 2009		2,250
Trade payables		61,680
Bank	19,427	
Buildings cost	225,000	
Accumulated depreciation 1 January 2009		
- Buildings		36,000
- Plant		22,500
Plant cost	112,500	
Land cost	450,000	
Purchases	115,869	
Administration costs	19,125	
Distribution costs	12,597	
Total	1,118,385	1,118,385

Notes:

1. Depreciation on buildings is to be charged at 2% straight line.
2. Depreciation on plant is to be charged at 25% reducing balance.
3. It was decided by Miranda Ltd's directors to revalue the land at 31 December 2009. The directors took the opinion of a professional valuer who deemed the property to have a current fair value of $600,000. The directors wish to incorporate this valuation in its financial statements.
4. Closing inventory was valued at $31,869.
5. A general allowance of 3% of receivables is to be maintained (Round answer to nearest $).
6. Tax charge is estimated at $4,832.
7. A final dividend of 10c per share has been declared before the year end.

Required:

Prepare the statement of comprehensive income, statement of changes in equity and the statement of financial position for Miranda Limited for the year ended 31 December 2009.

Chapter 15

Accounting standards

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CHAPTER CONTENTS

IAS 37 PROVISIONS AND CONTINGENCIES

In previous sessions all the transactions which we have seen and accounted for have happened or been certain to happen.

A provision is an uncertain future obligation that the business may or may not have to settle. Provisions can be used to manipulate the financial statements through creative accounting.

To counteract this IAS 37 states provisions can only be recognised if they meet three criteria:

1. There is a present obligation, legal or constructive, as a result of a past event.
2. It is probable that a transfer of resources embodying economic benefits will be required to settle the obligation.
3. A reliable estimate of the amount of payment can be made.

The double entry to create a provision would be:

Dr	Relevant expense a/c	(Statement of comprehensive income)
Cr	Provision	(Statement of financial position)

Contingent liabilities

A contingent liability exists when any of the following situations occur:

- A possible obligation that arises from past events and existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

  OR

- A present obligation that arises from past events but it fails criteria 2 and 3 (above) of a provision.
- Disclose in the notes to the financial statements unless a REMOTE possibility.

Contingent assets

A contingent asset arises from possible future income.

- It is a probable/possible asset that arises from past events whose existence in confirmed by the occurrence or non occurrence of uncertain future events not wholly within the control of the entity.
- Recognised in the financial statements only when it becomes virtually certain that receipt of the asset will be made and is no longer a contingent asset.
- Disclose in the notes to the financial statements if PROBABLE.

Example 1

Consider the following scenarios:

1. The directors of Charlotte Ltd would like to refurbish some of its retail stores in the next accounting period. They estimate that this would cost $200,000 and would like to provide for this amount in their year end financial statements.
2. Charlotte Ltd sells high fashion clothing and accessories and has an established policy of allowing customers to return goods if customer finds the goods unsuitable or they have a change of mind, even if they provide no receipt. Charlotte Ltd has no legal obligation to do this. The directors have estimated that sales returns next year would be $130,000 based on past trading experience.
3. Charlotte Ltd is also being taken to court by a customer for injury due to one of the products Charlotte Ltd sells. The customer is claiming damages of $75,000. Charlotte Ltd's solicitors are of the opinion that there is a 60% chance that the company would have to settle the claim as the court case is in its final stages.

Required:

Discuss the accounting treatment of each scenario above.

IAS 10 EVENTS AFTER THE REPORTING PERIOD

An event after the reporting period is an event that occurs between the accounting year end and the date on which the financial statements are authorised for issue.

We must consider which of these events causes us to ADJUST our financial statements or not.

Adjusting events

Provide additional evidence of conditions that existed at the statement of financial position date.

Non-adjusting events

Events that have no impact on the conditions at the statement of financial position date.

GOING CONCERN IS THE ONLY EXCEPTION

Example 2

You have been asked by your manager to look into the following events that occurred between the accounting year end of 31 December 2009 and 31 March 2010:

1. Major acquisition of a competitor announced on 15 January 2010.
2. The bankruptcy of a major customer on 8 February 2010.
3. Sale of inventory for a price significantly lower than the original cost on 3 January 2010.
4. Major fire in a warehouse, destroying two thirds of the company's inventory on 23 February 2010.
5. Discovery of a material sales ledger fraud on 28 January 2010 that took place throughout the financial year.
6. Dividends were declared on 31 January 2010.
7. 100,000 ordinary shares issued on 1 March 2010.

Required:

For each event state whether it is an adjusting or non-adjusting event per IAS 10.

IAS 18 REVENUE RECOGNITION

This standard reinforces the importance of the accruals concept. We must decide at which point in time we can recognise the revenue from the sale of goods and the rendering of services.

- **Sale of goods** – All FIVE criteria must be met:
  1. Risks and rewards of ownership of the goods have passed to the buyer.
  2. The business has no continuing managerial involvement.
  3. The amount of revenue can be reliably measured.
  4. It is probable that the economic benefits associated with the transaction will flow to the business.
  5. Costs incurred can be reliably measured.
- **Rendering of services** – All FOUR criteria must be met:
  1. The stage of completion of the service can be reliably measured.
  2. The amount of revenue can be reliably measured.
  3. It is probable that the economic benefits associated with the transaction will flow to the business.
  4. Costs incurred can be reliably measured.

IAS 8 CHANGES IN ACCOUNTING POLICY, ESTIMATES AND ERRORS

An accounting policy is a specific principle or rule applied by the business in preparing its financial statements. These policies are derived from accounting standards.

We have seen a few accounting standards in this syllabus so far which require a choice of policy such as:

- IAS 16 Property, plant and equipment

  We have a choice of whether or not to revalue non-current assets.

- IAS 2 Inventory

  We have a choice of whether to value at inventory at cost using FIFO or weighted average cost methods.

Changing accounting policy

Where possible a business should try to avoid changing their accounting policies to keep consistency of preparation of accounts from one year to another. However, there may be situations whereby the business must change policy because the law or standard has changed or the existing policy is inappropriate and a change would result in a more appropriate presentation.

The accounting treatment of a change in accounting policy is to:

- Adjust opening retained earnings on the SOCIE.
- Restate comparative information.
- Give additional disclosure if impact is material.

Essentially what we are doing is applying a retrospective restatement of the financial statements as if the new policy had always been in place.

Changing accounting estimates

An accounting estimate is a judgement required in the application of accounting policies. Examples used in this syllabus so far:

- Depreciation method.
- Method used for calculating the allowance for receivables.
- Amount of income tax to charge for the year.

The accounting treatment of a change in accounting estimate is to:

- Apply the revised estimate in the current year and going forward.
- Give additional disclosure if impact is material.

What we are doing with this is applying a prospective adjustment.

Example 3

On 1 January 2002 White Ltd purchased a building for $200,000 and decided to depreciate it over 10 years with no residual value.

On 1 January 2005 White Ltd decided to reduce the useful life of the building to 5 years with no residual value.

Required:

What will be the depreciation charge on the building for the year ended 31 December 2005 and the carrying value of the building as at that date?

Prior period errors

Most errors discovered in the current year can be corrected in the current year. However, if we discover an error that related to the prior year accounts, a prior period adjustment would need to done, much in the same way as a change of accounting policy.

The accounting treatment of a prior period error is to:

- Adjust opening retained earnings on the SOCIE.
- Restate comparative information.
- Give additional disclosure if impact is material.

Again, applying a retrospective restatement.

Chapter 16

Incomplete records

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INTRODUCTION

As the name suggests, incomplete records are any form of accounting records other than the full double entry system.

In reality, accountants come across incomplete records almost daily. This is because their clients are not likely to fully understand the double entry system. We still however, need to prepare a set of financial statements for the client.

Main reasons for incomplete records:

- Poor accounting records.
- Fire, flood or theft of accounting records.
- A figure is unknown.

We can use many techniques to help us ascertain a missing balance, these techniques are:

- Accounting equation.
- Ledger accounts.
- Profit percentages.

ACCOUNTING EQUATION

We saw in session 2 how the accounting equation is used to help us construct the statement of financial position:

ASSETS = CAPITAL + LIABILITIES

Generally in an incomplete records scenario you will be asked to calculate any figure contained within the owner's capital part of this equation.

Therefore, it is necessary to rearrange the accounting equation as follows:

ASSETS – LIABILITIES = CAPITAL

Assets minus liabilities are referred to as net assets:

Net Assets = Capital + Profit - Drawings
Or
Change in Net Assets = Capital Introduced + Profit – Drawings

Example 1

Mr Fraser's statement of financial position at 31 December 2008 shows that the business has net assets of $5,000. The statement of financial position at 31 December 2009 shows that the business has net assets of $8,000.

Mr Fraser's drawings for the year amounted to $2,500 and he didn't introduce any further capital in the year.

Required:

Calculate the profit for the year ended 31 December 2009.

Example 2

Mrs Tang made a profit for the year of $50,000 and has closing net assets of $250,000. During the year ended 31 March 2010 capital of $40,000 was introduced in cash and drawings of $2,000 were taken out in cash each month.

Required:

Calculate the opening balance of net assets for Mrs Tang.

USING LEDGER ACCOUNTS

Another technique we can use is preparing ledger accounts to find missing figures such as:

Ledger Account	Possible Missing Figures
Trade Receivables Control Account	• Credit sales • Money received from credit customers
Trade Payables Control Account	• Credit purchases • Money paid to credit suppliers
Cash at Bank	• Money stolen • Drawings
Cash in Hand	• Money stolen • Drawings

Example 3

Suppose that the opening balance on the trade receivables control account was $50,000, there had been receipts from credit customers in the year of $45,000, irrecoverable debts that have been written off worth $5,000 and the closing balance on the trade receivables control account was $55,000.

Required:

What were the credit sales for the year?

Example 4

Suppose that the opening balance on the trade receivables control account was $30,000, there have been total receipts from customers of $55,000 of which $15,000 relates to cash sales and $40,000 relates to receipts from credit customers. Discounts allowed in the year totalled $3,000 and the closing balance on the trade receivables control account was $37,000.

Required:

What are the total sales for the year?

Example 5

The opening balance on the trade payables control account was $30,000. Payments made to credit suppliers during the year were $33,000, discounts received are $4,000 and the closing balance on the trade payables control account was $26,000.

Required:

What was the credit purchases figure for the year?

Example 6

On 1 January 2009 the bank is overdrawn by $1,367, payments in the year totalled $8,536 and on 31 December 2009 the closing balance was a credit balance at the bank of $2,227.

Required:

What is the total receipts figure for the year?

Example 7

Scott has a cash float at the beginning of the year of $900. During the year cash of $10,000 was banked, $1,000 was paid out for drawings and wages of $2,000 was paid.

Scott decided to increase the float to $1,000 at the end of the year.

Required:

How much cash was received from customers during the year?

PROFIT PERCENTAGES

The gross profit of a business can be expressed as a percentage. We can use these profit percentages (being either a gross profit mark up or margin) to help us calculate missing figures in cost of sales.

Mark-up - Gross profit is a % based on COST

	$	$	%
Sales		5,000	125
Less: Cost of sales			
Opening inventory	3,000		
Purchases	2,000		
Closing inventory	-1,000		
		(4,000)	100
Gross profit		1,000	25

25%
Mark-up

Margin - Gross profit is a % based on SALES

	$	$	%
Sales		5,000	100
Less: Cost of sales			
Opening inventory	3,000		
Purchases	2,000		
Closing inventory	-1,000		
		(4,000)	80
Gross profit		1,000	20

20%
Margin

Example 8

- Mark-up 10%
- Sales $6,600
- Opening inventory $300
- Closing inventory $500

Required:

Complete a trading account from the above information.

Example 9

- Margin 5%
- Purchases $2,840
- Opening inventory $800
- Closing inventory $600

Required:

Complete a trading account from the above information.

COST OF LOST INVENTORY

In incomplete record questions, it is likely that inventory has been lost due to the infamous fire or flood.

Closing inventory that has not been lost is subtracted in cost of sales because by definition, the inventory has not been sold in the year.

Lost inventory has also not been sold in the year and therefore also needs subtracting within cost of sales.

Therefore, to work out the cost of lost inventory, complete the trading account from the information given and then lost inventory can be calculated as a balancing figure.

Example 10

- Margin 20%
- Sales $100,000
- Opening inventory $10,000
- Closing inventory (after fire) $3,000
- Purchases $82,000

Required:

Calculate the value of the inventory lost in the fire.

Chapter 17

Partnerships

CHAPTER CONTENTS

INTRODUCTION

This is a business that is owned by two or more people, some of which will be actively involved in the business. The partners and the business are legally the same entity and therefore the partners are jointly liable for any business debts.

- Advantages of forming a partnership:
  - More access to capital
  - Additional expertise / skill set
  - Risk sharing

PARTNERSHIP AGREEMENT AND PROFIT SHARING

A partnership agreement formalises the way profits are shared/split between the partners.

A partnership agreement may therefore include the following provisions when allocating profit.

- Interest on capital

  To reward partners who have invested more, the partnership may allocate some of the profits based on level of capital invested.

- Salaries

  To reward partners who have taken on extra responsibilities, they may receive a salary. A partner's salary is not a business expense like the salary of an employee, but a way in which profits are allocated.

- Interest on drawings

  To penalise partners who make excessive drawings, the partnership may charge interest on drawings. Interest on drawings results in a reduction in the amount of profit the partner is allocated.

- After these allocations, the balance of profit is shared according to a **profit sharing ratio (PSR)**.

Example 1

Tinky and Winky are in a partnership, they agreed to share out profits of $150,000 in the ratio 2:1.

Required:

How should the profit be shared between the partners?

Example 2

George, Brad and Matt are partners sharing profits in the ratio 3:2:1 with each of them having invested $50,000 into the business. In the year ended 31 December 2009, the business makes a profit of $96,000.

The partnership agreement states the following:

- A salary of $20,000 is to be awarded to Brad.
- Interest on capital is provided at 2% per annum
- Interest is charged on drawings exceeding $30,000 at 5% per annum
- Brad took drawings of $25,000 on 1 January 09 and Matt took drawings of $50,000 on 30 June 2009.

Required:

How is the profit for the year split between George, Brad and Matt?

Guaranteed minimum profit share

A partner may be guaranteed a minimum share of the profits.

Where this is the case:

- Profits should initially be allocated as normal, in accordance with the above.
- If the partner has not received the minimum share which is guaranteed to him, the shortfall is given to him by taking it from the other partners in accordance with the profit sharing ratio.

Example 3

Bobby, Mac and Estee are in business sharing profits 5:3:2 after allowing salaries of \$30,000 each for Bobby and Mac. Estee has a guaranteed minimum profit share of \$120,000. Profit for the year is \$260,000.

Required:

Show the appropriation of the profit for the year.

PARTNERSHIP FINANCIAL STATEMENTS

Largely, partnership financial statements are the same as a sole trader's with the exception of the capital section of the statement of financial position.

AB Partnership Statement of Financial Position (extract) as at 31 December 2009.

Equity	$	$
Capital account - Partner A	50,000	
Capital account - Partner B	25,000	
Current account - Partner A	20,000	
Current account - Partner B	5,000	
		100,000

The capital section includes details of each partner's capital and current accounts.

Partners' capital account

This account records the capital introduced into the partnership by each partner and long term withdrawals of capital.

This account is relatively fixed unless more capital is introduced.

Partners' capital account

Dr	A	B		A	B Cr
	$	$		$	$
Capital withdrawals			Balance b/f	25,000	25,000
Balance c/f	50,000	25,000	Capital introduced	25,000	0
	50,000	25,000		50,000	25,000
			Balance b/f	50,000	25,000

Partners’ current account

This account records each partner’s share of profits and any drawings out of the business by each partner.

Partners' current account

Dr	A	B		A	B Cr
	$	$		$	$
Balance b/f	0	1,000	Balance b/f	15,000	0
Interest on drawings	1,000	500	Interest on capital	5,000	2,500
Drawings	10,000	5,000	Salary	25,000	0
Balance c/f	50,000	5,000	Profit share	16,000	9,000
	61,000	11,500		61,000	11,500
			Balance b/f	50,000	5,000

The current account will usually have a credit balance but may have a debit balance indicating that a partner has withdrawn more profits than they were entitled to.

Example 4

At 1 January 2009 Graham and Chris have the following balances on their accounts:

Graham	**Chris**
Capital account $60,000 credit	Capital account $90,000 credit
Current account $18,450 debit	Current account $40,200 credit

The profit for the year ended 31 December 2009 was $19,000 split on a ratio of 3:2 for Graham and Chris respectively.

During the year Graham took drawings of $9,000 and Chris $3,000. Graham also withdrew $10,000 capital from the business and Chris injected a further $5,000 capital into the business.

Required:

Draw up the partners’ capital and current accounts for the year to 31 December 2009.

Example 5

A partnership has four partners – Jason, Howard, Gary and Mark. In the year to 30 June 2007 the partnership has made profits totaling $106,250.

Jason is rich. He was made a partner because he could invest $100,000 into the partnership. He withdrew $30,000 from the business on 1 July 2006.

Howard is poor but clever and could only invest $20,000 into the partnership. Due to him being clever and completing work quicker than the other partners he took responsibility for hiring and firing staff in the business. He withdrew $30,000 on 30 June 2007.

Gary invested $50,000 into the partnership. He has a liking for designer clothes and fast cars. Consequently he withdrew $25,000 on 1 July 2006 and a further $25,000 on 1 January 2007.

Mark also invested $50,000 and withdrew $30,000 on 1 July 2006. Mark's wife has just had a baby and he would therefore like to have a guaranteed share of the profits.

The partners have decided that profits should be distributed at a ratio of 2:1:3:4 (Jason : Howard : Gary : Mark) assuming profits accrue evenly over the year.

Required:

Using the amounts detailed above, allocate the profits of the business in accordance with the following partnership agreement:

(a) Interest on capital is 5% per annum

(b) Howard is to receive a salary of $5,000

(c) Interest on drawings is 10% per annum

(d) Profit sharing ratio is as stated 2:1:3:4

(e) Mark has a guaranteed minimum profit share of $42,500.

Example 6

Ollie and Joe are in a partnership selling motor vehicles. The profits for the year ended 31 December 2009 were $180,000. The partnership agreement has always stated that profits are to be shared equally. On 30 April 2009 it was decided that Ollie would receive a salary of $22,500 per annum and the remaining profits were to be shared in the ratio 1:3.

Both partners had an opening credit balance on their accounts of $5,000 and the profits have been deemed to have accrued 1/3 before the 30 April and 2/3 after.

Required:

Show the appropriation of the profits to the partners' current accounts for the year.

LOANS FROM PARTNERS

A partner may make a loan (advance) to the business.

The loan is initially recorded by:

Dr	Bank	(Statement of financial position)
Cr	Loan liability	(Statement of financial position)

Any interest paid is accounted for by:

Dr	Interest expense	(Statement of comprehensive income)
Cr	Bank	(Statement of financial position)

GOODWILL

Goodwill arises due to the excellence or good reputation the partnership has built up over the years. It is calculated as follows:

	$
Value of the business	X
Fair value of net assets	(X)
Goodwill	X

Goodwill belongs to the partners in the same ratio as their profit share agreement.

Goodwill therefore only needs accounting for in the following scenarios:

- When a partner retires.
- When a new partner is admitted into the partnership.
- When the partners agree to a change in the profit share ratio.

Example 7

Bruce and Diana have been in a partnership for a number of years. The opening balances on their capital accounts at the start of the year were $75,000 and $60,000 respectively. The partnership agreement states that profits must be shared amongst the partners equally.

During the year, they decided to admit a new partner into the partnership, Paul who will invest $45,000 cash into the partnership.

After admitting Paul, the partnership agreement was revised to show the new profit sharing ratio as 2:2:1 for Bruce, Diana and Paul respectively.

At the date of the admittance of Paul in the partnership the book value on net assets of the business is $75,000 and the fair value on net assets is $90,500. The business as a whole is valued at $113,000.

Required:

What is the goodwill that arises and how is the admittance of Paul accounted for in the partnership accounts.

Chapter 18

Statements of cash flow

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CHAPTER CONTENTS

INTRODUCTION

The statement of cash flow is a primary financial statement and provides fundamental information to the user of accounts. It highlights the key areas where a business has generated and spent physical cash.

Good cash management ensures a business has sufficient cash to run its day to day operations.

Prior to this session we have focused on profit, but cash is equally vital for the success of a business, especially in the short term. If a business has limited cash funds available it will struggle to survive in the short term.

Advantages of statements of cash flow

The statement of cash flows is one of the most useful financial statements and has many benefits to the users of the financial statements such as:

- Cash flow balances are a matter of fact and are not distorted by accounting policies.
- Cash flow balances are objective, unlike profit, which is subjective.
- Users of financial statements can establish exactly the cash generation of a business.
- Users can identify exactly how this cash has been utilised.
- Users can assess the liquidity of a business and assess its ability to repay debts as they fall due.
- Loans repaid and received are clearly listed in the cash flow statement.
- Users can assess management attitude to capital expenditure.
- Interest payments are highlighted in the cash flow.

IAS 7

IAS 7 lays down the requirements of a statement of cash flow. It gives us a detailed proforma and certain definitions:

- Cash

  Cash on hand and demand deposits. An example would be cash in the bank less any overdraft.

- Cash equivalents

  Short term, highly liquid investments.

  (These will be stated as current assets in statement of financial position).

STATEMENT OF CASH FLOW PROFORMA

Jonathan Ltd Statement of cash flows for the year ended 31 December 2009

	$	$
Cash flows from operating activities		
Profit before tax	44,400	
Adjustments for non-cash items:		
Depreciation / amortisation charge	17,600	
Loss / (profit) on disposal of non-current assets	(6,320)	
Finance cost	2,000	
Investment income	(80)	
(Increase)/decrease in inventory	2000	
(Increase)/decrease in receivables	(800)	
Increase/(decrease) in payables	200	
Cash generated from operations	59,000	
Interest paid	(1,900)	
Taxation paid	(17,850)	
Net cash from operating activities		39,250
Cash flows from investing activities		
Purchase of non-current assets	(41,600)	
Proceeds from the sale of non-current assets	27,320	
Interest received	40	
Dividends received	40	
Net cash used in investing activities		(14,200)
Cash flows from financing activities		
Proceeds from the issue of share capital	10,000	
Proceeds from long-term borrowings	3,000	
Repayments of long term borrowings	(25,000)	
Dividends paid	(20,000)	
Net cash from financing activities		(32,000)
Movement in cash and cash equivalents		(6,950)
Cash and cash equivalents b/f		6,450
Cash and cash equivalents c/f		(500)

CASH FLOWS FROM OPERATING ACTIVITIES

Cash generated from operating is the principal revenue-producing activities of the business. There are two methods of calculating cash from operations – the direct or indirect method:

1. Direct method

This method is used when we are given information from the ledger accounts and not just the financial statements.

	$
Cash sales	X
Cash received from credit customers	X
Cash purchases	(X)
Cash paid to credit suppliers	(X)
Cash expenses	(X)
Cash wages and salaries	(X)
Cash generated from operations	X

2. Indirect method

Where ledger information is not available, cash generated from operations can be derived from the financial statements. This method is in the proforma above at is more frequently tested.

	$
Profit before tax	X
Adjustments for non-cash items:	
Depreciation / amortisation charge	X
Loss / (profit) on disposal of non-current assets	X/(X)
Finance cost	X
Investment income	(X)
(Increase)/decrease in inventory	(X)/X
(Increase)/decrease in receivables	(X)/X
Increase/(decrease) in payables	X/(X)
Cash generated from operations	X

Interest and tax paid would then be deducted from cash generated from operations to find cash generated from operating activities.

Example 1

You have been provided with the following financial statement extracts for the year to 31 December 2009:

Statement of comprehensive income (extract)

Depreciation	(1,875)
Profit on disposal of non-current assets	225
Profit before interest and tax	3,975
Finance costs	(450)
Taxation expense	(1,050)
Profit for the year	2,475

Statement of financial position (extract)

	2009	2008
Current Assets	$	$
Inventory	5,100	5,700
Receivables	5,700	4,350
Current Liabilities		
Payables	5,550	4,800

Taxation paid in the year was $900.

Required:

Calculate the cash generated from operating activities using the indirect method.

Example 2

The following information relates to Empress Limited:

Cash sales	$55,000
Cash received from customers	$44,000
Cash purchases	$33,000
Cash paid to suppliers	$12,000
Cash expenses	$11,000
Cash wages and salaries	$20,000

Required:

Calculate the cash generated from operations using the direct method.

ISOLATING CASH FLOWS

You may be asked to calculate certain items from cash generated from operating activities and find the true cash receipt/ payment these could include:

- Interest paid
- Tax paid.

To find these figures it may be useful to use ledger accounts for interest and tax to find the payment.

Example 3

A company reports the following amounts in its financial statements relating to interest:

Finance costs charged to the statement of comprehensive income	\$5,100
Interest accrual b/f	\$180
Interest accrual c/f	\$465

Required:

What interest did the company pay in the year?

Example 4

A company estimated its tax payable for the year ended 31 December 2009 is \$35,970. The company had estimated its tax payable for the year ended 31 December 2008 at \$32,648. The tax charge reported in the statement of comprehensive income for the year to 31 December 2009 was \$36,150.

Required:

What tax was paid in the year?

CASH FLOWS FROM INVESTING ACTIVITIES

Cash flows from investing activities are cash spent on non-current assets, and other external investments such as shares in another business. But also proceeds from the sale of and cash income from these investments.

Cash flows from investing activities		
Purchase of non-current assets	(X)	
Proceeds from the sale of non-current assets	X	
Interest received	X	
Dividends received	X	
Net cash used in investing activities		(X)

You may be asked to calculate certain items from cash used in investing activities and find the true cash receipt/ payment these could include:

- Cash paid to acquire PP+E and other investments.
- Cash proceeds from disposals.
- Interest/dividends received in cash.

Example 5

You have been provided with the following financial statement extracts for the year to 31 December 2009:

Statement of comprehensive income (extract)	**$**
Depreciation	22,500
Loss on disposal of non-current assets	6,375

Statement of financial position (extract)

	2009	2008
Non-current Assets	$	$
Land, PP+E at cost	465,000	405,000
PP+E accumulated depn	(247,500)	(283,500)
Equity		
Revaluation reserve	30,000	0

PP+E costing $67,500 were disposed of during the year. Land was revalued during the year.

Required:

Calculate the cash paid to acquire PP+E and the proceeds from the disposal of PP+E in the year.

Example 6

A company reports the following amounts in its financial statements relating to interest and dividend income:

Interest income in the statement of comprehensive income	$2,340	
Dividends received in the statement of comprehensive income	$4,470	
Interest receivable b/f		$18
Interest receivable c/f		$645

Required:

What interest and dividends did the company receive in the year?

CASH FLOWS FROM FINANCING ACTIVITIES

Cash flows from financing activities include the proceeds from the issue of shares and long-term borrowings made or repaid.

Cash flows from financing activities		
Proceeds from the issue of share capital	X	
Proceeds from long-term borrowings	X	
Repayments of long term borrowings	(X)	
Dividends paid	(X)	
Net cash from financing activities		X

You may be asked to calculate certain items from cash from financing activities and find the true cash receipt/ payment these could include:

- Cash proceeds from the issue of shares
- Cash proceeds / repayments from long-term borrowings
- Dividends paid in cash.

Key point!

Remember that a bonus issue of shares is for free therefore cash is not involved.

Example 7

You have been provided with the following financial statement extracts for the year to 31 December 2009:

Statement of financial position (extract)

	2009	2008
Equity	$	$
Share capital ($1)	180,000	150,000
Share premium	540,000	405,000

Required:

Calculate the cash proceeds from issuing shares during 2009.

Example 8

You have been provided with the following financial statement extracts for the year to 31 December 2009:

Statement of financial position (extract)

	2009	2008
Non-current Liabilities	$	$
10% loan notes	0	300,000
8% loan notes	210,000	90,000

Required:

Calculate the cash paid/received relating to long-term borrowings in the year.

Example 9

You have been provided with the following financial statement extracts for the year to 31 December 2009:

Statement of comprehensive income (extract)	**$**
Profit for the year	117,945

Statement of financial position (extract)

	2009	2008
Equity	$	$
Retained earnings	532,500	476,400

Required:

Calculate the dividend paid in 2009.

Example 10 – Putting it all together

The accountant of Radiance Ltd, who needs your help to prepare the statement of cash flows, provides the following information:

Radiance Limited Statement of financial position as at 31 December

	2009		2008	
	$	$	$	$
Non-current assets				
Property plant and equipment cost		220,000		180,000
Property plant and equipment accum depreciation		(92,000)		(78,000)
		128,000		102,000
Current assets				
Inventory	17,000		12,000	
Trade receivables	10,000		2,000	
Government bonds	10,000		10,000	
Bank	16,000		3,000	
		53,000		27,000
Total assets		181,000		129,000
Equity and liabilities				
Equity				
Share capital ($1)	65,000		45,000	
Share premium	12,000		10,000	
Retained earnings	68,000		24,000	
		145,000		79,000
Non-current liabilities				
10% loan note		20,000		30,000
Current liabilities				
Trade payables	13,000		19,000	
Taxation	3,000		1,000	
		16,000		20,000
Total equity and liabilities		181,000		129,000

Radiance Limited Statement of comprehensive income (extract) for the year ended 31 December 2009

	$
Profit before interest and tax	52,000
Finance costs	(2,000)
Taxation expense	(6,000)
Profit for the year	44,000

Required:

Prepare the statement of cash flows for Radiance Ltd for the year ended 31 December 2009.

Chapter 19

Conceptual framework

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CHAPTER CONTENTS

THE FRAMEWORK

The conceptual framework lays out the fundamental principles, concepts and assumptions when preparing the financial statements.

The framework is not itself an accounting standard nor can it override the requirements of an existing standard.

Underlying concepts

Going concern

Accounts are normally prepared on the going concern basis. This means that they are prepared on the assumption that a business will continue for the foreseeable future, assumed to be a year.

Non-current assets and liabilities can only be included in financial statements which are prepared on the going concern basis.

Accruals

The financial statements are prepared on the accruals basis, meaning that transactions are reported in the period to which they relate, regardless of when cash is received or paid.

Consistency

Transactions should be accounted for consistently year on year. This facilitates comparison between different years' accounts.

Fair presentation

Financial statements are required to give a fair presentation of financial position and performance. This is assumed to be achieved where accounting standards and the framework are followed.

Qualitative characteristics

To help give a fair presentation the framework details four qualitative characteristics of financial statements that we must always bear in mind when choosing accounting policies:

Relevance

We must provide financial information that is relevant to influence the economic decisions of the users of that information. To be relevant, the information should have:

- A predictive value.

- A confirmatory value.

Reliability

We must prepare financial information that can give a fair presentation of the entity's financial performance. To help us give reliable information we must try to follow the following principles:

- Faithful representation
- Neutrality
- Substance over form
- Completeness
- Prudence.

Comparability

Financial information should have the ability to be compared with other businesses in the sector and with its own performance over time:

- Consistency
- Disclosure.

Understandability

We should prepare financial information that is useful to users with reasonable business and accounting knowledge.

It is important to acknowledge that sometimes there may be a conflict between the qualitative characteristics.

In a case of conflict, the framework requires that a balance must be achieved.

BASES OF VALUATION

Items in the financial statements can be valued in a number of ways:

Historic cost

Items are stated in the accounts at the cash price at acquisition or obligation.

This method is most commonly used.

Net realisable value

The actual or estimated selling price less any cost to sell.

Economic value

The value derived from an asset's ability to generate future cash flows.

Replacement cost

The cash price today to replace items in the financial statements with similar items.

HISTORIC COST ACCOUNTING

As previously mentioned, historic cost accounting is the most common basis for valuation. It is important to understand the advantages and disadvantages of this valuation method:

Advantages

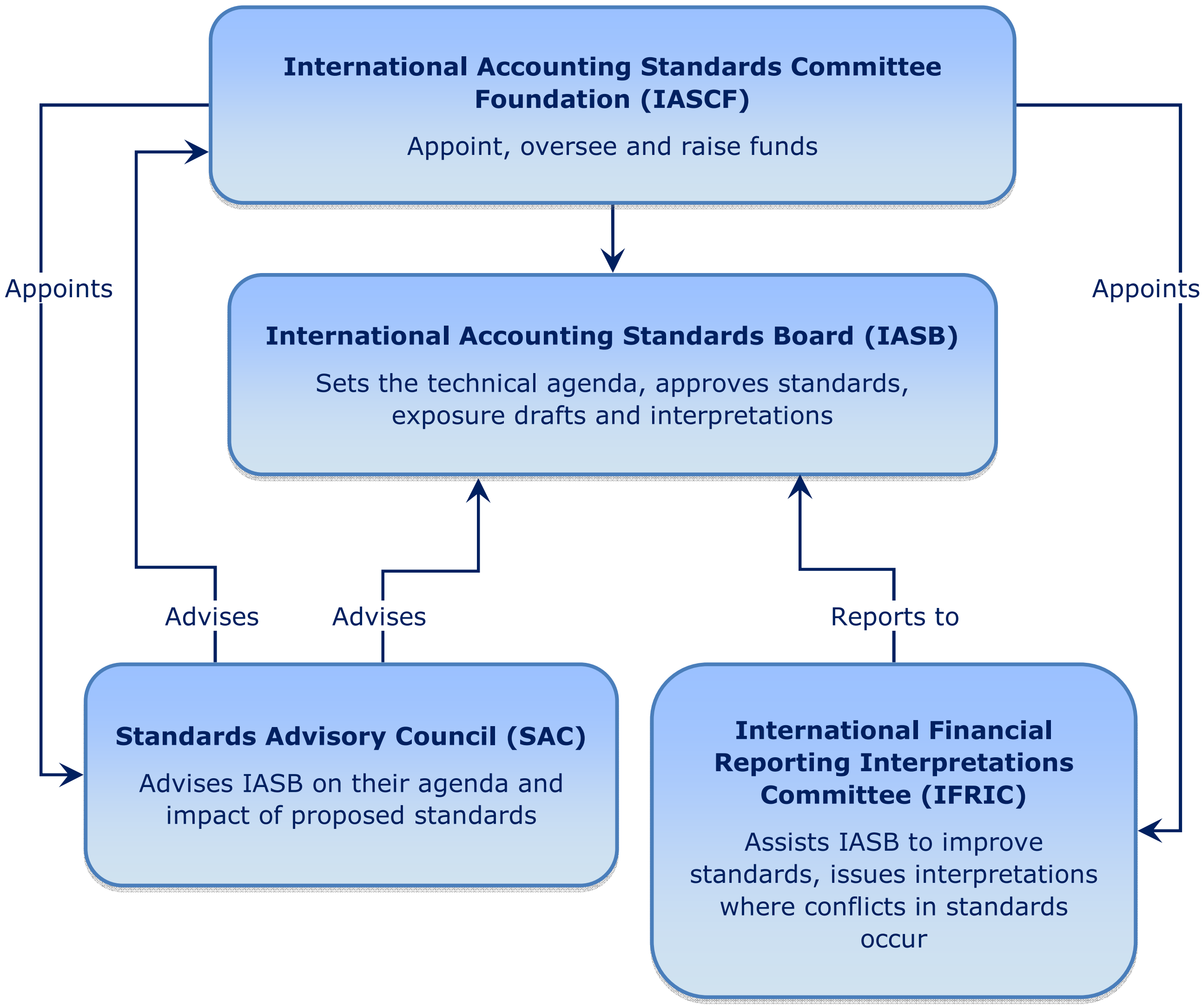
- Cost is known and can be verified (therefore more reliable).
- Gives rise to more comparable financial statements.
- Widely understood.
- Lack of reasonable alternatives.

Disadvantages

- The carrying value of assets are often substantially different to market value.
- The financial statements does not show true business value.
- Inflation is not taken into account, therefore in times of rising prices profits can be overstated.
- Comparisons of performance and position over time can be unrealistic.

WHO REGULATES FINANCIAL REPORTING?

There are many organisations involved with developing a set of high quality, global standards.



THE ROLE OF IFRS

The IASB has developed a set of global financial reporting standards to support the needs of the users of the financial statements. These are known as:

- IAS – International accounting standards.
- IFRS – International financial reporting standards.

The standards are a set of detailed rules giving guidance on how to account for different types of transactions and events. For example IAS 2 details rules on how to account for inventory and IAS 16 for non-current assets, both of which you have already seen in this syllabus.

Chapter 20

Appendix - solutions to exercises and examples

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CHAPTER 2: FINANCIAL STATEMENTS

Example 1

		ASSETS	=	CAPITAL	+LIABILITIES	
1.7.2009	Cash	20,000	=	20,000		
3.7.2009	Van	9,500				
	Cash	(9,500)				
		0	=	0		
7.7.2009	Cash	5,000	=			5,000
		25,000	**=**	**20,000**	**+**	**5000**

CHAPTER 3: DOUBLE ENTRY BOOKKEEPING

Example 1 (George)

Journal

1.4.2009

Dr Bank a/c	$50,000
Cr Capital a/c	$50,000

2.4.2009

Dr Purchases a/c	$5,000
Cr Trade Payables a/c	$5,000

3.4.2009

Dr Cash a/c	$6,000
Cr Sales a/c	$6,000

4.4.2009

Dr Trade payables a/c	$5,000
Cr Bank a/c	$5,000

5.4.2009

Dr Rent expense a/c	$450
Cr Bank a/c	$450

6.4.2009

Dr Trade receivables a/c	$6,000
Cr Sales a/c	$6,000

7.4.2009

Dr Purchases a/c	$7,000
Cr Trade payables a/c	$7,000

8.4.2009

Dr Motor vehicles a/c	$7,000
Cr Cash a/c	$7,000

Main Ledger

Bank / Cash a/c

DR		$			CR $
1.4.2009	Capital	50,000	4.4.2009	Trade payables	5,000
3.4.2009	Sales	6,000	5.4.2009	Rent	450
			8.4.2009	Motor vehicle	7,000
				Balance c/f	43,550
		56,000			56,000
	Balance b/f	43,550			

Capital a/c

DR		$			CR $
	Balance c/f	50,000	1.4.2009	Bank	50,000
				Balance b/f	50,000

Purchases a/c

DR		$			CR $
2.4.2009	Trade payables	5,000			
7.4.2009	Trade payables	7,000		Balance c/f	12,000
		12,000			12,000
	Balance b/f	12,000			

Trade payables a/c

DR		$			CR $
4.4.2009	Bank	5,000	2.4.2009	Purchases	5,000
	Balance c/f	7,000	7.4.2009	Purchases	7,000
		12,000			12,000
				Balance b/f	7,000

Sales a/c

DR		$			CR $
			3.4.2009	Cash	6,000
	Balance c/f	12,000	6.4.2009	Trade receivables	6,000
		12,000			12,000
				Balance b/f	12,000

Rent a/c

DR		$		CR $
5.4.2009	Bank	450	Balance c/f	450
	Balance b/f	450		

Trade receivables a/c

DR		$		CR $
6.4.2009	Sales	6,000	Balance c/f	6,000
	Balance b/f	6,000		

Motor vehicles a/c

DR		$		CR $
8.4.2009	Cash	7,000	Balance c/f	7,000
	Balance b/f	7,000		

Trial balance

Account name	Financial Statement	DR $	CR $
Bank	SFP	43,550	
Capital	SFP		50,000
Purchases	SOCI	12,000	
Trade payables	SFP		7,000
Sales	SOCI		12,000
Rent	SOCI	450	
Trade receivables	SFP	6,000	
Motor vehicles	SFP	7,000	
Total		69,000	69,000

Closing Inventory Journal

Dr Inventory (SFP)	7,000
Cr Closing Inventory (SOCI)	7,000

George Statement of Comprehensive Income for the two weeks ended 14 April 2009

	$	$
Sales		12,000
Less: Cost of sales		
Opening inventory	0	
Purchases	12,000	
Closing inventory	-7,000	
		(5,000)
Gross profit		7,000
Other income		0
Less: expenses		
Rent	450	
		(450)
Profit for the year		**6,550**

George Statement of Financial Position as at 14 April 2009

	Cost $	Accumulated Depreciation $	Carrying Value $
Non–current assets			
Motor vehicles	7,000	0	7,000
Current assets			
Inventory		7,000	
Trade receivables		6,000	
Cash at bank		43,550	
			56,550
Total assets			**63,550**
Capital			
Opening capital		50,000	
Profit		6,550	
Drawings		0	
			56,550
Non–current liabilities			0
Current liabilities			
Trade payables		7,000	
			7,000
Total capital and liabilities			**63,550**

Example 2 (Tina)

Journal

1.1.2010

Dr Cash a/c	$65,000
Cr Capital a/c	$65,000

2.1.2010

Dr Purchases a/c	$8,000
Cr Trade payables a/c	$8,000

7.1.2010

Dr Cash a/c	$4,000
Cr Sales a/c	$4,000

8.1.2010

Dr Trade payables a/c	$4,000
Cr Bank a/c	$4,000

14.1.2010

Dr Insurance expense a/c	$75
Cr Bank a/c	$75

15.1.2010

Dr Trade receivables a/c	$12,000
Cr Sales a/c	$12,000

16.1.2010

Dr Purchases a/c	$10,000
Cr Trade payables a/c	$10,000

18.1.2010

Dr Computer equipment a/c	$3,000
Cr Cash a/c	$3,000

20.1.2010

Dr Rent expense a/c	$150
Cr Bank a/c	$150

21.1.2010

Dr Cash a/c	$10,000
Cr Sales a/c	$10,000

25.1.2010

Dr Petty cash a/c	$100
Cr Bank a/c	$100

31.1.2010

Dr Stationery expense a/c	$30
Cr Petty cash a/c	$30

Main Ledger

Bank / Cash a/c

DR		$			CR $
1.1.2010	Capital	65,000	8.1.2010	Trade payables	4,000
7.1.2010	Sales	4,000	14.1.2010	Insurance	75
21.1.2010	Sales	10,000	18.1.2010	Computer equipment	3,000
			20.1.2010	Rent	150
			25.1.2010	Petty cash	100
				Balance c/f	71,675
		79,000			79,000
	Balance b/f	71,675			

Capital a/c

DR		$			CR $
	Balance c/f	65,000	1.1.2010	Bank	65,000
				Balance b/f	65,000

Purchases a/c

DR		$			CR $
2.1.2010	Trade payables	8,000			
16.1.2010	Trade payables	10,000		Balance c/f	18,000
		18,000			18,000
	Balance b/f	18,000			

Trade payables a/c

DR		$			CR $
8.1.2010	Bank	4,000	2.1.2010	Purchases	8,000
	Balance c/f	14,000	16.1.2010	Purchases	10,000
		18,000			18,000
				Balance b/f	14,000

DR — Sales a/c — CR

		$			$
	Balance c/f	26,000	7.1.2010	Cash	4,000
			15.1.2010	Trade receivables	12,000
			21.1.2010	Cash	10,000
		26,000			26,000
				Balance b/f	26,000

DR — Insurance a/c — CR

		$			$
14.1.2010	Bank	75		Balance c/f	75
	Balance b/f	75			

DR — Trade receivables a/c — CR

		$			$
15.1.2010	Sales	12,000		Balance c/f	12,000
	Balance b/f	12,000			

DR — Computer equipment — CR

		$			$
18.1.2010	Cash	3,000		Balance c/f	3,000
	Balance b/f	3,000			

DR — Rent a/c — CR

		$			$
20.1.2010	Bank	150		Balance c/f	150
	Balance b/f	150			

Petty cash a/c

DR					CR
		$			**$**
25.1.2010	Bank	100	31.1.2010	Stationery	30
				Balance c/f	70
		100			100
	Balance b/f	70			

Stationery a/c

DR					CR
		$			**$**
31.1.2010	Petty cash	30		Balance c/f	30
	Balance b/f	30			

Trial balance

Account name	Financial Statement	**DR** $	**CR** $
Bank	SFP	71,675	
Capital	SFP		65,000
Purchases	SOCI	18,000	
Trade payables	SFP		14,000
Sales	SOCI		26,000
Insurance	SOCI	75	
Trade receivables	SFP	12,000	
Computer equipment	SFP	3,000	
Rent	SOCI	150	
Petty cash	SFP	70	
Stationery	SOCI	30	
Total		105,000	105,000

Closing Inventory Journal

Dr Inventory (SFP)	5,000
Cr Closing Inventory (SOCI)	5,000

Tina Statement of Comprehensive Income for the month ended 31 January 2010

	$	$
Sales		26,000
Less: Cost of sales		
Opening inventory	0	
Purchases	18,000	
Closing inventory	-5,000	
		(13,000)
Gross profit		13,000
Other income		0
Less: expenses		
Insurance	75	
Rent	150	
Stationery	30	
		(255)
Profit for the year		**12,745**

Tina Statement of Financial Position as at 31 January 2010

	Cost $	Accumulated Depreciation $	Carrying Value $
Non–current assets			
Computer equipment			
	3,000	0	3,000
Current assets			
Inventory		5,000	
Trade receivables		12,000	
Cash at bank		71,675	
Petty cash		70	
			88,745
Total assets			**91,745**
Capital			
Opening capital		65,000	
Profit		12,745	
Drawings		0	
			77,745
Non–current liabilities			0
Current liabilities			
Trade payables		14,000	
			14,000
Total capital and liabilities			**91,745**

CHAPTER 4: INVENTORY

Example 1 (Shay)

Statement of Comprehensive Income for the year

	$000	$000
Revenue		300,000
Less: Cost of sales		
Opening inventory	50,000	
Purchases	180,000	
Carriage inwards	20,000	
	250,000	
Closing inventory	-84,000	
		(166,000)
Gross Profit		**134,000**
Less: Expenses		
Carriage outwards	9,000	
Other expenses	68,000	
		(77,000)
Profit for the year		**57,000**

Example 2 (Navigator)

FIFO

Total purchases	3,000 pens
Total sales	1,700 pens
Closing inventory	1,300 pens

Valuation

900 pens @ $5.40 each	$4,860
400 pens@ $5.25 each	$2,100
=	**$6,960**

Weighted average cost

Periodic method

Average weighted cost per unit = $\dfrac{\$14,735 \text{ total cost}}{3,000 \text{ units}}$

= $4.91

Closing inventory = 1,300 units * $4.91

= **$6,383**

Continuous method

	IN			OUT			BALANCE		
Date	**No.**	**Cost**	**Total**	**No.**	**Cost**	**Total**	**No.**	**Cost**	**Total**
03/01	500	4.00	2000.00				500		2000.00
07/01				300	4.00	1200.00	200		800.00
12/01	500	4.60	2300.00				700		3100.00
13/01				400	3100 divided by 700	1771.00	300		1329.00
16/01	400	4.75	1900.00				700		3229.00
17/01				300	3229 divided by 700	1384.00	400		1845.00
22/01	700	5.25	3675.00				1100		5520.00
29/01				700	5520 divided by 1100	3513.00	400		2007.00
31/01	900	5.40	4860.00				1300		**6867.00**

Therefore Statement of Comprehensive Income for the month of January is as follows:

All $	**FIFO**		**Weighed Av. Cost (Periodic)**		**Weighted Av. Cost (Continuous)**	
Revenue		17,000		17,000		17,000
Cost of sales						
Opening inventory	0		0		0	
Purchases	14,735		14,735		14,735	
Closing inventory	**-6,960**		**-6,383**		**-6,867**	
		(7,775)		(8,352)		(7,868)
Gross profit		9,225		8,648		9,132

Example 3 (Radiance Kitchenware)

		$	$
Closing valuation			42,800
Less			
Damaged inventory	Table	(500)	
	Chairs	(400)	(900)
Add NRV			
	Table (200 – 50)	150	
	Chairs	80	230
			42,130

Cost of Sales		
Opening inventory	45,678	
Purchases	98,000	
Closing inventory	-42,130	
		101,548

CHAPTER 5: NON-CURRENT ASSETS

Example 1

	Capital	Revenue
Purchase of a motor vehicle	√	
Purchase of a tax disc		√
Fuel		√
Insurance		√
C D player	√	
Alloy wheels	√	
New tyre		√

Example 2 (Mr Bubble)

i)

$$\frac{150{,}000 \quad - \quad 20{,}000}{5} = \text{\$26,000 per annum (y/e 31.12.05 to y/e 31.12.09)}$$

ii)

$$26{,}000 \times \frac{5}{12} = \$10{,}833 \quad \text{y/e 31.12.05}$$

$$\$26{,}000 \left.\begin{array}{l} \text{y/e 31.12.06} \\ \text{y/e 31.12.07} \\ \text{y/e 31.12.08} \\ \text{y/e 31.12.09} \end{array}\right.$$

$$26{,}000 \times \frac{7}{12} = \$15{,}167 \quad \text{y/e 31.12.10}$$

Example 3 (Mr Jazzy)

(i)

	$
Cost	25,000
Dep'n (25%*25,000)	(6,250)
Carrying value 31.12.06	**18,750**
Dep'n (25% * 18,750)	(4,688)
Carrying value 31.12.07	**14,062**
Dep'n (25% * 14,062)	(3,515)
Carrying value 31.12.08	**10,547**

(ii)

Cost	25,000
Dep'n (25%*25,000*3/12)	(1,563)
Carrying value 31.12.06	**23,437**
Dep'n (25% * 23,437)	(5,859)
Carrying value 31.12.07	**17,578**
Dep'n (25% * 17,578)	(4,394)
Carrying value 31.12.08	**13,184**

(i)

DR		**Cost**			**CR**
		$			**$**
1.10.2006	Bank	25,000		Balance c/f	25,000
	Balance b/f	25,000			

DR		**Accumulated depreciation**			CR
		$			**$**
	Balance c/f	6,250	31.12.2006	Dep'n (I/S)	6,250
			1.1.07	Balance b/f	6,250
	Balance c/f	10,938	31.12.07	Dep'n (I/S)	4,688
		10,938			10,938
			1.1.07	Balance b/f	10,938
	Balance c/f	14,453	31.12.08	Dep'n (I/S)	3,515
		14,453			14,453
				Balance b/f	14,453

(ii)

DR		Cost			CR
		$			**$**
1.10.2006	Bank	25,000		Balance c/f	25,000
	Balance b/f	25,000			

DR		Accumulated depreciation			CR
		$			**$**
	Balance c/f	1,563	31.12.2006	Dep'n (I/S)	1,563
			1.1.07	Balance b/f	1,563
	Balance c/f	7,422	31.12.07	Dep'n (I/S)	5,859
		7,422			7,422
			1.1.07	Balance b/f	7,422
	Balance c/f	11,816	31.12.08	Dep'n (I/S)	4,394
		11,816			11,816
				Balance b/f	11,816

Example 4 (Mrs Kemp)

	$
Cost (1.04.2005)	22,000
Dep'n (20%*22,000*9/12)	(3,300)
Carrying value 31.12.05	**18,700**
Dep'n (20% * 18,700)	(3,740)
Carrying value 31.12.06	**14,960**
Dep'n (20% * 14,960)	(2,992)
Carrying value 31.12.07	**11,968**
Dep'n (20% * 11,968)	(2,394)
Carrying value 31.12.08	**9,574**
Dep'n (20% * 9,574*6/12)	(957)
Carrying value 1.07.09	**8,617**

	$
Cost	**22,000**
Accumulated depreciation	(13,383)
Carrying value 1.07.09	**(8,617)**

	$
Sale proceeds	**8,000**
Carrying value at 1.07.09	(8,617)
Loss on disposal	**(617)**

Journal entries

Step 1

Dr Disposals	$22,000
Cr Motor vehicle (cost)	$22,000

Step 2

Dr Acc Dep'n	$13,383
Cr Disposals	$13,383

Step 3

Dr Bank	$8,000
Cr Disposals	$8,000

DR		Cost			CR
		$			$
1.1.2009	Balance b/f	22,000	1.7.09	Disposals	22,000

DR		Accumulated depreciation			CR
		$			$
1.7.09	Disposals	13,383	1.7.09	Balance b/f	13,383

DR		Disposals a/c			CR
		$			$
1.07.09	Motor vehicle (cost)	22,000	1.07.09	Acc Dep'n	13,383
			1.07.09	Bank	8,000
				I/S (Loss)	617
		22,000			22,000

Example 5 (Lesley)

	$
Sale proceeds	**1,500**
Carrying value at 1.03.10	(3,400)
Loss on disposal	**(1,900)**

Journal entries

Step 1

Dr Disposals	$15,000
Cr Old Van (cost)	$15,000

Step 2

Dr Acc Dep'n	$11,600
Cr Disposals	$11,600

Step 3

Dr New Van (cost)	$18,000
Cr Bank	$16,500
Cr Disposals (Part exchange allowance)	$1,500

Disposals a/c

DR		$			CR $
1.03.10	Old Van (cost)	15,000	1.03.10	Acc Dep'n	11,600
			1.03.10	Part exchange allowance	1,500
				I/S (Loss)	1,900
		15,000			15,000

Example 6 (Chris)

(i)	$
Cost (1.01.1994)	45,000
Acc Dep'n (45,000*2%*15 years)	(13,500)
Carrying value 1.01.2009	**31,500**

	$
Valuation	150,000
Carrying value at 1.01.09	(31,500)
Revaluation gain	**118,500**

(ii)

Dr Cost	$105,000
Dr Accumulated depreciation	$13,500
Cr Revaluation reserve	$118,500

DR — Cost — CR

		$			$
1.1.2009	Cost b/f	45,000			
1.1.2009	Revaluation reserve	105,000		Balance c/f	150,000
		150,000			150,000
	Balance b/f	150,000			

DR — Accumulated depreciation — CR

1.1.2009	Revaluation reserve	13,500	1.1.2009	Balance b/f	13,500

DR — Revaluation reserve — CR

		$			$
			1.1.2009	Cost	105,000
	Balance c/f	118,500	1.1.2009	Acc Dep'n	13,500
		118,500			118,500
				Balance b/f	118,500

(iii)

Depreciation charge for y/e 31.12.09 = $150,000 /35 = $4,286

CHAPTER 6: IRRECOVERABLE DEBTS AND ALLOWANCES

Example 1

Zippy Traders

This debt should be treated as an irrecoverable debt. Therefore the entry needed would be:

Dr	Irrecoverable debts	$4,000
Cr	Trade receivables	$4,000

Bungle

This debt is neither an irrecoverable or doubtful debt at this stage. This is because the debt is not yet due and we know where Bungle lives. We also have no reason to suspect that Bungle cannot afford to repay the debt.

Example 2

Allowance for receivables working

	$	$
Receivables		152,000
Irrecoverable debt write off		(6,000)
Specific allowances	4,600	(4,600)
	1,400	(1,400)
		140,000
General allowance (6%)	8,400	
Allowance required c/f	14,400	
Allowance b/f	(8,000)	
Increase in allowance	6,400	

Trade Receivables

Dr	$		Cr $
Balance b/f	152,000	Irrecoverable debts	6,000
		Balance c/f	146,000
	152,000		152,000

Irrecoverable Debts

Dr	$		Cr $
Trade receivables	6,000	Expense for the year to SOCI	12,400
Allowance for receivables	6,400		
	12,400		12,400

Allowance for Receivables

Dr	$		Cr $
Balance c/f	14,400	Balance b/f	8,000
		Irrecoverable debts	6,400
	14,400		14,400

Example 3

Allowance for receivables working

	$	$
Receivables		114,000
Irrecoverable debt write off		(4,000)
Specific allowance	10,000	(10,000)
		100,000
General allowance (3%)	3,000	
Allowance required c/f	13,000	
Allowance b/f	(4,400)	
Increase in allowance	8,600	

Dr **Trade Receivables** **Cr**

	$		$
Balance b/f	114,000	Irrecoverable debts	4,000
		Balance c/f	110,000
	114,000		114,000

Dr **Irrecoverable Debts** **Cr**

	$		$
Trade receivables	4,000	Expense for the year to SOCI	12,600
Allowance for receivables	8,600		
	12,600		12,600

Dr **Allowance for Receivables** **Cr**

	$		$
Balance c/f	13,000	Balance b/f	4,400
		Irrecoverable debts	8,600
	13,000		13,000

Example 4

Dr Bank	$100
Cr Trade receivables	$100

Allowance required c/f	*0*
Allowance b/f	*(100)*
Decrease in allowance	*(100)*

Dr Allowance for receivables	$100
Cr Irrecoverable debts	$100

CHAPTER 7: ACCRUALS AND PREPAYMENTS

Example 1 (Mrs Nelly)

Estimate of charges for Nov 09 and Dec 09 (using 31.10.09) gas bill:
=2/3 x $300
=$200

The entry needed would be:

Dr	Gas expense	$200
Cr	Accruals	$200

Gas expense a/c

DR					CR
		$			**$**
30.04.09	Cash	300			
31.07.09	Cash	310			
31.10.09	Cash	300			
31.12.09	Accrual	200	31.12.09	Expense for the year to SOCI	1,110
		1,110			1,110
			01.01.10	Accrual b/f	200

It is important to remember to carry forward any accrual or prepayment to the next accounting period.

Example 2 (Julia)

Estimate of charges for Jan 09 and Feb 09 (using 09.01.09) rent bill:
=2/3 x $1,650
=$1,100

The entry needed would be:

Dr	Rent expense	$1,100
Cr	Accruals	$1,100

Rent expense a/c

DR					CR
		$			**$**
07.04.08	Cash	1,500	01.03.08	Accrual b/f	1,200
09.07.08	Cash	1,950			
06.10.08	Cash	2,250			
09.01.09	Cash	1,650			
28.02.09	Accrual	1,100	28.02.09	Expense for the year to SOCI	7,250
		8,450			8,450
			01.03.09	Accrual b/f	1,100

Example 3 (Mariah)

Amount prepaid (1.1.09 to 31.07.09) = 7/12 x $1,800
= $1,050

The entry needed would be:

Dr	Prepayments	$1,050
Cr	Insurance expense	$1,050

Insurance expense a/c

DR					CR
		$			**$**
01.08.08	Cash	1,800	31.12.08	Prepayment	1,050
			31.12.08	Expense for the year to SOCI	750
		1,800			1,800
01.01.09	Prepayment b/f	1,050			

Example 4 (Mariah)

Amount prepaid (1.1.10 to 31.07.10) = 7/12 x $2,200
= $1,283

The entry needed would be:

Dr	Prepayments	$1,283
Cr	Insurance expense	$1,283

Insurance expense a/c

DR					CR
		$			**$**
01.01.09	Prepayment b/f	1,050	31.12.09	Prepayment	1,283
01.08.09	Cash	2,200	31.12.09	Expense for the year to SOCI	1,967
		3,250			3,250
01.01.10	Prepayment b/f	1,283			

Example 5 (Jen)

DR — **Rental income a/c** — **CR**

		$			**$**
01.12.08	Accrued income b/f	27,600		Cash	718,050
30.11.09	Income for the year to SOCI	722250	30.11.09	Accrued income	31,800
		749,850			749,850
01.12.09	Accrued income b/f	31,800			

Example 6 (Mandy)

Income received in advance (May 2010) = 1/3 x $600
= $200

The entry needed would be:

Dr	Rental income	$200
Cr	Deferred income	$200

DR — **Rental income a/c** — **CR**

		$			**$**
30.04.10	Deferred income	200	01.05.09	Deferred income b/f	200
30.04.10	Income for the year to SOCI	2,150	01.06.09	Cash	600
			01.09.09	Cash	450
			01.12.09	Cash	500
			01.03.10	Cash	600
		2,350			2,350
			01.05.10	Deferred income b/f	200

CHAPTER 8: SALES TAX

Example 1

$	Sales tax charged on Sales	Sales tax recovered on Purchases	Amount payable to tax authority
Manufacturer	15		**15**
	(15%*100)		
Wholesaler	24	(15)	**9**
	(15%*160)		
Retailer	45	(24)	**21**
	(15%*300)		

Example 2

		$
i)	List price	2,000
	Trade discount @ 5%	(100)
	Net amount	1,900
	Sales tax @ 15%	285
	Gross amount	2,185

Dr Trade receivables	2,185
Cr Sales	1,900
Cr Sales tax control a/c	285

		$
ii)	Net amount	1,000
	Sales tax @ 15%	150
	Gross amount	1,150

Dr Purchases	1,000
Dr Sales tax control a/c	150
Cr Cash	1,150

		$
iii)	Net amount	20
	Sales tax @ 15%	3
	Gross amount	23

Dr Stationery expense	20
Dr Sales tax control a/c	3
Cr Cash	23

Sales tax control a/c

Dr	$		Cr $
Purchases	150	Sales	285
Stationery	3		
Balance c/f	132		
	285		285
		Balance b/f	132

CHAPTER 9: BOOKS OF PRIME ENTRY

Example 1 (Gary)

Payables Ledger Control Account

DR		**$**			**CR $**
	Returns outwards	3,950		Balance b/f	12,785
	Payments	37,500		Purchase day book	44,999
	Discounts received	1,400			
	Contra	900			
	Balance c/f	14,034			
		57,784			57,784
				Balance b/f	14,034

Example 2 (Paris)

Payables Ledger Control Account

DR		**$**			**CR $**
	Purchase returns	14,000	1.07.08	Balance b/f	53,500
	Discounts received	12,000		Credit purchases	300,000
	Payments	263,100			
	Contra	17,500			
30.06.09	Balance c/f	46,900			
		353,500			353,500
			1.07.09	Balance b/f	46,900

Receivables Ledger Control Account

DR		**$**			**CR $**
1.07.08	Balance b/f	51,500		Sales returns	17,000
	Credit sales	450,000		Discounts allowed	11,000
				Irrecoverable debts	2,500
				Cash received	438,580
				Contra	17,500
			30.06.09	Balance c/f	14,920
		501,500			501,500
1.07.09	Balance b/f	14,920			

CHAPTER 10: CONTROL ACCOUNT RECONCILIATIONS

Example 1 (Explorer Rain Wear)

DR — Payables Ledger Control Account — CR

		$			$
	2. PDB casting error	1,000	31.12.07	Original balance b/f	22,550
	3. Purchase returns	1,590		1. Invoice omitted	1,200
	4. Discounts received	10			
	5. Contra	500			
31.12.07	Amended balance c/f	20,650			
		23,750			23,750
			1.01.08	Balance b/f	20,650

Balance per payables ledger (list) $ 20,650

Example 2 (Benji)

DR — Receivables Ledger Control Account — CR

	$		$
Original balance b/f	72,266	1. Contra	14,592
		2. SDB casting error	2,500
		3. Discounts allowed	36,015
		4. Irrecoverable debts	3,000
		Amended balance c/f	16,159
	72,266		72,266
Balance b/f	16,159		

	$
Original total of balances on receivables ledger	70,659
4. Irrecoverable debts	(3,000)
5. Cash received from customers	(20,000)
6. Invoice posting error	(31,500)
Revised total of balances on receivables ledger	**16,159**

Example 3 (Gaga Co)

	$
Original balance on Rihanna Co's account in Gaga co	118,000
2. Discounts not allowed	500
3. Contra	(5,000)
Revised balance on Rhinana Co account in Gaga co	**113,500**

	$
Original balance per supplier statement from Rihanna Co	138,000
1. Purchase returns	(15,000)
4. Payment	(9,500)
Correct amount owed by Gaga Co to Rihanna Co	**113,500**

Example 4 (Michael)

1. Yes, as casting error affects control account only
2. No, as the error will affect both the control account and total list of receivables balances
3. Yes, as entry not posted in the control account.
4. Yes, as entry not posted in the list of individual receivables balances
5. Yes, as casting error affects control account only
6. Yes

CHAPTER 11: CORRECTION OF ERRORS AND SUSPENSE ACCOUNTS

Example 1

	Entry recorded	$	Should have been	$	Correcting entry	$
1	Not recorded		Dr Stationery expense	500	Dr Stationery expense	500
			Cr Bank	500	Cr Bank	500
2	Dr Computer equipment (NCA)	400	Dr Computer repairs expense	400	Dr Computer repairs expense	400
	Cr Bank	400	Cr Bank	400	Cr Computer equipment (NCA)	400
3	Dr Bank	60	Dr Bank	60	Dr Discounts received	60
	Cr Discounts received	60	Cr Commission income	60	Cr Commission income	60
4	Dr Property maintenance expense	550	Dr Property maintenance expense	5,500	Dr Property maintenance expense	4,950
	Cr Bank	550	Cr Bank	5,500	Cr Bank	4,950
5	Dr Receivables Control Account	1,000	Dr Payables Control Account	1,000	Dr Payables Control Account	2,000
	Cr Payables Control Account	1,000	Cr Receivables Control Account	1,000	Cr Receivables Control Account	2,000

Example 2

Dr Stationery expense $30

Cr Suspense a/c $30

Example 3

DR	Suspense Account		CR
	$		$
3. Stationery	340	Per TB	2,812
6.Commission received	250	5. Discounts allowed	2,620
7.Rental income	3,742	8. Utilities	600
10.Receivables Control	2,500	9. Drawings	800
	6,832		6,832

	Entry recorded	$	Should have been	$	Correcting entry	$
1	Dr Computer (NCA)	350	Dr Computer (NCA)	3,500	Dr Computer (NCA)	3,150
	Cr Bank	350	Cr Bank	3,500	Cr Bank	3,150
2	None		Dr Depreciation expense	583	Dr Depreciation expense	583
			Cr Accumulated Depreciation	583	Cr Accumulated Depreciation	583
3	Dr Stationery expense	780	Dr Stationery expense	440	**Dr Suspense a/c**	**340**
	Cr Bank	440	Cr Bank	440	Cr Stationery expense	340
	Cr Suspense a/c	**340**				
4	Dr Rent and rates	1,000	Dr Purchases	1,000	Dr Purchases	1,000
	Cr Trade payables	1,000	Cr Trade payables	1,000	Cr Rent and rates	1,000
5	**Dr Suspense a/c**	**2,620**	Dr Discounts allowed	1,310	Dr Discounts allowed	2,620
	Cr Receivables Control Account	1,310	Cr Receivables Control Account	1,310	**Cr Suspense a/c**	**2,620**
	Cr Discounts allowed	1,310				
6	Dr Bank	125	Dr Bank	125	**Dr Suspense a/c**	**250**
	Dr Commission income	125	Cr Commission income	125	Cr Commission income	250
	Cr Suspense a/c	250				
7	Dr Bank	3,742	Dr Bank	3,742	**Dr Suspense a/c**	**3,742**
	Cr Suspense a/c	**3,742**	Cr Rental income	3,742	Cr Rental income	3,742
8	**Dr Suspense a/c**	**600**			Dr Utilities expense	600
					Cr Suspense a/c	**600**
9	**Dr Suspense a/c**	**800**	Dr Drawings	400	Dr Drawings	400
	Cr Bank	400	Cr Bank	400	Dr Purchases	400
	Cr Purchases	400			**Cr Suspense a/c**	**800**
10	Dr Receivables Control Account	1,250	Dr Payables Control Account	1,250	**Dr Suspense a/c**	**2,500**
	Dr Payables Control Account	1,250	Cr Receivables Control Account	1,250	Cr Receivables Control Account	2,500
	Cr Suspense a/c	**2,500**				

Example 4

	$ **Dr**	$ **Cr**
Draft profit		199,871
2. Depreciation	583	
3. Stationery		340
5. Discounts allowed	2,620	
6. Commission income		250
7. Rental income		3,742
8. Utilities expense	600	
9. Purchases	400	
	4,203	**204,203**
Revised profit		**200,000**

CHAPTER 12: BANK RECONCILIATIONS

Example 1 (Mary Kay)

Adjusted Cash Book

DR			CR		
		$			**$**
30.04.10	Balance b/f	20,095	11.04.10	Standing Order	750
18.04.10	BACS	3,500	14.04.10	Direct Debit	750
			24.04.10	Bank Charges	500
			30.04.10	Balance c/f	21,595
		23,595			23,595
1.05.10	Balance b/f	21,595			

Bank Reconciliation

		$
Balance per bank statement		19,550
Less: Unpresented cheques	1440	(150)
	1443	(395)
	1444	(165)
	1445	(245)
Add: Outstanding lodgements	6532	3,000
Balance per adjusted cash book		21,595

Example 2 (Rose)

DR **Adjusted Cash Book** **CR**

		$			$
	1. Cheque error	459	30.11.09	Balance b/f	2,400
	7. BACS	6,196		2. Direct Debit	225
				5. Dishounoured cheque	1,450
				6. Bank charges	1,400
				8. Cheque 100600	180
			30.11.09	Balance c/f	1,000
		6,655			6,655
1.12.09	Balance b/f	1,000			

Bank Reconciliation

	$
Balance per bank statement	(1,550)
Less: Unpresented cheques	(5,840)
Add: Outstanding lodgements	8,390
Balance per adjusted cash book	1,000

CHAPTER 13: LIMITED COMPANY ACCOUNTS

Example 1 (Big Boss Ltd)

Dr Bank	$37,500
Cr Share capital	$37,500

Example 2 (Big Boss Ltd)

Dr Bank	$62,500
Cr Share capital	$12,500
Cr Share premium	$50,000

Example 3 (Big Boss Ltd)

i)

Dr Bank	$6,250
Cr Redeemable preference shares	$6,250

ii) Dividend payable:

Ordinary s/h = 200,000 shares x $0.05
= $10,000

Redeemable preference s/h = $6,250 x 6%
= $375

Journal entries:

Dr Finance cost	$375	
Cr Accrued redeemable preference shares	$375	
Dr Retained earnings	$10,000	
Cr Dividend payable		$10,000

Example 4 (Banana Bread Ltd)

25,000 (50,000/2) bonus shares x $0.50 = $12,500

Dr Share premium	$12,500
Cr Share capital	$12,500

Example 5 (Banana Bread Ltd)

i)

Total shares pre rights issue = 50,000+25,000

= 75,000 shares

Rights issue shares =75,000/3

=25,000

Dr Cash	37,500 (25,000 shares x $1.50)
Cr Share capital	12,500 (25,000 shares x $0.5)
Cr Share premium	25,000 (25,000 shares x $1.00)

ii)

Total shares post rights issue = 75,000+25,000

= 100,000 shares

Dividend = 100,000 shares x $0.05

= $5,000

Dr Retained earnings	$5,000
Cr Dividend payable	$5,000

iii)

Share capital = 50,000 (25,000+12,500+12,500)

Share premium = 62,500 (50,000-12,500+25,000)

Retained earnings = 110,000 (100,000+15,000-5,000)

Example 6 (Banana Bread Ltd)

	Share capital	Share premium	Retained earnings
	$	$	$
Bal b/f 1.01.09	25,000	50,000	100,000
Bonus issue	12,500	(12,500)	
Rights issue	12,500	25,000	
Profit for the year			15,000
Dividend payable			(5,000)
Bal c/f 31.12.09	**50,000**	**62,500**	**110,000**

Example 7 (Moodle Ltd)

Dr Cash $4,500,000 (30,000 x $150)

Cr Loan notes $4,500,000

Interest to 31.12.09 = $4,500,000 x 10% x 6/12

= $225,000

Dr Finance cost $225,000

Cr Accrued interest $225,000

Example 8 (The City Ltd)

DR **Taxation** **CR**

		$			$
1.10.09	Cash	255,000	1.01.09	Balance b/f	250,000
			31.12.09	Under provision to SOCI	5,000
31.12.09	Balance c/f	270,000	31.12.09	Tax charge to SOCI	270,000
		525,000			525,0000
			1.12.10	Balance b/f	270,000

CHAPTER 14: FROM TRIAL BALANCE TO FINANCIAL STATEMENTS

Example 1

Journals

				Dr	Cr
1.	Dr	Depreciation charge (150,000 x 2%)		3,000	
	Cr	Accumulated depreciation - Buildings			3,000
2.	Dr	Depreciation charge (422,987 x 10%)		42,299	
	Cr	Accumulated depreciation – P & M			42,299
3.	Dr	Closing inventory (SFP)		28,990	
	Cr	Closing inventory (SOCI)			28,990
4.	Dr	Allowance for receivables	Work 1	3,688	
	Cr	Administration expenses			3,688
5.	Dr	Taxation expense		25,000	
	Cr	Taxation liability			25,000
6.	Dr	Retained earnings		3,000	
	Cr	Dividends payable (prefs)			3,000
7.	Dr	Retained earnings(100,000 / 0.5 x 15c)		30,000	
	Cr	Dividends payable			30,000
8.	Dr	Loan interest (10,000 – 5,000)		5,000	
	Cr	Loan interest accrual			5,000

Working 1

Allowance for receivables

			01/04/09	b/f	5,987
31/03/07	Irrecoverable debts	3,688			
31/03/10	c/f (45,987 x 5%)	2,299			
		5,987			5,987

Jewel Limited
Statement of Comprehensive Income
Year ended 31 March 2010

	$
Revenue	365,000
Cost of sales (32,000 + 69666 – 28990)	(72,676)
GROSS PROFIT	292,324
Distribution costs	(49,000)
Administration expenses (48,000 + 3000 + 42,299 – 3688 - 1000)	(88,611)
PROFIT FROM OPERATIONS	154,713
Finance costs	(10,000)
PROFIT BEFORE TAX	144,713
Income tax	(25,000)
PROFIT FOR THE PERIOD	119,713

Jewel Limited
Statement of financial position as at 31 March 2010

	$	$
Non – current assets		
Tangible assets (150,000 + 422,987 – 3,000 – 42,299)		527,688
Current assets		
Inventory	28,990	
Trade receivables (45,987 – 2,299)	43,688	
Cash	73,958	
		146,636
Total assets		674,324
Equity and liabilities		
Ordinary share capital	100,000	
Preference share capital	50,000	
Retained earnings (234,666 + 119,713 – 30,000 – 3,000 Pref Div)	321,379	
		471,379
Non – current liabilities		
Loan notes		100,000
Current liabilities		
Trade payables	39,945	
Debenture accrual	5,000	
Dividend payable	33,000	
Taxation	25,000	
		102,945
Total liabilities		674,324

	Ordinary Shares $	**Preference Shares $**	**Revaluation Reserve $**	**Retained Earnings $**	**Total $**
Balance @ 01/04/09	100,000	50,000		234,666	384,666
Profit for the year				119,713	119,713
Dividends: ord				(30,000)	(30,000)
pref				(3,000)	(3,000)
Shares issued					
Revaluation					
Balance @ 31/03/10	100,000	50,000		321,379	471,379

Example 2

Journals

1	Dr	Depreciation charge (225,000 x 2%)	$4,500
	Cr	Buildings accumulated dep'n	$4,500
2	Dr	Depreciation charge (112,500-22,500) x 25%	$22,500
	Cr	Plant accumulated dep'n	$22,500
3	Dr	Land valuation (600,000 - 450,000)	$150,000
	Cr	Revalauation reserve	$150,000
	NOTE: Land is never depreciated		
4	Dr	Inventory (SFP)	$31,869
	Cr	Inventory (SOCI)	$31,869
5	Dr	Irrecoverable debts (working 1)	$1,676
	Cr	Allowance for receivables	$1,676
6	Dr	Taxation expense	$4,832
	Cr	Taxation liability	$4,832
7	Dr	Retained earnings (52,500 shares at 10c)	$5,250
	Cr	Dividend payable	$5,250

Working 1

Allowance for receivables

			01.01.09	b/f	2,250
			31.12.09	Irrecoverable debts	1,676
31.12.09	c/f (130,867 x 3%)	3,926			
		3,926			3,926

Miranda Limited
Statement of Comprehensive Income
Year ended 31 December 2009

	$
Revenue	193,500
Cost of sales (33,000 + 115,869 – 31,869)	(117,000)
GROSS PROFIT	76,500
Distribution costs	(12,597)
Administration expenses (19,125+4,500+22,500+1,676)	(47,801)
PROFIT FROM OPERATIONS	16,102
Finance costs	(0)
PROFIT BEFORE TAX	16,102
Income tax	(4,832)
PROFIT FOR THE PERIOD	11,270
Other comprehensive income:	
Gain on revaluation	150,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	161,270

Miranda Limited
Statement of financial position as at 31 December 2009

	$	$
Non – current assets		
Tangible assets (600,000 + 225,000 - 36,000 - 4,500 + 112,500 - 22,500 - 22,500)		852,000
Current assets		
Inventory	31,869	
Trade receivables (130,867 – 3,926)	126,941	
Bank	19,427	
		178,237
Total assets		1,030,237
Equity and liabilities		
Ordinary share capital	52,500	
Share premium	18,000	
Retained earnings (731,955 + 11,270 – 5,250)	737,975	
Revaluation reserve	150,000	
		958,475
Non – current liabilities		0
Current liabilities		
Trade payables	61,680	
Taxation	4,832	
Dividend payable	5,250	
		71,762
Total liabilities		1,030,237

	Ordinary Shares $	**Share Premium** $	**Revaluation Reserve** $	**Retained Earnings** $	**Total** $
Balance @ 01/01/2009	52,500	18,000	0	731,955	802,455
Profit for the year				11,270	11,270
Dividends				(5,250)	(5,250)
Shares issued	0	0			
Revaluation			150,000		150,000
Balance @ 31/12/2009	52,500	18,000	150,000	737,975	958,475

CHAPTER 15: ACCOUNTING STANDARDS

Example 1

1. The refurbishment is planned to commence in the following year, the issue here is whether or not we should provide for this future expenditure.

   It must not be provided for because it is not a present obligation. The directors intend to refurbish the stores but they may choose not to in the following year. Therefore it fails the first criteria to meet a provision.

2. Charlotte Ltd's established policy allowing customers to return goods has created a valid expectation from its customers. This in turn has created a constructive obligation, therefore meeting the first criteria of a provision. It also meets criteria 2 and 3 of a provision as $130,000 being the reliable estimate and this is from past trading experience so it is probable that these returns could happen.

3. The court case meets the criteria of a provision as it is a present legal obligation; it is probable (60%) chance of settlement which can be reliably measured ($75,000).

Example 2

1. Non-adjusting – plans announced after the accounting year end
2. Adjusting – indicates that the customer's debt was irrecoverable at the accounting year end 31 December 2009
3. Adjusting – the sale of inventory at less than cost indicates that it should have been valued at NRV in the accounts
4. Non-adjusting (unless going concern issues raised)
5. Adjusting – discovery of fraud indicates that the financial statements are incorrect at the accounting year end
6. Non-adjusting
7. Non adjusting

Example 3

	$
Cost	200,000
2002 Depreciation	(20,000)
2003 Depreciation	(20,000)
2004 Depreciation	(20,000)
CV 31.12.2004	140,000
2005 Depreciation	(70,000)
(140,000 / 2 years remaining)	
CV at 31.12.2005	70,000

CHAPTER 16: INCOMPLETE RECORDS

Example 1

Change in net assets		Capital introduced		Profit for the year		Drawings in period
3,000	=	0	+	?	-	2,500

This can be written as:

3,000	-	0	+	2,500	=	Profit
Profit	=	5,500				

Example 2

	$
Opening capital (Bal fig)	184,000
Profit	50,000
Capital introduced	40,000
Drawings (2,000 x 12)	(24,000)
Closing capital	250,000

Example 3

DR **Trade receivables control account** **CR**

	$		$
Balance b/f	50,000	Receipts	45,000
Sales (Bal Fig)	55,000	Irrecoverable debts	5,000
		Balance c/f	55,000
	105,000		105,000

Example 4

Trade receivables control account

DR	$		CR $
Balance b/f	30,000	Credit receipts	40,000
Credit sales (Bal Fig)	50,000	Discounts allowed	3,000
		Balance c/f	37,000
	80,000		80,000

	$
Credit sales	50,000
Cash sales	15,000
Total sales	65,000

Example 5

Trade payables control account

DR	$		CR $
Payments	33,000	Balance b/f	30,000
Discounts received	4,000		
Balance c/f	26,000	Purchases(Bal Fig)	33,000
	63,000		63,000

Example 6

Bank

DR		$	CR		$
31/12/09	Receipts(Bal Fig)	12,130	01/01/09	Balance b/f	1,367
			31/12/09	Payments	8,536
			31/12/09	Balance c/f	2,227
		12,130			12,130

Example 7

DR		Cash		CR
		$		$
	Balance b/f	900	Banked	10,000
			Drawings	1,000
	Receipts(Bal Fig)	13,100	Wages	2,000
			Balance c/f	1,000
		14,000		14,00

Example 8

Sales		6,600	110%
Cost of sales			
Opening inventory	300		
Purchases (Balancing Figure)	6,200		
Closing inventory	-500		
		(6,000)	100%
Gross profit (6,600 / 110 x 10)		600	10%

Example 9

Sales (3,040 / 95 x 100)		3,200	100%
Cost of sales			
Opening inventory	800		
Purchases	2,840		
Closing inventory	-600		
		(3,040)	95%
Gross profit		160	5%

Example 10

Sales		100,000	100%
Cost of sales			
Opening inventory	10,000		
Purchases	82,000		
Closing inventory	-3,000		
Inventory lost in fire (balancing figure)	-9,000		
		(80,000)	80%
Gross profit (100,000 / 100 x 20)		20,000	20%

CHAPTER 17: PARTNERSHIPS

Example 1

	Tinky	Winky	Total
	$	$	$
Profit for the year			150,000
PSR (2:1)	100,000	50,000	(150,000)
Total	100,000	50,000	0

Example 2

	George	Brad	Matt	Total
	$	$	$	$
Profit for the year				96,000
Salary		20,000		(20,000)
Interest on capital ($50,000 x 2%)	1,000	1,000	1,000	(3,000)
Interest on drawings ($20,000 x 5% x6/12)			-500	500
Residual profit				73,500
PSR (3:2:1)	36,750	24,500	12,250	(73,500)
Total	37,750	45,500	12,750	0

Example 3

	Bobby	Mac	Estee	Total
	$	$	$	$
Profit for the year				260,000
Salary	30,000	30,000		(60,000)
Residual profit				200,000
PSR (5:3:2)	100,000	60,000	40,000	(200,000)
Guaranteed minimum (5:3)	(50,000)	(30,000)	80,000	0
Total	80,000	60,000	120,000	0

Example 4

Capital account

Dr	Graham	Chris		Graham	**Cr** Chris
Capital withdrawal	10,000		Balance b/f	60,000	90,000
Balance c/f	50,000	95,000	Bank		5,000
	60,000	95,000		60,000	95,000
			Balance b/f	50,000	95,000

Current account

Dr	Graham	Chris		Graham	**Cr** Chris
Balance b/f	18,450		Balance b/f		40,200
Drawings	9,000	3,000	Profit share (3:2)	11,400	7,600
Balance c/f		44,800	Balance c/f	16,050	
	27,450	47,800		27,450	47,800
Balance b/f	16,050		Balance b/f		44,800

Example 5

	Jason	**Howard**	**Gary**	**Mark**	**Total**
Profit					106,250
Interest on capital	5,000	1,000	2,500	2,500	(11,000)
Salaries	-	5,000	-	-	(5,000)
Interest on drawings	(3,000)	-	(3,750)	(3,000)	9,750
					100,000
P.S.R. 2 : 1 : 3 : 4	20,000	10,000	30,000	40,000	(100,000)
	22,000	16,000	28,750	39,500	-
Guaranteed share (2:1:3)	(1,000)	(500)	(1,500)	3,000	
	21,000	15,500	27,250	42,500	

Example 6

	Ollie	Joe	Total
	$	$	$
Profit share to 30 April ($180,000 x 1/3)			60,000
PSR (1:1)	30,000	30,000	(60,000)
Profit share to 31 December ($180,000 x 2/3)			120,000
Salary ($22,500 x 8/12)	15,000		(15,000)
Residual profit			105,000
PSR (1:3)	26,250	78,750	(105,000)
Total	71,250	108,750	0

Example 7

Goodwill:	$
Value of the business	113,000
Fair value of net assets	(90,500)
Goodwill	22,500

Capital account

Dr	Bruce	Diana	Paul		Bruce	Diana	Paul Cr
Goodwill new PSR	9,000	9,000	4,500	Balance b/f	75,000	60,000	
				Goodwill old PSR	11,250	11,250	
Balance c/f	77,250	62,250	40,500	Cash			45,000
	86,250	71,250	45,000		86,250	71,250	45,000
				Balance b/f	77,250	62,250	40,500

Goodwill

DR	$		CR $
Bruce	11,250	Bruce	9,000
Diana	11,250	Diana	9,000
		Paul	4,500
	22,500		22,500

CHAPTER 18: STATEMENTS OF CASH FLOW

Example 1

Cash flows from operating activities	$
Profit before tax (2,475+1,050)	3,525
Adjustments for non-cash items:	
Depreciation	1,875
Profit on disposal	(225)
Finance costs	450
Working capital changes:	
Decrease in inventory (5,700 - 5,100)	600
Increase in receivables (5,700 - 4,350)	(1,350)
Increase in payables (5,550 - 4,800)	750
Cash generated from operations	5,625
Interest paid	(450)
Taxation paid	(900)
Cash generated from operating activities	4,275

Example 2

Cash sales	55,000
Cash received from customers	44,000
Total cash received	99,000
Cash purchases	33,000
Cash paid to suppliers	12,000
Cash expenses	11,000
Cash wages and salaries	20,000
Total cash paid	76,000
Cash generated	23,000

Example 3

Dr	Interest		Cr
	$		$
Cash paid (Bal fig)	4,815	Accrual b/f	180
Accrual c/f	465	To SOCI	5,100
	5,280		5,280

Example 4

Dr	Taxation		Cr
	$		$
Cash paid (Bal fig)	32,828	Balance b/f	32,648
Balance c/f	35,970	To SOCI	36,150
	68,798		68,798

Example 5

Dr	PP+E cost		Cr
	$		$
Balance b/f	405,000	Disposal	67,500
Revaluation gain	30,000		
Additions (Bal fig)	97,500	Balance c/f	465,000
	532,500		532,500

Dr	PP+E acc depn		Cr
	$		$
Disposals (Bal fig)	58,500	Balance b/f	283,500
		Charge for year	22,500
Balance c/f	247,500		
	306,000		306,000

Dr	Disposals		Cr
	$		$
Cost	67,500	Accum depn	58,500
		Proceeds (Bal fig)	2,625
		Loss	6,375
	67,500		67,500

Example 6

Dr	Interest receivable		Cr
	$		$
Balance b/f	18	Cash received (Bal fig)	1,713
To SOCI	2,340	Balance c/f	645
	2,358		2,358

There were no balances for dividends receivable in the year so the dividend in the SOCI must equal what was received of $4,470.

Example 7

Dr	Share capital		Cr
	$		$
		Balance b/f	150,000
Balance c/f	180,000	Cash received (Bal fig)	30,000
	180,000		180,000

Dr	Share premium		Cr
	$		$
		Balance b/f	405,000
Balance c/f	540,000	Cash received (Bal fig)	135,000
	540,000		540,000

Total cash received from share issues in 2009 (135,000+30,000) = $165,000

Example 8

Dr 10% loan notes Cr

	$		$
Cash paid (bal fig)	300,000	Balance b/f	300,000
Balance c/f	0		
	300,000		300,000

Dr 8% loan notes Cr

	$		$
		Balance b/f	90,000
Balance c/f	210,000	Cash received (Bal fig)	120,000
	210,000		210,000

Example 9

	$
Balance b/f	476,400
Profit for the year	117,945
Less: dividend paid (Bal fig)	(61,845)
Balance c/f	532,500

Example 10

	$	$
Cash flows from operating activities		
Profit before tax (44,000+6,000)	50,000	
Adjustments for non-cash items:		
Finance costs	2,000	
Depreciation (92,000 – 78,000)	14,000	
(Profit) / loss on the disposal of a non current asset	-	
Working capital changes:		
Increase in inventory (17,000 – 12,000)	(5,000)	
Increase in receivables (10,000 – 2,000)	(8,000)	
Decrease in payables (19,000 – 13,000)	(6,000)	

Cash generated from operations	47,000	
Interest paid	(2,000)	
Taxation paid (working 1)	(4,000)	
Cash generated from operating activities		41,000
Cash flow from investing activities		
Purchase of a non-current asset (220,000 – 180,000)	(40,000)	
Disposal of a non-current assets	-	
Interest received	-	
Dividends received	-	
Net cash used in investing activities		(40,000)
Cash flow from financing activities		
Proceeds from the issue of shares (65,000 – 45,000) + (12,000 – 10,000)	22,000	
Receipt of loans	-	
Repayment of loans	(10,000)	
Dividends paid	-	
CASH FLOW FROM FINANCING ACTIVITIES		12,000
Movement in cash and cash equivalents in the year		13,000
Cash and cash equivalents at the beginning of the period (10,000+3,000)		13,000
Cash and cash equivalents at the end of the period (10,000+16,000)		26,000

Working 1 - Taxation

Dr		Taxation	Cr
	$		$
Cash paid (Bal fig)	4,000	Balance b/f	1,000
Balance c/f	3,000	To SOCI	6,000
	7,000		7,000