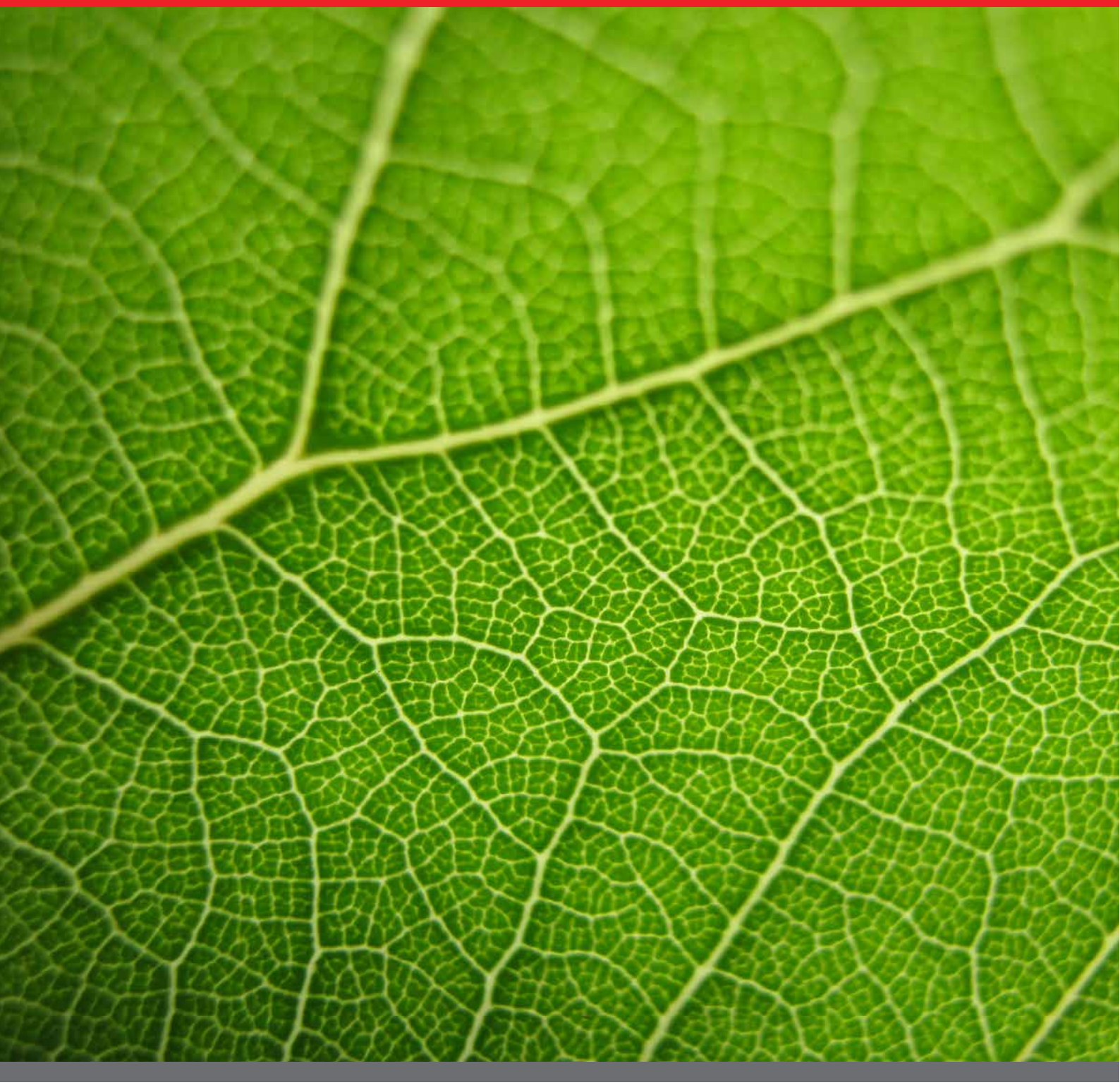
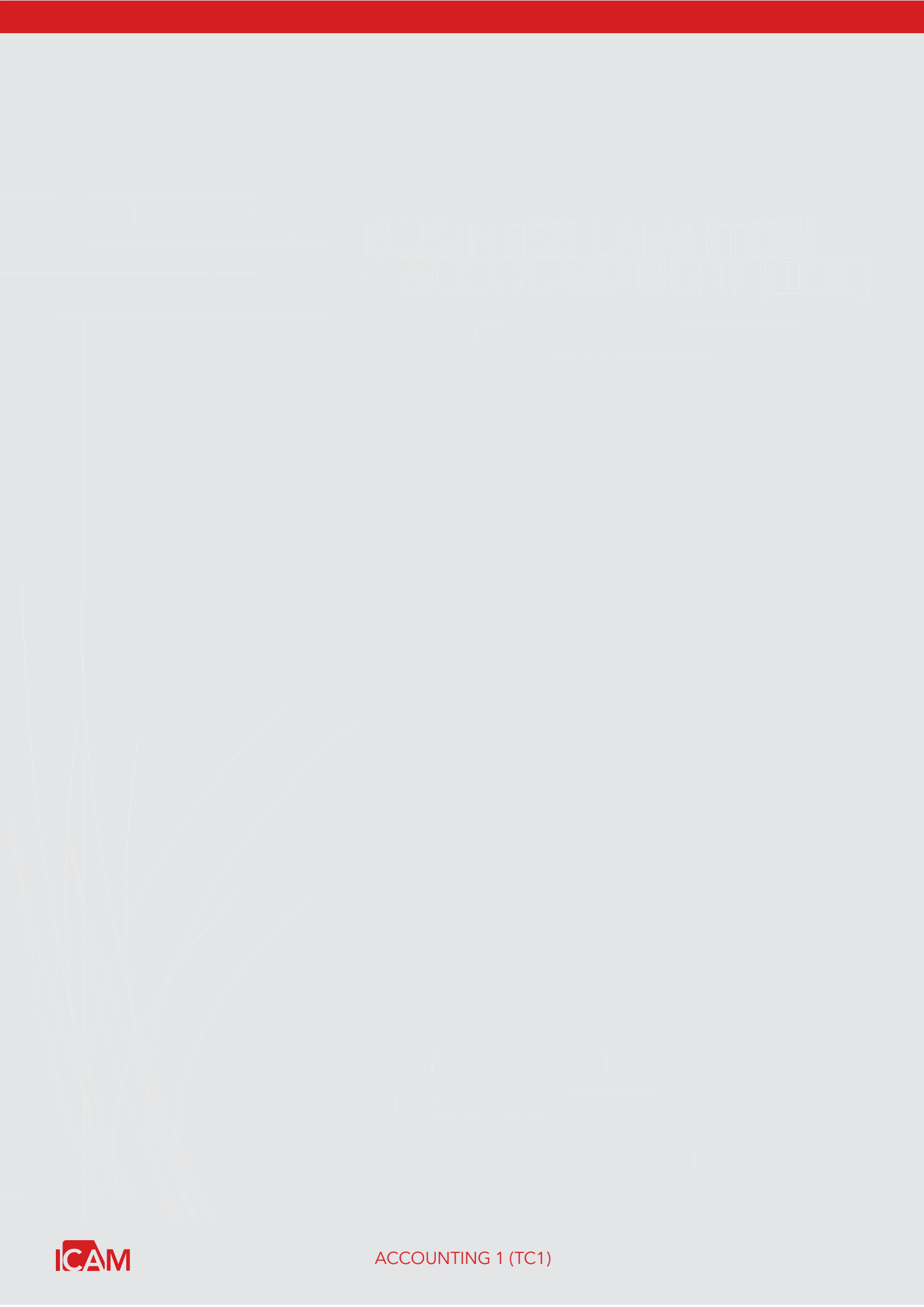
JULY 2014

ACCOUNTING 1 (TC1)

TECHNICIAN DIPLOMA IN ACCOUNTING



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
IN MALAWI


BUSINESS LAW (TC3)
ACCOUNTING (TC1)

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PREFACE

INTRODUCTION

The Institute noted a number of difficulties faced by students when preparing for the Institute's examinations. One of the difficulties has been the unavailability of study manuals specifically written for the Institute's examinations. In the past students have relied on text books which were not tailor-made for the Institute's examinations and the Malawian environment.

AIM OF THE MANUAL

The manual has been developed in order to provide resources that will help the Institute's students attain the needed skills. The manual has been developed in such a way that even those who would like to study on their own can do that. It is therefore recommended that each student should have their own copy.

HOW TO USE THE MANUAL

Students are being advised to read chapter by chapter since subsequent work often builds on topics covered earlier.

Students should also attempt questions at the end of the chapter to test their understanding. The manual will also be supported with a number of resources which students should keep checking on the ICAM website.

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TC1: ACCOUNTING/1

AIMS OF THE COURSE

i. To develop the student's knowledge and understanding of techniques in accounting.
ii. To enable the student to prepare final accounts for different forms of businesses.
iii. To develop the student's understanding of internal controls in an accounting system.

LEARNING OBJECTIVES

By the end of the course the student should be able to:-

i. Appreciate the role of accounting within organizations.
ii. Understand the system of internal checks in collecting, processing and summarizing of accounting data and maintaining accounting records.
iii. Prepare final accounts and be familiar with accounts for limited companies.

FORMAT AND STANDARD OF THE EXAMINATION PAPER

The paper will consist of two sections; section A and section B. **Section A** will be compulsory with one question. The question will be on **preparation of final accounts for various forms of businesses with some adjustments**. This section will carry 40 marks. **Section B** will have **4 questions,** each carrying 20 marks. Candidates will be required to answer **any three** questions from section B.

SPECIFICATION GRID

This grid shows the relative weightings of topics within this course and should provide guidance regarding study time to be spent on each.

Syllabus Area	Weighting (%)
Maintaining financial records and adjustments to accounting records and financial statement.	35
Accounting and reporting concepts.	25
Accounting and reporting for various business organizations.	25
Role of computers and regulation of accounting in Malawi.	15
Total	100

Learning Outcomes

1.1 Accounting and the accounting process

In the assessment, candidates may be required to:-

1 Define accounting and its purpose

2 Describe the main financial statements namely:
   i) Statement of profit or loss
   ii) Statement of financial position

1.2 Financial Accounting vs. Management Accounting

1 Describe financial and management accounting
2 Understand the relationship between financial and management accounting
3 Compare and contrast financial and management accounting

1.3 Qualitative characteristics of accounting information

1 Identify the attributes of accounting information to include, but not limited to:
   i) Relevance
   ii) Timeliness
   iii) Accuracy
   iv) Completeness
   v) Reliability
   vi) Targeted audience
   vii) Comparability
   viii) Understandability

1.4 Accounting principles and concepts

1 Understand the role of the accounting regulatory system, including the roles of the IFRS Foundation, the International Accounting Standards Board, and other international bodies
2 Understand the role of International Financial Reporting Standards
3 Distinguish accounting principles from accounting concepts
4 Learn the important underlying accounting concepts, such as:
   i) Historical cost
   ii) Money measurement
   iii) Business entity
   iv) Dual aspect
   v) Time interval
5 Identify the fundamental accounting concepts that include:
   i) Going concern
   ii) Consistency
   iii) Prudence
   iv) Accruals
   v) Separate Determination
   vi) Substance over form
   vii) Materiality

1.5 Users of accounting information and their needs

1 Identify the main users of accounting information and their needs to include:

i) Management
ii) Shareholders(current and potential)
iii) Employees
iv) Trade Union groups
v) Banks and lenders
vi) Tax collectors and government agencies
vii) Business contact groups
viii) The general public
ix) Suppliers

1.6 The role of computers in accounting

1 Describe the accounting documents and management reports produced by computerised accounting systems, and understand the link between the accounting system and other systems in the business
2 Compare and contrast manual and computerised accounting systems
3 Consider the risks to data security, data protection procedures, and the storage of data under computerised accounting systems

1.7 Regulation of accounting in Malawi

1 Understand the evolution of the legal and regulatory environment affecting accounting in Malawi
2 Understand the current regulatory environment of accounting in Malawi, including the main agencies and instruments such as:

i) The Malawi Stock Exchange
ii) The Institute of Chartered Accountants in Malawi
iii) The Malawi Accountants Board
iv) The Companies and Taxation Acts

2.1 Elements of accounting information

In the assessment, candidates may be required to:-

1 Identify the elements of accounting information that include:

i) Assets, including both current and non current
ii) Liabilities, including both current and non current
iii) Owners equity
iv) Revenue and expenses

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2 Learn the distinction between capital and revenue expenditure, including the implication of wrong accounting treatment of expenditure on the financial statements

3 Understand the accounting treatment of capital receipts, joint expenditure, and loan interest

2.2 Types of business transactions

1 Understand a range of business transactions including

i) Sales

ii) Purchases

iii) Receipts

iv) Payments

v) Petty cash

vi) Payroll

2 Understand the implications of cash and credit transactions, including where applicable, the effect of cash and trade discounts

2.3 Source documents

1 Outline the purpose and content of a range of business documents to include but not limited to

i) Invoice

ii) Credit note

iii) Remittance advice

iv) Statement of account

2 Prepare a petty cash voucher

3 Prepare the financial documents to be sent to credit customers

4 Prepare remittance advice to accompany payment to suppliers

2.4 Books of original entry

1 Identify the types of books of original entry and outline the purpose and content of each book of original entry including its format

2 Outline how the books of original entry integrate with the double entry book-keeping system

3.1 Recording day books

1 Record sales and purchase transactions taking into account discounts, VAT, and the impact on the value added tax account where applicable, as follows:

i) Enter supplier invoices and credit notes in the appropriate day books

ii) Record sales and purchase returns in the appropriate day books

iii) Prepare the financial documents to be sent to credit customers

iv) Understand the purpose of an aged receivable analysis

v) Produce statements to be sent to credit customers

vi) Explain the need to deal with discrepancies in customer and supplier records quickly and professionally

vii) Understand how data entry in day books differ when computerised systems are in use

2 Record transactions in the cashbook including any value added tax and discounts effects where applicable, paying particular attention to:
   i) Totaling, balancing, and cross casting the cashbook columns
   ii) Identifying and dealing with discrepancies

3 Enter and analyse petty cash transactions in the petty cashbook including any value added tax effects where applicable, paying attention to:
   i) Balancing off the petty cashbook using imprest and non imprest systems
   ii) Reconciling the petty cashbook with cash in hand
   iii) Preparing and accounting for petty cash reimbursement

4 Prepare and enter the journal entries to process payroll transactions including:
   i) Calculation of wages for employees paid by the hour, paid by output, and salaried employees
   ii) Accounting for payroll costs and deductions
   iii) The employer's responsibilities for taxes, pension contributions, and other deductions
   iv) Identity of the different payment methods in a payroll system, e.g. cash, cheques, and automated bank transfers
   v) Why authorisation of payroll transactions and security of payroll information is important in an organisation

3.2 The concept of double entry

1 Define the accounting equation

2 Understand by applying the accounting equation in situations such as:
   i) Introduction of capital
   ii) Purchase of an asset by cheque
   iv) Purchase or sale of an asset on credit
   v) Payment of a liability
   vi) Effect of profit and loss on capital
   vii) Treatment of drawings

3 Understand how the accounting equation relates to the double entry book keeping system

4 Process financial transactions from the books of original entry into the double entry book keeping system

3.3 Charts and coding of accounts

1 Importance of charting and coding of accounts in processing of financial transactions

2 Define an accounting code and identify different types of codes including:
   i) Sequence
   ii) Block

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iii) Significant digit
iv) Hierarchical
vi) Faceted

3 Code supplier and customer accounts
4 Coding general ledger accounts consistent with a predetermined chart of accounts

4.1 Balancing ledger accounts

In the assessment, candidates may be required to:-

1 Understand the five steps towards the balancing of ledger accounts
2 Justify the frequency of balancing of ledger accounts
2 Understand the meaning of such terms as: c/d, b/d and closed off
3 Explain the importance of balancing of receivables and payables ledger accounts

4.2 The trial balance

1 Prepare ledger balances, clearly showing the balances carried down and brought down as appropriate
2 Define and understand the nature of a trial balance
3 Understand the nature and impact of errors and closing inventory on the trial balance, and how these are dealt with.

4.3 Periodic adjustments

1 Understand how the matching concept applies to accruals and prepayments
2 The nature and purpose of accruals
3 The accounting treatment of prepayments, with and without an opening balance
4 The accounting treatment of expenses with prepaid and accrued elements
5 Prepayments and accruals in the financial statements
6 The nature of bad debts and ways in which they may arise
7 Understand the nature and purpose of the allowance for doubtful debts including:
i) How the allowance may be estimated
ii) The accounting entries necessary to recognize the allowance
iii) How the allowance may be increased or decreased
iv) The impact of cash discounts on accounts receivable
8 Understand the nature of non-current assets and purpose of depreciation, including terms such as:
i) Depreciable amount
ii) Useful life
iii) Residual value
9 Explain the purpose and function of an asset register
10 Understand the four most common causes of depreciation
11 Identify and calculate depreciation using the commonly used methods that include:

i) Straight line method
ii) Reducing balance method

12 Understand the case for using other depreciation methods that include:
i) Revaluation method
ii) Depletion unit method
iii) Machine hour method
iv) Sum of the year's digit method
v) Units of output method

13 Understand how the appreciation in the value of non current assets is treated

4.4 Statement of profit or loss

1 Identify the information from the trial balance needed for the preparation of the statement of profit or loss

2 Understand the nature and purpose of the statement of profit or loss and how the following are arrived:
i) Gross profit
ii) Cost of goods sold
iii) Net profit or loss

3 Understand the accounting treatment of returns, carriage, and the adjustment for inventory when preparing the statement of profit or loss

4.5 Statement of financial position

1 Identify the information from the trial balance needed for the preparation of the statement of financial position

2 Understand the purpose and nature of the statement of financial position, and identify the items and layout of:
i) Non current and current assets
ii) Non current and current liabilities
iii) Capital

3 Recognise how the accounting equation underlines the statement of financial position

5.1 Errors and correction of errors

In the assessment, candidates may be required to:-

1 Identify types of errors in a book keeping system that are disclosed by extracting a trial balance

2 Identify types of errors in a book keeping system that are not disclosed by extracting a trial balance

3 Use the journal to correct identified errors

4 Redraft a trial balance following the correction of errors

5 Identify when a suspense account is required and show how to clear the suspense account using the journal

6 Understand situations when errors may or may not affect the statement of profit or loss

5.2 Bank reconciliation statement

1 Explain the purpose of reconciliation between the bank ledger and the corresponding bank statement

2 Identify errors and omissions in the bank ledger account and in the bank statement

3 Identify timing differences

4 Make the correcting entries in the bank ledger account

5 Prepare the reconciliation between the bank statement balance and the corrected bank ledger account

6 Identify the bank balance to be reported in the financial statements

7 Understand the arguments for the timing and frequency of the bank reconciliation statements

8 Understand the process of conducting bank reconciliation under a computerized environment

5.3 Disposal of non current assets

1 Identify the ledger accounts needed for recording the disposal of a non current asset

2 Prepare journal and ledger entries to record the acquisition and disposal of a non current asset

3 Calculate and record profits or losses on disposal of a non current asset for reporting in the statement of profit or loss

4 Calculate the profit or loss of a revalued non current asset

5.4 Receivables and payables control accounts

1 Describe the purpose of control accounts as a checking devise to aid management and help identify book keeping errors

2 Explain why it is important to reconcile control accounts regularly and to deal with discrepancies quickly and professionally

3 Prepare the receivable control account or receivable ledgers by accounting for:

i) Sales

ii) Sales returns

iii) Payments from customers including checking the accuracy and validity of receipts against relevant supporting information

iv) Settlement discounts

v) Irrecoverable debt and allowance for irrecoverable debts including any effect of value added tax where applicable

4 Prepare the payables control account or payables ledgers by accounting for:

i) Purchases

ii) Purchase returns

iii) Payments to suppliers including checking the accuracy and validity of the payments against relevant supporting information

iv) Settlement discounts

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5.5 Accounting for inventory

1 Recognise the need for adjustments for inventory in preparing financial statements
2 Record opening and closing inventory
3 Identify the various methods for valuing inventory and calculate the value of closing inventory using the following methods:
   i) First in, first out (FIFO)
   ii) Last in, first out (LIFO)
   iii) Average cost
   iv) Periodic weighted average cost
4 Recognise which cost should be included in valuing inventory
5 Understand the impact of accounting concepts on the valuation of inventory
6 Identify the impact of inventory valuation methods on profit and on assets

5.6 Accounts from incomplete records

1 Describe the circumstances which may lead to incomplete records
2 Understand and apply techniques in preparing accounts from incomplete records as follows:
   i) Use of accounting equation
   ii) Use of ledger accounts to calculate missing figures
   iii) Use of cash and/or bank summaries
   iv) Use of profit percentages to calculate missing figures

5.7 Value added tax

1 Identify sources of information on value added tax and explain the relationship between the business entity and the relevant government tax agency
2 Explain the general principles of the operation of value added tax including:
   i) Requirements for registration
   ii) Main information to be included on business documentation
   iii) Types of taxable supplies and their classification for value added tax
   iv) Accounting and payment of value added tax
   v) Penalties for late returns or late payment of value added tax
3 Calculate value added tax on inputs and outputs
4 Record the consequent accounting entries and calculate the value added tax due to/from the business

6.1 Partnership accounts

In the assessment, candidates may be required to:-

1 Define a partnership
2 Explain the purpose and content of a partnership agreement
3 Explain, calculate and account for appropriation of partnership profit:

i) Salaries of partners
ii) Interest on drawings
iii) Interest on capital
iv) Share of residual profit

4 Explain the difference between partner's capital and current accounts
5 Prepare the partner's capital and current accounts
6 Prepare the final accounts for a partnership
7 Explain and account for the admission of a new partner including the treatment of any goodwill arising

6.2 Final accounts for a limited company

1 Understand the capital structure of a limited liability company including:
i) Ordinary shares
ii) Preference shares (redeemable and irredeemable)
iii) Debentures and Loans
2 Understand the nature of reserves
3 Identify and report reserves in a statement of financial position
4 Prepare a statement of financial position or extracts as applicable from given information
5 Understand why the heading retained earnings appears in a company statement of financial position
6 Prepare a statement of profit or loss or extracts as applicable from given information
7 Understand how accounting concepts apply to revenue and expenses
8 Calculate revenue, cost of sales, gross profit for the year, and total comprehensive income from given information
9 Differentiate between profit and cash flow
10 Understand the need for management to control cash flow

REFERENCES

ICAM *Accounting 1* Manual

Frank wood *Business Accounting*

Glautier & Underdown *Accounting Theory & Practice*

CHAPTER 1

INTRODUCTION TO ACCOUNTING

1.0 LEARNING OBJECTIVES

The objective of this chapter is to impart on to the students the definition of Accounting, with an emphasis on the differences between two main branches of accounting. It also highlights the common users of accounting information and their information needs as well as qualities of good accounting information.

1.1 ACCOUNTING AND THE ACCOUNTING PROCESS

Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.

The managers of businesses want to know whether they are making profits or not, how much they owe to different stakeholders and how much the business is owed. The purpose of accounting is, therefore, to provide the information required by presenting it in standard and logical form.

Accounting can be divided into 'financial accounting' and 'management accounting'.

1.2 FINANCIAL ACCOUNTING

Financial accounting consists of two elements:

- Bookkeeping, is that part of accounting concerned with the recording of business transactions on a day-to-day basis,
- Preparation of financial statements from the book-keeping records. These financial statements summarize the business transactions for a period, normally one year.

1.3 MANAGEMENT ACCOUNTING

The Charted Institute of Management Accountants defines management accounting as 'the application of professional knowledge and skill in the preparation and presentation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operations of the undertaking'.

1.4 THE MAIN DIFFERENCES BETWEEN FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING

The main differences are now summarized through a comparison chart below:

Comparison chart

Attribute	Financial Accounting	Management Accounting
Format:	Financial accounts are supposed to be in accordance with a specific format by IAS so that financial accounts of different organizations can be easily compared.	No specific format is designed for management accounting systems.
Planning and control:	Financial accounting helps in making investment decision, in credit rating.	Management Accounting helps management to record, plan and control activities to aid decision-making process.
External Vs. Internal:	A financial accounting system produces information that is used by parties external to the organization, such as shareholders, bank and creditors.	A management accounting system produces information that is used within an organization, by managers and employees.
Focus:	Financial accounting focuses on history.	Management accounting focuses on future & Present.
Users:	Financial accounting reports are primarily used by external users, such as shareholders, bank and creditors.	Management accounting reports are exclusively used by internal users viz. managers and employees.
Reporting frequency and duration:	Well-defined - annually, semi-annually, quarterly	As needed - daily, weekly, monthly.
Optional:	Preparing financial accounting reports are mandatory especially for limited companies.	There are no legal requirements to prepare reports on management accounting.
Objectives:	The main objectives of financial accounting are :i) to disclose the end results of the business, and ii) to depict the financial condition of the business on a particular date.	The main objectives of Management Accounting are to help management by providing information that used by management to plan, evaluate, and control.
Legal/rules:	Drafted according to GAAP - General Accepted Accounting Procedure.	Drafted according to management suitability.

Attribute	Financial Accounting	Management Accounting
Accounting process:	Follows a full process of recording, classifying, and summarising for the purpose of analysis and interpretation of the financial information.	Cost accounts are not preserved under Management Accounting. The necessary data from financial statements and cost ledgers are analyzed.
Segment reporting:	Pertains to the entire organization or materially significant business units.	May pertain to smaller business units or individual departments, in addition to the entire organization.
Nature of information:	Focus on quantitative information	Focus on both qualitative and quantitative information

1.5 THE MAIN FINANCIAL STATEMENTS AND THE NEEDS OF THEIR USERS

There are two main financial statements that are normally prepared by various organizations. These are:

(a) The Statement of Profit and Loss and Comprehensive Income (Trading profit and loss account)
This is basically used to show the financial performance of the business by stating whether the business has made a profit or a loss. It is normally divided into two parts with one part reporting the amount of **Gross profit** that the business has made and the other part reporting the amount of **Net profit** made by the business.

(b) The Statement of Financial Position (Balance sheet)
This is used to show the financial position of the business as at a particular date in terms of assets, liabilities and capital that the business has at that particular point in time.

Other financial statements that business organizations prepare include:

(a) the cash flow statement,
(b) the statement of changes in equity and
(c) group accounts

For this syllabus we will only look at the income statement and the statement of financial position.

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1.6 USERS OF ACCOUNTING INFORMATION AND THEIR NEEDS

There are many stakeholders interested in the financial information of businesses with diverse needs.

- **Management**

Management will be interested in the analysis of revenues and expenses so as to obtain information that is useful when formulating plans and making decisions. When the budget for the business has been prepared, the accounting function can produce figures for what actually happens as the period progresses and compare it with the budgets. Deviations from plans can then be investigated and appropriate action taken.

- **Shareholders/ (owners) and potential shareholders**

Shareholders need to be informed about the way in which management has used the funds which the shareholders or owners have invested in the business. This involves reporting on past events, however, shareholders and potential shareholders will additionally be interested in the future performance and the historical information will act as a guide to the future if they have to decide whether to sell their shares or vote on proposals.

- **Financial analysts/ advisors**

Financial analysts who advise investors such as insurance companies, pension funds, unit trusts and investment trusts are some of the most sophisticated users of accounting information.

- **Employees and their trade union representatives**

These need financial information in order to be able to assess the performance of the business. Employees are mainly interested in the security of their jobs and promotion through growth as the years go by. The trade unions use the financial **information** to substantiate claims for higher wages for their members and better conditions of service. Hence, the success of different divisions is of much interest to these stakeholders.

- **Banks/lenders**

These includes some lenders who have financed the business over long periods of time by lending money which will be repaid after so many years, and short-term lenders such as banks that permit a business to overdraw its accounts over a number of weeks or months, and suppliers of raw materials, which permit them to buy goods from them and pay later.

Lenders will be interested in the security of their loans, and will examine the financial statements to make sure that the company will repay the capital on due

dates and meet the interest requirements as they fall due. Hence the availability of cash and value of assets making up the security will be important to them.

- **Tax collectors and Government agencies**

The tax authorities will be interested in the assessment of the profits on which to charge the tax for period, whereas other agencies will wish to collect information that would show trends in the economy.

- **The business contact group**

Customers will be interested to assess the company's ability to satisfy long term contracts when an order is about to be placed, and competitors will use the information for comparison purposes.

- **The public**

Environmental pressure groups, members of the community in which the business operates may be interested in the affairs of the business.

- **Conclusion**

It can be noted that financial statements serve a variety of user groups that have different interests and different levels of complexity.

1.7 QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

These are the attributes that make the information provided in the financial statements to be more meaningful to the users. These include:

(a) Relevance and purpose

Good quality information should have a purpose and be relevant for that purpose. If information does not have a purpose then it is useless and might as well not be produced. Information is relevant if it has the ability to influence the economic decisions of users

Information provided by the financial statements must be relevant. In cases where the users have to make a choice between alternative options, the option selected should be the one that would be of most use in taking economic decisions, that is, it should provide maximum information that is relevant.

Relevant information has predictive value or confirmatory value. Where the information enables the users to evaluate or assess past, present and future events**,** it is predictive. Information is confirmatory if it helps users to confirm or to correct their past evaluations and assessments. It is possible for information to have both predictive and confirmatory value.

For information to have predictive value, it does not have to be presented in an explicit forecast form, but the ability to make predictions will be helped by the manner in which information relating to past transactions and events is displayed.

(b) Timeliness

Information should be communicated to a manager in time for him to do something about it. For example a monthly report detailing a problem should be produced quickly enough to enable the manager to take corrective action.

(c) Accuracy

The report should be as accurate as possible, it should not contain material errors.

(d) Complete

Information should be as complete as it needs to be, but it should not be excessive. A report that draws attention to significant items will be useful. Sometimes management only want to be informed when something out-of- the-ordinary has happened. (Reporting by exception.)

(e) Communicated to the right person

Within a business, management information should be directed to the managers who will use it or do something about it

(f) Reliability

Information provided by the financial statements must be reliable.
Information is reliable when:

(i) the users can depend on it as faithfully representing what it purports to represent or what could be reasonably expected to represent;
(ii) it is free from deliberate or systematic bias (neutrality);
(iii)it is free from material error;
(iv)it is complete within the context of materiality; and
(v) in conditions of uncertainty, a certain level of caution has been applied in exercising judgment and making the necessary estimates (prudence).

- **Faithful representation**

For the information to represent faithfully the transactions and events it purports to represent, it is important that they are accounted for and presented in accordance with their substance and economic reality rather than their legal form

- **Neutrality**

Information must be free from bias **(neutrality)**. Financial statements will not be deemed neutral if the selection and presentation of information is such that it influences the making of a decision or judgment in order to achieve a predetermined result

- **Completeness**

Information must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading hence unreliable or insufficient in relation to its relevance

- **Prudence**

Prudence is the inclusion of a certain level of caution in exercising judgments required in making the estimates under conditions of uncertainty, in such a way that assets and/or income should not be overstated or liabilities and/or expenses should not be understated. In exercising prudence, it is not permissible to create hidden reserves or make excessive provisions, deliberate understatement of assets or income, or deliberate overstatement of liabilities or expense.

(g) Comparability

The financial statements should enable users to make comparison of an entity over time to identify trends in its performance and financial position. They should also enable the users to compare and evaluate the relative performance and financial position of different entities. Therefore, consistency is required.

It is important that users should be able to identify differences between accounting policies adopted from period to period, accounting policies adopted in accounting for like transactions and other similar events, and accounting policies adopted by different organizations.

(h) Understandability

Users need to be able to understand the information provided to them. If he does not understand it, or misunderstands it, he is unlikely to use it or will take a bad decision.

Understandability depends on two factors:

(a) The way in which the information is presented; and

(b) The capabilities of the users

Users are assumed to have reasonable knowledge of business and economic activities and are willing to study the information provided to them reasonably well

(i) Materiality

Information is **material** to the financial statements if its misstatement or omission may reasonably be expected to influence the economic decisions of users.

Financial statements need to include all material information and immaterial information need not be shown in the financial statements

As to whether information is material will depend on the size and nature of the item being judged in the particular circumstances.

(j) Appropriate channel of communication

This refers to the method by which the information is given, for example; verbal, formal, informal, e-mail and so on.

1.8 LIMITATIONS ON THE QUALITATIVE CHARACTERISTICS

In certain circumstances there is need to strike a balance to enable the objectives of the financial statements to be met when a conflict arises between characteristics.

(a) Relevance and reliability

When there is a conflict, it is normally appropriate to use the information that is the most relevant of whichever information is available. For example, there may be a conflict over timeliness. Delays in providing information will make it out of date and, therefore, less relevant, but there is need to clear all uncertainties to make the information reliable which would result in delays. Financial statements should only be provided when they are sufficiently reliable.

(b) Neutrality and prudence

Neutrality means freedom from bias, whereas prudence might involve bias because it seeks to ensure that assets and gains are not overstated and liabilities and losses are not understated in situation of uncertainty. It is, therefore, important to ensure that deliberate understatements of assets and gains or overstatement of liabilities and expenses is avoided.

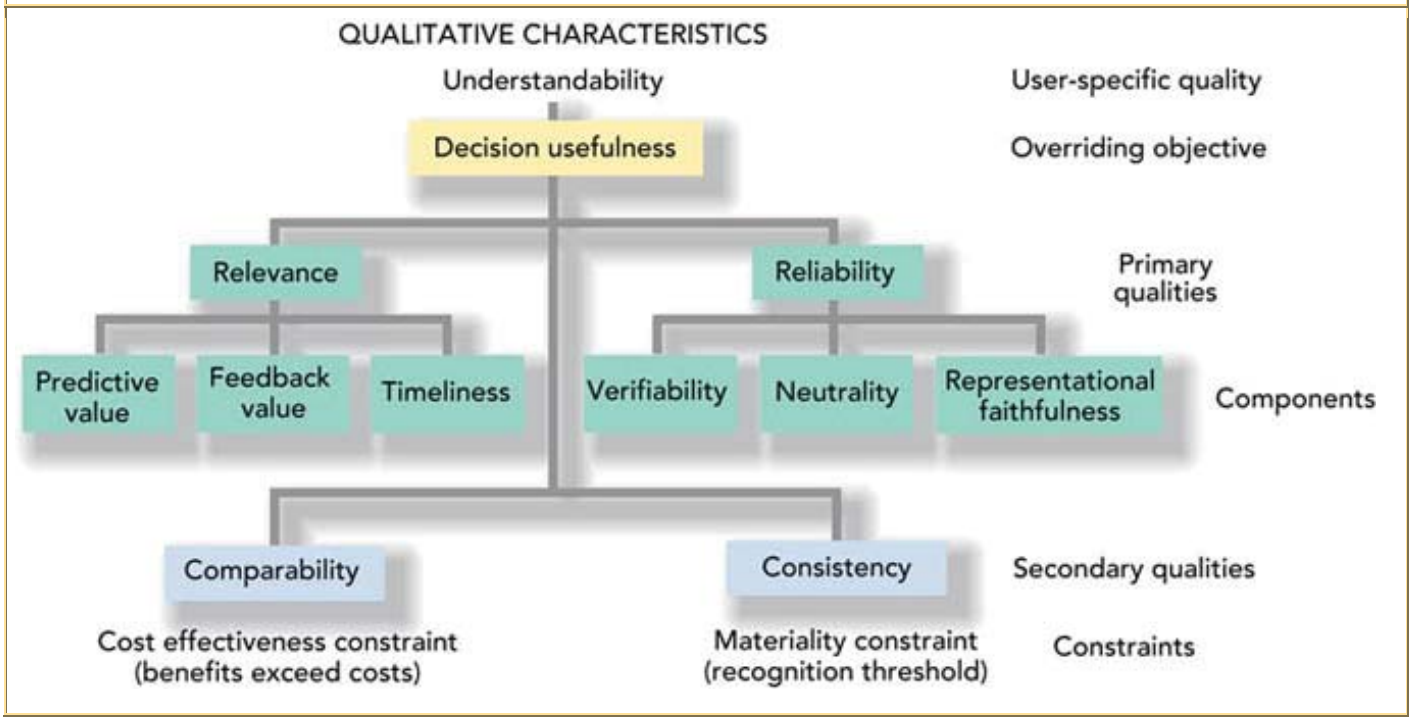
(c) Understandability

Information that is relevant and reliable should be included even if other users may not understand it.

Alternatively, the qualities can be presented in a tabular form as follows:

GRAPHIC

Hierarchy of Desirable Characteristics of Accounting Information



1.9 ACCOUNTING CONCEPTS

(a) Introduction

Financial statements are prepared for different stakeholders to use irrespective of their varying needs. It is therefore necessary that all the various stakeholders should believe that the assumptions upon which the financial statements are based are valid and appropriate. If they don't they will not trust the financial statements.

Basic accounting concepts are the broad assumptions which underlie the periodic financial statements of business entities.

(b) Underlying accounting concepts

These are accounting concepts which have been applied ever since financial statements were first produced for external reporting purposes and they have now become second nature to accountants and are not generally reinforced, other than through custom and practice

These basic underlying concepts include:

(i) The historic cost concept

This concept determines the basis for valuation of assets. It states that assets should be valued at cost. Thus the value of an asset in the statement of financial position should be based on the price that was paid for it..

(ii) The money measurement concept

This states that accounting information is only concerned facts that can be measured in monetary units and those facts which most people will agree to the monetary value of the transaction.

This means that accounting can never tell you everything about a business. For instance accounting does not show the following:

- whether the business has good or bad managers
- whether there are serious problems with the workforce
- whether a rival product is about to take away the business's customers
- whether the government is about to pass a law which will cost the business a lot of extra expenses in future

(iii) The business entity concept

This concept implies that the affairs of a business entity are to be treated as being separate from the non – business activities of its owners. Thus income and expenditure, assets and liabilities of the business should not be combined with those of the owner when preparing the financial statements of the business.

NOT FOR SALE

The only time when the personal resources of the proprietor affects the accounting records of a business is when they introduce new capital into the business or take drawings out of the business.

(iv) The dual aspect concept

This states that there are two aspects of accounting, one represented by the assets of the business and the other by the claims against those assets (i.e. liabilities). The concept states that these two aspects must always be equal to each other. This is shown by the accounting equation which states that **Assets = Capital + Liabilities.**

Double entry is the name given to the method of recording transactions under the dual aspect concept where every transaction leads to two accounting entries, in one account a credit entry is made and in another account a debit entry is made. The total of the debit entries and credit entries made from all business transactions should always be equal.

(v) The time interval concept

This states that financial statements are prepared at regular intervals of one year. On the other hand, management accounts which are for internal use may be prepared more frequently for instance on monthly basis.

(c) Fundamental accounting concepts

These comprise of a set of concepts considered so important that they have been enforced through accounting standards and / or through the companies Acts. They include the following:

(i) going concern concept

This concept implies that the business will continue to operate for the foreseeable future and that there is no intention to put the company into liquidation or to make drastic cut backs to the scale of operations.

The main significance of this concept is that the assets of the business should not be valued at their breakup value, which is the amount that they would sell for if they were sold off when the business breaks up, but rather assets should be valued at their historic cost less accumulated depreciation. (i.e. at their net book value).

(ii) consistency concept

Accounting is not an exact science. There are many areas in which judgment must be used to calculate or estimate the money values of items appearing in accounts.

Consistency requires that similar items should be accorded similar accounting treatment.

In preparing accounts, consistency should be observed in two respects.

- Similar items within a single set of accounts should be given similar accounting treatment.
- The same treatment should be applied from one accounting period to another I accounting for similar items. This allows valid comparisons to be made from one period to the next.

However a business can change the method used e.g. depreciation method, but when such a change occurs and the profits calculated in that year are affected by a material amount then the effect of the change should be stated either in the fundamental statements or the reports that accompany them.

(iii) Prudence

Very often accountants have to use their judgment to decide which figure to take for an item. The prudence concept states that accountants should always exercise caution when dealing with uncertainty while at the same time ensuring that financial statements are neutral such that assets or income are not overstated and liabilities or expenses are not understated.

For instance, assume that the business is selling washing machines. Each machine costs K100, 000 to buy, but can be sold for K150, 000. Stocks of these machines should be valued at K100, 000. Valuing the machines at K150, 000 would mean that the business is anticipating making a profit before the profit is realized (i.e. obtained in cash)

In another example, assume a business buys some goods for K1200 but because of a sudden slump in the market it has reached to the extent that only K900 is likely to be received when the goods are sold. The prudence concept suggests that the stocks of these goods should be valued at K900 and K300 deducted as an expense from profit. It is not enough to wait until the goods are sold and then recognize the K300 loss, the loss should be recognized as soon as it is foreseen.

(iv) The accruals concept

The accruals concept states that net profit is the difference between revenue and the expense incurred in generating the revenues.

i.e. Revenue – Expenses = Net profit

Determining the expenses used up to obtain revenues is referred to as matching expenses against revenues. This concept implies that all income and charges relating to the period to which the financial statements relate should be taken into account without regard to the date of receipt or payment.

(v) Separate determination

In determining the aggregate amount of each asset or liability, the amount of each individual asset or liability should be determined separately from all other assets and liabilities. For instance if a business has three machines, the amount at which machinery is shown in the statement of financial position should be the sum of the values calculated individually for each of the three machines. Only when individual values have been derived should a total be calculated.

The separate determination also prohibits the netting off of potential gains. For instance if the business is being sued by a customer for K10, 000 and there is a high probability that the business will lose the case, the prudence requires the K10, 000 to be included as liability in the financial statements. However, if the same business is suing a supplier for K6000 where it has a good probability of winning the case, the concept of separate determination does not allow the business to offset the two claims, leaving a net liability of K4000 to appear in the financial statements, but only the probable K10, 000 expense should be recognized in the financial statements.

(vi) Substance over form

When the legal form of a transaction differs from its real substance, accountants should show the transaction in accordance with its real substance which is basically, how the transaction affects the economic situation of the business. For instance assume that a business bought a car on hire purchase

From a legal point of view, the car does not belong to the business until all the hire purchase installments have been paid, and an option has been taken up whereby the business takes over legal possession of the car.

On the other hand, from an economic point of view, the business has used the car for business purposes, just as any other car owned by the business. In this

case the business will show the car bought on hire purchase in its ledger accounts and balance sheet as though it were legally owned by the business, but also showing separately the amount still owed for it. In this case, the substance of the transaction has taken precedence over the legal form of the transaction.

(vii) Materiality

Under materiality concept, only material items should appear in the financial statements. Items are material if their omission or misstatement would influence the economic decisions of users based on the financial statements.

An error which is too trivial to affect a user's understanding of the financial statements is said to be immaterial hence it may be overlooked.

1.10 THE ROLE OF COMPUTERS IN ACCOUNTING

1.10.1How computers are linked together

Computers are linked together through a network. A network is a group of two or more computer systems linked together. There are many types of computer networks, including:

- **local-area networks (LANs):** The computers are geographically close together (that is, in the same building).
- **wide-area networks (WANs):** The computers are farther apart and are connected by telephone lines or radio waves.
- **campus-area networks (CANs):** The computers are within a limited geographic area, such as a campus or military base.
- **metropolitan-area networks MANs):** A data network designed for a town or city.
- **home-area networks (HANs):** A network contained within a user's home that connects a person's digital devices.

Special forms of these networks emerged over the last few years as a result of the extension of the Internet. It is now becoming increasingly common for businesses to have an '**Intranet**', a network based on Internet technologies where data and information private to the business is made available to employees of the business. Some also have '**Extranets**' where data and information private to the business is made available to the specific group of outsiders, for example making a company's stock records available on-line to the major customers.

Ready made software *vs* tailor-made programmes

The software used may be developed in-house (by employees) or written under contract with an outside business or agency. Such systems are tailored to exactly what the business wants and are sometimes referred to as 'bespoke' systems.

Expensive, specially designed software (often called 'customised' software) of this type will be used, generally, only by large businesses. Many medium-sized and smaller businesses will not require such solutions, and will rely on 'off-the-shelf' software packages. Most of these are flexible enough to be adapted to meet the major needs of most businesses.

Most financial accounting and bookkeeping programs are purchased off-the-shelf and then developed in-house.

1.10.2Introduction to spread sheets and database packages

The spreadsheet is the software tool most used by accountants. Spreadsheets first appeared in 1979. The screen is divided into vertical columns and horizontal rows. Each cell is referred to by its co-ordinate, cell C12 is in column C row 12. Formulae can be entered to link cells.

Spreadsheets can be used for presenting financial plans and budgets as a table, calculating tax, investment and loans with ease, calculating statistics using built-in functions (such as averages, standard deviations, time series and regression analysis), consolidation (merging of branch or departmental accounts), creating multi-dimensional spreadsheets that enable far deeper analysis of data, facilitating currency conversion, and timetabling and roster planning of staff within organizations or departments.

On the other hand, databases are designed for more general purpose rather than for specific tasks that accountants perform. They are organized into collections of related files into which records are held. In order to create computing expertise and sound knowledge of accounting system is required.

Security aspects – the importance of backing up data and using passwords
One of the most important principles in computing is the discipline of backing up data held on computer. Backing up is now performed easily by simply copying the relevant files to another computer or storage medium. This serves the purpose that, if anything ever goes wrong with the data, then the business can always revert to a backup copy of the data. Software packages routinely used by accountants, such as spreadsheets, can be programmed to automatically back up work every few minutes so that it is not all lost should the computer or program crash.

When computers are being used along with an accounting package, it is normally possible for passwords to be set up to restrict which personnel have access to certain parts of the computerized elements of the accounting system.

NOT FOR SALE

1.10.3 Regulations relating to the storage of personal data on computer

Most businesses that make extensive use of computers for accounts, payroll, and any other applications that involve personal details of individuals need to protect the data. The Data Protection Act 1998 must be observed when personal data is held on the computer.

SUMMARY OF THE CHAPTER

This chapter introduced students to accounting by defining two main categories of accounting. Also, there were clarifications that were made for selected fields of study that are closely linked to accounting. The main financial statements, their uses and respective needs were explained. Finally, qualitative characteristics of accounting information and key accounting concepts were described in detail.

END OF CHAPTER QUESTIONS

Q1
State the differences between financial accounting and management accounting.

Q2
*Identify any **five** qualitative characteristics of accounting information.*

Q3
Define reliability and its attributes.

EXAMINATION TYPE QUESTION

(a) Explain the difference between fundamental accounting concepts and accounting bases by giving suitable examples. **4 Marks**

(b) Management of a newly established subsidiary company hired an accountant to maintain the company's books of accounts. Initially the accountant had problems choosing an appropriate accounting policy. However, she was advised that when selecting an accounting policy, its appropriateness should be considered in the context of the following objectives:

Relevance

Reliability

Comparability

Understandability

Required:

Explain the meaning of **each** of the terms listed above. **6 Marks**

CHAPTER 2

REGULATION OF ACCOUNTING IN MALAWI

2.0 LEARNING OBJECTIVES

This chapter aims to introduce the regime that regulates the accounting profession in Malawi. It therefore highlights the relevant regulatory framework and the institutions that regulate enforces the required standards and systems within the profession.

2.1 MALAWI STOCK EXCHANGE

The main provisions that regulate listed companies in Malawi are contained in three documents. These are:

MSE Listing Requirements – Section 8 sets out financial information which may be required to be included in listing particulars, pre-listing statements, circulars, interim and preliminary reports and the annual financial statements. Section 5 is also relevant as it outlines the different methods of bringing securities to listing and includes specific requirements to be followed in relation to each method.

Listing Requirements on Alternative Markets– the relevant guideline is 16.8.All the provisions of Section 5 of the MSE Listings Requirements are applicable with the exception that the period of the immediate past performance is one year instead of three years.

Members' rules - The Board shall ensure that proper books of account are kept of the financial affairs of the Exchange and that these books of account shall be kept at the principal office of the Exchange. Such books will be preserved by the Secretary for a period of seven (7) years from the date of the last entry therein and shall at all reasonable times be open for inspection by any member of the Board. Within five (3) months of the end of every financial year the Board will ensure that an annual report, audited Accounts consisting of a Balance sheet and a Revenue and Expenditure Account and any subsidiary statements and accounts as may be necessary or required by law shall be prepared and signed by the Chairman and two members of the Board.

The Secretary will lodge a signed copy of these documents together with the Annual Report of the Board with the Registrar within not more than five (5) months of the end of the financial year. Copies will also be circulated to every member of the Exchange.

2.2 THE SOCIETY OF ACCOUNTANTS IN MALAWI (INSTITUTE OF CHARTERED ACCOUNTANTS IN MALAWI) AND MALAWI ACCOUNTANTS BOARD (MAB)

The Society of accountants in Malawi has not directly and exclusively charged with the regulation of the profession in Malawi. However the successor institution Institute of the Chartered Accounts in Malawi through the Malawi Accountants Board division does the regulating.

In May 2013 the Malawi Parliament passed Public Accounts and Auditors bill into law. The effect of the enactment has been:

to repeal the Public Accountants and Auditors Act of 1982 and introduce a new legislation that will reform the regulation and control of the accountancy profession in the country

To set up a body representing accountants and auditors in the country through allowing the establishment of Malawi Accountants Board

To allow the country to have its own regulatory accountancy board which will also be administering accountancy examinations thereby avoiding reliance on foreign accountancy professional bodies to administer exams, thereby easing the problems that students encounter when processing their exams

Public Accountants Examinations Council (PAEC) is thus abolished and a new body known as the Institute of Chartered Accountants in Malawi (ICAM) formed.

This restructuring has provided for a stronger Government regulation with a mechanism to oversee the activities of the profession, National qualification of accounts profession as there will be a removal of dual membership of foreign accountancy bodies and corruption fight since the profession is a strong gate keeper in the fight against corruption and money laundering.

2.3 COMPANIES ACT

Chapter 46:03 of Laws of Malawi covers Accounts and Audit in Part X. There are sections covering Keeping of Accounting Records, Annual Return, Circulation of Statement of Accounts and Reports, Group Accounts, Directors' Report, Auditors and Penalties among other contents.

2.4 INTERNATIONAL ACCOUNTING STANDARDS (IFRSs)

Financial Reporting Framework in Malawi

In Malawi, all the companies that have public accountability are required to apply Full IFRSs. A company has public accountability if:

- it is a listed company or is in the process of listing with the Malawi Stock Exchange or any other recognised stock exchange. The listing can either be for the company's equity or debt.
- its articles provide for unrestricted transfer of shares or it is a Public Company in terms of the Malawi Companies Act 1984
- it is permitted by its articles to offer shares to the public
- it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, an insurance entity, securities dealer/broker, pension fund or mutual fund

- it is a corporation or company that is owned by the public through the Government for example statutory corporations, also known as Parastatals
- it is has a legal requirement to publish general purpose financial statements in any public media
- it is a material subsidiary of an entity with public accountability

Malawi plans to require the IFRS for SMEs for all other companies.

In May 2013, the Pan African Federation of Accountants (PAFA) recently decided to adopt international standards in accounting and auditing, including IFRSs, IPSASs, ISAs and the IFRS for SMEs.

SUMMARY OF THE CHAPTER

This chapter introduced students to the regulatory environment of the accountancy profession in Malawi.

END OF CHAPTER QUESTIONS

Q1
What is the significance of IFRSs in Malawi? Explain.

EXAMINATION TYPE QUESTION

In May 2013, the Malawi Parliament passed Public Accounts and Auditors bill into law. Briefly explain what has been the effect of the enactment? **5 Marks**

NOT FOR SALE

CHAPTER3

ACCOUNTING INFORMATION

3.0 LEARNING OBJECTIVES

By the end of this topic, students will be expected to know the elements of accounting information and how these elements relate to the accounting equation. They will also be able to explain why and how the accounting equation should balance.

3.1 ELEMENTS OF ACCOUNTING INFORMATION

a) Assets

Assets are the resources, that is, items belonging to a business and used in the running of the business. They may be non-current assets, (such as buildings, machinery or office furniture), or current assets (such as inventory, accounts receivable or cash)

An **asset** is something valuable which a business owns or has the use of. Assets include property of all kinds; buildings, machinery, motor vehicles and inventory of goods, and others are debts owed by customers and the amount of money in the bank.

Non- current assets

Non-current assets are assets that have long life, bought with the intention of using them in the business and not meant for resale. This means that non-current assets are held and used in operation over a number of accounting period.

Current assets

These are assets that are held only for a short time and include inventory heldfor resale, amounts receivable from customers, cash and other assets with a short life

b) Liabilities

Liabilities are sums of money owed by a business to outsiders such as **a bank** or trade accounts payable.
A liability is something which is owed to somebody else.
'Liabilities' is the accounting term given to debts of the business and are owed to accounts payable.

Liabilities include amounts owed by the business for goods and services supplied to the business and for expenses incurred but not yet paid by the business. Money borrowed by the business is also a liability.

3.2 THE ACCOUNTING EQUATION AND STATEMENT OF FINANCIAL POSITION

(a) The accounting equation

This is the basic fundamental rule of accounting which states that the assets and liabilities of a business must always be equal. It can be explained by saying that if a business is to be set up and start trading, it will need resources.

If the owner of the business has supplied all of the resources, this can be shown as:

Resources supplied by the owner = resources in the business

In accounting, the amount of the resources supplied by the owner is called capital and the actual resources that the business has are called assets. Hence in this case the accounting equation can be shown as

Capital = Assets

However, usually other people other than the owner provide resources for some of the assets. Liabilities is the name given to the amount owing to these people for these assets. In this case, the accounting equation is changed to:

Capital = Assets – Liabilities

This is the most common way in which the accounting equation is presented. Alternatively, the accounting equation may be shown as:

Assets = Capital + Liabilities

(b) The statement of financial position (balance sheet) and the effects of business transactions

The accounting equation is expressed in a statement of financial position called the balance sheet.

The balance sheet shows the financial position of an organization at a particular point in time. In other words it represents a snapshot of the organization at that date for which it was prepared.

Let us consider the effect of a series of transactions on the balance sheet.

(i) **The introduction of capital**

Assume that on 1 May 2013, Mr. Botha started in business and deposited K60,000 into a bank account opened specially for the business. The balance sheet would show the following:

Assets: cash at bank	K 60,000
Capital	K 60,000

(ii) The purchase of an asset by cheque

Now suppose that on 3 May 2013, Mr. Botha buys a small shop for K32, 000 paying by cheque. This transaction brings about a decrease in cash at the bank and an additional new asset building. The balance sheet would now show the following:

Assets: shop	K 32, 000
Cash at bank	K28, 000
	K60, 000
Capital	K60, 000

Always the two parts of the balance sheet must be equal as is the case.

(iii) The purchase of an asset and the incurring of a liability

Suppose that on 6 May 2013, Mr. Botha buys some goods for K7000 from Mr. Phiri, and agrees to pay for them some time later. The effect of this is that a new asset, stock of goods is acquired, and a liability for the goods is created. A person to whom money is owed for the goods acquired is known as a creditor (or a payable). The balance sheet now becomes:

Assets: shop	K32, 000
Stock of goods	K 7, 000
Cash at bank	K 28, 000
	K67, 000
Less creditor	(K 7, 000)
	K60, 000
Capital	K60, 000

(iv) Sale of an asset on credit

Now suppose that on 10 May 2013, goods which cost K600 were sold to Mr. Banda for the same amount, the money to be paid later. The effect in this case is a reduction in the stock of goods and the creation of an asset. A person who owes the business money is called a debtor (or a receivable).

The balance sheet now becomes:

Assets: shop	K32, 000
Stock of goods	K 6, 400
Debtor	K 600
Cash at bank	K28, 000
	K67, 000
Less creditor	(K 7, 000)
	K 60, 000
Capital	K60, 000

(v) Sale of an asset for immediate payment

Suppose that on 31 May 2013, goods which cost K400 were sold to Mr. Jere for the same amount. Mr.Jere paid for them immediately by cheque. In this case, one asset stock of goods is reduced while another asset, cash at bank is increased. The balance sheet now becomes:

Assets: shop	K32, 000
Stock of goods	K 6, 000
Debtor	K 600
Cash at bank	K28, 400
	K67, 000
Less creditor	(K 7, 000)
	K60, 000
Capital	K60, 000

(vi) The payment of a liability

On 15 May 2013, Mr. Botha pays a cheque for K3000 to Mr. Phiri in part payment of the amount owing. This reduces the asset cash at bank and the liability to the creditor. The balance sheet now becomes:

Assets: shop	K32, 000
Stock of goods	K 6, 000
Debtor	K 600
Cash at bank	K25, 400
	K64, 000
Less creditor	(K 4, 000)
	K60, 000
Capital	K60, 000

(vii) Collection of an asset

Suppose that Mr. Banda, who owed Mr. Botha K600, makes a part payment of K200 by cheque on 31 May 2013. The effect of this is that one asset (debtors) is reduced and another asset (cash at bank) is increased. The balance sheet now becomes:

Assets: shop	K32, 000
Stock of goods	K 6, 000
Debtor	K 400
Cash at bank	K25, 600
	K64, 000
Less creditor	(K 4, 000)
	K60, 000
Capital	K60, 000

3.3 EQUALITY OF THE ACCOUNTING EQUATION

As noticed from the examples above every transaction has affected two items. It has either changed two assets by reducing one and increasing the other or changed the liabilities. This is the reason why the two sections of the balance sheet or the accounting equation are always equal.

Some of the examples of the effects of transactions on the accounting equation are:

Example of transaction effect

a) Owner pays capital into the bank	increase assets (Bank)	increase capital
b) Buy goods by cheque	decrease asset (Bank)	increase asset (Stock of goods)
c) Buy goods on credit	increase asset (Stock of goods)	increase liability (Trade Payables)
d) Sale of goods on credit	decrease assets (Stock of goods)	increase asset (Trade Receivables)
e) Sale of goods for cash	decrease assets (Stock of goods)	increase asset (Bank)
f) Pay creditor	decrease asset (Bank)	decrease liability (Creditor)
g) Debtors pay money owing By cheque	decrease asset (Receivables)	increase asset (Bank)
h) Owner takes money out of The business bank account For own use (drawings)	decrease asset (Bank)	decrease capital
i) Owner pays creditors from Private money outside the Business	decrease liability (Creditor)	increase capital

SUMMARY OF THE CHAPTER

The chapter gave explanation to elements of accounting information. It also incorporated the accounting equation as well as illustrating how business transactions affect the statement of financial position in various instances. The reason for always having the two sections of the statement of financial equation or the accounting equal was given.

END OF CHAPTER QUESTIONS

Q1

Using the statement of financial position (or the statement of financial condition), give a detailed example of accounting equation that highlights the equality of the accounting equation.

NOT FOR SALE

Q2

In testing the equality of the accounting equation, show the effects which the following transactions will have on the accounting equation for a business entity (that is, indicate whether there will be an increase, a decrease or no effect in every case on assets, liabilities and capital).

You are expected to show the amounts and to name the assets or liabilities affected in all cases.

(a) Bought goods on credit for MK1,783,500.
(b) Owner pays creditor MK628,325 from private money outside the business.
(c) Debtors pay all the money owing by cheque. Total that was outstanding on the account was MK370,000.
(d) Repaid by cash an amount of MK10,000 a loan owed to Chikondi Chatha.
(e) Bought additional premises paying MK1,388,000 by cheque.
(f) Manyanani lends the firm MK92,300 in cash.
(g) The business pays K77,000 to a creditor in cash.
(h) The business returns goods quoted at MK60,000 to the supplier whose bill it has not paid.
(i) The owner takes out MK172,000 cash for his personal use.
(j) Bought merchandise for cash for MK488,000.

Hint: Use a table identifying the transactions, effects on assets, effects on liabilities, and effect on capital. State all cases where there is no effect. That is:

Transaction number	effects on assets	effects on liabilities	effect on capital

(TOTAL: 20 MARKS)

CHAPTER 4

TYPES OF BUSINESS TRANSACTIONS

4.0 LEARNING OBJECTIVES

By the end of this chapter, students are expected to understand a range of types of business transactions including Sales, Purchases, Receipts, Payments, Petty cash and Payroll. They will also understand the implications of cash and credit transactions, including where applicable, the effect of cash and trade discounts.

4.1 NATURE OF A TRANSACTION

There are many forms which a business deal can take. At this point you may be aware that various events change two items in the statement of financial position. This aspect will be discussed further when we shall be dealing with Double Entry system of accounting, Events which result in such changes are known as 'transactions' This means that if the proprietor asks the price of some goods, but does not buy them, there is no be

Accounting for Sales

Sales of inventory may be on credit or on cash basis.

Suppose that on 3 August 2013 goods were sold for K375,000 to Luwani.

First, an asset account is increased. The increase in the asset of trade receivables requires a debit and the debtor is Luwani, so that the account concerned is that of Luwani. Second, the asset inventory is decreased. For this a credit entry to reduce an asset is needed. The movement of inventory is clearly the result of a 'sale' and so it is the sales account that needs to be credited.

If on 4 August 2013 goods are sold for K55,000 cash being received immediately at the time of sale then the asset of cash is increased so that the cash account must b debited. The asset of inventory is reduced. The reduction of an asset requires a credit and the movement of inventory is represented by 'sales'. Thus the entry needed is a credit in the sales account.

Accounting for Purchases

Similarly, purchases of inventory may be on credit or on cash basis.

Suppose that on 1 August 2013 goods costing K165,000 are bought on credit from Jamali.

First, the twofold effect of the transaction must be considered so that bookkeeping entries can be worked out. The asset of inventory is increased. An increase in asset needs a debit entry in an account. Here the account is one designed for this type of inventory movement. It is clearly a 'purchase, movement so that the account to use must be the purchases account. Second, there is an increase in a liability. This is the liability of the business to Jamali because the goods bought have not yet been paid for. An increase in a liability needs a credit entry. In this case, it would be a credit entry to Jamali's account.

If on 4 August 2013 goods costing K310,000 are bought, cash being paid for them immediately at the time of purchase, as before asset inventory has increased, so a debit entry will be needed. The movement of inventory is that of a 'purchase', so the purchases account needs to be debited. Second, the asset cash is reduced and must be credited.

Accounting for Receipts

All receipts must reflect that an asset cash (if paid for in cash) or bank (if by cheque) has increased by debiting either cash account or bank account and crediting the source (say a debtor's account).

Accounting for Payments

Similarly, all payments must reflect that an asset cash (if paid for in cash) or bank (if by cheque) has reduced by crediting either cash account or bank account and debiting the receiver of the funds (say a creditor's account).

Accounting for Petty cash

Petty cash is recorded through a petty cash book. The question is *where does the money paid come from*? The **imprest system** is one where the cashier gives petty cashier enough cash to meet the petty cash needs for the following period. Then at the end of the period, the cashier finds out the amounts spent by the petty cashier, by looking at the entries in the petty cash book. At the same time the petty cashier may give the petty cash vouchers to the cashier so that the entries in the petty cash book may be checked. The cashier then passes cash to the value of the amount spent on petty cash to bring it back up to the level it was at when the period started. This amount is known as petty cash float.

The relevance of discounts

Discounts may be offered to retailers by wholesalers or manufacturers for bulk purchases (trade discount) or in order to induce customers to pay their accounts quickly (cash discounts). Whereas cash discounts always appear in the profit and loss part of the Trading and Profit and Loss account and part of double entry trade discount are just netted off the initial selling price on the invoice but are not part of bookkeeping entries

Accounting for Payroll

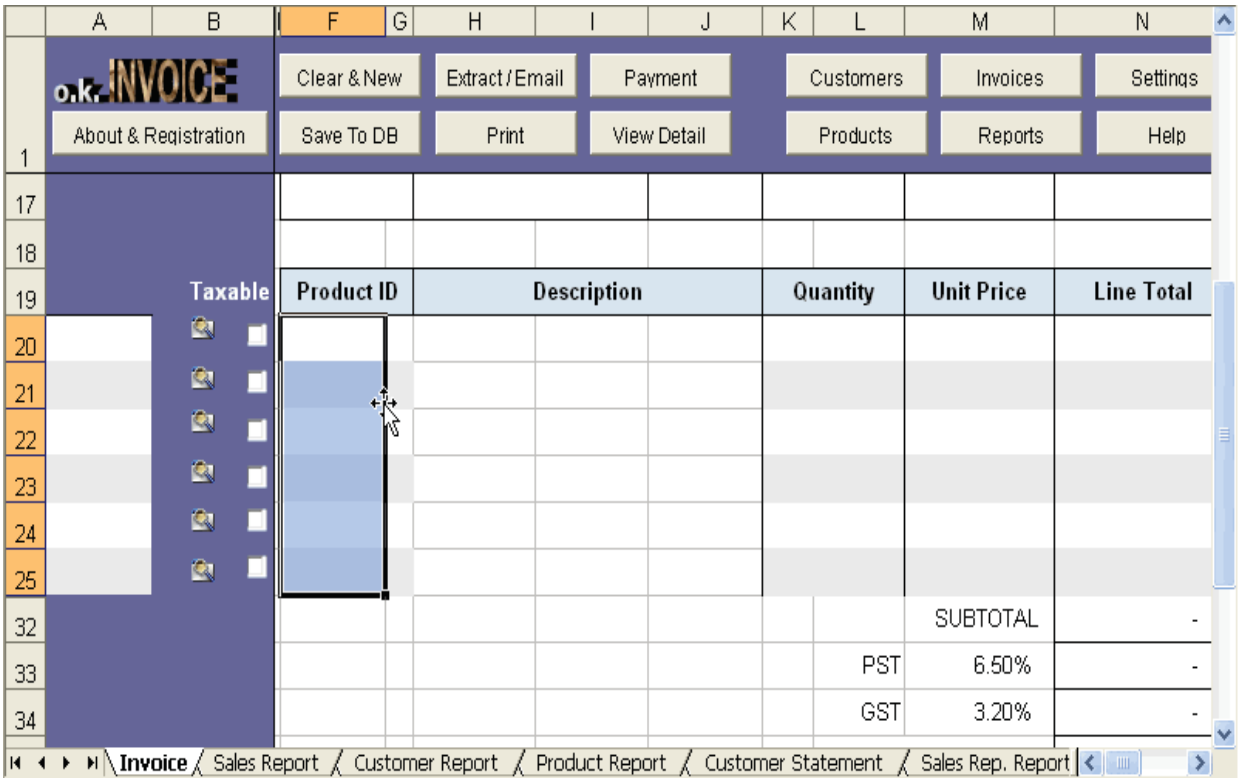
Modern accounting systems include a payroll module. Businesses with large number of employees would find this particularly useful as payroll systems require a good deal of regular processing. Some of important aspects this module should handle are PAYE, pension, and loans and advances.

This area of accounting is usually under a specialized accounting officer and contained some in-built controls such as salaries and wages control accounts as part of internal checks.

4.2 SAMPLES OF VARIOUS DOCUMENTS USED IN ACCOUNTING ENVIRONMENT

An invoice

This is a source document used to record credit sales.



A credit note

This is a source document used to record a reduction in an amount which a customer is owing.

Xin Cube Inc
Reg No:

Code: CN13030001
Date: 29-Mar-2013
Payment Terms 30 Days

Bill To:

Gary Butler
Go Voice
3033 Schaefer Ave.
Chino
CA 91710
US
Phone: (909) 628-7377 Fax: (909) 628-7378
Tax No:

Ship To:

Gary Butler
Go Voice
3033 Schaefer Ave.
Chino
CA 91710
US
Phone: (909) 628-7377 Fax: (909) 628-7378

Credit Note

Description	Quantity	Unit Price	Discount	Amount
APPLE IPAD CASING - WHITE	50 PC	160.00	0.00	8,000.00
APPLE IPAD CASING - BLACK	50 PC	160.00	0.00	8,000.00

US Dollar Sixteen thousand eight hundred and 00/100

Sub Total:	16,000.00
Discount:	0.00
Add. Discount:	0.00
VAT	800.00
	0.00
	0.00
Shipping:	0.00
Tax:	0.00
Total:	**16,800.00**

Note:
Thanks for your business!
This credit note is generated using Xin Inventory 2.0

Authorized Signature,



Xin Cube Inc

380 Francisco St
San Francisco
CA 94133
United State

Phone: (415) 989-1188 Fax: (415) 989-2288
Email: admin@xincube.com
Website: 74-2999212

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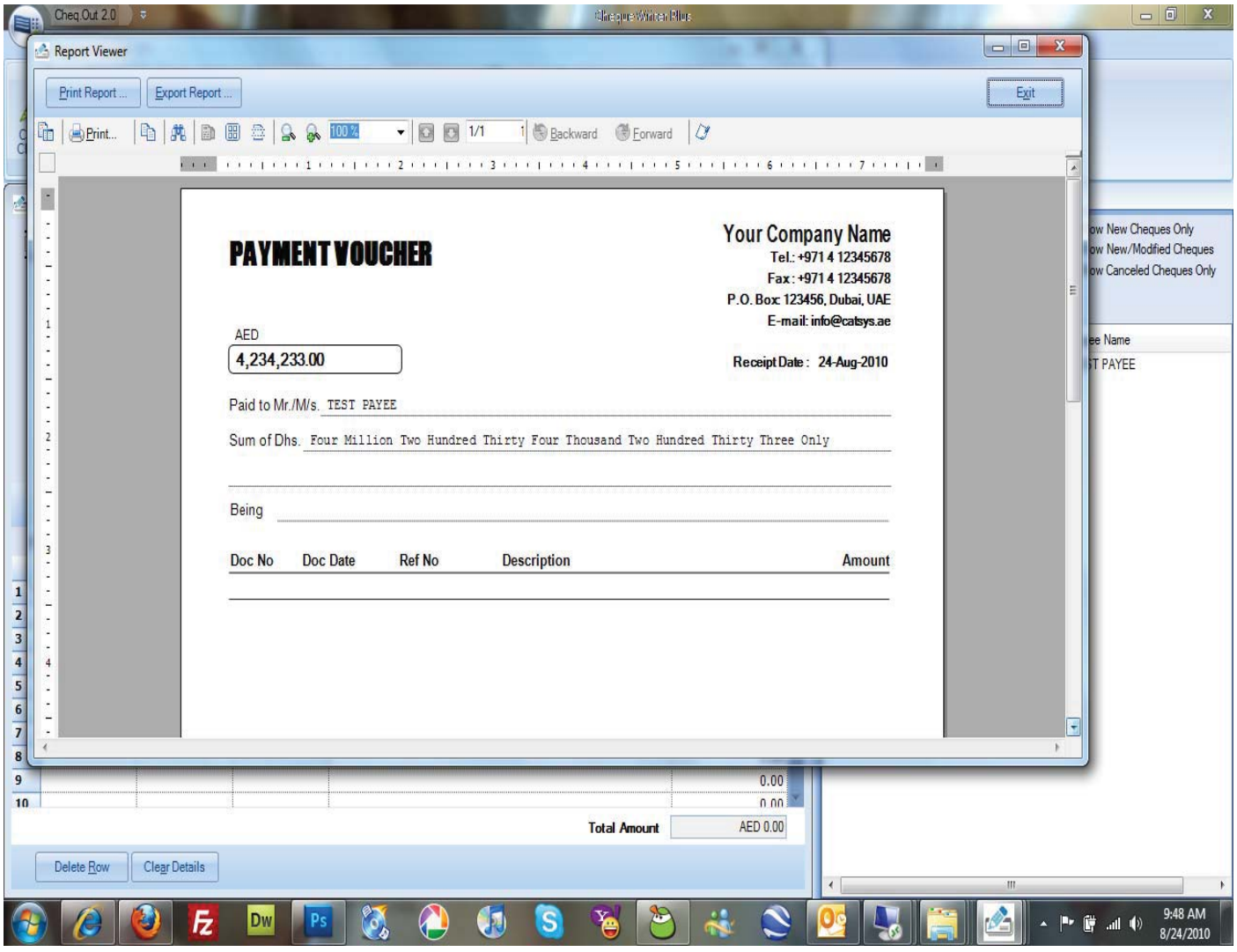
A payment voucher

A payment voucher is a document that explains the intent of a company to pay an external affiliate. For example, a company may make a purchase or a payment to another company and provide a voucher to explain the costs involved.



SUMMARY OF THE CHAPTER

The chapter explained the accounting treatment of the main types of business transactions and justified the treatment as given. It also highlighted the operation of key elements in accounting stating how the selected elements are applied in accounting set ups.

END OF CHAPTER QUESTIONS

Q1

Explain your understanding of an 'accounting transaction'.

Q2

*In accounting for payroll, list any **three** items that an accountant would expect the relevant computer applications to handle.*

NOT FOR SALE

CHAPTER 5

BOOKS OF ORIGINAL ENTRY AND LEDGERS

5.0 LEARNING OBJECTIVES

The objective of this chapter is to introduce to the students books of original entry and ledgers. By end of this topic, the students will therefore be expected to understand the types of books used in accounting. Uses of these records are explained and coding and control accounts are also mentioned. However, as one of the day books, the cash book is discussed later in detail to underline its importance.

5.1 THE GROWTH OF A BUSINESS

When a business is small, all the double entry accounts can be kept in one book called a ledger. With the growth of the business, it becomes impossible to use just our book because of the large number of pages required for a lot of transactions, which would make the book too large to handle. Furthermore, the growth in the business might necessitate the employment of several bookkeepers, and using one book would make it difficult for each one to do his/her work.

As a result of this, there is need to use more books whereby similar types of transaction are put together and have one book in which they are recorded.

5.2 BOOKS OF ORIGINAL ENTRY

When transactions take place, there is need to record as much details as possible of the transactions.

Books of original entry are the books in which transactions are first recorded. Each type of transaction will have a separate book.

The nature of the transaction affects which book it is entered into. The following details of transactions are entered in these books:-

- The date on which each transaction took place (transactions are recorded in date order)
- Details relating to the transaction are entered in the details column.
- A folio column entry is made cross-referencing back to the source document.
- The monetary amounts are entered in columns provided in the books of original entry for that purpose.

5.3 TYPES OF BOOKS OF ORIGINAL ENTRY

Books of original entry are called “day books” or “journals.”

- Sales day book (sales journal) in which credit sales are entered.
- Purchases day book (purchases journal) in which credit purchases are recorded.

- Returns inwards day book (returns inwards journal) in which returns inwards are entered
- Returns outwards day book (Returns outwards journal) in which returns outwards are recorded.
- Cash book in which receipts and payments are recorded (both cash and cheque transactions)
- General journal (journal) for other items

5.4 USING MORE THAN ONE LEDGER

Entries are made in the books of original entry, and then summarized, and the summary information is entered, in double entry, to accounts kept in various ledgers. The use of a set of ledgers rather than just one big ledger makes it easier to divide the work between different bookkeepers.

5.5 TYPES OF LEDGERS

Most businesses use the following ledger:

- Sales ledger. This is for customers' personal accounts
- Purchases ledger. This is for suppliers' personal accounts
- General ledger. This contains the remaining double entry accounts; expenses, income, fixed assets and capital

5.6 TYPES OF ACCOUNTS

All accounts are sometimes described as personal accounts or as impersonal accounts.

- ***Personal accounts:*** for debtors and debtors and creditors (customers and suppliers)
- ***Impersonal accounts***
  These are divided into "real" accounts and "nominal" accounts.
- ***Real accounts*** are accounts in which possessions such as buildings, machinery, fixtures and stock, are recorded.
- ***Nominal accounts*** are accounts in which expenses, income and capital are recorded

5.7 THE PURCHASE DAY BOOK

Purchase day book is used to keep a list of invoices received from suppliers of goods and services to the business. It is a "book" of prime entry or a primary record.

The need for the purchase day book

A business needs to keep track of all of its purchases transactions together so that it knows how much it owes to particular suppliers at any one time.

a. It is simpler to allow the amount it owes to the supplier to build up and then "make a single payment" to each supplier rather than to pay each invoice separately.

b. The business needs to take full advantage of the credit period offered by suppliers and pay close to the end of the credit period of which the supplier allows
c. It will want to keep a record of the total purchases which it makes in each period

Taking advantage of the suppliers' allowed credit periods helps the cash flow of the business. If it pays earlier than it needs:-

1. It may pay more interest on larger bank overdraft it needs
2. Lose interest on a positive amount of cash instead of an overdraft

To meet these needs the source documents must be recorded in the purchases day book

Example of the purchases day book

DATE	SUPPLIER NAME	REF	TOTAL	SALES TAX
12.08.13	Maya Trading	PL 1	K5000	K324
14.08.13	Viwemi Ltd	PL 2	K4300	K134
23.08.13	Twanda Plc	PL 3	K14500	K2110

Note

The purchases day book is regularly summarized and the information is posted to the general ledger by debiting the purchases account and crediting the payables control account. The same information should also be posted to the individual supplier's accounts concerned by crediting their accounts in the payables personal ledger.

Some organizations assign **"**sequential numbers to purchase invoices**"** to ensure that all purchases invoices are included in the reports.

5.8 THE PURCHASE RETURNS DAY BOOK

The purchase returns day book lists credit notes received in respect of the purchase returns in chronological order.

- A business will return goods that are "faulty" or damaged and will expect a credit note from the supplier
- Goods bought on **"**sale or returns**"** basis will be returned if they cannot be sold
- If goods have been ordered by the business and are in good condition but are "surplus to the requirements" the supplier may or may not agree to accept them as returns and to issue a credit note.

Purchase returns might be recorded in the purchases day book as "negative amount"

Note

Purchase returns might be recorded in the purchases day book as "negative amount. The purchase return day book is regularly summarized and posted to the general ledger by

debiting the payables control account and crediting the purchase returns account. The individual supplier's accounts will also be debited with the value goods returned in the suppliers personal accounts.

Entering purchase transactions in the day books
This will be similar to the procedure for writing up the sales day book and the sales returns day book.

a. In manual accounting systems, invoice details will be entered in the purchase **day book** and **credit notes** in **the purchase returns day book** by hand.
b. In computerised purchase ledger systems, purchase invoice entering will be done by entering details onto the computer records through a keyboard and a visual display unit (VDU) or monitor.

Analysis of purchases
The purchases day book may have further analysis columns which split the purchases into different categories in addition to the date, transaction reference number, supplier name, supplier account number, and the net total before tax, sales tax and gross total.

The nature of the business will determine how the purchases are analysed. A business may have separate day books for inventory purchases and expenses. **"**Expenses day book"
A spreadsheet may be used to analyse purchases in a purchase day book.
Computerised accounting packages may have analysed sales day books and purchases day books.

Coding in the purchases ledger
The purchasing company will have to allocate codes to different suppliers.
In the purchase system the obvious codes are:

- Supplier account number
- Product or service number
- Purchase invoices sequence number

The supplier account number is a unique identification number used to identify and distinguish the suppliers even where they have the same name**.**
The product or service code identifies the type of the product or service. This enables the company to build controls when posting the general ledger. A sequential numbering of purchase invoices may be put in place to ensure the completeness and assist prevention of fraud.

5.9 THE SALES DAYBOOK

- The sales daybook is used to record all invoices sent to customers for goods which a business sells on credit.
- The sales daybook should contain the following details pertaining to sales invoices issued:

(a) The date of the sale
(b) Name of the customer
(c) Invoice number
(d) Reference number column
(e) Final amount of the invoice

- A sales daybook may appear like this;

Sales daybook

Date	customer	invoice number	ref	amount
Sept 1	A. James	145	SL 2	K2300
2	M. Phiri	147	SL 3	K3500
7	J. Mwase	149	SL 4	K2700
15	C. Manase	151	SL 6	K7800
	Total			**k16300**

Note.

Information from the sales daybook will be summarized at the end of a period and posted to the general ledger by debiting the receivables control account and crediting the sales account. The same information will also be posted to the customer's individual personal accounts by debiting the customers accounts in the personal ledger.

5.10 THE SALES RETURN DAYBOOK

- The sales day book is used to record credit notes sent to customers for goods returned by customers. Alternatively, the credit notes sent may be recorded in the sales day book as negative amounts to reduce the value of sales invoices.
- The sales return daybooks summaries are posted to the genera ledger by debiting the sales returns day book and crediting the receivables control account. The individual customers account concerned in the personal ledger should also be credited with the value of the credit note to show the reduction in the amount owing.

5.11 CONTROL ACCOUNTS

- A control account is an account in the general ledger in which a record is kept of the total value of similar but individual items. Control accounts are chiefly used for trade receivables and payables.
- A receivables control account is an account in which records are kept of transactions involving all receivables in total and receipts from customers in total.
- A payables control account is an account in which records are kept of transactions involving all payables in total and payments in total made to suppliers.

Example

On examining the books Azimenye Ltd, you ascertain that on 1 October 2010 the receivables ledger balances were k8024 debit and k57 credit, and the payables ledger balances on the same date k6235 credit and k105 debit.

For the year ended 30 September 2013 the following particulars are available:

	K
Sales	63728
Purchases	39974
Cash from trade accounts receivable	55212
Cash to trade accounts payable	37307
Discount received	1475
Discount allowed	2338
Returns inwards	1002
Returns outwards	535
Bad debts written off	326
Cash received in respect of debit balances in the payables ledger	105
Contra settlement between payables and receivables	434
Allowances to customers on goods damaged in transit	212

On 30 September 2013 there were no credit balances in the receivables ledger except those outstanding on 1 October 2012, and no debit balances in the payables ledger. You are required to write up the following accounts recording the above transactions bringing down the balances as on 30 September 2013.
(a) Receivables control account
(b) Payables control account

Receivables control account

	K		K
Balance B/d	8024	Balance B/d	57
Sales	63728	cash	55212
		Discount allowed	2338
		Returns inwards	1002
		Bad debts	326
		Contra settlement	434
		Allowance on goods damaged	212
Balance c/d	57	balance c/d	12228
Total	**71809**	total	**71809**

Payables control account

	K		K
Balance B/d	105	Balance B/d	6235
Cash	37307	purchases	39974
Discount received	1475	cash	105
Returns outwards	535		
Contra settlement	434		
Balance c/d	6458		
Total	**46314**	total	**46314**

SUMMARY OF THE CHAPTER

This chapter introduced books of prime entry (also known as books of original entry, day books or journals) *excluding* cash books which will be handled in the next chapter. The usefulness of the books was explained. The relationship with ledgers and control accounts were clarified.

END OF CHAPTER QUESTIONS

Q1 Day books terminology

Give other terms that are used to name day books.

*Q2*Importance of day books

State the main reason for having day books in an accounting system.

EXAMINATION TYPE QUESTION

(a) List any **four** books of original entry (that is books of prime entry), giving an alternative name in each case **(2 Marks)**

(b) Roshan Barucha, a sole trader specialising in material for Asian clothing, has the following purchases and sales for September 2012:

September 1 Bought from Farouk Patel Stores: silk for MK400,000; cotton for Mk800,000. Both transactions attracted a 25 percent trade discount.
September 8 Sold to Wasubweni: lycra goods for MK280,000; woolen items for MK440,000. There was no any trade discount for these transactions.
September 15 Sold to Mumderanji Simfukwe: silk MK360,000; lycra MK1,440,000; cotton goods MK1,200,000. All these were traded at less 20 percent trade discount.
September 23 Bought from C Karim: cotton MK880,000; lycra MK520,000. These goods were transacted at less 25 percent trade discount.
September 24 Sold to Matofotofo : lycra goods at MK420,000; cotton MK480,000, less 10 Percent trade discount in both cases.
September 31 Bought from Haroon: lycra goods MK2,700,000, less 33 1/3 percent trade discount.

Required:

(i) Prepare the purchases and sales day books of Roshan Barucha from the above transactions.

(6 Marks)

(ii) Post the items to the personal accounts, specifying the types of ledger concerned.

(8 Marks)

(iii) Post the totals of the day books to the sales and purchases accounts in the general ledger.

(4 Marks) **(TOTAL: 20 MARKS)**

CHAPTER 6

THE CASH BOOK

6.0 LEARNING OBJECTIVES

The objective of this chapter is to introduce to the students the Cash Book as one of books of original entry. Therefore by end of this topic, the students will be expected to understand the cash book, its uses, the bank reconciliations and how these are prepared.

6.1 CASH BOOKS

6.1.1 Drawing up a Cash Book

The cash book consists of the cash account and bank account put together in one book. In the cash book, the debit column for cash is put next to the debit column for bank. The credit column for cash is put next to the credit column for bank. This enables the business to record all money received and paid out on a particular date on the same page.

The bank column contains details of the payments made by cheque and direct transfers from the bank account and of money received and paid into the bank. The bank will have its own record of the account in its books. From time to time, or on request from the business, the bank sends a copy of the account in its books to the business known as a bank statement, which the business uses to check against the bank columns in its cash book to ensure that there are no errors.

6.1.2 Cash paid into the bank

When customers pay their accounts in cash and, later, a part of the cash is paid into the bank, the receipt of the cash is debited to the cash column on the date received, the credit entry being in the customer's personal account.

The cash banked has the effect of (i) decreasing the asset cash; therefore, credit the asset cash account represented by the cash column in the cash book, and (ii) increasing the asset of bank; therefore debit the asset bank account, which is represented by the bank column in the cash book.

When the whole of the cash received is banked immediately the receipt is entered directly into the bank column.

When the business requires cash, it may withdraw the cash from the bank. The effect is (i) asset bank is decreased; the action being crediting the bank account that is the bank column in the cash book and (ii) the asset of cash is increased; the action being debiting the asset account; that is the cash column in the cash book.

NOT FOR SALE

.3 The use of folio column

When many books are being used, mentioning the other account in which the transaction is to be found, may not be enough information to find the other account quickly. Therefore a folio column is introduced to facilitate quicker finding of the other account. In each account and in each book being used, a folio column is added, shown on the left of the money columns. The name of the other book and the number of the page in the other book where the other part of the double entry was made is stated against each and every entry in this column. To ensure that the double entry is completed the folio column should only be filled when the double entry has been completed.

Using one book as a means of entering transactions into the accounts, so as to perform or complete the double entry is called posting. The advantage of using folio entries is that they speed up the process of finding the other side of the double entry. If an entry has not been filled in, it may indicate that the double entry has not yet been made. Looking through the entry lines in the folio columns to ensure that they have all been filled helps detect such errors quickly.

CASH DISCOUNTS

In order to induce customers to pay their accounts quickly, a business may accept a smaller sum in full settlement if payment is made within a certain period of time. The amount of the reduction of the sum to be paid is known as cash discount.

The rate of the cash discount is shown as a percentage. The percentage allowed, and the period within which payment is to be made, are quoted on all sales documents by the seller.

Cash discounts always appear in the profit and loss part of the Trading and Profit and Loss account. They are not part of the cost of goods sold, nor are they a deduction from selling price.

Discounts column in cash book

The discount s allowed account and the discounts received account are maintained in the general ledger along with other revenue and expense accounts. To avoid too much reference to the General ledger, extra columns for discount are used in the cash book. Each side of the cash book will have an extra column added in which the amounts of discounts are entered. Discounts received are entered in the discounts column on the credit side of the cash book, and discounts allowed in the discounts column on the debit side of the cash book.

Example

Enter the following transactions for the month of May 2013 in the cash book, balance off the cash book and show the discount accounts in the general ledger

May 1 balance brought down from April:	K
Cash	29
Bank	654
Accounts receivables accounts:	
B Konda	120
M Kaka	280
D Songa	40
Accounts payables accounts:	
U Banda	60
A Kande	440
R Seka	100
2 B Konda pays us by cheque, having deducted 2.5% cash discount k3	117
8 we pay R Seka his account by cheque, deducting 5% cash discount k5	95
11 we withdrew k100 from the bank for business use	100
16 M Kaka pays us his account by cheque less 2.5% discount k7	273
25 we paid office expenses in cash	92
28 D Songa pays us in cash after deducting a discount of k2	38
29 we pay U Banda by cheque less 5% discount k3	57
30 we pay A Kande by cheque less 2.5% discount k11	429

Cash book

Date	Item	Folio	Discount	Cash	Bank	date	Item	Folio	Discount	Cash	Bank
			K	K	K				K	K	
May											
1	Bal b/d			29	654	8	R. Seka	PL5	5		95
2	B. Konda	SL1	3		117	11	Cash	C			100
11	Bank	C		100		25	Office Exp	GL2		92	
16	M. Kaka	SL2	7		273	29	U. Banda	PL3	3		57
28	D. Songa	SL3	2	38		30	A. Kande	PL4	11		429
						31	Balances	c/d		75	363
			12	167	1044				19	167	1044
June											
1	Balances			75	363						

Sales ledger

B Konda

Balance	b/d	K120	Bank		K117
			Discount		3

M Kaka

Balance	b/d	K280	Bank		K273
			Discount		7

D Songa

Balance b/d	K40	Cash	K38
		Discount	2

Purchase ledger

U Banda

Bank	K57	balance b/d	K60
Discount	3		

R Seka

Bank	K95	balance b/d	K100
Discount	5		

A Kande

Bank	K429	balance b/d	K440
Discount	11		

General ledger

Office expenses

Cash	K92		

Discount received

		Total for the month	K19

Discount allowed

Total for the month	K12		

Exercise

Enter the following in the three–column cash book of an office supply shop, balance–off the cash book at the end of the month and show the discount accounts in the general ledger

2013

June 1 balance brought forward; cash K420, bank K4940

1 the following paid us by cheque, in each case deducting a discount of 5%
S Braga K820, L Pine K320 G Hodd K440 M Rae K1040
2 cash sales paid directly into the bank K740
3 paid rent by cash K340
4 we paid the following accounts by cheque in each case deducting 2.5%
cash discount M Peters K360 G Graham K960 F Bell K400
8 withdrew cash from the bank for business use K400
10 cash sales K260
12 B Age paid us their account of K280 by cheque less a discount of K4
14 paid wages by cash K540
16 we paid the following accounts by cheque R Todd K310 less K15 discount
F Dury K412 less K12 discount.
20 bought fixtures by cheque K4320
24 bought lorry by cheque K14300
29 received K324 cheque from A Line
30 cash sales K 980
30 bought stationery paying by cash K56

6.3 THE BANK RECONCILIATION STATEMENTS

(a) Completing entries in the cash book

Funds paid into and out of the bank are entered into the bank columns of the cash book. The bank will also keep record of the flow of funds into and out of the business bank account.

At any one time, it is unlikely that the balance in the business cash book and the balance shown by the Bank records will be same. This is the case for the following reasons:

1. Items may have been paid into or out of the bank account that have not been recorded in the cash book.
2. There may be items entered into the cash book that have not yet been entered in the bank's re cords of the account. These are called **Timing Differences**

The cash book entries need to be compared to the record held by the bank. Banks usually send "bank statements" to their customers which can be used for reconciliation.

Dr **CASH BOOK (Bank columns only)** **Cr**

2013		K	2013	K
Mar 1	Balance b/d	2500	Mar 6 M Kennedy	650
15	James Brown	1000	25 Joseph	1800
24	K Phillip	1500		

BANK STATEMENT

2013		Withdrawals K	Deposits K	Balance K
Mar 1	Balance b/d			2500
7	M Kennedy	650		1850
15	Deposit		1000	2850
24	Deposit		1500	4350
27	Joseph	1800		2550
31	Bank transfer- Booth		500	3050
31	Bank charges		200	2850

In this cash, the balances in the cash book and in the bank statement are the same.

The balance on the cash book might be different from that on the bank statement due to the following reasons

-Unpresented cheques will cause the balances to be different

-Bank lodgments' not yet credited to the business's bank account will cause the two balances to be different.

(b) Procedure for preparing bank reconciliations

"The cash book and the bank statement will rarely agree at given date.

Following procedures should be followed to ensure that the reconciliation between them is performed correctly:

1. Identify the cash book balance and the bank balance on the date to which you wish to reconcile.
2. ''**Add up the cash book** "for the period since the last reconciliation and identify and note any errors found.
3. Examine the bank statement for the same period and identify those "**items which appear on the bank statement but which have not been entered in the cash book**.
    i. Standing orders
    ii. Direct debits
    iii. Bank charges
    iv. Dividend receipts from investments
    v. Interest received

4. Identify all the reconciling items due to "**timing differences**

ADJUSTED CASH BOOK BALANCE	K	K
Cash book balance brought down		XX
Add: correction of understatement	X	
Receipts not entered in cash book		X
		XX
Less: Corrections of overstatements	X	
Payments/charges not entered in cash book		X
		(XX)
Corrected cash book balance		**XX**

Bank reconciliation

(c) Timing and frequency of the bank reconciliations

The following factors determine the frequency of performing bank reconciliations:-

7 where **Frequency and volume of transactions** – The likelihood of error is greater there are more transactions

8 **Other controls** – If there are very few other checks on cash, the greater the need for a bank reconciliation.

9 **Cash flows** – If the company has to keep a very close watch on its cash position, then the reconciliation should be performed as often as the information on cash balance is required.

10 **Number of bank accounts** – The more the bank accounts are operated, the more difficult it becomes to perform regular reconciliation.

(a) Reconciliation on computerised systems

There is no difference between reconciliations of a manual cash book and reconciliation of a computerised cash book.

(b) Computer controls over cash

The computer will have "programmed controls" built in to prevent or detect many of the errors that can be made in a manual system.

- **Casting** – computers are programmed to add correctly
- **Updating from ledgers** - The bank account will be updated from the sales ledger, purchase ledger and any relevant ledger.
- **Combined computer and manual cash books**

Many organizations will normally maintain a manual cash book in addition to computerised cash book.

NOT FOR SALE

Example – bank reconciliations

Sarah prepares a bank reconciliation statement for her business bank account at the end of each month. At 31 May 2013 her ledger balance was K2,759 (credit) and her bank statement showed that she had funds of K131 at the bank. She has the following information:

(i) The bank debited Sarah's account with charges of K129 during May. Sarah has not recorded the charges.

(ii) Sarah arranged for K2,500 to be transferred from her personal bank account into the business bank account. The bank made the transfer on 30 May, but Sarah has not made any entry for it in her records.

(iii) On 22 May Sarah withdrew K100 cash which she did not record.

(iv) Cheque number 543987 which Sarah issued to a supplier appears on the bank statement as k650. Sarah incorrectly recorded the cheque as K560.

(v) On 31 May, Sarah lodged K457. This amount appears on the bank statement dated 3 June.

(vi) Sarah was advised by the bank that she earned K52 interest for the period in May that her account was in credit. Sarah recorded this in May, but the bank did not credit her account until June.

(vii) Three of the cheques issued in May, with a total value of K942, were not debited on the bank statement until after 31 May.

(viii) A cheque for K276, issued to a supplier was cancelled, but Sarah has not recorded the cancellation of the cheque.

Required:

(a) Show the bank account in Sarah's general ledger, including any adjusting entries required due to the information in (i) to (viii) above.

(b) Prepare a reconciliation of the bank statement balance to the corrected balance on the bank account in Sarah's general ledger.

(c) Indicate how the bank balance will be reported in Sarah's final accounts, and the value to be reported.

Solution

(a) Bank Account

	K		K
Transfer from personal account	2500	Balance B/d	2759
Cheque cancelled	276	Bank charges	129
		Drawings	100
		Understated cheque	90
Balance C/d	302		
	3078		3078

(b) Bank reconciliation statement

	K
Balance as per bank statement	131
Add outstanding lodgements (k457 + k52)	509
Less unpresented cheques	(942)
Balance as per bank account	(302)

(c) The bank balance will be reported as an overdraft under Current Liabilities in the Statement of Financial Position. The amount to be reported will be K302.

SUMMARY OF THE CHAPTER

This chapter introduced the cash book as one of books of prime entry (also known as books of original entry, day books or journals). The usefulness of this book was explained and how bank reconciliation statements are prepared were illustrated in appropriate detail.

END OF CHAPTER QUESTIONS

Q1 Bank reconciliations terminology

Explain the following terms as they relate to Bank Reconciliations.

a. *Deposits in transit*
b. *Outstanding checks*
c. *Bank charges*
d. *Non-sufficient fund cheques (NSF cheques)*

Q2 Question: Bank Reconciliations

Company A's bank statement dated 31 December 2013 shows a balance of K24,594.72. The company's cash records on the same date show a balance of K23,196.79. The following additional information is available:

1. *The following cheques which had been issued by the company to its customers are still outstanding:*

No. 846 issued on Nov 29	*K320.00*
No. 875 issued on Dec 26	*49.21*

No. 878 issued on Dec 29 275.00

No. 881 issued on Dec 31 186.50

2. *A deposit of K400.00 made on 31 December does not appear on bank statement.*
3. *An NSF cheque of K850 was returned by the bank with the bank statement.*
4. *The bank charged K50 as service fee.*
5. *Interest income earned on the company's average cash balance at bank was K1,250.*
6. *The bank collected a note receivable on behalf of the company. Amount received by the bank on the note was K550. This includes K50 interest income. The bank charged a collection fee of K10.*

7. *A deposit of K430 was incorrectly entered as K340 in the company's cash record**s.***

Required:

Prepare a bank reconciliation statement using the above information.

Write brief notes, comparing and/or contrasting the following pairs of accounting terms, as the case may be:

(a) Trade Discount *and* Cash Discount. **(4 marks)**

(b) Bank Loan *and* an Overdraft (Bank Overdraft Facility). **(4 marks)**

CHAPTER 7

CHARTS OF ACCOUNTS AND CODING OF ACCOUNTS

7.0 LEARNING OBJECTIVES

The objective of this chapter is to explain the importance of charting and coding of accounts in processing of financial transactions. The accounting code and different types of codes including sequence**,** block**,** significant digit**,** and hierarchical faceted are also explained. Finally, code supplier and customer accounts and aspects of coding general ledger accounts are handled.

7.1 CODING DATA

CODES

It is necessary to take a look at the importance of coding in transaction processing because coding is at the centre of transaction processing and the integrity of the information obtained from it. Codes are used because the can identify items more precisely and concisely than written descriptions, as such the help to classify items into groups for recording data.

> A **code** is defined as a system of symbols designed to be applied to a classified set of items to give a brief accurate reference, facilitating entry, collection and analysis

Coding saves time in copying out data because codes are shorter than longhand descriptions. In view of this, and to save storage space, computer systems make use of coded data

7.2 CODING IN THE ACCOUNTS RECEIVABLE LEDGER

The accounts receivable ledger consists of individual accounts for each credit customer. Each customer is allocated an account and identified by a unique code number. If there were two customers with the same name, with a unique code, these would be distinguished. In addition to the customer account number other examples of codes in a sales system can incorporate the following important information:

- Sale invoice numbers
  A sequential coding of invoices ensures completeness and helps elimination of errors such as missing invoices, or goods not being invoiced

- Product or service code numbers
  In addition to customer identification number, a code can incorporate product identification. For example customer John may be buying more

than one type of product form the company such as home theatres and television sets. Separate identification of the products will enable the transaction to be correctly posted not just in the accounts receivable ledger but also in all relevant accounts in the general ledger.

There are many coding systems (or combinations of them) that may be used when designing codes to offer the flexibility that the company needs and are described below.

7.3 SEQUENCE CODES

Sequence codes make no attempt to classify the item to be coded. It simply puts the next available number in a rising sequence. New items can only be inserted at the end of the list and therefore the codes for similar items may be very different.

7.4 BLOCK CODES

Block codes provide a different sequence for each different group of items. For example for a particular company, customers may be divided up according to area:

South	Code numbers 10000 - 19999
North	Code numbers 20000 – 29999
East	Code numbers 30000 – 39999
West	Code numbers 40000 – 49999

Within each block coding for customers is then sequential.

7.5 SIGNIFICANT DIGIT CODES

Significant digit codes incorporate some digits which are part of the description of the item being coded.

For example:

4000	Electric light bulbs
4025	25 watts
4040	40 watts
4060	60 watts
4100	100 watts

7.6 HIERARCHICAL CODES

4	Business
4 2	Finance
4 2 1	Cost accounting

NOT FOR SALE

4 2 1.4 Standard costing
4 2 1.4 7 Variance analysis
4 2 1.4 7 2 Fixed overhead variance

7.7 FACETED CODEs

Faceted codes are made up of a number of sections each section of the code representing a different feature of the item. A good example may be found in a clothing factory where a code might be based on the following facets.
Garment type Customer type Colour Size Style

If SU stood for suit, M for male, B for blue, a garment might be given the code SU M B 36 15. On the other hand, ND F W 14 22 might represent a woman's white night dress size 14, style 22. One of the greatest advantages of this system is the type of item can be recognized from the code.

Faceted codes can also be entirely numerical.

7.8 CODING IN THE GENERAL (NOMINAL) LEDGER

A nominal ledger consists of a large number of coded accounts. Part of a nominal ledger might, for example, be as follows:

Account code	Account name
100200	Plant and machinery (cost)
100300	Motor vehicles (cost)
300000	Total receivables
400000	Total payables
500130	Wages and salaries
500140	Rent and rates
500150	Advertising expenses
500160	Bank charges
500170	Motor expenses
500180	Telephone expenses
600000	Sales
700000	Cash

A business chooses its own codes for the nominal ledger. The codes given above have been taken from a sample in a manual.

7.9 POSTING THE DAY BOOK TOTALS

The day book totals for sales and returns are posted to **the nominal ledger receivables control account**, **the sales tax control** and **the sales account**. The amounts owed by individual customers are entered in the **sales ledger personal accounts** (where these are maintained as memorandum accounts separate from the nominal ledger).

It has been seen above how details of sales may be entered in the sales day book. One of the reasons for maintaining the sales day book was the need to make sure that the business receives the money due from all of the sales it makes. There is therefore need to have a record which shows when the business should ask for the money. The sale day book cannot provide such information for the following reasons:

(a) For many businesses the chronological record of the sales transactions might involve very large numbers of invoices per day or week

(b) The same customer might appear in several places in the sales day book, for purchases he makes on credit at different times, so that a customer may owe money on several unpaid invoices at any point in time.

There is, therefore the need for a way of showing **who** owes **what** amount to the business and **when**

7.10 PERSONAL ACCOUNTS FOR RECEIVABLES

The above need is met by maintaining **personal accounts** for each individual customer in the **receivables ledger**.

(a) Each individual sales transaction is entered in the sales day book and needs to be recorded in the personal receivables ledger account of the customer.

(b) The totals of the day books need to be posted to the total receivables and sales accounts in the general ledger.

Personal accounts are also called **memorandum accounts** to indicate that, recording of transactions in these books are **not** part of the double entry

7.11 RECORDING THE DOUBLE ENTRY

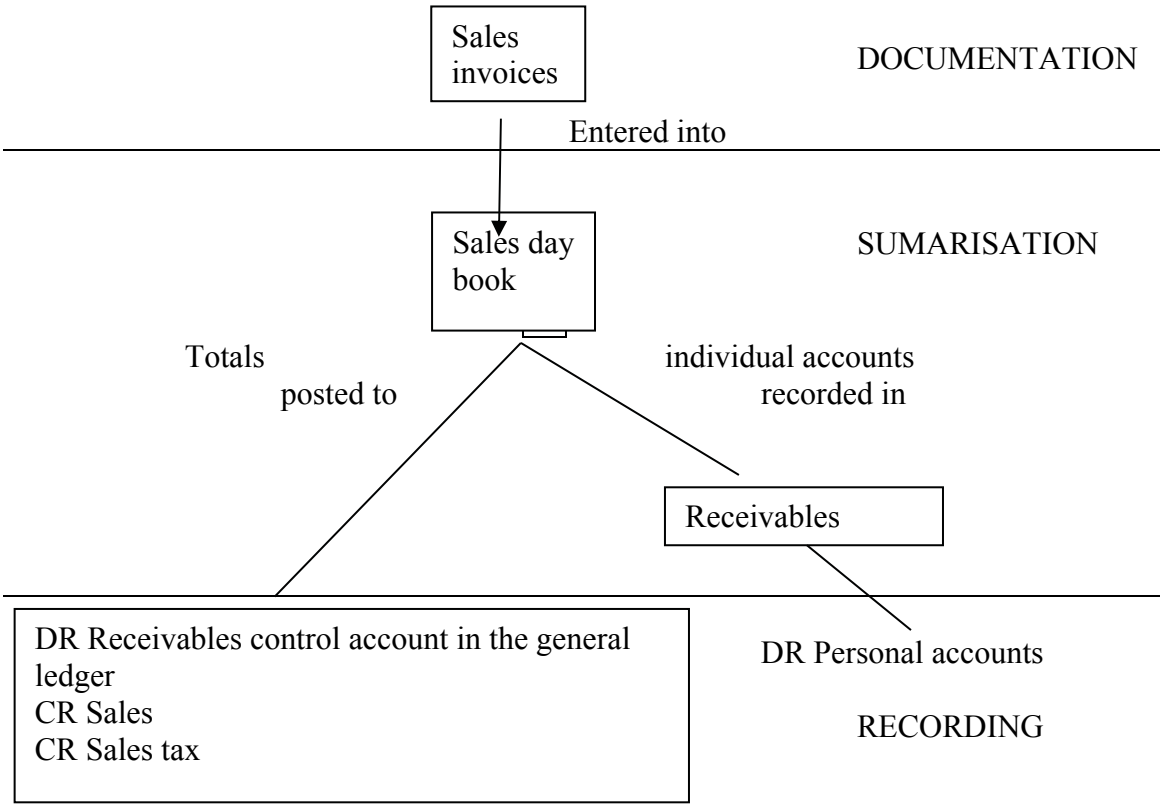
The transactions entered in the sales day book need to be recorded in the double entry system of bookkeeping.

To do this the sales day books must be **totalled** and **ruled off,** to include all transactions since the book was last ruled off as shown on page 1.

The business will also have a cash account as part of its double entry posted from the cash book. This is the general ledger account in which receipts and payments

of cash are recorded. However, when there is a credit transaction no entry is made in the cash account because initially no cash was received or paid.

Therefore, the receivables control account (total receivables account) is used as shown on next page.



7.12 THE DOUBLE ENTRY

The sales summarized in the sale day book are transactions that have two aspects:

- An increase in our **assets** (receivables)
- An increase in **income** (sales)

> A **receivables control account or 'sales ledger control account",** is maintained in the general ledger to record in total the amounts which are posted to customers' individual personal memorandum accounts in the receivables ledger.

For sales made to credit customers the entries made will be a **debit** to the receivables control account and a **credit** to the sales account.

- The **receivables control account** records an **asset** – the debts owed by customers.

- The **sales account** records **income** – the amount of sales which the business is making.

The basic double entry is shown as follows:

		Mk	Mk
DEBIT	Receivables control account	X	
CREDIT	Sales account		X

There is no need to record each sales transaction separately in the general ledger. The day book totals are used to summarize the transactions.

7.13 VAT

Sales tax is charged on the sales and the business must account to the authorities for the output tax it collects. In order to keep track of the amount it owes to or is owed by the authorities, the business keeps a **Sales Tax Account** (also called **Sales Tax Control Account**) in the general ledger.

The sales tax which customers owe to the business is included in the overall amount owed (total receivables), but the other side of the entry for the amounts of tax invoiced to customers is **an increase in the liability of the business to pay over sales tax to the authorities.** The double entry therefore will take the form of:

		Mk	Mk
DEBIT	Receivables control account	X	
CREDIT	Sales account		X
	Sale Tax account		X

7.14 SALE RETURNS DAY BOOK

The double entry arising from posting from a **sales returns day book** will be like a mirror image (the opposite) of the posting of sales. When goods are returned, there is need to reverse the transaction (or part of it) as it was shown in the books when the sale was recorded

		Mk	Mk
DEBIT	Sales returns account	X	
	Sale Tax account	X	
CREDIT	Receivables control account		X

NOT FOR SALE

7.15 SALES

It was mentioned above that sales can be analysed into different categories in the sales day book. Instead of maintaining a single account in the general ledger for sales, a business may split sales into a number of general ledger accounts so that it has **a record in the general ledger of the amounts of different types of sales.**

Update the dates in examples

SUMMARY OF THE CHAPTER

This chapter introduced a number of key aspects of charts of accounts and coding to the students. This is a noteworthy area in accounting practice since various accounting systems take a number of coding formats and charts of accounts are varied.

END OF CHAPTER QUESTIONS

Q1 **Coding**

Give an example of coding that may be used in the general (nominal) ledger.

CHAPTER 8

THE ACCOUNTING EQUATION

8.0 LEARNING OBJECTIVES

The objective of this chapter is to introduce to the students the concept of the Accounting Equation. The students will therefore appreciate that the whole financial accounting is premised on this simple idea.

8.1 THE ACCOUNTING EQUATION

By adding up what the accounting records say belongs to a business and deducting what they say the business owes, one can identify what a business is worth according to those accounting records. The whole financial accounting is based on this very simple idea and is known as the accounting equation.

It is explained by saying that if a business is to be set up and start trading, it will need resources. If these are entirely supplied by the owner of the business, it can be shown as:

Resources supplied by the owner = Resources in the business, or

Capital = Assets

Usually, however, people other than the owner will have supplied some of the assets. Liabilities is the name given to the amounts owing by the business. The equation therefore now changes to:

Capital = Assets – Liabilities

This is the most common way in which the accounting equation is expressed. It can be seen that the two sides of the equation will have the same totals. This is because we are dealing with the same thing from two different points of view – the value of the owners' investment in the business and the value of what is owned by the owners.

8.2 ALTERNATIVE PRESENTATION

With the form of accounting equation given in the section above, one can no longer see at a glance what value is presented by the resources in the business. You can see this more clearly if you switch assets and capital around to produce the alternative form of the accounting equation:

Assets = Capital + Liabilities

This can then be replaced with words describing the resources of the business:
Resources: what they are = Resources : who supplied them
(Assets) (Capital + Liabilities

8.3 EQUALITY OF THE ACCOUNTING EQUATION

It is a fact that no matter how one present the accounting equation, the totals of both sides will *always* equal each other, and that will *always* be true no matter how many transactions there may be. The actual assets, liabilities and capital may change, but the total of those assets will always equal to capital +liabilities. The ultimate conclusion of business transaction will therefore be explained by the effect on statement of financial position totals.

Capital is often called **equity** or net worth. It comprises funds invested in the business by the owner plus any profits retained for use in the business less any share of profits paid out of the business to the owner.

8.4 DUAL ASPECT

As stated, there are two aspects to accounting, one represented by the assets of the business and the other by the claims against them. The concept states that these two aspects are always equal to each other. Double entry is the name given to the method of recording transactions under the dual aspect concept.

8.4 WHAT ELSE WOULD AFFECT CAPITAL?

The accounting equation is expressed in a financial position statement called the **statement of financial position.** The statement shows the financial position of an organization at a point in time. It presents a snapshot of the organization at the date for which it is prepared. There are many transactions that affect the statement. Examples are:

(a) The introduction of capital
(b) The purchase of an asset by cheque
(c) The purchase of an asset and the incurring of a liability
(d) The sale of an asset on credit
(e) The sale of an asset for immediate payment
(f) The payment of a liability

SUMMARY OF THE CHAPTER

This chapter introduced the accounting equation and the dual aspect concept. Alternative form of presenting the equation was also explained.

END OF CHAPTER QUESTION

Consider various transactions and names of accounts that are to be debited and those that are to be credited. Appreciate the effect these transactions have on the accounting equation and capital of a business.

Q1

You are given the following list of transactions for Attika Mwaswera (AM), an entrepreneur:

2013

November 1	Started business with K100,000 in the bank.
November 2	Tatandala lent AM K4,000 in cash.
November 3	Bought goods on credit from Fatsani worth K8,400 and from Sokosa worth K36,000.
November 4	Took K2,500 cash and paid it into the bank.
November 6	Sold goods on credit at a sum of K1,800 to Chazilala.
November 8	Chazilala returned goods to MB whose amount was K400.
November 10	Sold goods on credit to Moyenda and Penyani, invoicing them K1,900 and K3,200 respectively.
November 12	MB returned goods to Fatsani whose value was K1,400.
November 14	Bought scrap van for K26,000 on credit from Chelsea Motors.
November 15	Bought office furniture on credit at an amount of K6,000 from Kalipentala.
November 18	MB returned goods to Sokosa whose value was K1,100.
November 19	Bought goods worth K2,200 in cash.
November 20	Goods for an amount of K700 was sold for cash.
November 24	Paid Fatsani K10,700 by cheque.
November 25	Moyenda returned goods to MB whose invoice value was K300.
November 26	Returned some of the furniture costing K1,600 to Kalipentala.
November 27	MB put a further K5,000 into the business in the form of cash.
November 28	Paid Chelsea Motors K26,000 by cheque for the purchase of the scrap van.

Required:

Record the transactions above in the accounts of Attika Mwaswera using T-Accounts. **[TOTAL 20 MARKS]**

CHAPTER 9

DOUBLE ENTRY BOOK KEEPING

9.0 LEARNING OBJECTIVES

By the end of this chapter, students will be able to record the entries in books of accounts using the double entry book-keeping.

9.1 THE DOUBLE ENTRY SYSTEM FOR ASSETS, LIABILITIES AND CAPITAL

Double entry book keeping is the system of accounting which reflects the fact that:

- Every financial transaction affects the entity in two ways and gives rise to two accounting entries, one a debit entry and the other a credit entry.
- The total value of the debit entries is therefore always equal at any time to the total value of credit entries.

9.2 THE ACCOUNTS FOR DOUBLE ENTRY

Each account should be shown on a separate page in the accounting books. The double entry system divides each page into two halves. The left side of each page is called the debit side while the right hand side of the page is called the credit side. The title of each account is written a cross the top of the account at the centre.

i.e.
Title of the account

Left hand side DEBIT side	Right hand side CREDIT side

These are commonly called T – accounts.
As observed in the previous chapter, transactions increase or decrease assets, liabilities or capital. Thus in terms assets, liabilities and capital:

- To increase an asset we make a debit entry.
- To decrease an asset we make a credit entry.
- To increase a liability/capital account we make a credit entry.
- To decrease a liability/capital account we make a debit entry.

Capital account

Decrease (-)	Increase (+)

Asset account

Increase (+)	Decrease (-)

Liability account

Decrease (-)	Increase (+)

Worked examples

Enter the following transactions using the double entry book keeping system

1) The owner starts the business with K10, 000 in cash on 1 August 2013.

Effect of the transaction	**action**
Increases the asset cash	debit the cash account
Increases the capital	credit the capital account

Cash account

2013			
Aug 1 capital	K10, 000		

Capital

		2013	
		Aug 1 cash	K10000

The double entry is completed by a cross reference to the title of the other account in which the double entry is completed. I.e. capital will appear as a narrative in the cash account and cash will appear as a narrative in the capital account.

2) A van bought for K 4500 cash on 2 August 2013.

Effect of the transaction	**action**
Increase the asset of van	debit the van account
Decrease the asset of cash	credit the cash account

Van account		cash account	
2013			2013
Aug 2 cash K4500			Aug 2 van K4500

3) Fixtures (e.g. shelves) are bought on credit from shop fixtures for K1250 on 3 August 2013.

Effect of transaction	**action**
Increase the asset of fixtures	debit fixtures account
Increase the liability of shop fitters	credit shop fitters account

Fixtures account		shop fitters account	
2013			2013
Aug 3 shop fitters K 1250			Aug 3 fixtures K1250

4) Paid the amount owing to shop fitters in cash on 17 August 2013.

Effects of transaction	**action**
Decrease the liability to shop Fitters	debit the shop fitters account
Decrease the asset of cash	credit the cash account

9.3 THE ASSET OF INVENTORY

Inventory movements

- Increase in inventory

Increases in inventory may be due to the following causes:

(a) The purchase of additional goods

(b) The return into the business of goods previously sold.

To distinguish the two aspects of the increase of inventory of goods, two accounts are opened:

(i)A purchase account in which purchases of goods are recorded

(ii) A returns inwards account in which goods being returned into the business are recorded (this is also called a sales return account)

So for increases in inventory, we need to choose which of these accounts to use to record the debit entry of the transaction

- Decrease in inventory

Decreases in inventory can be due to the following causes

(a) The sale of goods

(b) Goods previously bought by the business now being returned to the supplier

In order to distinguish the two aspects of the decreases in inventory, two accounts are opened:

(i)A sales account to record the value of goods sold

(ii) A return outwards account in which goods returned to suppliers are recorded. (This is also called a purchase returns account).

So for decreases in inventory, we need to choose which of these two accounts to use to record the credit side of the transaction.

Examples

i. purchase of stock on credit
On 1 August 2013, goods costing K165 were bought on credit from D Henry.
The dual effects of this transaction are:
(1) Asset of inventory increased; therefore the action is to debit the purchases account.
(2) Liabilities increased; hence the payable's account (D Henry) should be credited.

The entries will be as follows

Purchases account		D Henry account	
Debit			credit
Aug 1 D Henry	K165		Aug 1 purchase K165

(b) Purchase of sock for cash

On 2 August 2013, goods costing K310 are bought, cash being paid for them immediately at the time of purchase

In this case the dual effects are:

(1) asset of inventory is increased therefore the purchases account is debited
(2) asset of cash is decreased, hence the cash account should be credited

The entries will be as follows:

Purchases account		cash account	
Debit			credit
Aug 2 cash	K310		Aug 2 purchases K310

(c) Sale of inventory on credit
On 3 August 2013, goods were sold on credit for K375 to Mr. Jere.
The dual effects of this transaction area:

(1) An asset receivables increases, therefore the receivables account (Jere) is debited
(2) The asset of inventory decreases; hence the sales account is credited.

The entries are as follows:

Jere account (receivable)		sales account	
Debit			credit
Aug 3 sales	K375		Aug 3 Jere K375

(d) Sale of stock for cash

On 4 August 2013, goods are sold for K55, cash being received immediately at the time of sale.

The dual effects of the transaction here are as follows:

(1) the asset cash is increased therefore we debit the cash account
(2) the asset of inventory is reduced , hence the sales account is credited

The entries are as follows:

Cash account		sales account	
Debit			credit
Aug 4 sales	K55		cash K55

e) Returns inwards

On August 5th 2013, goods which had been previously sold to Mr. Lowe for K29 are now returned to the business.

Effect of the transaction	Action
1. Asset of stock increase	Debit returns inwards account.
2. Decrease in asset (debtors)	Credit debtors (Lowe) account.

The entries are as follows:

Returns inwards		Lowe	
Debit			Credit
Aug 5th Lowe K29			Aug returns inwards K29

Om 6th August 2013, goods previously bought for K96 are returned by the business to Mr Lungu.

Effect of transaction	Action
1. The liability creditors decrease.	Debit creditors account.
2. An asset of stock is decreased.	Credit returns outwards account.

Lungu

Debit		Credit
Aug 6th Returns outwards K96		

Returns inwards

Debit		Credit
		Aug Lungu K96

9.4 DOUBLE ENTRY FOR EXPENSES AND REVENUE

Example

a) Rent of K20 is paid in cash.

Here the dual effect is as follows:

i. The total of the expenses of rent is increased. Expenses entries are shown as debits; therefore the action is to debit the rent account with K200.

ii. The asset of cash is decreased. This means the cash must be credited with K200 to show the decrease of the asset.

Summary: Debit Rent account with K200.
Credit Cash account with K200.

b) Motor expenses of K355 are paid by cheque.

The dual effect is as follows:

i. The total for motor expenses paid is increased, hence the action required is to debit the motor expenses account with K355.

ii. The asset cash in the bank is decreased. This means that the bank account must be credited with K355 to show the decrease of the asset.

Summary: Debit Motor expenses account.
Credit Bank account.

c) K60 cash is received for commission earned by the business.

The dual effect is as follows:

i. The asset cash is increased; hence a debit entry of K60 is made on the cash account to increase the asset.

ii. The revenue account, commission received is increased. Revenue is shown by a credit entry; hence the commission received account is credited with K60.

Summary: Debit Cash account with K60.
Credit Commission received with K60.

NOT FOR SALE

9.5 DRAWINGS

- Sometimes the owners take cash out of the business for their private use. This is known as drawings.
- Any money taken out of a business will educe capital. Drawings should be treated as expenses of a business.
- An increase in drawings is a debit entry in the drawings account with the corresponding credit being an asset account such as cash or bank.

NB: In theory, the debit entry should be made in the capital account since drawings decrease capital, However to prevent the capital account becoming full of small transactions, drawings are not entered in the capital account, instead a drawings account is opened.

Example:
On 25th August the owner takes K50 cash out of the business for his own use.
The dual effect of the transaction is as follows:

1) Capital is decreased; hence the drawings account is debited.
2) Cash is decreased and the cash account is credited.

i.e.

Drawings	
Cash K 50	

Cash	
	Drawings K 50

Exercise1

Prepare the T accounts for the following transactions for the month of June

July	1	started in business with K5000 in the bank and K1000 cash
	2	bought stationery by cheque K75
	3	bought goods on credit from smart K2100
	4	sold goods for cash K340
	5	paid insurance by cash K290
	7	bought a computer on credit from M Jere K700
	8	paid expenses by cheque k32
	10	sold goods on credit to Mr. Mbewe K630
	11	returned goods to smart K550
	14	paid wages by cash K210
	17	paid rent by cheque K225
	20	received a cheque for K400 form Mr Mbewe.
	21	paid Mr. Jere by cheque K700
	23	bought stationery on credit form stationery Ltd K125
	24	paid stationery Ltd by cheque K120

9.6 BALANCING OFF ACCOUNTS AND PREPARING A TRIAL BALANCE

At the end of the accounting period, all the accounts of the business must be balanced off and the balances from the accounts should be picked up and a trial balance should be prepared.

Balancing off accounts

When balancing the accounts, the following steps should be followed:

(i) Add up both sides of the accounts to find out their totals

(ii) Deduct the smaller total from the larger total to find the balance

(iii) Enter the balance on the side with the smallest total to balance off the two sides of the account. This is called **a balance carried down.**

(iv) Enter the totals on both sides of the accounts which should be equal to balance off the accounts.

(v) Enter the balancing figure which is on the smallest total below the totals on the opposite side. This is called a balance brought down

Example1.

Sales account

	K		K
Balance carried down	753		
		Cash	310
		receivables	123
		cash	320
Total	**753**		
		Balance brought down	753

Example 2

M. Jere account (receivable)

	K		K
Sales	234	cash	234
Sales	125	cash	125
Sales	300	balance carried down	300
Total	**659**		
Balance brought down	300		

9.7 PREPARING A TRIAL BALANCE

A trial balance is a list of balances extracted from the accounts. All the debit balances are shown on one column and credit balances on the other column. If the double entry for the transactions has been done properly, the total of all the debit balances must be equal to the total of all the credit balances .where this is not the

case then it means that errors may have been made when recording the transactions.

(a) Total debit entries = Total credit entries.
Under the double entry bookkeeping:

- For each debit entry there is a corresponding credit entry.
- For each credit entry there is a corresponding debit entry.

Therefore all the items recorded in all the accounts on the debit side should equal, in total, to all the items recorded on the credit side of the accounts.

In order to check that for each debit entry there is a credit entry, a trial balance is prepared. This is a list of account balances arranged according to whether they are debit balances or credit balances.

The trial balance always has the date of the last day of the accounting period to which it relates.
It is normal to prepare a trial balance at the end of an accounting period before preparing an income statement and statement of financial position (balance sheet). An **income statement** shows what profit has been earned in a period. A **statement of financial position (balance sheet)** shows what assets and liabilities of a business are at the end of the period.

(b) Trial balances and errors

The fact that the trial balance **'balances'**, does not necessarily mean that all the entries in accounts are correct. There are certain types of error that will not affect the balancing of a trial balance.
Errors that would be revealed by a trial balance are; addition errors, using one figure for a debit entry and another for the credit entry, and entering only one side of a transaction.

(c) Closing inventory

Inventory at the end of a period is not usually found in an account in the ledger. It is found from stock records and physical stocktaking. Sinceit is not generally found in the ledger, it does not generally appear in a trial balance. However, opening inventory is often recorded in a ledger account, so that the inventory balance at the start of a period, would be included in the trial balance prepared at the end of that period.

Example
Enter up the necessary accounts for the month of may from the following transactions relating to a small firm, then balance off the accounts and extract a trial balance as at 31 May 2013

May 1 started business with capital in cash of K800 and K2200 in the bank.
2 bought goods on credit form the following, J Mwase K610, P Gondwe K213, NThindwa K524
4 sold goods on credit to S Chipeta K340, G Lungu K720
6 paid rent by cash K180
9 S Chipeta paid us his account by cheque k340
12 we paid the following by cheque J Mwase K530, P Gondwe K213
15 paid carriage by cash K38
18 bought goods on credit from K Manda K291, D Soko K940
21 sold goods on credit F Bonongwe K810
31 paid rent by cheque K 230

Capital account

	K		K
Balance carried down	3000		
		Cash	800
		Bank	2200
Total	**3000**		
		Balance brought down	3000

Cash account

	K		K
Capital	800	rent	180
		Carriage	38
		Balance carried down	582
Total	**800**		
Balance brought down	582		

Bank account

	K		K
Capital	2200	J Mwase	530
S Chipeta	340	P Gondwe	213
		Rent	230
		Balance carried down	1567
Total	**2540**		
Balance brought down	1567		

Rent account

	K		K
Cash	180	balance carried down	410
Bank	230		
Total	**410**		**410**
Balance brought down	410		

Carriage account

	K		K
Cash	**38**	balance carried down	**38**
Balance brought down	38		

Sales account

	K		K
S Chipeta	340		
		G Lungu	720
		F Bonongwe	810
Balance carried down	1870		
Total	**1870**		
		Balance brought down	1870

S Chipeta

	K		K
Sales	**340**	bank	**340**

G Lungu

	K		K
Sales	**720**	balance carried down	**720**
Balance brought down	720		

F Bonongwe

	K		K
Sales	**810**	balance carried down	**810**
Balance brought down	810		

Purchases account

	K		K
J Mwase	610	balance carried down	2578
P Gondwe	213		
NThindwa	524		
K Manda	291		
D Soko	940		
Total	**2578**		
Balance brought down	2578		

J Mwase

	K		K
Bank	530	Purchases	610
Balance carried down	80		
Total	**610**		
		Balance brought down	80

P Gondwe

	K		K
Bank	**213**	Purchases	**213**

N Thindwa

	K		K
Balance carried down	**524**	Purchases	**524**
		Balance brought down	524

K Manda

	K		K
Balance carried down	**291**	purchases	**291**
		Balance brought down	291

D Soko

	K		K
Balance carried down	**940**	purchases	**940**
		Balance brought down	940

Trial balance as at 31 May 2013

Account	Debit	Credit
	K	K
Capital		3000
Cash	582	
Bank	1567	
Rent	410	
Carriage	38	
Sales		1870
Receivables		
G Lungu	720	
F Bonongwe	810	
Purchases	2578	
Payables		
J Mwase		80
N Thindwa		524
K Manda		291
D Soko		940
Total	**6705**	**6705**

SUMMARY OF THE CHAPTER

This chapter tackled aspects of double entry of bookkeeping. Accounting treatment of various elements (including inventory, expenses and revenue) were illustrated. The mechanics of preparing trial balance through this system were also dealt with.

END OF CHAPTER QUESTION

Q1 **Double entry system for financial transactions**

*It is known that for the purpose of the accounting equation approach, all the accounts are classified into the following **five** types: assets, liabilities, income/revenues, expenses, or capital gains/losses.*

Required:
Explain how the double entry rules operate through these types of accounts

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CHAPTER 10

BALANCING OF ACCOUNTS AND PREPARING A TRIAL BALANCE

10.0 LEARNING OBJECTIVES

By the end of this chapter, students will be able to prepare ledger balances, clearly showing the balances carried down and brought down as appropriate, define and understand the nature of a trial balance and understand the nature and impact of errors and closing inventory on the trial balance, and how these are dealt with.

10.1 BALANCING OFF ACCOUNTS

Balancing the accounts is done in five stages as follows:

(vi) Add up both sides of the accounts to find out their totals (do not write any thing in the account yet)
(vii) Deduct the smaller total from the larger total to find the balance
(viii) Now enter the balance on the side with the smaller total. The totals will now be equal**.**
(ix) Enter the totals on both sides of the accounts level with each other.
(x) Now enter the balance on the line below the totals on the opposite side to the balance shown above the totals.

The balance above the totals is described as the **balance carried down (balance/d)**

The balance below the totals is described as the **balance brought down (balance b/d)**

When the total of the debit side originally exceeded the credit side, the balance is kwon as a debit balance whereas when the total of the credit side originally exceeded the debit side, the balance is known as a credit balance.

Accounts for creditors and debtors

When balancing the accounts for creditors and debtors there will be two situations, (i) where the account has been fully paid and (ii) where the account has not been paid for in full

1. Where the account has been paid in full
   The following example shows how to balance the account when it has been fully paid up

On January 5, 2010 Chisale bought goods from Chibwe Enterprise for K2, 500 and on January 10 he bought further goods from Chibwe Enterprise for K5, 000
On January 16 Chisale paid Chibwe Enterprise the invoice for K2, 500 and the invoice for K5, 000 was paid on 24 January 2010.

In the books of Chibwe Enterprise these will appear as follows:

		Chisale			
Date	Details	Amount	Date	Details	Amount
2010		MK	2010		MK
Jan 5	Sales	2,500	Jan 16	Bank	2,500
Jan 10	Sales	5,000	Jan 24	Bank	5,000
		7,500			7,500
			"Closed off"		

In this situation the account is said to be **closed off.**

2. Where the account is not fully paid for.
In this case one or more invoices are outstanding as in the following example.
In the same month of January 2010 Chibwe Enterprise sold goods to Mayamiko and received a cheque as follows.

January 3 Sales K3, 500
January 8 Sales K2, 300
January 15 Sales K4, 000
January 20 Cheque K5, 800
January 27 Sales K3, 200

The account is recorded as follows:

		Mayamiko			
Date	Details	Amount	Date	Details	Amount
2010		MK	2010		MK
Jan 3	Sales	3,500	Jan 20	Bank	5,800
Jan 8	Sales	2,300	Jan 31	Balance c/d	7,200
Jan 15	Sales	4,000			
Jan 27	Sales	3,200			
		13,000			13,000
Feb 1	Balance b/d	7,200			

The examples above are for accounts for debtors. A similar approach would be followed in respect of creditors, but the balances would be on the opposite sides.

10.2 PREPARING A TRIAL BALANCE

A trial balance is a list of balances extracted from the accounts. All the debit balances are shown in one column and credit balances in the next column. If the double entry for the transactions has been done properly, the total of all the debit balances must be equal to the total of all the credit balances. Where this is not the case, it means that errors may have been made when recording the transactions.

Total debit entries = Total credit entries.

Under the double entry bookkeeping:

- For each debit entry there is a corresponding credit entry.
- For each credit entry there is a corresponding debit entry.

Therefore all the items recorded in all the accounts on the debit side should equal, in total, to all the items recorded on the credit side of the accounts.

Total debit balances = total credit balances

The trial balance always has the date of the last day of the accounting period to which it relates.

It is normal to prepare a trial balance at the end of an accounting period before preparing an income statement and statement of financial position (balance sheet). An **income statement** shows what profit has been earned in a period. A **statement of financial position (balance sheet)** shows what assets and liabilities of a business are at the end of the period.

Using the example from the previous chapter, we now balance the accounts and extract a trial balance.

		Cash			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 1	Capital	10,000	Jul 5	Insurance	2,900
Jul 4	Sales	3,400	Jul 14	Wages	2,100
			Jul 31	Balance c/d	8,400
		13,400			13,400
Aug 1	Balance b/d	8,400			

Income account and purchases and expenses are not carried forward????

		Bank			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 1	Capital	50,000	Jul 2	Stationery	750
Jul 20	Mbewe	4,000	Jul 8	Gen. expenses	320
			Jul 17	Rent	2,250
			Jul 21	Jeke	7,000
			Jul 30	Maye Stationers	1,250
			Jul 31	Balance c/d	42,430
		54,000			54,000
		42,430			

		Capital			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 31	Balance c/d	60,000	Jul 1	Bank	50,000
				Cash	10,000
		60,000			60,000
			Aug 1	Balance b/d	60,000

		Stationery			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 2	Bank	750	Jul 31	Balance c/d	2,000
Jul 23	Maye Stationers	1,250			
		2,000			2,000
Aug 1	Balance b/d	2,000			

		Kondwani			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 11	Returns	5,500	Jul 3	Purchases	21,000
Jul 31	Balance c/d	15,500			
		21,000			21,000
			Aug 1	Balance b/d	15,500

		Purchases			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 3	Kondwani	21,000	Jul 31	Balance c/d	21,000
Aug 1	Balance b/d	21,000			

		Sales			
Date	Details	Amount	Date	Details	Amount
2008		MK	2009		MK
Jul 31	Balance c/d	9,700	Jul 4	Cash	3,400
			Jul 10	Mbewe	6,300
		9,700			9,700
			Aug 1	Balance b/d	9,700

		Insurance			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 5	Cash	2,900	Jul 31	Balance c/d	2,900
Aug 1	Balance b/d	2,900			

		Computer			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 7	M Jeke	7,000	Jul 31	Balance c/d	7,000
Aug 1	Balance b/d	7,000			

		M Jeke			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 21	Bank	7,000	Jul 7	Computer	7,000
				"closed off"	

		General expenses			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 8	Bank	320	Jul 31	Balance c/d	320
Aug 1	Balance b/d	320			

		Mbewe			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 10	Sales	6,300	Jul 20	Bank	4,000
			31	Balance c/d	2,300
		6,300			6,300
Aug 1	Balance b/d	2,300			

		Returns outwards			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 31	Balance c/d	5,500	Jul 11	Kondwani	5,500
			Aug 1	Balance b/d	5,500

		Wages			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 14	Cash	2,100	Jul 31	Balance c/d	2,100
Aug 1	Balance c/d	2,100			

		Rent			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 17	Bank	2,250	Jul 31	Balance c/d	2,250
Aug 1	Balance b/d	2,250			

		Maye Stationers Ltd			
Date	Details	Amount	Date	Details	Amount
2009		MK	2009		MK
Jul 30	Bank	1,250	Jul 23	Stationery	1,250
				"Closed off"	

Trial balance as at 31 July 2009		
	DR	CR
	MK	MK
Cash	8,400	
Bank	42,430	
Capital		60,000
Stationery	2,000	
Kondwani		15,500
Purchases	21,000	
Sales		9,700
Insurance	2,900	
Computer	7,000	
General expenses	320	
Mbewe	2,300	
Returns outwards		5,500
Wages	2,100	
Rent	2,250	
	90,700	90,700

10.3 TRIAL BALANCES AND ERRORS

The fact that the trial balance **'balances'**, does not necessarily mean that all the entries in accounts are correct. There are certain types of error that will not affect the balancing of a trial balance.
Errors that would be revealed by a trial balance are; addition errors, using one figure for a debit entry and another for the credit entry, and entering only one side of a transaction.

Closing inventory

Inventory at the end of a period is not usually found in an account in the ledger. It is found from stock records and physical stocktaking. Sinceit is not generally found in the ledger, it does not generally appear in a trial balance. However, opening inventory is often recorded in a ledger account, so that the inventory balance at the start of a period would be included in the trial balance prepared at the end of that period.

SUMMARY OF THE CHAPTER

This chapter illustrated the five steps towards the balancing of ledger accounts and justified the frequency of balancing of ledger accounts. It also illustrated how ledger balances are derived clearly showing the balances carried down and brought down as

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appropriate. Then, the nature of a trial balance was explained and how the adjustments to errors and closing inventories are dealt with were explained.

END OF CHAPTER QUESTIONS

Q1 Balancing off accounts and extraction of the trial balance

Enter up the necessary accounts for the month of May from the following transactions relating to a small firm, then balance off the accounts and extract a trial balance as at 31 May 2013

May 1 Started business with capital in cash K8, 000 and K22, 000 at the bank.
May 2 Bought goods on credit from the following: J Mwandama K6, 100, P Gomani K2, 130, N Thindwa K5, 240
May 4 Sold goods on credit to S Chisale K3, 400, G Lungumadzi K7, 200
May 6 Paid rent by cash K1, 800
May 9 S Chisale paid his account by cheque K3, 400
May 12 We paid the following by cheque J Mwandama K5, 300, P Gomani K2, 130
May 15 Paid carriage in cash K380
May 18 Bought goods on credit from K Mandala K2, 910, D Sokosa K9, 400
May 21 Sold goods on credit F Bonongwe K8, 100
May 31 Paid rent by cheque K2, 300

EXAMINATION TYPE QUESTION

When balancing ledger accounts, five steps are followed.

Required:

(i) Describe sequentially the **five** steps that are followed when balancing ledger accounts. **2½ Marks**
(ii) Explain when the balancing of ledger accounts is usually done. **2 Marks**
(iii) Explain the importance of balancing ledger accounts. **1½ Marks**

CHAPTER 11

BAD DEBTS AND ALLOWANCES FOR DOUBTFUL DEBTS

11.0 LEARNING OBJECTIVES

This section will cover some adjustments that must be made to the accounts in the form of: bad debts and allowances for doubtful debts

11.1BAD DEBTS AND PROVISION FOR DOUBTFUL DEBTS (Uncollectable accounts Receivable): Bad debts arise from credit sales. Customers who buy goods on credit may fail to pay perhaps due to dishonesty, bankruptcy or death. For one reason or another business may decide that a debt is uncollectable. Bad debts are a business risk. They are therefore accounted for as normal business expenses. They must be charged to the Income Statement as an expense when calculating profit.

11.2 WRITING OFF UNCOLLECTABLE ACCOUNTS RECEIVABLES:

When a sale is made, the invoiced amount is shown in the trading account and the gross profit earned is shown in the account. Subsequent failure to collect the debt is a separate matter which is reported in the Income Statement as bad debts written off.

ILLUSTRATION

(I) ABC Traders sold goods to John worth K 3000.00 on 29th June 20xx

Account Entry 1 Debit John (Debtor) K 3,000
Credit Sales K 3,000

These two entries will subsequently go into the trial balance and be taken to the trading account.

(ii) At the end of the accounting period it ascertained that John will pay his debt of K 3000

Accounting Entry: Debit Bad Debts Account K 3,000
Credit John K 3,000

When posted the account of John as a debtor will balance off.

The value of John as a debtor becomes zero. The bad debts account reduces the profit that would have been reported during that period.

11.3 BAD DEBTS WRITTEN OFF AND SUBSQUENTLY PAID

Sometimes a debtor who was written off may pay. In such case the amount received should be recorded as additional income in the Income Statement of the period in which the payment is received. The entries to affect this would be: -

(i) Cash Received K 3000
John K 3000
Recording the receipt of cash asset

(ii) John K 3000
Bad debts Recovered K 3000
Introducing the Bad Debt recovered Account

(iii) Bad Debts recovered Account K 3000
Income Statement K 3000

Transferring the amount previously written off to the current Income Statement.

11.4 ALLOWANCES FOR DOUBTFUL DEBTS

The previous section has assumed that the bad debtor John was a known customer. In most business situations the identities of uncollectable amounts is not known until after some period. When a business expects uncollectable debts but does not yet know which specific debts will be bad, it can make a provision for doubtful debts. A provision for doubtful debts provide for future bad debts as required by the prudence concept.

Determining the size of the Provision

A provision for bad and doubtful debts may be estimated through: -

- **Past experience:** Experience will show how many debtors default payment after a certain period
- **Aging:** A process of aging will show how many debtors remain past the credit period.
- **Percentage of outstanding debtors:** Like experience, businesses have established percentages of defaulting debtors in their respective areas of trade.

(a) Making the Provision

When a provision is made for the first time the initial amount of the provision is charged as an expense in the Income Statement.

ILLUSTRATION

ABC Traders have decided that it will maintain a provision for bad debts of 2% of its outstanding debtors. If this amounts to K 5000,000 the entries would be: -

Debit Income Statement K 500,000
Credit Provision for Doubtful Debts K 500,000
To create a Provision

In the Income Statement the provision of K 500,000 will appear as an expense reducing profit. In the balance Sheet the whole provision will be deducted from debtors.

(b) Increasing the Provision

When a provision already exists but is to be increased, the amount of the increase in the provision is charged in the Income Statement as an expense.

ILLUSTRATION

ABC Traders have decided to increase the provision to K 520,000

Debit Income Statement	K 20,000	
Credit Provision for Doubtful Debts		K20,000

To increase the provision.

In the Income Statement only K 20,000 would be charged as an expense for the period. In the Balance Sheet K 520,000 (the whole amount) should be deducted from total amounts of receivables.

(c) Reducing the Provision

When a provision already exists but there is need to reduce it, the amount of the reduction should be credited to the Income Statement and debited to the Provision Account.

ILLUSTRATION

ABC Traders have decided that that the provision for doubtful debts should be reduced to K 510,000 this year

Entry: Debit Provision for Doubtful debt	K 10,000	
Credit Income Statement		K10,000

To reduce the Provision. In the Income Statement only K 10,000 will be credited. In the Balance Sheet the whole amount of the revised provision of K 510,000 should be deducted from the total debtors.

SUMMARY

A business cannot avoid losses arising from bad debts: -

- Bad debts should be written off as soon as they are known.
- If a debtor was written off, but subsequently pays his or her debt, the amount received must be added to the Income Statement of the period in which cash was received.
- When the specific debt is not yet known a provision for the general debts must be made through a charge to the Income Statement.
- Changes in the provision will be affected through debiting or crediting the Income Statement with the difference i.e. debiting to increase or crediting to decrease the provision.
- The adjusted provision should be deducted from total accounts receivable in the balance Sheet to give a realistic estimate of the net realizable value of the receivables.

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SUMMARY OF THE CHAPTER

This chapter illustrated the nature and purpose of the allowance for doubtful debts including how the allowance may be estimated, the accounting entries necessary to recognize the allowance, how the allowance may be increased or decreased and the impact of cash discounts on accounts receivable.

END OF CHAPTER QUESTIONS

Q1 A business has always made an allowance for doubtful debts at a rate of 5% of trade receivables. On 01st January 2013 the allowance for this, brought forward from the previous year, was K260,000.

During the yearto 31st December 2013 the bad debts written off amounted to K540,000. On 31st December 2013 the remaining trade receivables totaled K6,200,000 and the usual allowance for doubtful debts should be made.

You are to show:

(a) The Bad Debts Account for the year ended 31 December 2013.
(b) The Allowance for Doubtful Debts Account for the year.
(c) Extract from Income Statement for the year.
(d) The relevant extract from the Statement of Financial Position as at 31st December 2013.

Q2 Discuss why an accountant only need to create an expense for the difference between provisions (allowances) for two years.

CHAPTER 12

DEPRECIATION OF NON – CURRENT ASSETS

12.0 LEARNING OBJECTIVES

This chapter aims at explaining the principle of depreciation of non-current assets. Determining the cost of property, plant and equipment, explaining the nature and purpose of depreciation and the different methods of depreciation and their possible effect on income, accounting for the acquisition, disposition and depreciation of non – current assets, describing the reporting of depreciation in the financial statements, and explaining the nature of wasting assets and the different methods of accounting for their depletion are the areas covered.

12.1 CLASSIFICATION OF NON – CURRENT ASSETS

Non – Current assets can be grouped into Real Property which includes land and anything attached to it. Personal Property which includes everything else that be owned other than real property. These are things such as plant, equipment, furniture, motor vehicles, machinery, patents and copyrights.

Non – current assets can also be grouped as tangible and intangible assets. That is those with physical form such as machinery and equipment and intangible assets being those without physical substance like patents, copyrights, leases, franchises, trademarks and goodwill. These are said to be long term because they are expected to bring future economic benefit and have legal status that allow them to be classified as property (expect for goodwill).

Long term investments such as Government bonds are shown in the balance sheet under the heading of investments.

Non – depreciable and depreciable assets: Land is non – depreciable because it does not loose its capability to serve its purpose.
Property, plant and equipment are depreciable assets because they wear and tear due to use or as time pass on.

Amortisation is the process of depreciating intangible assets such as patent.
Depletion is the process of depreciating wasting assets such as mines, oil and gas wells, fisheries and timber plots.

12.2 THE COST OF NON – CURRENT ASSETS

Non – Current Assets may be purchased for cash or on account. The amount at which Non – Current Assets should be recorded in the books of accounts is the total initial outlay needed to put them in use . This includes: -

- Purchase price
- Transportation charges
- Installation costs
- Interest charges
- Any other costs incurred up to the point of placing the asset in service.

Transactions involving the purchase of non – current assets may be recorded by debiting the appropriate asset account and crediting the bank account or appropriate liability account such as Accounts payable, notes payable or mortgage payable. Improvements to property, plant and machinery add value and the total cost of such improvements should be added by debiting the asset.

12.2.1 Depreciation of non – current assets

As is the case with all adjustments in the accounts the main task in attempting to determine net income or loss on a periodic basis is to allocate revenue to the period in which it is earned and to assign expenses to the periods that have benefited from the outlays.

Non – current assets frequently last for many years and accordingly benefit a number of periods. The process of determining and recording the depreciations of most long - term assets is carried out in an effort to assign their cost to the periods that they benefit or serve.

Depreciation is there for a process of cost allocation and not asset valuation. The net amount of an asset i.e. Cost less depreciation are simply the portions of the original costs which have not yet been allocated to expense. It does not represent current values. It is therefore important to remember that the statement of financial position does not reflect the current values of a business.

12.3 CAUSES OF DEPRECIATION

Most non – current assets lose their usefulness over time. Depreciation is the allocation of the cost of the long – term assets over future periods expected to benefit from its use. The two major types of depreciation are: -

Physical depreciation: This refers to the loss of usefulness of an asset because of: -

(i) **Deterioration** from age and wear and tear. It is generally continuous though not necessarily uniform from period to period.

(ii) **Erosion, rust, rot and decay:** Assets exposed to the elements may wear out at a fairly regular rate than those that are protected. The speed of deterioration is however related to the extent to which they are used.

Functional Depreciation: This refers to the loss of usefulness because of inadequacy or obsolescence.

(i) **Obsolescence** is the process of becoming out of date. Technological development is bringing new and better and more efficient machines and equipments replacing old ones very fast.

(ii) **Inadequacy:** The growth of a business may bring about a need for bigger machines and equipments

- **Time:** Amortisation is based on the length of time an asset has been used e.g. a lease is based on time, patents are also based on length of time.
- **Extraction:** Depletion is a result of extracting raw materials such as oil, minerals e,t,c.

Information for calculating depreciation

There many and different ways of calculating depreciation for non – current assets but in all cases the following information is essential: -

1. The cost of the asset
2. The estimated salvage value or scrap value.
3. Estimated economic life of the asset.
4. The rate of depreciation.

All the four items listed above are estimates subject to changes in environmental and personal factors. For instance the salvage value of an asset cannot be realistically estimated because of time. It may be many years to come before the asset is disposed. The economic life as is influenced by many factors such as usage, or technological developments. The rate of depreciation is dependent upon usage and the environment under which the asset is being used. To sum up therefore it is evident that all the information necessary to calculate the amount of depreciation is subjective.

12.4 METHODS OF CALCULATING DEPRECIATION

The most commonly used methods of calculating depreciation are: -

1. Straight – line method
2. Declining – balance method
3. Sum – of – the – years – digits method
4. Units – of – output method.

Straight – Line Method

This method seeks to allocate the cost of the asset to the estimated economic life in equal amounts. Taking into consideration scrap value, dividing the cost the number of years as follows: -

$$\frac{\text{COST – SCRAP VALUE}}{\text{NUMBER OF YEARS}}$$

Straight – Line method is most commonly used. It is easy to calculate

Declining – balance method

This method seeks to allocate larger amounts of depreciation to early years and less as the asset grows older. A rate is calculated using the following formula: -

$\text{Rate} = (1 - \sqrt[n]{s \div c}) \times 100$

Where n = number of years of estimated life
s = estimated salvage value
c = original cost

This rate is applied to the declining balance of the cost over the years.

Example

Dandwe manufacturers Ltd purchased a machine on January 1st 20X3 for K 23,000,000. It is estimated to last for four years during which time it will produce 100,000 units of output as follows: -

YEAR 1	50,000 Units
YEAR 2	10,000 Units
YEAR 3	10,000 Units
YEAR 4	30,000 Units

The machine is expected to be sold for K 3,000,000 at the end of year 4. Calculate annual depreciation for four years using: -

(i) Straight – Line – Method

(ii) Declining – Balance – Method

Solution

Straight – Line - Method

$\frac{K\ 23 - k3}{4} = 5$

Annual depreciation = K5 million.

Declining – Method

$$R = (1 - n\sqrt{\frac{s}{C}}) \times 100$$

$$= (1 - 4\sqrt{\frac{3}{23}}) \times 100$$

$$= 39{,}9\%$$

YEAR 1	23X 39.9% = 9477	9.2
YEAR2	(23 – 9.2) = 13.8X39,9	5.5
YEAR 3	(13.8 – 5.5) = 8.3X 39.9	3.3
YEAR 4	(8.3 – 3.3) = 5X39.9	2.0
		20.0
	COST	23.0

NET BOOK VALUE = 23 – 20 = 3.0 Million

The salvage value under Straight – Line method and the net book value under the declining – balance method are not same.

Sum – of – the - years – digits - method

Unlike the declining – balance – Method Sum – Of – The - Year – Digits – Method involves reducing the rate of depreciation steadily by using the – sum – of – the – digits as denominator. For example if the asset is estimated to last for four years the denominator for each year will be 4+ 3 + 2 + 1 = 10 or

$S = N\frac{(n+1)}{2} = 4\frac{(4+1)}{2} = 4\ (2.5) = 10$

Using the example in Dandwe Manufacturing Company, depreciation for the machines over its four year life would be as follows: -

YEAR	COST	RATE	ANNUAL	CUMULATIVE
MILLION		DEPRECIATION		
1	K 23	4/10	9.2	9.2
2	K 23	3/10	6.9	16.1
3	K 23	2/10	4.6	20.7
4	K 23	1/10	2.3	23.0

Units of – Output or Units – of – Production or Machine – Hour – Method

These methods allocate the cost to the unit of output in a given period or allocate to an hour of production.

12.5 CHOOSING A DEPRECIATION METHOD

There is no depreciation method that is better than the other. All methods have different characteristics which may be preferred by business operators. For instance: Straight – Line – Method is easy to calculate and understand. It allocates equal amounts to all years of the assets economic life.

Declining – Balance – Method is more difficult to calculate. It depreciates an asset more during its early years than later years.

Sum – of – the – digit – Method allocate more depreciation to early years.

12.6 ACCOUNTING FOR DEPRECIATION

The aims of accounting for depreciation is to allocate and reflect the cost of a non – current asset in the general profit and determining progress in the business.

Depreciation is usually calculated at the end of an accounting period along with other necessary adjusting entries.

An expense account may be opened for each asset but it is common to have a summary of assets with related accumulated depreciation account.

In the normal course of events the only entries made in the accumulated depreciation account are those made at the end of each period to record the depreciation for the period ended.

Double Entry

Once the amount of depreciation for an asset has been established for the period the following entries are made: -

1. Debit the comprehensive income statement with the amount of depreciation for the year
   Credit the accumulated provision for depreciation account
2. The accumulated balance in the accumulated account will then be used to reduce the book value of the asset at the end of each accounting period.
3. The asset account remains unchanged unless there have been any disposals or additions. It will be closed once the asset is fully depreciated or disposed.

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Example

Using the information in Dandwe Manufacturing Company the accounts using Straight – Line – Method would be as follows; -

MACHINE ACCOUNT

ACCUMULATED PROVISION FOR DEPRECIATION ACCOUNT

YEAR	MONTH			YEAR	MONTH		
1	DEC.	31	Balance c/d K 5 million	1	DEC	31	Income Statement K 5 Million
2	DEC.	31	Balance c/d K 10 Million	2	JAN	1	Balance b/d K 5 Million
2	DEC	31	Income Statement K 5 Million				
K 10 Million	K 10 Million						
3	DEC.	31	Balance c/d K 15 Million	3	JAN	1	Balance b/d K 10 Million
	DEC	31	Income Statement K 5 Million				
K 15 Million	K 15 Million						
4	DEC.	31	Balance c/d K 20 Million	4	JAN	1	Balance b/d K 15 Million
	DEC.	31	Income Statement K 5 Million				
K 20 Million	K 20 Million						
				5	JAN	1	Balance b/d K 20 Million

By comparing the balance in the Machine Account with any credit balance in the accumulated depreciation account the business can tell the book value of its assets at the end of each period.

CHANGES IN NON – CURRENT ASSET

Asset of a business may increase through purchase of new ones or revaluation of the existing ones. In such cases depreciation is going to be based on the new values as shown in the asset account.

DISPOSITION OF NON – CURRENT ASSETS

Long term assets may be disposed of in any one of the following ways: -

1. It may be discarded or retired
2. It may be sold
3. It may be exchanged or traded in for property of similar kind or other property.

When an asset is to be disposed the following steps must be taken: -

1. Identify the value of the asset as recorded in the asset account (Historical Cost)
2. Credit the asset account and debit a disposal account with the historical cost of the asset .Debit: Disposal Account
   Credit: Asset Account
3. Identify the accumulated depreciation of the asset to the date of disposal.
4. Debit the Accumulated depreciation account and credit the disposal account with the amount.
   Debit: Accumulated Provision for Depreciation
   Credit: Disposal Account

5. Debit a cash account and credit the disposal account.
   Debit: Cash Account
   Credit: Disposal Account with the cash received on disposal end result.

In Point 2 : The asset account will be cleared of the asset cost having transferred the amount to the disposal account.

Point 4: The depreciation amount associated with the disposed asset is transferred to the disposal account to determine the book value of the asset.

Point 5: In the disposal account the difference between historic cost (Debit) and accumulated depreciation plus cash received will be profit or loss on the disposal of the asset.

Illustration

The following information relate to the activities of ABC Manufacturer Ltd during the year ending 31st December 20X3 : -

1. On 16th March, weighing scales with an original cost of K 100,000 and K 75,000 accumulated depreciations respectively were discarded.
2. On 5th May, a machine costing K 300,000 was purchased, depreciation is at the rate of 10% (Full year's depreciation) for the year of purchase.
3. One machine costing K 300,000 which had been bought 3 years ago was sold for K 225,000. A second similar machine which was bought at K 300,000 was sold for K 175,000, depreciation for both machines was 10%.

Required:

Draw journal entries to show the disposal of these assets

Solution

Journal Entries

1.	Accumulated depreciation	K 75,000	
	Loss on discarded asset	K 25,000	
	Weighing scales		K 100,000
	To record the disposal of an asset at no value.		
2.	Statement of Comprehensive Income	K 30,000	
	Accumulated depreciation		K 30,000
	To record depreciation change charge for the year of purchase		
3(a)	Bank	K 225,000	
	Accumulated depreciation	K90,000	
	Disposal of office equipment		K 300,000
	Gain as sale of asset at a profit		K 15,000
	To record the sale of an asset at a profit		
3 (b)	Bank	K 175,000	
	Accumulated depreciation	90,000	
	Loss on sale of asset	35,000	
	Machine account		K 300,000
	To record the sale of an asset at a loss.		

12.7TRADE – IN OR EXCHANGE OF NON – CURRENT ASSETS

If an asset is traded – in on purchase of another, a trade – in allowance may be granted. The value agreed upon by the buyer and seller is known as fair market value. The trade – in allowance may be equal to, greater, or less than the undepreciated cost of the asset. The allowance, however does not reflect fair market values of assets so that losses and gains arising from trade – in allowances may not be an accurate measurement of a situation

Types of trade - ins

(a) In a transaction which involves trading – in similar assets losses are recognized but not gains i.e following the concept of conservatism.

Example

A delivery truck bought 3 years ago costing k 56,000.00 is being traded for another similar one. Accumulated depreciation on the old truck is K 48,000.00 and the fair market value of the new one is K 70,000.00. K12,000.00 has been granted as trade – in allowance.

Solution – similar asset

- Book value of the old truck= K 56,000 – 48,000= K 80,000
- Cash paid for the new truck= K 70,000 – 12,000= K 58,000
- Gain on trade – in = K 12,000 – 8,000= K 4,000
-

For accounting purposes the depreciable amount of the new truck is the sum of the undepreciated cost of the old truck and the cash paid for the new truck i.e. (K 8,000 + 58,000 = K 66,000)

Journal entries for this transaction would be as follows: -

Delivery equipment (New Truck)	K 66,000	
Accumulated depreciation old delivery truck	K 48,000	
Delivery truck (old)		K 56,000
Bank		K 58,000

To record the purchase of a new truck on trade – in basis.
Note that the gain on trade – in of K 4,000 has not been recognized.

Loss on trade – in

If the fair market value of the asset had been K 65,000 instead of K 70,000 the trade – in value of the old asset would have been K 7,000 instead of K 8,000 and a loss of K I,000 would have been recognized as follows: -

Delivery equipment (new truck)	K 65,000	
Accumulated depreciation (old truck)	K 48,000	
Loss on exchange of truck	K 1,000	
Delivery equipment (old truck)		K 56,000
Bank		K 58,000

To record the purchase of a new truck on trade – in basis.

(a) In a transaction involving a dissimilar asset any gain or loss resulting from the transaction should be recognized and recorded in the accounts.

Example

A threshing machine costing K 250,000.00 charged to the office equipment account, had

K 50,000 accumulated depreciation credited to the accumulated depreciation account for two years. At the end of that period the machine was traded – in on new cash register costing

K 575,000. The trade – in allowance was K 170,000 and the balance of K 405,000 was paid in cash.

Solution

The entries for this transaction would be : -

Office equipment (cash register)	K 575,000	
Accumulated depreciation	K 100,000	
Office equipment (threshing machine)		K 250,000
Bank		K 405,000
Gain on exchange of office equipment		K 20,000

To record the purchase of a new cash register on exchange.

Had the trade – in allowance been lees than the undepreciated cost of the threshing machine the difference would have been reported as a loss on exchange of office equipment.

12.8 WASTING ASSETS

A wasting asset is any real property which is acquired for the purpose of removing or extracting the valuable natural resource on or in the property. Examples of wasting assets

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are wood lots, mines, oil wells, or any property out of which the valuable product is expected to be eventually removed or exhausted.

Depletion

The consumption and exhaustion of wasting assets is called depletion. Information necessary for computation is: -

Cost of the asset

Estimated quantity of deposits or resources

Unit cost of the deposits

Depletion expenses would be : -

COST ÷Estimated Quantity OF Output x Unit Cost

SUMMARY OF THE CHAPTER

In this chapter, the main features of depreciation were handled. It was known that it is the process of allocating the cost of a non – current asset to unit of output; it is a measure of the wear and tear of a non – current asset through usage and passage of time; is subjective because it is influenced by changing and different conditions under which the asset may be used; and that it is a non – cash expense hence it does not provides funds for replacement of assets although it is generally referred to as a provision for depreciation.

It was also learnt that: (a) Non – current assets are recorded at cost in the books of accounts. Any changes in these amounts are reflected through an accumulated depreciation account. (b) There are many methods of depreciation but commonly used are the Straight – line method and the reducing – balance method. (c) As asset is fully depreciated when the recorded depreciation equal to the cost of the asset. Since depreciation is based on the estimated useful life, an asset may still be in use after it has been fully depreciated (d) Depreciation affects profit measurement because the annual depreciation is charged as an expense in the statement of comprehensive income. (e) At the end of its useful life the asset may be scrapped without residual value, sold or traded – in for another similar or dissimilar asset. In such cases a loss or gain on disposal may be made and charged to the Income Statement.

END OF CHAPTER QUESTIONS

Q1

A company, which makes up its accounts annually to 31st December, provides for depreciation of its machinery at the rate of 10 percent per annum on diminishing balance system. On 31st December 2013, the machinery consisted of three items purchased as under:

	K
On 1 January 2011 Machine A	*Cost 3,000,000*
On 1 April 2012 Machine B	*Cost 2,000,000*
On 1 July 2013 Machine C	*Cost 1,000,000*

Required:

Provide calculations showing the depreciation provision for the year 2013

Q2 Explain how the unit of output method is used in estimating depreciation amounts. Give an example of its use.

Q2

X is a multi-millionaire and runs a fruit juice processing plant. He trades under the name Saimon Enterprises. The company depreciates machinery at a rate of 20 % per annum on a reducing balance basis. It provides a full year's depreciation in the year an asset is acquired, and no provision is made in the year of disposal. At 1 November 2013, the cost of Saimon's machinery was K70 million, and the net book value was K50 million. During the year to 31 October 2014, a machine which had cost K10 million and had been depreciated for three years was traded in for a new one. The new machine cost K20 million, and the trade in value was K5 million. At 31 October 2014 the balance of the cost of the new machine was still outstanding.

Required:

(a) Calculate the profit or the loss on the machine that was traded in.**4 Marks**

(b) Calculate the depreciation charge for machinery for the year to 31 October 2014. **4 Marks**

(c) Show the following ledger accounts for the year:

(i) machinery at cost; **5 Marks**

(ii) accumulated depreciation **4 Marks**

(d) Calculate the total charge to be reported in the Statement of Profit or Loss for the year to 31 October 2014 in respect of machinery. **1 Mark**

(e) Show the balances to be reported in the Statement of Financial Position as at 31 October 2014, due to these transactions. **2 Marks**

TOTAL 20 MARKS

CHAPTER 13

ACRUALS AND PREPAYMENTS

13.0 LEARNING OBJECTIVES

The accruals basis of accounting consists of recording revenue in the period in which it is earned and recording expenses in the period in which they are incurred. The receipt or disbursement of cash in the same period may or may not be involved. Revenue is generally recognized when services are performed or goods are provided, and is considered to be earned when in exchange for something of value is received or legal claim is made.

Expenses should be recognized when goods or services are consumed. The accruals basis of accounting involves the period – by – period matching of revenue with expenses that caused or aided in producing that revenue. In keeping business records, accountants must think in terms of time intervals and must be sure that the revenues and expenses are accounted for in the proper accounting period.

13.1 PREPAID EXPENSES

A prepaid expense is an item that was purchased and considered to be an asset when acquired but which will be consumed or used up in the near future and thus become an expense.

Purchase of various sorts of supplies and payments for utilities and insurance are good examples of prepaid expenses. At the end of the period, the portions of such assets that have expired or have been consumed must be determined and entries made by debiting the proper expense accounts and crediting the proper prepaid expense accounts.

ILLUSTRATION

ABC Traders purchased office supplies for K 7,500 and a three year fire insurance policy for K 3,000

The entry would be: -

Debit Office Supplies	K 7,500
Debit Prepaid Insurance	K 3,000
Cash	K 10,500

To record the purchase of Office Supplies and Insurance

At the end of accounting period a physical count indicated that there was K 1,250 worth of office supplies on hand. The insurance policy covering the current year has been (K 3,000/3) K 1,000.

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Entries for prepaid expenses are as follows: -

Office Supplies Expenses	K 6,250
Office Supplies	K 6,250

To record office supplies used

Insurance Expense	K 1,000
Prepaid Insurance	K 1,000

To record expired insurance for the year.

The value of accruals and prepayments for items which relate to a period of time is found by apportioning the cost of the item on time basis. Unless the period of time covered by these payments coincides exactly with the accounting period, adjustments are needed to take account of the assets created where payments are made in advance, and the liability which arises when benefits are paid for in arrears.

PREPAYMENT EXAMPLE

ABC Traders LTD makes up its accounts to 31st December. The company made up the following cash payments in respect of rates: -

YEAR	MONTH	PAYMENT
20X1	OCTOBER	K 9,000
20X1	APRIL	K 10,000
20X1	OCTOBER	K 10,000

The prepayments for rates relate to the six months period starting the month in which they are paid.

Required:

Prepare a rates account for the year 20x1

SOLUTION

RATES ACCOUNT

(1)	Jan 20x1	b/d	4,500	31.12.20x1	C/d	5,000
	April	Cash	10,000	Income Statement		19,500
	October	Cash	10,000			
			24,500			24,500
(2)	Balance	b/d	5,000			

(i) The balance brought down at the start of year is half of payment of K 9,000 made in October 20x0 covering three months to March.

(ii) The balance of K 5,000 carried down at the end of year 20x1 is an asset since it is payment in advance for the first three months of 20x2.

EXAMPLE

Kamphunga LTD makes up his accounts to December 31. The following payments were made in respect of electricity.

YEAR	MONTH	PAYMENT
20X0	OCTOBER	K 40,000
20X1	JANUARY	K 60,000
20X1	APRIL	K 63,000
20X1	JULY	K 40,000
20X1	OCTOBER	K 50,000
20X2	JANUARY	K 75,000

The payments are for electricity consumed during the three months immediately prior to the months in which they are made.

Required
Record the above transactions in the Company's electricity account for 20x1 and 20x2

Solution

ELECTRICITY ACCOUNT

20X1					
			Balance c/d		K 60,000
January	Cash	60,000			
April	Cash	63,000			
July	Cash	40,000			
October	Cash	50,000			
31.12.20x1	Balance c/d	75,000	31.12.20x1	Income Statement	K 228,000
		K 288,000			K 288,000
20x2					
January	Cash	75,000	1.1.20x1	Balance b/d	75,000

(1)The credit balance of K 60,000 brought down would have been a liability at 31st December 20x0 shown in the balance sheet. It relates to electricity consumed in the last three months of 20x0 payments for it was made in January 20x1.

13.2 ACRUED INCOME
The accrued basis concept of accounting states that revenue is recognized in the accounting period in which it is earned and expenses are recognized in the accounting period in which they are incurred. Accrued income is income earned but not received during an accounting period i.e. amount owed or where a business receives income other than sales revenue it may have earned some income.
For Example
Accrued interest may be interest payable or interest receivable. Accrued rent may be rent payable or rent receivable. One is an expense the other is revenue.

13.3 OTHER CONSIDERATIONS
The combined effect of the realization and matching concepts plus the accruals basis concept provide some assurance that income is accurately measured.

Under the accruals basis concept

(I) Expenses may be paid for in advance (prepayments) or in arrears (accrued).

(II) Similarly revenue may be received in advance or be accrued.

(III) Debit closing balances in an expense account represent an outstanding balance of a prepayment. It is an asset shown as a current asset in the balance sheet.

(IV) Credit closing balance, in an expense account; represent outstanding balance in amount owing. It is a liability and appears as a current liability in the balance sheet.

SUMMARY OF THE CHAPTER

The chapter introduced periodic adjustments to accounts in the forms of accruals and prepayments. This introduction was supported through the use of the principles contained in the accruals concept after which respective nature and purpose of the adjustments were illustrated. The treatment of revenue owing at the end of a period was also provided followed by presentation of the items in financial statements.

END OF CHAPTER QUESTIONS

Q1 Indicate the placement of prepayments in the current assets sequence.

Q2 Indicate the placement of accruals in the current liabilities sequence.

Q3 During the year ended 28th February 2014, Ndazizwa bought some packaging materials for K2,200,000 and there were materials in hand at the year-end of K400,000

Required:

Prepare the packaging materials account for Ndazizwa for the year ended 28th February 2014 and explain how the balance on account will be treated in the Statement of Financial Position.

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CHAPTER 14

STATEMENTS OF PROFIT OR LOSS

14.0 LEARNING OBJECTIVES

By the end of this chapter, you should be able to explain the importance of the income statements and prepare the income statement with all the adjustments.

14.1 INTRODUCTION TO FINANCIAL STATEMENTS

You learnt in an earlier chapter that accounting is a process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. This process is shown in figure 1. By now you have looked at the first five stages shown in the figure. The communication aspect that has been mentioned in this definition is the same as stage six in the figure. This is the last step in the definition of accounting. It refers to the preparation and presentation of financial statements. Financial statements ensure that the economic information is communicated to users in an effective manner.

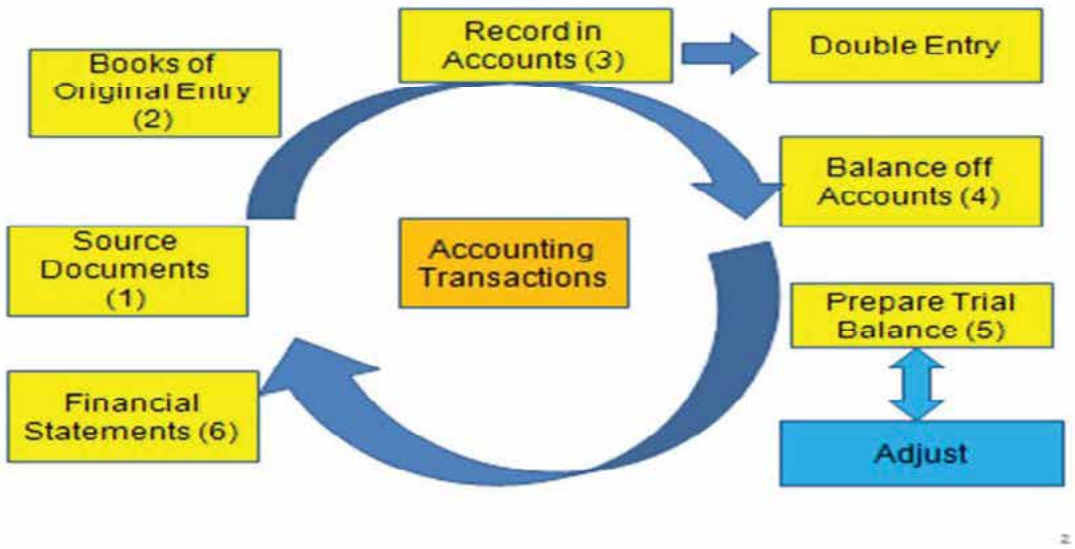

Figure 14.1: The Accounting Process

The income statement is one of the components of financial statements which we should prepare and present to the users of accounting or economic information.

14.2 PURPOSE OF INCOME STATEMENTS

Businesses are set up for the sole reason of making profits. It is important for the owners of businesses to check whether they are making profits or not. The income statement is prepared in order to assess if the business is making profits or losses in a given period. This is referred to as financial performance of a business. This statement is prepared for a period and not as at any particular point in time.

14.3 INCOME STATEMENT FORMAT

The income statement has two components:

- Trading account
- Profit and loss account

14.3.1 Trading Account

This section focuses on the revenue from the sale of goods and the cost of the goods which have been sold. The difference between the sales figure (revenue) and the cost of goods is called gross profit. Gross profit is an indicator of the initial profit earned by a business. If the cost of goods sold is greater than the sales figure, the outcome will be a gross loss. Normally, businesses should have gross profits. The profits will enable the organisations to cover non-trading expenses.

The cost of goods sold is made up opening inventories and purchase made in the period less closing inventories. Closing inventories, which are unsold inventories during a period, are not included in the cost of goods sold because they have not been sold. Closing inventories will become opening inventories in the following year. They will be part of the cost of goods sold in the period in which they will be sold.

Example 1

Atate made sales of K1,000,000 for the period ended 31 December 2012. Opening inventories amounted to K20,000, purchases K500,000 and closing inventories K80,000. You are required to prepare a trading account for the period ended 31 December 2013.

Solution

Atate

Trading account for the year ended 31 December 2012

	K	K
Sales		1,000,000
Opening inventories	20,000	
Add : Purchases	500,000	
Less : Closing inventories	(80,000)	
Cost of goods sold		(440,000)
Gross profit		560,000

Please note that opening inventories and purchases represent the cost of goods available for sale. Closing inventories then removed to establish the cost of goods sold.

14.3.2 Profit and Loss Account

Once the gross profit has been calculated in the trading account, the next step is to consider all the expenses not related to the trading activities. The net profit is calculated in this section. The net profit is the difference between gross profit and the other expenses. This figure is very important when assessing the financial performance of a business.

Expenses to be included in the preparation of the profit and loss account would have been included in the trial balance as shown in figure 1. So these expenses will be isolated from the trial balance prepared for the period.

Example 2

Continuing from example 1, Atate had the following expenses in the year ended 31 December 2012:

General expenses	K40,000
Lighting expenses	K80,000
Rent	K190,000

You are required to prepare a profit and loss account for Atate for year ended 31 December 2012.

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Solution

Atate

Profit and loss account for the year ended 31 December 2012

	K	K
Gross profit		560,000
General expenses	40,000	
Lighting expenses	80,000	
Rent	190,000	
Total expenses		(310,000)
Net profit		250,000

A complete income statement for Atate for the period ended 31 December 2013 will be as follows:

Atate

Income statement for the year ended 31 December 2013

	K	K
Sales		1,000,000
Opening inventories	20,000	
Add : Purchases	500,000	
Less : Closing inventories	(80,000)	
Cost of goods sold		(440,000)
Gross profit		560,000
General expenses	40,000	
Lighting expenses	80,000	
Rent	190,000	
Total expenses		(310,000)
Net profit		250,000

14.4 OTHER ISSUES

14.4.1 Net Profit for the Year

Net profit belongs to the owners of the businesses. Therefore, the net profit increases capital. However, the capital figure will not be increased to show an increase in capital. You should only increase the capital figure when the owners the business have injected additional capital in the business. The relationship between capital and net profit will become clear when we will be looking at the other component of financial statements, the statement of financial position.

14.4.2 Returns

In chapter 5, you covered returns inwards (sales returns) and returns outwards (purchases returns) day books. Returns inwards reduce the sales figure in the trading account. Returns outwards are subtracted from the purchases figure. Returns inwards and outwards are also recorded in the trial balance for the period.

Example 3

The following is an extract of the trial balance of Atate as at 31 December 2013.

	Dr	Cr
	K	K
Sales		1,000,000
Purchases	500,000	
Returns inwards	90,000	
Returns outwards		60,000

You are required to prepare a trading account for the period ended 31 December 2013.

Solution

Atate
Trading account for the year ended 31 December 2013

	K	K
Sales		1,000,000
Less: Returns inwards		(90,000)
		910,000
Purchases	500,000	
Less : Returns outwards	(60,000)	
Cost of goods sold		(440,000)
Gross profit		470,000

14.4.3 Carriage

When businesses have purchased inventory, they need to transport the inventories to the business premises. In the course of doing this, the businesses incur costs. These costs are called carriage inwards. In the trading account, carriage inwards is added to purchases.

As part of a marketing strategy, businesses may deliver goods to customers. In this case the business incurs costs. These costs are called carriage outwards. Carriage outwards are recorded as expenses in the profit and loss account.

14.4.4 Accruals and Prepayments

In chapter 13 you looked at how to account for accruals and prepayments. Accruals increase the respective expense items while prepayments reduce the respective expenses. This ensures that all the expenses period should be recorded as expenses in that period.

14.4.5 Depreciation

You have learnt that depreciation is an expense. As such depreciation charge for the period should be recorded as an expense in the profit and loss account.

14.4.6 Allowances for Receivables and Irrecoverable Debts

You will recall that irrecoverable debts (bad debts) are treated as expenses in the profit and loss account. Increases in the allowance for receivables (provision for doubtful debts) are recorded as expenses in the profit and loss account. On the other hand, decreases in the allowance for receivables are treated as income and so are added to gross profit in the profit and loss account.

14.5 COMPREHENSIVE EXAMPLE

The following balances were extracted in the books of Atate Hawkers as at 31 December 2013.

	K
Loan from Financial Solutions Ltd	5,000
Capital as at 1 January 2013	25,955
Drawings	8,420
Cash at bank	3,115
Cash in hand	295
Trade receivables	12,300
Trade payables	9,370
Inventory as at 31 December 2012	23,910
Inventory as at 31 December 2013	47,475
Motor vehicle at cost	4,100
Office equipment	6,250
Sales	130,900
Purchases	92,100
Returns inwards	550
Carriage inwards	215
Returns outwards	307
Carriage outwards	309
Motor expenses	1,630
Rent paid	3,320
Rent payable	350

Telephone expenses	405
Wages and salaries	12,810
Insurance	492
Office expenses	1,377
Sundry expenses	284

The Income statement will be presented as follows:

Atate Hawkers
Income Statement for the year ending 31 December 2013

	K	K	K
Sales			130,900
Less returns inwards			(550)
			130,350
Opening inventory		23,910	
Add purchases	92,100		
Add carriage inwards	215		
	92,315		
Less returns outwards	(307)		
		92,008	
		115,918	
Less closing inventory		(47,475)	
Cost of sales			(68,443)
Gross profit			61,907
Less other operating expenses			
Carriage outwards		309	
Motor expenses		1,630	
Rent		3,320	
Telephone expenses		405	
Wages and salaries		12,810	
Insurance		492	
Office expenses		1,377	
Sundry expenses		284	
Total expenses			(20,627)
Net operating profit			**41,280**

Note that other figures have been used in the preparation of the income statement. These figures will be used when we will be looking at the statement of financial position.

SUMMARY OF THE CHAPTER

In this chapter you have looked at the purpose and preparation of the income statement. You have learnt that you need to make adjustment in order to establish a proper income statement. Some of the adjustments include allowances for receivables and irrecoverable debts, depreciation, accruals and depreciation.

EXAM TYPE QUESTION

HKJ Trading is in a business of trading in various merchandise. The trial balance for the year ended 30 November 2013 is as follows:

	Dr	Cr
	K	K
Sales		820,000
Return inwards	25,000	
Purchases	465,000	
Carriage inwards	15,000	
Carriage outwards	40,000	
Salary and wages	60,000	
Return outwards		30,000
Insurance costs	20,000	
Advertisements	60,000	
Rates	10,000	
Rent	35,000	
Capital		500,000
Opening inventories	80,000	
Motor van (cost)	400,000	
Motor van (accumulated depreciation)		120,000
Furniture and fittings (cost)	300,000	
Furniture and fittings (accumulated depreciation)		100,000
Receivables	180,000	
Drawings	40,000	
Bank		50,000
Payables		120,000
Discount allowed	10,000	
	1,740,000	1,740,000

Additional information:

(1) Closing inventories as at 30 November 2013 were K90,000
(2) Depreciation charges

Motor van	20% on reducing balance method
Equipment	10% on straight line method

(3) Accrued insurance for the year K6,000
(4) Prepaid rent for the year was K5,000
(5) Provision for doubtful debts has been set at 3% of the receivables

Required:

Prepare the Income Statement for HJK Trading for the year ended 30 November 2013.

NOT FOR SALE

CHAPTER 15

STATEMENT OF FINANCIAL POSITION

15.0 LEARNING OUTCOMES

By the end of this chapter students are expected to be able to prepare a statement of financial position.

15.1 PURPOSE OF THE STATEMENT OF FINANCIAL POSITION

In the previous, chapter you looked at the accounting process. You will recall that the last step in this process is the production of financial statements. A statement of financial position is one of the components of financial statements which should be prepared as one way of communicating financial information. The statement of financial position shows the position of a business at any particular point in time. Financial position is presented in terms of the business's assets, liabilities and capital.

15.2 FORMAT OF A STATEMENT OF FINANCIAL POSITION

The statement of financial position contains assets, liabilities and capital of a business.

Assets

Assets represent resources which are owned by the business. When preparing the statement of financial position, assets are grouped into two:

- Non-current assets and;
- Current assets

Non-current assets

Non-current assets are assets which are expected to be used by the organization for a long time in the course of generating revenue or income for the business. The business will benefit through the use of these assets for a long period of time. The intention of the business is to use the assets and not necessarily reselling them. Land, buildings, fixtures, plant and machinery are the examples of non-current assets.

You should remember that non-current assets are generally depreciated. However, there are other non-current assets which are not depreciated. An example of such assets is land. Depreciation has been covered in chapter 12.

Current assets

Current assets are assets that are held only for a short time and are certainly going to change their form within twelve months of the date of the statement of financial position. These assets are not depreciated. Examples of current assets are inventories, trade receivables, cash at bank and cash in hand.

Current assets are presented in the statement of financial position according to their liquidity. Liquidity means the easiness of current assets when they are being converted into cash. So we start with those current assets that are furthest away from being converted into cash and finish with the cash itself.

The order of presenting current assets will be as follows:

i. Inventory
ii. Accounts receivable
iii. Cash at bank
iv. Cash in hand

Liabilities

Liabilities represent obligations which the business expects to settle. Liabilities are also classified into two:

- Current liabilities
- Non-current liabilities

Current liabilities

Current liabilities are obligations that must be paid within a year from the end of the previous accounting period. Examples of current liabilities are accounts payables and bank overdrafts.

Non-current (long-term) liabilities

Non-current (long-term) liabilities are obligations that will be paid in a period of more than one year from the end of the previous accounting period. They include loan notes/debentures and bank loans

Capital

Capital represents money and other resources put into the business by the owner. The net profit for the year increases capital. On the other hand, drawings (amounts withdrawn by the owner from the business for personal use), reduce capital. When preparing the

statement, assets are equal to capital plus liabilities. You will recall that this is the accounting equation.

15.3 EXAMPLE

The following balances were extracted in the books of Atate Hawkers as at 31 December 2013.

	K
Loan from Financial Solutions Ltd	5,000
Capital as at 1 January 2013	25,955
Drawings	8,420
Cash at bank	3,115
Cash in hand	295
Trade receivables	12,300
Trade payables	9,370
Inventory as at 31 December 2012	23,910
Inventory as at 31 December 2013	47,475
Motor vehicle at cost	4,100
Office equipment	6,250
Sales	130,900
Purchases	92,100
Returns inwards	550
Carriage inwards	215
Returns outwards	307
Carriage outwards	309
Motor expenses	1,630
Rent paid	3,320
Rent payable	350
Telephone expenses	405
Wages and salaries	12,810
Insurance	492
Office expenses	1,377
Sundry expenses	284

The statement of financial position of Atate Hawkers will be as follows:
Atate Hawkers
Statement of financial position as at 31 December 2013

	K	K
Non- current assets		
Motor vehicles		4,100
Office equipment		6,250
		10,350
Current assets		
Inventory	47,475	
Trade receivables	12,300	
Cash at bank	3,115	
Cash in hand	295	
		63,185
Total assets		73,535
Capital and Reserves		
Capital at 1 January 2003		25,955
Add net profit for the year		41,280
		67,235
Less drawings		(8,420)
		58,815
Long term liabilities		
Loan from Blue Co Ltd		5,000
Current liabilities		
Trade payables	9,370	
Other payables-rent	350	
		9,720
Total capital and Liabilities		73,535

SUMMARY OF THE CHAPTER

This chapter has focused on the preparation of the statement of financial position. You have leant that the purpose of this statement is to show the financial position of a business as at any particular point in time in terms of assets, liabilities and capital.

EXAM TYPE QUESTION

HKJ Trading is in a business of trading in various merchandise. The trial balance for the year ended 30 November 2013 is as follows:

	Dr	Cr
	K	K
Sales		820,000
Return inwards	25,000	
Purchases	465,000	
Carriage inwards	15,000	
Carriage outwards	40,000	
Salary and wages	60,000	
Return outwards		30,000
Insurance costs	20,000	
Advertisements	60,000	
Rates	10,000	
Rent	35,000	
Capital		500,000
Opening inventories	80,000	
Motor van (cost)	400,000	
Motor van (accumulated depreciation)		120,000
Furniture and fittings (cost)	300,000	
Furniture and fittings (accumulated depreciation)		100,000
Receivables	180,000	
Drawings	40,000	
Bank		50,000
Payables		120,000
Discount allowed	10,000	
	1,740,000	1,740,000

Additional information:

(1) Closing inventories as at 30 November 2013 were K90,000
(2) Depreciation charges

Motor van	20% on reducing balance method
Equipment	10% on straight line method

(3) Accrued insurance for the year K6,000
(4) Prepaid rent for the year was K5,000
(5) Provision for doubtful debts has been set at 3% of the receivables

Required:

Prepare the statement of financial position for HJK Trading as at 30 November 2013.
(Adapted from PAEC FA4 Exam December 2009)

NOT FOR SALE

CHAPTER 16

CLOSING INVENTORY VALUATION

16.1LEARNING OUTCOMES

By the end of this chapter, students should be able to explain the methods of valuing inventory and the advantages and disadvantages of inventory valuation method. They are also expected to value inventory and explain the inventory taking methods.

16.1 INVENTORY VALUATION

You noted in chapter 14 that calculation of cost of goods sold in the trading account takes into account of opening and closing inventories. In this chapter, you will learn how to value inventories.

Valuation of inventories is important for the following reasons:

- It enables businesses to establish the value of closing inventories
- Values attached to inventories form a basis for setting selling prices
- It facilitates the calculation of cost of sales and profits

You can see that inventory valuation is important when preparing financial statements as the above reasons affect either the income statement or the statement of financial position.

Historical costs are generally used in the valuation of inventories. Historical costs are the costs which were incurred to produce or purchase inventories. The main ways of determining the historical cost of inventory are:

i. First In First Out (FIFO) method
ii. Average Cost (AVCO) method

16.1.1 First In First Out (FIFO)

This method assumes that the first components of inventory to be brought into stock are the first ones to be sold out or issued out to production in the case of a manufacturing business.

The FIFO method is logical in the sense that it portrays what should happen in practice; goods acquired first should be used first. The method is very easy to use. It is also recommended by International Accounting Standard (IAS 2) *Inventories*.

However, the assumption that the inventories which have been acquired should be used first might not hold true if the goods have been mixed up in a warehouse or store room.

Example 1

A business has kept the following record for its inventory for the month of January 2013:

2 January	Bought 100 units at K50 each
7 January	Bought 70 units at K55 each
14 January	Sold 120 units
22 January	Sold 30 units

Required:

Calculate value of inventory left in the business at the end of the month and the cost of goods sold during the period.

Solution

Application of the FIFO method is illustrated in Table 16.1

Table 1 : FIFO Method

Date	Description	Units bought	Units sold	Balance (Units)	Balance (K)
2 Jan	Purchases	100 @ K50 each	100	100	5,000
7th Jan	Purchases	70 @ K55 each	70	170	100 units @ K50 each = 5,000 70 units @ K55 each = 3,850 Total =5,850
14th Jan	Sales		120 (100 units @ K50 each and 20 units @ K55 each)	50	50 units @ K55 each = **2,750**
22nd Jan	Sales		30 units @ K55 each	20	20 units @ K55 each = **1,100**

You will notice from the table that items bought on 2nd January were sold first, and then those bought on 7th January and so on. This means that the 120 units sold on 14th January

were drawn as follows :100 units from the items bought on 2nd January and 20 units from the items which were bought on 7th January .The 30 units sold on 22nd January were taken from the remaining 50 units bought on 7th January. At the end of the month, there are 20 units from the lot which was purchased on the 7th January.

Cost of goods sold will be calculated as follows:

100 units at K50 each = K5,000 plus 50 units at K55 each = K2,750.
So total cost of sales will amount to K7,750.

16.1.2 Average Cost (AVCO)

The AVCO method involves valuing items of inventory sold or issued to production at the average cost of all inventories in stock. This means that a new average cost will be calculated whenever additional items of inventories have been acquired or produced.

Unlike the FIFO method which assumes that goods acquired first will also be used first, the AVCO method implies that this assumption might not work. You have learnt that goods acquired on different times may be mixed up. In this case, it is difficult to identify the goods which were bought first. The use of average costs will be ideal in this scenario. This method is recommended by the IAS 2.

On the other hand, the use of the AVCO method is tedious as the business is required to calculate a new average cost upon receipt of additional inventories.

Example 2

We will use the same figures in example 1. You are required to calculate the value of closing inventory.

Solution

The average cost of inventory on 2nd January will be K50 per unit. However, following the acquisition of 70 units on 7th January, we are required to calculate another average cost for the 170 units. The calculation of average costs is shown in Table 16.2.

Date	Description	Units bought	Units sold	Average cost	Balance (Units)	Balance (K)
2 Jan	Purchases	100 @ K50 each	100	50*	100	5,000
7th Jan	Purchases	70 @ K55 each	70	52**	170	8,850
14th Jan	Sales		120	52	50	2,600
22nd Jan	Sales		30	52	20	1040

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*(K5,000/100)
** {(100 x K50) + (70 x K55))/170}

Therefore the 120 units sold will be valued at K52 each. Total cost of sales will be 120 x 52= K6,240. The average cost of the remaining 50 units will be: K2,600. This will be the cost of remaining two units since no additional inventory has been brought in. The cost of inventory at the end of the month will be 20 units x 52 = 1,040 as shown in the above table.

16.2 COMPARISON OF FIFO AND AVCO METHODS

Table 16.3: Comparison of FIFO and AVCO methods

	Method	Cost of sales (K)	Closing inventory (K)
1	FIFO	7,750	1,100
2	AVCO	6,250	1,040

You can see that each method gives a different value of inventory and cost of sales. This means that the profit figures reported by each method will also be different. It is important for businesses to apply the method which they will adopt consistently. This is in line with the consistency concept which you covered in …..Applying accounting policies facilitates effective comparison of financial statements.

16.3 INVENTORY TAKING

Inventory taking is the process of verifying the quantity balances of the entire range of items held in stock.

It is vital to take into account of security issues when conducting an inventory taking exercise. These may include ensuring that inventories are located in a secure building (location), not allowing unauthorized persons not allowed access and proper custody of store keys.

Inventory taking is important because:

i. It enables businesses to verify accuracy of stock records
ii. It provides support the value of stock in the statement of financial position.
iii. It may assist in the identification of fraud, theft or loss and other weakness in the management of inventory.

16.4 INVENTORY TAKING METHODS

There are two major methods of inventory taking. These are:

i. Periodic
ii. Perpetual (Continuous)

16.4.1 Periodic Method

Under this method, inventory taking exercise takes place at the end of a given period. This can be at the end of the year or any other point in time. Thorough is preparation needed; programme drawn up and agreed with all concerned parties, Stocktaking sheets prepared and duties communicated to all concerned parties

16.4.2 Perpetual (Continuous) Method

Inventory taking is conducted continuously throughout the year. The procedures for this method are similar to periodic inventory taking except that:

i. There is no need to close down stores while inventory taking
ii. Normal posting of receipts and issues on the inventory records can continue without interruption
iii. Inventory taking is done by few specially appointed, experienced and trained staff completely independent of stores staff

SUMMARY OF THE CHAPTER

This chapter was about the inventory valuation. You have learnt that you can use the First In First Out (FIFO) and the Weighted Average method (AVCO) to value inventories. You have also learnt that inventory taking is a very important exercise in inventory management.

End of Chapter Questions

The inventory movement for VJ hardware which sells roofing tiles was as follows for the month of October 2010:

1	Oct	Opening Inventories	2,000 units @ K300
4	Oct	Purchased	1,000 units @ K320
7	Oct	Sold	2,500 units @ K600
10	Oct	Purchased	3,000 units @ K300
15	Oct	Purchased	1,000 units @ K320
20	Oct	Sold	2,000 units @ K600
25	Oct	Purchased	1,500 units @ K330
30	Oct	Sold	2,000 units @ K600

Required:

Compute the value of the closing inventories using both the First-in-First-Out (FIFO) and Average Cost methods of inventory valuation. **18 Marks**

CHAPTER 17

ERRORS AND THEIR CORRECTION

17.0LEARNING OUTCOMES

By the end of this chapter, students should be able to explain the types of errors, correct errors, and prepare suspense accounts.

17.1 INTRODUCTION

Human beings are prone to making mistakes and errors in everything they do. The area of accounting is no exception. Individuals who are responsible for providing financial information may make mistakes and errors. This may be due lack of accounting knowledge, negligence, fraud or even mere failure to follow laid down procedures. The implication of mistakes and errors is that the financial information which will be provided in a form of financial statements may not give a true state of affairs. You should remember that accounting information forms a basis of decision-making and so provision of distorted and misleading information will affect the decisions which will be made. In this case, it is imperative that accounting errors and mistakes should be corrected. In this chapter you will learn how to correct errors.

17.2 TYPESOF ERRORS

There are two types of errors in accounting:

i. Errors that do not affect the trial balance
ii. Errors that affect the trial balance

17.2.1 Errors That Do Not Affect the Balancing of the Trial Balance

In chapter 10 you learnt that once the accounts have been balanced off, the next step is to prepare a trial balance. Remember that a trial balance is a list of account balance. The idea behind the trial balance is that the totals in the debit column should be equal to the totals in the credit column. We can assume that once the totals have agreed, then there are no errors. However, under certain circumstances, the trial balance may agree even though we have made some errors. These are the errors which do not affect the trial balance; the totals still agree. The errors are as follows:

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(a) **Errors of Omission**

This is where a transaction is completely omitted from the books.

Example:

The purchase of goods for resale from Chisomo Kampeni for K50, 000 on invoice number 11256 was not entered in the purchases day book. This transaction would not be posted to the purchases ledger, but when a trial balance is extracted it would still balance.

The error should be corrected by entering the transaction in the books. The journal entries are as follows:

DATE	DESCRIPTION	DEBIT	CREDIT
	Purchases Chisomo Kampeni *Being correction of transaction previously omitted*	50,000	 50,000

(b) **Errors of Commission**

This type of error arises where the correct amount is entered, but in the wrong account.

Example

Purchase of goods from J Cham'bwinja for K65, 000 entered in the account J Chambwinda. The error should be corrected as follows:

DATE	DESCRIPTION	DEBIT	CREDIT
	J. Chambinda J. Cham'bwinja *Being correction of transaction entered in wrong account*	65,000	 65,000

(c) **Errors of Principle**

This type of error occurs when the **correct amount** is entered in the **wrong class of account**.

Example

An acquisition of a second-hand motor vehicle for K950, 000 is debited to motor expenses account. This error will be corrected by debiting the motor vehicle account and crediting the motor expenses account.

(d) **Compensating Errors**

This is where errors cancel each other out i.e. a debit entry cancelling out a credit entry. For example, the amounts transferred from the cash book to the salaries account and motor expenses have been overstated and understated by K35, 000 respectively. The trial balance will still balance. To correct this error we should debit the motor expenses account by K35,000 and credit the salaries account by K35,000 as well.

(e) **Errors of Original Entry**

An error of original entry occurs where the original amount is incorrect, yet the double entry is correctly done using this incorrect amount. In this case, the equality of the trial balance will still be maintained. For example, a cheque in settlement of an electricity bill for K5, 560 is entered in the books as K8, 560. In this case, both the expense account and the cash book will be understated by K3,000 but the trial balance will still balance. To correct this error we should debit the electricity account by K3,000 and credit the cash book by a similar amount.

(f) **Complete reversal of the entries**

With this type of error the correct amounts and accounts are used, but each item is entered on the wrong side of the accounts. For example, a receipt of cash K2, 500 from a customer is entered on the credit side of the cash book and on the debit side of the customer's account.

Correcting this type of errors involves two stages namely: reversing the entries and then entering the amounts on the correct sides of the two accounts. In terms of reversing the entries, we should debit the cash book by K2,500 and credit the customer's account by K2,500. The incorrect entries have now been reversed. We should then debit the cash book by K2,500 and credit the customer's account by K2,500. The second set of entries implies that the correct entries have now been made in the two accounts. You will notice that in total the cash book has been debited by K5,000 while the customer's account has been credited by a similar amount. In other ways, we just need to double the initial amount and make sure that the amount has been entered on the correct sides of the accounts.

(g) **Transposition errors**

This is where a wrong sequence of the individual characters within a number is entered.

Example

K856 entered as K586 in the general expenses account and cash book. The transposition must be in both the debit and credit entries. Correcting this error involves adding K270 to K586 so that the figure which has been recorded in both accounts should be K856 i.e. debiting the general expenses account and crediting the cash book by K270.

17.2.2 Errors that Affect the Balancing of the Trial Balance

The totals on the two sides of the trial balance should be equal. However, sometimes the totals might not be equal. This may be due to the following reasons:

a) Errors in double entry book keeping. For instance a transaction being recorded in only one account or a transaction may be recorded in one account as one figure and in another account as a different figure. These errors are corrected following double entry principles as they are made within double entry.

b) Errors in drawing out and adding up a trial balance. For example, a debit balance in an account may be taken to the trial balance as a credit balance, or an account balance may be transposed as it is being taken to the trial balance. You should remember that the trial balance is not part of double entry system and so such errors are corrected through the double entry rules. Just revise the trial balance by recording the amounts on the correct sides of the trial balance or enter the correct amount. The trial balance total will now be equal.

17.2.2.1 Correction of Errors Affect the Balancing of the Trial Balance

When we have errors which affect the balancing of the trial balance, the totals fail to agree. In this case the difference is entered in the suspense account**.** This is the account which temporarily holds the difference in the trial balance and may also be usedto record items where the bookkeeper is not certain where the entries should be recorded. Balances in the suspense account should not be kept permanently. We should establish the causes of the errors and then clear the balances in the suspense account. Figure 17.1 shows an extract of the trial balance with an entry for the suspense account.

Figure 1: Extract Trial Balance

	Dr	Cr
	MK	MK
Sub-totals	99,500	100,000
Suspense	500	
Totals	100,000	100,000

Example:

The trial balance of Giant did not agree because the debit balances totalled K12,000 whereas the credit balances totalled K8,700. An investigation was conducted. The causes, the following errors were discovered:

a) A sale of K2,200 was debited to Smith instead of Simon
b) A sale for K4,200 was correctly entered in the sales account but was not debited to Jones' personal account
c) A purchase of K7,500 was correctly entered in the nominal account but was omitted from the personal account.

Prepare journal entries to show the correction of the above errors and hence prepare the suspense account to clear the Trial balance difference.

Solution:

In this example, the totals of the trial balance are not equal. This means that we need to insert a line for suspense account and K3,300 will be entered on the credit side. The trial balance will balance temporarily.

Error a:

This error does not affect the trial balance agreement. The double entry is complete although the transaction was recorded on the correct side of a wrong account. This will be corrected by Debiting Simon A/c and Crediting Smith A/c with K2,200.

Error (b)

The second error affects the trial balance agreement. This transaction has been entered once in the books of accounts and so the double entry is not complete. This is a case of single entry. There is need to enter the transaction in the account of Jones. We will do this by making a debit entry in Jones' account. A corresponding entry will be made in the Suspense account.

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You should note that this transaction was to be recorded in the sales and Jones accounts. Since the entry in the sales account was made, the correction will involve Jones' account and the Suspense account and not the sales account again. This will then be Debit Jones A/c and Credit Suspense A/c with K4,200

Error (c)

The third error affects the trial balance just as (b) above. This is also as a result of single entry as the purchase was only recorded in the purchases account and not in the account of the Supplier. Correction will therefore be as follows: Debit Suspense and Credit Trade Payable with K7,500.

Below are the journal entries showing the correction of the above three errors.

DATE	DESCRIPTION	DEBIT	CREDIT
a)	Simon	2,200	
	Smith		2,200
b)	Jones	4,200	
	Suspense		4,200
c)	Suspense	7,500	
	Trade payables		7,500

Here now is how the suspense account will look like. We have been informed that the credit side of the trial balance has a shortfall of K3,300. This K3,300 is transferred to the credit side of the suspense account. If the shortfall were on the debit side the balance would also appear on the debit side of the suspense account.

Suspense Account

Trade payables	7,500	Difference per Trial Balance	3,300
		Jones	4,200
	7,500		7,500

At the moment the two sides of the suspense account have now agreed. This means that the causes of the difference in the trial balance have all been discovered and corrected. Otherwise, if the two sides of the suspense account do not agree, even after some errors being discovered and corrected, the implication is that there is need for further investigations.

SUMMARY OF THE CHAPTER

In this chapter you have been introduced to accounting errors. You have learnt that there are two types of errors. These are the errors which do not affect the balancing of the trial balance and the errors which affect the balancing of the trial balance. Correction of errors which affect the balancing of the trial balance calls for the use of the suspense account.

EXAM TYPE QUESTION

A student pursuing the Certificate in Financial Accounting (CIFA) course was recruited on a temporary basis to assist in reducing the workload in the accounting department of Shopleft Retail Shop. The student was asked to correct the following errors from the transactions for the month of July 2008.

(1) Credit purchases from J Bhana amounting to K24,000 were recorded correctly in personal account but in purchases account it was recorded as K42,000.

(2) A cash discount of K15,000 from a supplier was recorded as a credit to suppliers account and as a debit to the discount received account.

(3) Cash sales amounting to K40,000 were completely omitted from the accounting records.

(4) Goods returned by cash customers amounting to K12,000 were recorded in the debtors control account.

(5) Purchase of computers for resale amounting to K70,000 were recorded as fixed assets.

(6) Rent paid amounting to K30,000 was debited to both the rent and cash book accounts.

(7) The cash book was credited with an amount of salaries paid amounting to K65,000 but no corresponding entry was made in the salaries account.

(8) The Accountant forgot to charge depreciation for a piece of office equipment. The cost of this equipment was K240,000 and its residual value was K20,000. The company policy is to depreciate equipment using the sum of digit method and the economic life is estimated at 4 years. The asset has two years of its useful economic life remaining as at the end of the financial year.

Required:

i. Briefly describe **five** types of errors which do not affect the correctness of the trial balance.

10 Marks

ii. From the information given above from (1) to (7), prepare journal entries **without** narratives to correct the errors identified.

7 Marks

CHAPTER 18

CONTROL ACCOUNTS

18.1LEARNING OUTCOMES

By the end of this chapter, the students should be able to explain the importance of control accounts, draw up a receivables control account and draw up a payables control account.

18.1 BACK GROUND INFORMATION

To ensure financial soundness of a business, managers of the business must put in place measures to ensure that the business's assets and resources are controlled. Such measures are known as internal controls. It is imperative that that every system of transactions undertaken in the business has internal controls to ensure that the information reported by such system is true and fair.

To ensure the appropriateness of accounting records, **control** accounts are prepared for a particular system (say a purchase system). The control accounts record the same information that is recorded in the sales ledger (for a sales system) or the purchase ledger (for a purchase system) and at the end the information in the control is compared to that in the ledger concerned. This is done to check the arithmetical accuracy as well as proper entries in the records.

A control account is an account in the general ledger which keeps a record of a total number of similar individual items. For large entities, the control account forms part of the double entry system.

18.2 THE RECEIVABLES/ SALES LEDGER CONTROL ACCOUNT

This is an account which keeps a record of all trade receivables in total. A business can have numerous trade receivables and each of them will have his/her account in the sales ledger. One special account will be needed to control the entries in all the trade receivables accounts, that is, the receivables control account.

The amount that is transferred to the receivables control account is the total in the sales day book. Remember that the total in the sales day book is transferred to the sales account in the general ledger. If control accounts are being used, this total has to be transferred to the receivables control account as well.

Any item that is recorded in one or more receivables' accounts in the sales ledger is also recorded in total in the receivables control account. It is important to know on which side

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of the control account, entries will be made. For instance, the following items will have to be totaled and entered in the receivables control account on the debit side:

i. Total of credit sales from the sales day book
ii. Total of customers' dishonored cheques and refunds made to customers
iii. Total of any interests charged on overdue accounts of customers.

The following items will have to be totaled and entered in the receivables control account on the credit side:

i. Total of cash /cheques received from customers
ii. Total of cash discounts allowed to customers
iii. Total of sales returns made by customers
iv. Total of debts that have been written off as irrecoverable.

18.3 TRADE PAYABLES/PURCHASES CONTROL ACCOUNT

This is an account which keeps a record of all trade payables in total. A business can have numerous trade payables and each of them will have his/her account in the purchases ledger. One special account will be needed to control the entries in all the trade payables' accounts, that is, the payables/purchases ledger control account.

The amount that is transferred to the payables control account is the total in the purchases day book. Remember also that the total in the purchases day book is transferred to the purchases account in the general ledger. If control accounts are being used, this total has to be transferred to the payables control account as well.

Any item that is recorded in one or more payables' accounts in the purchases ledger is also recorded in total in the payables control account. For instance, the following items will have to be totaled and entered in the payables control account on the debit side:

- Total of cash/cheques paid to suppliers
- Total of purchases returns made to suppliers
- Total of any discounts received from suppliers.

The following items will have to be totaled and entered in the receivables control account on the credit side:

- Total of credit purchases from suppliers
- Total of any interests charged by suppliers on overdue accounts

18.4 CONTRA ENTRIES

In a situation where one person/entity becomes both a customer and a supplier, for the purposes of control accounts, the balances in the two ledgers, that is the sales and purchases ledger, are off set to come up with one balance in the control account. The double entries required for the set offs are:

Dr Payables Control account
Cr Receivables Control account

With the amount involved.

Example 1

The following are the opening ledger balances and totals for the month of January 2012

Opening balances

	Debit	**Credit**
	MK	MK
Receivables ledger (MK)	46,217	
Payables ledger (MK)		23,993

Totals for the month to 31 January 2012

	MK
Purchases	76,474
Sales	126,024
Purchases returns	2,154
Receivables accounts settled by contra accounts with payables	455
Irrecoverable debts written off	1,253
Discounts and allowances to customers	746
Cash received from customers	120,464
Cash discounts received	1,942
Cash paid to suppliers	70,476
Cash paid to customers (Refunds)	52

Required:

i. Prepare receivables ledger control account

ii. Prepare payables ledger control account

Solution

Receivables control account will be drawn up as shown below :

Receivables Control

Balance b/f	46,217	Contra	455
Sales	126,024	Discounts allowed	746
Refunds	52	Irrecoverable debts	1,253
		Cash	120,464
		Balance c/d	49,375
	172,293		172,293

Using the above information, we can also prepare a payables control account.

Payables Control

Returns	2,154	Bal b/d	23,993
Contra	455	Purchases	76,474
Discount received	1,942		
Payments	70,476		
Balance c/d	25,440		
	100,467		100,467

18.5 IMPORTANCE OF CONTROL ACCOUNTS

You have learnt how the receivables and payables control accounts. But why do we need to prepare control accounts? Control accounts are important for the following reasons:

a) Provide a check on the accuracy of entries made in the personal accounts in the sales and purchases ledger.
b) Assist in location of errors
c) Provide an internal check where there is segregation of duties
d) Assist in extracting closing receivables, and payables ledger balances for use in the trial balance and statement of financial position.

18.6 CONTROL ACCOUNT RECONCILIATION AND THE LEDGER

At the end of a specified period, the balance on the control account must be checked and compared with the sum of the balances from the individual accounts in the sales or purchases ledger. In normal circumstances, the two totals must agree. However, if the balances do not agree, we should reconcile the two balances to ensure that all errors are discovered and any fraud, if any, is detected.

When reconciling the control account balance to the sum of balances of the accounts in the ledger, the following procedures should be followed:

i. Update the control account. This is achieved by bringing into the control account any item which has not been included in it but is supposed to be included; as well as removing from the control account any item which has been included in it but it is not supposed to be included. The end result is that the control account will have a new closing balance.

ii. Adjust the updated control account balance with any errors or omissions that have been made in the individual accounts in the ledger.

If all errors and omissions have been discovered and dealt with accordingly, the final amount arrived at after the second stage above must be equal to the sum of the balances in the accounts in the ledger. This is illustrated below:

i. Reconciliation of the Receivables Control Account with the Sales Ledger

	K
Updated balance in the Receivables control account	X
Add:	
Items to be credited but have not been credited in the sales ledger accounts, e.g. irrecoverable debts	X
	X
Less:	
Items to be debited but have not been debited in the sales ledger accounts, e.g. correction of under cast of sales	(X)
Balance from sum of trade receivables accounts	X

ii. Reconciliation of the Payables Control Account with the Purchases Ledger

	K
Updated balance in the Payables control account	X
Add:	
Items to be debited but have not been debited in ledger accounts	X
	X
Less:	
Items to be credited but have not been credited in ledger accounts	(X)
Balance from sum of Trade payables accounts	X

SUMMARY OF THE CHAPTER

In this chapter you have learnt that business prepare control accounts as part of internal controls. You have looked at the purposes of control accounts and how the receivables and payables control accounts are prepared. You have also learnt why periodic reconciliations between control accounts and ledger accounts are important. This ensures that causes of differences have been identified. Once this is done they can now be rectified.

END OF CHAPTER QUESTIONS

Q1
Explain the purposes of control accounts.

Q2
Explain how the following items are reflected in the receivables and payables control accounts :

Receipts from customers
Payments to suppliers
Discount allowed
Discount received
Dishonored cheques
Returns inwards and outwards

Q3

The following transactions relate to receivable and payable controls for G Motors for the month of September 2010:

NOT FOR SALE

		K
Balance b/f	- Receivables	140,000
	- Payables	90,000
Credit sales		600,000
Cash sales		180,000
Credit purchases		400,000
Cash purchases		50,000
Returns inwards from customers		10,000
Carriage inward for purchases		40,000
Interest on receivable		4,000
Bad debts		12,000
Provision for doubtful debts		16,000
Contra account (purchases)		25,000
Return outward to credit supplier		14,000
Cash from receivables		380,000
Payment to credit suppliers		250,000
Discount allowed to credit customers		17,000
Discount received from credit suppliers		10,000
Returns inward from credit customers		11,000
Dishonored cheque from a credit customer		8,000

Required:

(a) Prepare the receivable and payable control accounts for the month of September 2010.

17 Marks

(b) Outline **three** items which may result in differences between the amount of payables in ledger accounts and that on the supplier's statement.

3 Marks

CHAPTER 19

BANK RECONCILIATION

19.0LEARNING OUTCOMES

By the end of this chapter, the students should be able to explain the purpose of reconciliation between the bank ledger and the corresponding bank statement; identify errors and omissions in the bank ledger account and in the bank statement; identify timing differences; make the correcting entries in the bank ledger account; and prepare the reconciliation between the bank statement balance and the corrected bank ledger account.

19.1 THE NEED FOR BANK RECONCILIATION STATEMENTS

In chapter 6 you looked at how to prepare a cash book. You will recall that the cash books columns for cash and bank transactions. The bank columns are for all the transactions which go through an entity's bank account. In this case, the transactions which have been recorded in the bank columns of the cash book should be the same as the bank records for the business, which are being maintained by the bank. The records prepared by the bank will be in a form of a **bank statement**. However, there are times when the two sets of records are different. This calls for the preparation of a bank reconciliation statement.

19.2 BANK STATEMENT AND CASH BOOK BALANCES

Any transaction the business undertakes with the bank is recorded by both the business and the bank. One would expect that that the balance in the cash book of the business must be equal to that in the bank's books because the records of the two parties are the same. However, this is unlikely to be the case for the following reasons:

i. **Bank Charges:**
   Banks charge for the services they offer to their customer and these charges are directly recorded **(**debited)into the customer's account. The balance shown by the bank will therefore be different from that of the cash book of the business because the cash book will not record this charge made by the bank.

ii. **Bank Interests:**
Just as bank charges, a bank may give interest to the customers directly through the bank accounts or may charge interests on overdraft balances directly. This may bring about the differences in the balances reported by the two entities.

iii. **Standing Orders:**
These are orders customers give the bank to make regular payments at stated dates to persons or companies. The bank simply obeys the command and the payment is only reflected in the books of the bank and not the business' books, hence a cause of the disagreements between the two balances.

iv. **Direct Debits:**
This where an instruction is given to the business' creditors, (not the bank), to obtain the money directly from the business' bank account.

v. **Credit Transfers/Bank Giro Credits:**
These are the amounts that the business' customers pay directly into the business' bank account. The receipt will therefore be recorded in the books of the bank alone hence the difference arises between the two balances.

vi. **Unpresented Cheques:**
These are cheques that have been issued by the business to its payables but have not been presented to the bank to effect payment. This will be recorded in the business' cash book but the bank will not record this payment until the payables have actually presented the cheques to the bank.

vii. **Outstanding Bank Lodgements:**
These are the amounts or cheques that the business has deposited at the bank but the bank has not yet cleared them. They are also called **uncredited cheques.** These will be recorded by the business in its cash book but the bank will record these only when they are cleared.

viii. **Errors:**
In chapter 18 you noted that accounts personnel are bound to make errors. These errors may be committed when dealing with bank transactions. For example an error may be made when balancing the cash book and so the resulting balance might not be correct. Such an error will not appear in the bank's records. The implication is that there will be a difference between the balance shown by the cash book and that shown by the bank's records.

ix. **Dishonored cheques (or R/D cheques).**
These are cheques that the bank has denied to clear for various reasons. This cheque had been recorded initially in the business' books and when the bank denies payment, it won't be recorded in the bank's records. Until the business reverses the transaction involving that dishonored cheque, there will be a difference between the balance in the cash book and that in the bank statement.

When the cash book balance and the bank balance are not equal, we need to find out why the balances are not equal. This is achieved through the reconciliation process. The reconciliation process is a control measure to detect cash fraud.

19.3 FREQUENCY AND PURPOSES OF BANK RECONCILIATION

Bank reconciliation is an accounting procedure for agreeing the balance as per bank statement with the balance as per cash book. It is good practice to reconcile the bank balance with the cashbook balance as frequent as possible say at least once a month. How frequent the bank reconciliation statement may be prepared will depend on the following factors:

i. Frequency and volume of transactions :The likelihood of error is greater where there are more transactions
ii. Other controls: If there are very few other checks on cash, the greater the need for bank reconciliation.
iii. Cash flows: If the company has to keep a very close watch on its cash position, then the reconciliation should be performed as often as the information on cash balance is required.
iv. Number of bank accounts: The more the bank accounts are operated, the more difficult it becomes to perform regular reconciliation.

The bank reconciliation serves the following purposes:

i. Analysing the difference between the cashbook and the bank statement.
ii. Detecting and correcting errors committed by the bank or cash office
iii. Detecting possible misappropriation of funds
iv. Recognising or identifying appropriate expenditures or receipts made directly by the bank.
v. Ensuring that Commercial Bank's claims for reimbursement are not duplicated.

19.4 BANK RECONCILIATION PROCESS

To reconcile the two balances the following procedures are to be followed:

a) Update the cash book by taking into it some amounts that appear in the bank statement but not appearing in the cash book. If the cash book contained some errors, the update should include correcting such errors. For instance, bank charges will always be recorded in the bank statement and not in the cash book. The updated cash book should therefore include this item.

b) Identify any unpresented cheques. You noted that Unpresented cheques represent any amount shown by the cash book as a payment but has not been reflected as a debit in the bank statement

NOT FOR SALE

c) Identify any outstanding bank lodgements. Bank lodgements are amounts that have been recorded in the cash book as receipts but are not reflected as a credit in the bank statement.

Once the above procedures have been undertaken, we can now prepare the reconciliation statement. The reconciliation statement will be presented as follows:

Bank Reconciliation Statement as at …….

	K
Updated cash book balance	X
Add unpresented cheques	X
	X
Less bank lodgements	(X)
Balance per Bank Statement	X

Alternatively we can start with the balance as per the bank statement in which case the statement will be as follows:

Balance per bank statement	X
Add Bank lodgements	X
	X
Less Unpresented cheques	(X)
Balance per updated cash book	X

Regardless of the method used, the differences between the cash book balance and the balance on the bank statement will be explained. Let us now look at a practical example.

Example 1

From the following cash book and bank statement, draw up a statement reconciling the two balances:

Cash book

Dec 1. Balance b/d	3,480	Dec 8 A. Dalitso	698
" 7. P.J. Malumbo	176	" 15 R. Matemba	66
" 22. J. Elenda	146	" 28. G. Samalani	230
" 31. K. Wanda	498	" 31. Balance c/d	3,662
" 31. M. Balendo	356		
	4,656		4,656

Bank statement

			Dr	Cr	Balance
Dec	1.	Balance B/f			1,740
"	7.	Cheque		176	1,828
"	11	A. Dalitso	698		1,479
"	20	R. Matemba	66		1,446
"	22	Cheque		146	1,519
"	31	Credit transfer, J. Wadada		108	1,573
"	31	Bank charges	44		1,551

Solution

i. Entries in the cash book and on the bank statement are not recorded on the same side. A debit entry in the cash book would be reflected on the bank statement as a credit entry and the other way round.

ii. Let us spot any amounts appearing in the bank statement which do not appear in the cash book. We will then use these amounts to update the cash book. A credit transfer of K108 from J. Wadada and bank charges of K44 have not been recorded in the cash book and should be included in the cash book. In this way the cash book will be up to date.

Therefore, the updated cash book will be:

Balance b/d	3,662	Bank charges	44
J. Wadada	108	Balance c/d	3,726
	3,770		3,770

iii. We could have re-written the whole cash book but this may be time consuming. For examination purposes it is good to start with the balance which has been brought down (K3,726) as marks are not awarded for the original entries in the cash book.

iv. From the cash book and the bank statement, K330 paid to G. Samalani has not been presented to the bank for payment as at the date the reconciliation is being made. This is an unpresented cheque. Cheques from K. Wanda and M Balendo of K498 and K356 respectively have not been cleared by the bank. As a result they are not reflecting on the business' bank statement. The two cheques are bank lodgements as at 31 December 2012.

Bank Reconciliation Statement as at 31 December 2012

	K	K
Balance as per updated cash book		3,726
Add : Unpresented cheques		330
		4056
Less : Bank lodgements		
K. Wanda	498	
M. Balendo	356	(854)
Balance as per bank statement		3,202

Alternatively the bank reconciliation statement may also be prepared as follows:

Bank Reconciliation Statement as at 31 December 2012

	K	K
Balance as per bank statement		3,202
Add : Bank lodgements		
K. Wanda	498	
M. Balendo	356	854
		4,056
Less : Unpresented cheques		(330)
Balance as per updated cash book		3,726

19.5 OVERDRAFTS

An overdraft occurs when a business or a person draws from the bank more money than the money that it or he has in the bank. In this case, the bank becomes a liability to the business and the business an asset to the bank. We still need to check if the balances in the cash book and on the bank statement are equal. When overdraft balances are involved in the reconciliation processes, the presentation changes as follows in order to take care of the negative balances:

Bank reconciliation statement

	K
Updated cash book overdraft balance	X
Add bank lodgements	X
	X
Less Unpresented cheques	(X)
Overdrafts per Bank statement	X

OR

Overdraft per bank Statement	X
Add Unpresented cheques	X
	X
Less: bank lodgements	(X)

You will note that the items in the reconciliation statements are the same. You should be able to reconcile whether a business has an overdraft or not.

SUMMARY OF THE CHAPTER

In this chapter you have learnt that ideally the balance in the cash book and the balance on the bank statement should be equal. However, sometimes the balances are not equal. In this case you need to prepare a bank reconciliation account in order to identify the causes of the differences between the two balances. You have noted that it is good practice to prepare the bank reconciliation statements periodically.

END OF CHAPTER QUESTIONS

Q1
Explain the importance of the bank reconciliations.

Q2
Mention possible factors which may make the cash book balance to be different from the balance on the bank statement.

Q3

The bank transactions for a sole trader for the month of October 2009 were as follows:

NOT FOR SALE

Cash book

		K			CHQ	K
1 Oct	Balance b/f	20,000	2 Oct	Rent	0020	12,000
3 Oct	Cash banked	30,000	4 Oct	J Banda	0021	35,000
9 Oct	N Mota	25,000	7 Oct	Electricity	0022	30,000
10 Oct	Cash banked	40,000	8 Oct	K Mbewe	0023	11,000
13 Oct	Cash banked	50,000	12 Oct	H Sitima	0024	30,000
17 Oct	Cash banked	10,000	15 Oct	Purchases	0025	16,000
27 Oct	N Mota	45,000	18 Oct	City rates	0026	18,000
30 Oct	Cash banked	15,000	20 Oct	K Mbewe	0027	14,000
31 Oct	Balance c/d	38,000	25 Oct	Salaries	0028	80,000
			27 Oct	Kabula Pvt	0029	15,000
			29 Oct	J Banda	0030	12,000
		273,000				273,000

The bank statement as at the 31 October 2009 was as follows:

			Dr	Cr	Balance
			K	K	K
1 Oct	Balance b/f				20,000 Cr
2 Oct	Rent	0020	12,000		8,000 Cr
3 Oct	Cash			30,000	38,000 Cr
4 Oct	J Banda	0021	35,000		3,000 Cr
9 Oct	N Mota			25,000	28,000 Cr
10 Oct	Electricty	0022	30,000		2,000 Dr
10 Oct	K Mbewe	0023	11,000		13,000 Dr
10 Oct	Cash			40,000	27,000 Cr
12 Oct	Bank charges		4,000		23,000 Cr
13 Oct	Cash			50,000	73,000 Cr
15 Oct	Credit transfer			20,000	93,000 Cr

15 Oct	Purchases	0025	16,000		77,000 Cr
17 Oct	Cash			10,000	87,000 Cr
20 Oct	Direct debit – Game stores		25,000		62,000 Cr
21 Oct	K Mbewe	0027	14,000		48,000 Cr
26 Oct	Salaries	0028	80,000		32,000 Dr
27 Oct	N Mota			45,000	13,000 Cr
30 Oct	J Banda	0030	12,000		1,000 Cr
30 Oct	N Mota – Refer to drawer		45,000		44,000 Dr
31 Oct	Standing order		10,000		54,000 Dr

Required:

(a) Explain the difference between a bank lodgment and a direct debit.
4 Marks

(b) Prepare an updated cash book for the sole trader as at 31 October 2009.
7 Marks

(c) Prepare a bank reconciliation statement for the sole trader as at 31 October 2009 to agree with the balance on the bank statement and with the balance in the updated cash book. **7 Marks**

CHAPTER 20

PARTNERSHIPS

20.1 LEARNING OBJECTIVES

After studying this chapter, students are expected to define partnership and explain the purpose and content of a partnership agreement, explain, calculate and account for appropriation of partnership profit. Further they will be able to explain the difference between partner's capital and current accounts and prepare the final accounts for a partnership as well as explain and account for the admission of a new partner including the treatment of any goodwill arising.

20.1 THE NATURE OF A PARTNERSHIP

A partnership can be defined as the relationship which subsists between persons carrying on a business in common with a view of profits. The people who own a partnership are called partners.
A partnership has the following characteristics
(a) It is formed to make profits
(b) It must obey the law as given in the partnership Act
(c) Normally there can be a minimum of two partners and a maximum of twenty partners except for banks where there cannot be more than ten partners, and there is no limit on the maximum number for firms of accountants, solicitors, stock exchange members, surveyors, auctioneers, valuers, estate agents, land agents, estate managers or insurance brokers.
(d) The personal liability of each partner for the firm's liabilities is un limited except for limited partners. This means that individuals' personal assets may be used to meet any partnership liabilities in the event of partnership bankruptcy.
(e) Partners who are not limited partners are known as general partners.
Limited partnerships are partnerships containing one or more limited partners. Limited partners have the following characteristics:

(a) Their liability for the debts of the partnership is limited to the capital they have contributed into the firm. They cannot be asked for more money than their capital to pay for the firm's debts.
(b) They are not allowed to take part in the management of the partnership.
(c) They are not allowed to take out or receive back any parts of their contribution to the partnership during the life time of the partnership.

All the partners cannot be limited partners, so there must be at lest one general partner with unlimited liability.

20.2 PARTNERSHIP AGREEMENT

A partnership agreement is usually drawn up in order to specify the provisions of the contract between the partners. The agreement is likely to specify the following:

(a) Capital to be contributed by each partner
(b) Ratio for sharing profits or losses
(c) Rate of interest if any to be paid on capital
(d) Rate of interest to be paid charged on drawings
(e) Salaries to be paid to partners.
(f) Arrangements for the admission of new partners
(g) Procedure to be carried out when a partner retires or dies.

20.3 CAPITAL CONTRIBUTION

Partners must agree on how much capital each partner should contribute towards the firm operations.

20.4 PROFIT OR LOSS SHARING RATIO

Partners can agree to share profit or losses in any ratio that they wish. However, sometimes profits or losses might be shared in proportion to the amount of capital contributed by each partner.

20.5 INTEREST ON CAPITAL

If partners agree to pay interest on their capital the interest on capital is treated as a deduction prior to the calculation of profit and their distribution among the partners according to the profit ratio.
The rate of interest on capital is often based on the return which the partners would have received if they had the capital invested elsewhere.

20.6 INTEREST ON DRAWINGS

To deter the partners from taking out cash unnecessarily, partners may agree to be charging interest at an agreed rate on each withdrawal of money by the partner from the firm. The rate of interest on drawings should be sufficient to achieve for this purpose without being too harsh.

20.7 PARTNERSHIP SALARIES

One or more partners may have more responsibilities or tasks than the other partners, as a reward for this the partners may have a partnership salary which is deducted before sharing the balance of profits. Salaries for partners are treated as appropriation of profits, not as a charge against profit.
Performance – related payments to partners
Partners may agree that commission or performance – related bonuses be payable to some or all of the partners linked to their individual performance. As with salaries, these would be deducted before sharing the balance of profits.

NOT FOR SALE

Example of the distribution of profit

John and Jack have been in partnership for one year sharing profits and losses in the ratio of 3:2 respectively. They are entitled to 5% per annum interest on their capital. John having K20,000 capital and Jack K60,000. John is to have a salary of K15000. They charge interest on drawings, John being charged K500, and Jack K1000. The net profit, before any distributions to the partners, amounted to K50000 for the year ended 31 December 2007.
The distribution of profit between the partners can be shown as follows:

	K	K	K
Net profit			50000
Add; interest on drawings:			
John		500	
Jack		1000	1500
			51500
Less; salary for John		15000	
Interest on capital:			
John (5% x k20000)	1000		
Jack (5% x k60000)	3000	4000	(19000)
Profit available for distribution			32500

Distribution of profit:		
John (3⁄5)	19500	
Jack (2⁄5)	13000	32500

The K50000 net profit has been shared as follows:

	John K	Jack K
Balance of profit	19500	13000
Interest on capital	1000	3000
Salary	15000	
	35500	16000
Less interest on drawings	(500)	(1000)
	35000	15000

20.8 PARTNERSHIP CAPITAL AND CURRENT ACCOUNTS

In the partnership statement of financial position, net assets are financed by partners' capital and current accounts. A current account for each partner is maintained to record a wide range of items on a continuous basis for example to charge drawings and other personal benefits of the partners and to credit salaries, interest on capital, share of profits e.t.c. Each partner's capital account normally remains constant from year to year. These are called fixed capital accounts

Sometimes partners may wish to use fluctuating capital accounts, where the distribution of profits are credited to the capital accounts, and drawings and interest on drawings are debited to the capital accounts. In this case the balance on the capital account does not remain the same from year to year.

For the example above if fixed capital accounts are used the accounts to be opened would be as follows:

John – Capital

		Bank	k20000

Jack – capital

		Bank	k60000

John – current account

Drawings	k15000	share of profit	k19500
Interest on drawings	500	interest on capital	1000
Balance c/d	15500	salary	15000
	35500		35500

Jack – current account

Drawings	k 26000	interest on capital	k 3000
Interest on drawings	1000	share of profit	13000
		Balance c/d	11000
	27000		27000

Where fluctuating capital accounts are used, the accounts would be as follows:

John – capita account

Drawings	k15000	bank	k20000
Interest on drawings	500	share of profits	19500
		Interest on capital	1000
		Salary	15000
Balance c/d	40000		
	55500		55500

Jack - capital account

Drawings	k26000	bank	k60000
Interest on drawings	1000	interest on capital	3000
		Share of profits	13000
Balance c/d	49000		
	76000		76000

20.9 PREPARING FINAL ACCOUNTS FOR PARTNERSHIPS

Income statement and the statement of financial position for partnership

(a) Income Statement
If sales, inventory and expenses of a partnership are the same as those of a sale trade, then the income statement would be identical with that prepared for the sole trader, however a partnership would have an extra section at the end of the income section known as the profit and loss appropriation account. This is where the distribution of profit among partners is shown.

(b) Statement of financial position
The statement of financial position for a partnership is similar to that of a sole trader with the only difference being on the capital part which is split between capital account and current account for different partners.

Example

Frame and French are in partnership sharing profits and losses in the ratio 3:2.The following is their balance as at 30 September 2009.

		Dr	Cr
		K	K
Building (cost k10 000)		160,000.00	
Fixtures at cost		8,200.00	
Provision for depreciation: Fixtures			4,200.00
Accounts receivable		61,400.00	
Account payable			26,950.00
Cash at bank		6,130.00	
Inventory at 30 September 2008		62,740.00	
Sales			363,111.00
Purchases		210,000.00	
Carriage outwards		3,410.00	
Discount allowed		620.00	
Loan interest: P Prince		3,900.00	
Office expenses		4,760.00	
Salaries and wages		57,809.00	
Bad debts		1,632.00	
Allowance for doubtful debts			1,400.00
Loan from P Prince			65,000.00
Capitals: Finance			100,000.00
French			75,000.00
Current account: Frame			4,100.00
French			1,200.00
Drawings: Frame		31,800.00	
French		28,200.00	
		640,601.00	640,961.00

Required:
Prepare an income statement and profit and loss appropriate account for the year ending 30 September 2009, and a balance sheet as at that date.

(a) Inventory, 30 September 2009, K74 210.
(b) Expenses to be accrued: Office Expenses K215; Wages K720.
(c) Depreciation fixture 15 per cent on reduction balance basis, buildings K5 000.
(d) Reduce provision for doubtful debts to K1 250.
(e) Partnership salary: K30 000 to France. Not yet entered.
(f) Interest on drawings: Frame K900; French K600.
(g) Interest on capital account balances at 5 per cent.

Frame and French
Income Statement and Profit and Loss Appropriate Accounts for the year ending 30 September 2009

		K	K
Sales			363 111
Less Cost of goods sold:			
Opening inventory		62 740	
Add Purchases		210 000	
		272 740	
Less Closing Inventory		74 210	198 530
Gross profit			164 581
Add Reduction in allowance for doubtful debt			150
Less Salaries and wages (57 809+720)		58 529	
Office expenses (4 760+215)		4 975	
Carriage outwards		3 410	
Discount received		620	
Bad debts		1632	
Loan interest		3 900	
Depreciation: Fixture	600		
Building	5 000	5 600	78 666
Net profit			86 065
Add Interest on drawings			
Frame		900	
French		600	1 500
			87 565
Less Interest on capital			
Frame	5 000		
French	3 750	8 750	
Salary: Frame		30 000	38 750
Balance of profits			48 815
Shared: Frame		29 289	
French		19 526	48 815

NOT FOR SALE

Balance Sheet as at 30 September 2009

Non-current assets	Cost K	Depn k	N.B.V k
Building	210 000	55 000	155 000
Fixtures	8 200	4 800	3 400
	218 200	59 800	158 400
Current assets			
Inventory		74 210	
Accounts receivable	61 400		
Less Allowance (doubtful debt)	1 250	60 150	
Bank		6 130	140 490
Current liabilities			298 890
Account payables	26 590		
Expenses owing	935	27525	
Net current assets			
Non current liabilities			
Loan from P Prince		65 000	(92 525)
			206 365
Financed by			
Capital Accounts: Frame		100 000	
French		75 000	175 000

Capital Account	Frame	French	
Balance 1.20.2008	4 100	1 200	
Add Interest on capital	5 000	3 750	
Salary	30 000		
Balance of profit	29 289	19 526	
	68 389	24 476	
Less drawings	31 800	28 200	
Interest on drawings	900	600	
	35 689	(4 324)	31 365
			206 365

20.10 GOOD WILL

Good will is an intangible asset, which exist if the business was purchased and the amount paid was greater than the value of the net asset in most cases good will represents the value of the reputation of the business at the time it was purchased.

Purchased Good Will = Total prince less value of net identifiable assets.

Reasons for payment of good will
Purchased good will may exist for a business as a result of the following factors:

(a) If the business has a large number of regular customers who will continue to deal with the real owner.
(b) If the business has a good reputation.
(c) If the business has experienced and reliable employee's.
(d) If the business is situated in a good location.
(e) If the business has good contacts with suppliers.

Methods of calculating goodwill

When an agreement has been made between the buyer and the seller concerning how much is to be paid for a business the amount by which the agreed price exceeds the value of the net assets represents the goodwill. Various methods are used to help the buyer and the seller to come up with an agreed figure for a business. The calculations give the buyer and the seller a figure with which to begin discussions of the value of the business.

SUMMARY OF THE CHAPTER

This chapter tackled accounting aspects of other forms of business, namely partnership accounts and manufacturing accounts. Characteristics of partnerships, current and capital accounts, and how the profits are shared were explained. Accounting for goodwill was also introduced

End of chapter questions

Q1(a) Province, Region and Zone are in a partnership called PrEz. They share profits and losses in the ratio 3:2:1 respectively.
For the year ended 31st July 2013, their capital accounts remained fixed at the following amounts:

	K
Province	*800,000*
Region	*600,000*
Zone	*400,000*

The partnership provides for 15% interest per annum on outstanding capital amounts. In addition, Region and Zone receive annual salaries of K500,000 and K300,000 respectively. The net profit of the partnership for the year ended 31 July 2013, before taking any of the above into account, was K3 million.
Required:
Draw up the Partnership Appropriation Account for PrEz for the year ended 31st July 2013.

(b)On 1 August 2006, Province, Region and Zone agreed that goods worth K120,000 should be brought into the business records. On the same date, Tayanjana was admitted into partnership after contributing K400,000 cash as capital.
(i)Draw up the combined PrEz partners' capital accounts after admission of Tayanjana.
(ii) explain how you are getting the capital accounts figures that have been carried forward.

Q2

Lovemore and Loveness are in partnership sharing profits and losses equally.
The following is their trial balance as at 30th June 2013, with all amounts given in thousands of Malawi Kwacha (K000s), as shown.

	Dr	Cr
	K	K
Buildings (Cost K75,000)	50,000	
Fixtures at cost	11,000	
Provision for depreciation : Fixtures		3,300
Trade receivables	16,243	
Trade payables		11,150
Cash at bank	677	
Inventory at 30th June 2012	41,979	
Sales		123,650
Purchases	85,416	
Carriage outwards	1,288	
Discounts allowed	115	
Loan interest : First Merchant Bank	4,000	
Office expenses	2,416	
Salaries and wages	18,917	
Bad debts	503	
Provision for bad debts		400
Loan from First Merchant Bank		40,000
Capitals : Lovemore		35,000
Loveness		29,500
	Dr	Cr
Current accounts : Lovemore		1,306
Loveness	298	
Drawings : Lovemore	6,400	
Loveness	5,650	
	244,604	**244,604**

You are given the following additional information :

(i) Inventory as at 30th June 2013 was K56,340.

(ii) Expenses to be accrued: Office expenses K96; Wages K200.

(iii) Depreciate fixtures at the rate of 10% on reducing balance basis; and building at K1,000.

(iv) Reduce provision for bad debts to K320.

(v) K800 for partnership salary to Lovemore is not yet entered.

(vi) Interest on drawings: Lovemore K180; Loveness K120.

(vii) Capital account balances earn 10% interest.

Required:

(a) Prepare an Income Statement (comprising a trading and profit and loss account and an appropriation account) for the year ended 30th June 2013.

(9 marks)

NOT FOR SALE

(b) Prepare a Statement of Financial Position which should include summaries of partners' capital and current accounts for the year ended that date.
(11 marks)
Note: In both (a) and (b) vertical forms of presentation should be used.

[TOTAL 20MARKS]

CHAPTER 21

LIMITED COMPANIES

21.0 LEARNING OBJECTIVES

The objective of this chapter is to help students understand what items to be included in the financial statements. It also aims to remind the students on how to prepare financial statements in accordance to International Accounting Standards and assist them to differentiate between profit and cash flow, and understand the need for management to control cash flow.

21.1 NEED FOR LIMITED COMPANIES

Limited liability companies, more commonly referred to as limited companies, came into existence originally because of the growth in the size of businesses, and the need to have a lot of people investing in the business who would not be able to take part in its management.

21.1 PRIMARY FINANCIAL STATEMENTS

The preparation of final accounts start with the trial balance. When the debit and credit sides of the trial balance agrees, then the information is used to prepare Statement of Profit or loss and Other Comprehensive Income and Statement of Financial Position.

a) Statement of Profit or Loss and Other Comprehensive Income

This starts with Income (Revenue) for the whole period and then charges to the Income, cost of making that income in the Trading account. This then calculates gross profit which we subtract all expenses of running the business.

Statement of Comprehensive Income for XYZ for the year ending 31st December 2013

		MK
Revenue		XX
Less Return Inwards		(XX)
		XX
Less Cost of Sales (COSA)		
Opening Inventory	XX	
Add Purchases	XX	
	XX	
Less: Closing Inventory	(XX)	(XX)
Gross Profit		XX
Less : Expenses		
Rent	XX	
Salaries and wages	XX	
Water and electricity	XX	
Other operating expenses	XX	(XX)
Profit for the period		XX
Other comprehensive Income		
Revaluation Reserves		XX
Total comprehensive Income		XX

b) A Statement of Financial Position

This is a statement which shows all the list of assets and liabilities. The statement of financial position is a snapshot of what the business is wealth. This statement of financial position is not for the whole year but represents the values as at a particular date. The statement of financial position has the Asset on one side and Capital with liability on the other side. The arrangements of items in the statement of financial position starts with items which are not very liquid enough and ends with very liquid items.

Pro-forma

Statement of Financial Position of XYZ as at 31st December 2013

Non-Current Assets (NBV)	Cost	Dpn	C/	Amount
	MK	MK		MK
Property, Plant and Equipment	XX	XX		XX
Intangible Assets	XX	XX		XX
				XX
Current Assets				
Inventory		XX		
Receivables		XX		
Prepayments		XX		
Bank		XX		
Cash		XX		XX
				XX
Financed by Capital and Liabilities				
Capital				XX
Share Premium				XX
Add: Profit				XX
Other reserves				XX
				XX
Non-Current Liabilities				
Long term loan				XX
Provisions				XX
				XX
Current Liabilities				
Current portion of long term loan		XX		
Payables		XX		
Accruals		XX		XX
				XX

The capital side of a sole trader is represented as follows:

Capital	XX
Add: Profit	XX
	XX
Less: Withdrawals	(XX)
Capital	XX

While as capital side for a partnership is reflected as follows:

Capital	: A		XX
	B		XX
			XX
Current Accounts	:A	XX	
	B	XX	XX
			XX

The above formats mostly refer to sole traders and partnerships. However, with limited companies some items need emphasizing:

Share capital: shareholders of a limited company obtain their reward in form of a share of the profits, known as dividend. Main types of shares are preference shares and ordinary shares. Share capital has different meanings as can be authorized share capital and/or issued share capital. It can also be called-up capital, uncalled capital, calls in arrears, and paid-up capital.

Debentures: this term is used when a limited company receives money on loan, and certificates called debenture certificates are issued to the lender. Interest will be paid to the holder, the rate of interest being shown on the certificate.

Directors' remuneration: as directors exist only in companies, this type of expense is only found in company accounts. Directors are legally employees of the company, appointed by the shareholders. Their remuneration is charged to statement of profit or loss.

A fully worked example

You are to draw up a statement of profit or loss for year ended 31 December 2013 and a statement of financial position as at that date from the following trial balance and details of T Howe Limited:

NOT FOR SALE

	Dr	Cr
	K	K
Bank	6,723	
Trade receivables	18,910	
Trade payables		12,304
Inventory as 31 December 2012	40,360	
Buildings at cost	100,000	
Equipment at cost	45,000	
Profit as at 31 December 2012		15,286
General reserve		8,000
Foreign exchange reserve		4,200
Authorised and issued share capital		100,000
Purchases	72,360	
Sales		135,486
Carriage inwards	1,570	
Carriage outwards	1,390	
Salaries	18,310	
Rates and occupancy expenses	4,235	
Office expenses	3,022	
Sundry expenses		1,896
Provisions for depreciation 30 December 2012:		
Buildings		32,000
Equipment		16,000
Directors' remuneration	9,500	
	323,276	323,276

Notes at 31 December 2013

(i) Inventory at 31 December 2013 was K52,360.

(ii) Rates owing were K280; Office expenses owing were K190.

(iii) Dividend of 10 percent has been proposed.

(iv) Transfers to reserves are: General K1,000; Foreign exchange K800.

(v) Depreciation on cost : Buildings 5 percent; Equipment 20 percent.

Solution

T Howe Limited

Statement of Profit or Loss for the year ended 31 December 2013

Sales			135,486
Less Cost of goods sold			
Opening inventory	40,360		
Add Purchases	72,360		
Add Carriage inwards	1,570		
	114,290		
Less Closing inventory	52,360		
			61,930
Gross profit			73,556
Less Expenses			
Salaries		18,310	
Rates and occupancy		4,515	
Carriage outwards		1,390	
Office expenses		3,212	
Sundry expenses		1,896	
Depreciation: Buildings		5,000	
Equipment		9,000	
Directors' remuneration		9,500	52,823
Net profit			20,733
Add Unappropriated profits from last year			15,286
			36,019
Less Appropriations			
Proposed dividend		10,000	
General reserve		1,000	
Foreign exchange		800	11,800
			24,219

Statement of financial position as at 31 December 2013

Non-current assets	*Cost*	*Depn*	*Net*
Buildings	100,000	37,000	63,000
Equipment	45,000	25,000	20,000
	145,000	62,00_	83,000
Current assets			
Inventories		52,360	
Trade receivables		18,910	
Bank		6,723	
		77,993	
Less Current liabilities			
Trade payables	12,304		
Expenses owing	470		
Proposed dividend	10,000	22,774	
Net current assets			55,219
			138,219
Financed by			
Share capital: authorized and issued		100,000	
Reserves			
Foreign exchange		5,000	
General reserve		9,000	
Profit		24,219	
			138,219

END OF CHAPTER SUMMARY

This chapter was included as a revision on the preparation of financial statements with emphasis for the sole trader and partnerships.
Formatting is an important element in the preparation of financial statements and it is important that students should have a full understanding as to where assets, liability, Capital, income and expenditure are presented in the financial statement.

END OF CHAPTER QUESTIONS

Q1
Apart from statement of profit or loss what are the other statements which are supposed to be produced as part of final accounts?
Q2
What are drawings?
Q3
Determine the purchases figure if the opening inventories were K130,000, closing inventories K150,0000 and cost of sales figure was K800,000

Q4

List items which may appear under non-current liability section in the Statement of Financial position.

Q5

The owner of the Small Enterprise noted that the income statement as prepared by a consultant for the year ended 31 December 2012 was missing.

However, the owner managed to find the following information:

Unadjusted Trail balance as at 31 December 2012

	Dr K	Cr K
Capital		240,000
Profit and loss account		30,000
Purchases	320,000	
Sales		480,000
Stocks	161,000	
Debtors	105,000	
Cash and bank	70,000	
Prepayments – insurance	5,600	
Motor vehicle	112,000	
Accumulated depreciation		37,000
Creditors		84,000
Rent	17,600	
Wages	52,000	
Advertising	27,800	
	871,000	871,000

NOT FOR SALE

Statement of financial position as at 31 December 2012

	K
Capital	240,000
Profit and loss account	67,600
Creditors	84,000
Accruals – wages	8,000
	399,600
Non-current assets	
Motor vehicle	112,000
Accumulated depreciation	(57,000)
	55,000
Current assets	
Stocks	166,400
Debtors	105,000
Cash and bank	70,000
Prepayments	3,200
	399,600

Required:

Prepare a Statement of profit or loss for the year ended 31 December 2008 for the Small Enterprise. **6 Marks**

CHAPTER 22

INCOMPLETE RECORDS

22.0 LEARNING OBJECTIVES

At the end of this chapter, students are expected to construct final accounts from any set of accounting records which fall short of complete double entry. Since in extreme cases there may be no any records whatever of the day-to-day transactions, it is expected that the students shall be able to build up accounts largely from estimates. In other instances, books may have been kept by 'single entry' or data may be available by means of which double entry can be constructed.

22.1 APPROACH TO BE ADOPTED

In order to prepare the Statement of Profit and Loss and Comprehensive Income and the Statement of Financial Position, the following procedure is recommended:

Stage 1

Construct a statement of the financial condition at the beginning of the period. This requires assets and liabilities to be determined.

The values of any non-current assets can be obtained from such details as the trader is able to supply of their cost and the dates upon which they were acquired, provision for depreciation from the date of acquisition to the commencement of the current period being deducted. The trader must provide an estimate of the value of his inventories and particulars of any book debts and liabilities. Accounts should be opened, and estimated asset values posted to the debit side. Total of the book debts should be debited to total trade receivables account, and the total of the liabilities credited to a total trade payables account. This is illustrated in a later section. The excess of the aggregate of the assets over the liabilities may be taken to represent the amount of the trader's capital at the commencement of the period and should be credited to his/her capital account.

Stage 2

A careful analysis should be made of the bank statement, and a cash summary (which may take a form of receipts and payments account). For this purpose, analysis columns should be prepared for each of the principal headings of receipts and payments.

For example, the lodgments into the bank may be analysed under the heading of cash takings, income from investments, the sale of assets, new capital paid in and private income of the trader. Payments from the bank should be analysed as between payments for goods purchased, rent, rates, insurances and other business expenses, cheques cashed for wages, petty cash and personal expenditure, and cheques drawn for the trader's private purposes.

Stage 3

Ascertain the amounts of any cash takings which have not been paid into the bank, but have been used by the trader for the payment of business expenses, goods purchased for cash and personal expenses. An estimate should also be obtained of the value of any inventory which may have been withdrawn by the trader for his own personal use or for that of his/her family.

Stage 4
On completion of the above analysis, postings will be made as follows:

(1) From the debit side of the cash summary:
   (i) cash takings to the credit side of the total trade receivables account;
   (ii) income from investments (if any) to the credit of income from investments account;
   (iii) proceeds of sale of assets (if any) to the credit of the appropriate asset accounts;
   (iv) other items to the credit of the respective accounts.

If a profit or loss on the sale of assets is disclosed, this should be transferred either to Income Statement (the Statement of Profit and Loss and Comprehensive Income) or the proprietor's capital account.

(2) From the credit side of the cash summary:
   (i) payments for goods purchased to the debit of total trade payables account;
   (ii) payments of expenses to the debit of the relevant nominal account;
   (iii) cheques drawn for petty cash to the debit of petty cash account;
   (iv) the proprietor's personal drawings to the debit of his current account;
   (v) the purchase of assets (if any) to the debit of the respective assets accounts.

Stage 5
The amount of any cash takings used for business or private purposes should be noted, the appropriate account debited and the appropriate receivables (trade or other) account credited. Note, however, that in incomplete record situations, private drawings may need to be calculated as a balancing figure.

Stage 6
This involves calculating year-end adjustments and balances.
A schedule should be compiled of the book debts outstanding, the total of which should be carried down in the total trade receivables account. The balance of this account will now represent the total sales for the period and should be transferred to the credit of trading account.

Similarly, s schedule should be made of liabilities outstanding trade and other payables. The total should be carried down in the total trade payables account. The balance of this account will now represent the total purchase for the period and should be transferred to the debit of trading account.

Accruals and prepayments will be carried down as closing balances in the relevant expenses accounts.

Stage 7
The whole of the transactions will now be recorded in total double entry form and it will be possible to extract a Statement of Profit and Loss and Comprehensive Income as well as a Statement of Financial Position in the usual way.

22.3 RELIABILITY OF INFORMATION

The gross profit percentage revealed by the trading account may afford some indication as to the accuracy or otherwise of the data and estimates used in compiling the accounts. If it is found that this percentage is substantially lower than the percentage of gross profit normally earned in the particular trade, doubt would be thrown on the accuracy of the amounts of the opening and closing inventories, purchases or sales. Further enquiry would therefore be necessary. In particular, information should be elicited as to the style in which the trader lives. It will often be found that the amount of cash takings alleged to be withdrawn for private use is wholly incompatible with the size and character of the trader's domestic establishment and mode of life. A re-estimation of the amount of personal drawings might thus be necessary. See section x.5 on Use of the Gross Profit Percentage for further comments.

22.4 ILLUSTRATION 1

(note: the amounts used are for demonstration purpose only)
A is the proprietor of a grocery and general store. He has not previously engaged an accountant. He has informed you that this year the Commissioner of Taxes has refused to accept the account which A has supplied of his trading results for the year ended March 31 2013. That account is as follows:

	K		K
Payment for goods	9,495	Takings	10,930
Payment for expenses	1,130		
Profits	305		
	10,930		10,930

He instructs you to examine his records and prepare accounts.
From your examination of the records and from interviews with your client, you ascertain the following information:

(1) The takings are kept in a drawer under the counter; at the end of each day the cash is counted and recorded on a scrap of paper; at irregular intervals Mrs A transcribes the figures into a notebook; a batch of slips of paper was inadvertently destroyed before the figures had been written into the note book, but Mr and Mrs A carefully estimated their takings for that period, and the estimated figure is included in the total of K10,930.

(2) The following balances can be accepted:

NOT FOR SALE

March 31	2012 K	2013 K
Cash in hand	45	87
Balance at bank	156	219
Book debts	458	491
Payables for purchases of inventory	279	243
Inventory at cost	1,950	1,900

(3) Debts costing K356 were abandoned during the year as bad; the takings included K25 recovered in respect of an old debt abandoned in the previous year.

(4) A rents the shop and living accommodation on a weekly tenancy for K3 per week including rates; the rent is included in expenses of K1,130. The living accommodation may be regarded as one-third of the whole.

(5) The expenses total also includes:

(i) K35 running expenses of A's private car.

(ii) K60 for exterior decoration of the whole premises, the landlord having refused to have this done.

(iii) K160 for alterations to the premises to enlarge the storage accommodation,

(6) A takes K10 per week from the business and hands it over to his wife, who pays all the household and personal expenses except those referred to below.

(7) A pays for his own cigarettes and beer with cash taken from the drawer; this is estimated at K1.50 per week.

(8) A competed in a football pool for 30 weeks of the year, staking K1 each week, buying a postal order with cash taken from the drawer; his winnings totalled K59.

(9) During the year A bought a secondhand car (not used for business) from a friend; the price agreed was K350, but as the friend owed A K67 for goods supplied from the business the matter was settled by a cheque for the difference.

(10) An insurance policy for A's life matured and realized K641.

(11) A cashed a cheque for K100 for a friend; the cheque was dishonored and the friend is repaying the K100 by instalments. He had paid K40 by March 2013.

(12) Other private payments by cheque totalled K96 plus a further sum of K110 for income tax.

(13) You are to provide K42 for accountancy fees.

You are required to prepare:

(a) A Statement of Financial Position of the business as at March 31 2012;

(b) A Statement of Profit and Loss and Comprehensive Income for the year ended March 31 2013; and

(c) A Statement of Financial Position of the business as at March 31 2013.

SOLUTIONS

(a) A Statement of Financial Position of the business as at March 31 2012

Current assets	K
Inventory	1,950
Receivables	458
Cash at bank	156
Cash in hand	45
	2,609
Less payables	279
	2,330

(b) A Statement of Profit and Loss and Comprehensive Income for the year ended March 31 2013

	K	K
Sales		11,638
Opening inventory	1,950	
Purchases	9,459	
	11,409	
Less Closing inventory	1,900	
Cost of sales		9,509
Gross profit		2,129
Rent and rates (2/3 x K3 x 52 weeks)	104	
Sundry expenses	719	
Cost of enlarging storage accommodation	160	
Repairs (2/3 x K60)	40	
Bad debts (356 – 25)	331	
Accountancy fees	42	
		1,396
Net profit for the year		733

Note: the cost of enlarging storage accommodation could be capitalized but it has been written off in the year in which incurred on prudence grounds.

(c) A Statement of Financial Position of the business as at March 31 2013.

Current assets	K	K
Inventory		1,900
Receivables		491
Cash at bank		219
Cash in hand		87
		2,697
Less current liabilities		
Trade payables	243	
Accountancy fees	42	
		285
		2,412

Capital account of A	
Balance at 1 April 2012	2,330
Net profit	733
	3,063
Less drawings	651
	2,412

Workings

CASH SUMMARY

	K		K
Balance 1/4/12 (cash K45;		Expenses	1,130
Bank K156)	201	Purchases	9,495
Bad debt recovered	25	Cash drawings	520
Football pool winnings	59	Personal cigarettes etc	78
Insurance policy	641	Football pools	30
Repaid by friend	40	Car (K350 - K67)	283
Balance cash takings carried		Loan to friend	100
To total receivables account	11,182	Drawings by cheque	96
		Income tax	110
		Balance 31/3/13 (cash K87;	
Bank K219)	306		
	12,148		12,148

TOTAL RECEIVABLES

	K		K
Trade receivables 1/4/12	458	Cash takings	11,182
Balance = sales	11,638	Friend *re* car	67
		Bad debts w/o	356
Trade receivables 31/3/13	491		
	12,096		12,096

TOTAL PAYABLES

	K		K
Cash	9,495	Trade payables 1/4/12	279
Trade payables 31/3/13	243	Balance = purchases	9,459
	9,738		9,738

SUNDRY EXPENSES

	K		K
Cash	1,130	Rent	156
		Car expenses	35
		Repairs to premises	60
		Alterations	160
Balance = sundry expenses	719		
	1,130		1,130

DRAWINGS

	K		K
Cash	520	Football pool winnings	59
Cheques	96	Life policy money	641
Rent (private element)	52	Repayments by friend	40
Private car expenses	35	Balance = net drawings	651
Decorations (house(one-Third of K60)	20		
Purchase of car	350		
Cash paid to friend	100		
Cigarettes etc	78		
Football pools	30		
Income tax	110		
	1,391		1,391

22.5 USE OF THE GROSS PROFIT PERCENTAGE

In the above illustration there was sufficient information to enable the sales figure of K11,638 to be calculated from total trade receivables account.

In some questions, however, such information is not always readily available. In cases such as these, it may be possible to calculate sales indirectly as long as a gross profit percentage is provided.

The approach is quite simple:

(1) Calculate cost of sales:

Opening inventory + purchases – closing inventory;

(2) Convert cost of sales to sales:

eg if gross profit percentage is 20%, sales = 100/80 x cost of sales.

Once sales for the year have been estimated, and opening and closing trade receivables taken into account, the figure of cash takings can be calculated as a balancing figure in the total trade receivables account.

22.6 DEFICIENT ACCOUNTING RECORDS

Where the available records are so deficient that it is impossible to compile a reasonably complete cash summary, the only method of estimating the profit or loss for the period is to prepare statements of affairs showing the 'net worth' of the business at the beginning and at the end of the period respectively.

A statement of affairs for this purpose is a document in the form of a Statement of Financial Position, showing on one side the estimated amounts of the various assets, and on the other the liabilities, the difference between the two sides representing the proprietor's 'net worth' or capital at the date of the statement.

If a statement of affairs has been drawn up at the end of the preceding period, the opening capital for the current period would be shown thereby. It would then be necessary to prepare a similar statement at the end of the current period, and to find the difference between the opening and closing figures of capital, the amount of which, after adding back any sums withdrawn, and deducting any new capital introduced, would represent the profit or loss for the period.

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22.7 ILLUSTRATION 2

J's last statement of affairs prepared at January 1 was:

STATEMENT OF AFFAIRS

January 1

	K		K
Payables	6,000	Office furniture	500
Bills payable	500	Inventories	2,000
Capital account – being		Trade receivables	4,500
excess of assets over		Bills receivable	1,000
liabilities at this date	3,000	Cash	1,500
	9,500		9,500
	=====		=====

On December 31 he finds his liabilities to be: trade payables K4,500, bills payable K700; and his assets: office furniture K450, inventory K1,500, trade receivables K5,300, bills receivable K700, cash K800. His drawings during the period have amounted to K450. What profit has he made?

STATEMENT OF AFFAIRS

December 31

	K		K
Trade payables	4,500	Office furniture	450
Bills payable	700	Inventories	1,500
Capital account – being		Trade receivables	5,300
excess of assets over		Bills receivable	700
liabilities at this date	3,550	Cash	800
	8,750		8,750
	=====		=====

	K
Calculation of profit	
Capital, December 31	3,550
Drawings for the year	450
Capital, January 1	(3000)
Estimated net profit for the year	1,000
	=====

No great difficulty should be experienced in estimating values of the assets and liabilities at the end of the period under review, provided that the work of preparing the statement is undertaken shortly after that date, since the necessary material for the valuation will probably be still accessible. The preparation of earlier statements may present more difficulty, and the most searching enquiries may have to be made. Needless to say, this method of ascertaining results is most unsatisfactory, and the trader should be advised to install double entry book-keeping without delay.

SUMMARY OF THE CHAPTER

The chapter explained how accounts may be prepared from incomplete records. There are different situations where this approach may be appropriate. However, reliability of the information may be brought into question at times since the amounts used are mainly based on estimates.

END OF CHAPTER QUESTION

Q1 The following information is relevant to the calculation of the sales figure for Spencer, a sole trader who does not keep full accounting records but has opted to maintain all financial records in hard currency:

	K
Opening receivables	29,100
Cash received from credit customers and paid into the bank	381,600
Expenses paid out of cash received from credit customers before banking	6,800
Irrecoverable debts written off	7,200
Discounts allowed to credit customers	9,400
Cash sales	112,900
Closing receivables	38,600

What figure should appear in Spencer's trading account for sales?

EXAMINATION TYPE QUESTIONS

Question 1

You are provided with the following information for a receivables account of customer Liwiro:

Liwiro

2013		K	2013	K
May 1	Sales	20,500	May 17 Bank	30,000
May 14	Sales	36,000	May 28 Returns	5,000
May 31	Sales	18,000		

Required:

Establish the balance on this account at 31st May 2013 1 Marks

Question 2

(a) You are given the following figures for the year 2013 for Tayamba Kick Starters, a new business venture.

	MK
Inventories at 01st January 2013	400,000
Inventories at 31st December 2013	600,000
Purchases	5,200,000

A uniform rate of mark-up of 20% is applied.

Required:

Calculate the Cost of Goods Sold, Sales and Gross Profit figures for the business for the year ended 31st December 2013. *Show all your workings*. Prove your answer by preparing a trading account for the **(8 marks)**

(b) Scott Tabeledwa had the whole of his stock stolen from his warehouse on the night of 20 August 2013. Also destroyed were his sales and purchases journals, but the sales and purchases ledgers were salvaged. The following facts are known:

i. The amount for inventories was known at the last Statement of Financial Position date, 31st March 2013, to be MK1,248,000 at cost.

ii. Receipts from debtors during the period 01st April 2013 to 20th August 2013 amounted to MK3,174,500. Trade receivables at 31st March 2013 were MK1,427,800, at 20th August 2013 they were MK1,233,300

iii. Payments to creditors during the period 01st April 2013 to 20th August 2013 amounted to MK1,727,000. Trade payables at 31st March 2013 were MK763,300 and at 20th August 2013 they were MK628,900.

iv. The gross profit margin on all sales had been constant at 25%.

Required:

Construct a trading account for Scott Tabeledwa for the period ended 20th August 2013. You are expected to show the flow of all your workings.

(12 marks)

[TOTAL 20MARKS]

ANSWERS TO END OF CHAPTER QUESTIONS

Chapter 1

Answer 1
Text Section 1.4

Answer 2

Qualities of good accounting information

*Any **five** of:*

Relevance and purpose
Timeliness
Accuracy
Completeness
Communicated to the right person
Reliability
Comparability
Materiality
Appropriate channel of communication.

Note: Students should be able to explain in detail each of the given characteristic.

Answer 3

See text.

EXAMINATION TYPE QUESTION

(a) Fundamental accounting concepts are wide assumptions that are used in preparing the periodic financial accounts of a business. Examples are going concern, matching (accruals), prudence (conservatism) and consistency. These concepts are of overriding importance.

Accounting bases are the methods for applying fundamental accounting concepts to financial transactions and to items in financial accounts. Instances where the bases are important are: when accounting for stock, one may use FIFO, LIFO and AVCO as bases; straight line, reducing balance, (units of) output, depletion unit, machine hours rate, revaluation, sum of (years) digits may be used to depreciate non current assets.

(b) Relevance means the policy should produce information that is useful for assessing stewardship and for making economic decisions.

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Reliability means the policy must reflect substance of the transactions and other events that have occurred; neutral/free of bias; free of error. If produced under uncertainty, prudence ought to have been exercised.

Comparability means the outcome of applying the policy can be compared with similar information about the entity for some other period or point in time.

Understandability means the policy is capable of being understood by users who have a reasonable knowledge of business and economic activities and accounting.

Chapter 2

Answer 1

See text.

EXAMINATION TYPE QUESTION

See text (Section 2.2)

Chapter 3

Answer 1

An accounting equation example

Suppose a business reports MK2.5 million in total assets. The total of its liabilities, plus the capital invested by its owners, plus its retained profit, adds up to MK2.5 million. Otherwise, its books would be out of balance, which means there are bookkeeping errors.

Continuing with this example, suppose that the total amount of the liabilities of the business is MK1.0 million. This means that the total amount of owners' equity in the business is MK1.5 million, which equals total assets less total liabilities. The total owners' equity may be traceable to capital invested by the owners in the business as well as profit retained in the business. The total of these two sources of owners' equity is MK1.5 million.

The financial condition of the business in this example is summarized in the following accounting equation (in millions):

MK2.5 assets = MK1.0 liabilities + MK1.5 owners' equity

Looking at the accounting equation, one can see why the statement of financial condition is called the balance sheet; the equal sign means the two sides balance.

Note: This explains the dual aspect of accounting entries

EXAMINATION TYPE QUESTION

Indicating accounting effects of transactions on the accounting equation, showing the amounts and naming the assets and liabilities to be affected:

Transaction number	effects on assets	effects on liabilities	effect on capital
(a)	Increase in inventories by MK1,783,500	Increase in creditors by MK1,783,500	No effect
(b)	Increase in bank by MK628,325	No effect	Increase by MK628,325
(c)	Decrease in debtors by MK370,000 Increase in bank by MK370,000	No effect	No effect
(d)	Decrease in cash by MK10,000	Decrease in loans by MK10,000	No effect
(e)	Increase in land and buildings by MK1,388,000 Decrease in bank by MK1,388,000	No effect	No effect
(f)	Increase in cash by MK92,300	Increase in payables by MK92,300	No effect
(g)	Decrease in cash by MK77,000	Decrease in payables/creditors by MK77,000	No effect
(h)	Decrease in inventories by MK60,000	Decrease in payables/creditors by MK60,000	No effect
(i)	Decrease in cash by MK172,000	No effect	Decrease in capital by MK172,000
(j)	Increase in inventories by MK488,000	Decrease in cash by MK488,000	No effect

Whereas the items with 'no effect' may not attract any marks, the other two items which have the effects (an increase or a decrease) should be awarded ½ mark each, thus **1 mark each** per item.

(TOTAL: 20 MARKS)

Chapter 4

Answer 1

A transaction an event that take place in a business arrangement which will have a twofold effect on the statement of financial position bringing forth a change to the statement.

Answer 2

Pay As You Earn
Employees contributions to pension fund
Salary advances

Chapter 5

Answer 1

Books of original entry or books of prime entry

Answer 2

These are important because they are the books in which credit sales, purchases, and returns inwards and outwards of goods are first recorded. The details are then posted from them to the ledger accounts.

EXAMINATION TYPE QUESTION

(a) Sales day book (or sales journal or simply sales book)
Purchase day book (or purchase journal or simply purchases book)
Returns inwards day book (or returns inwards journal or returns inwards book); in every case 'return inwards' may be substituted by the term 'sales returns'
Returns outwards day book (or returns outwards journal or returns outwards book); 'returns outwards' may be referred to as 'purchases returns'.
Cash book or Petty cash book
General journal (or Journal if the term day book is used for other books of original entry)

(any 2 of the above, 1 mark each = 2 ,marks)

(b) **Purchases Day Book**

(1) Farouk Patel Stores 900,000 1 mark (½ for working, ½ for final answer)

(23) C Karim 1,050,000 1 mark (½ for working, ½ for final answer)

(31) Haroon 1,800,000 1 mark (½ for working, ½ for final answer)

3,750,000 ½

Sales Day Book

(8) Wasubweni 720,000 ½

(15) Mumderanji Simfukwe 2,400,000 1 mark (½ for working, ½ for final answer)

(24) Matofotofo 810,000 1 mark (½ for working, ½ for final answer)

3,930,000 ½

(6½ marks, but up to a maximum of 6 marks)

Purchases Ledger **Sales Ledder**

Farouk Patel Stores *Wasubweni*

(1) Purchases 900,000 (8) Sales 720,000

C Karim *Mumderanji Simfukwe*

(23) Purchases 1,050,000 (15) Sales 2,400,000

Haroon *Matofotofo*

(31) Purchases 1,800,000 (24) Sales 810,000

(Specifying the types of ledger concerned, ½ mark each making a total of 1 mark, listing the items as presented 1 mark for each item making a total of 6 marks; Purchases ledger has entries to the credit side and sales ledger has entries to the debit side:- this presentation should attract another 2 marks = 8 ½ marks available, with a maximum of 8 marks).

General Ledger

Sales Account

(31) Total for month 3,930,000 2 marks

Purchases Account

(31) Total for month 3,750,000 2 marks

(TOTAL: 20 MARKS)

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Chapter 6

Answer 1

a. *Deposits in transit*
These are deposits that are in the cash per books but not in the cash per bank statement. The reason is that there is delay between when the cash gets recorded on the books and when the bank records the deposit. Deposits in transit are determined by comparing the deposits listed on the books with the deposits listed on the bank statement.

b. *Outstanding checks*
These are checks that have been deducted from the cash per the books but not the cash per the bank statement. The reason is that there is a delay between when the check gets recorded on the books and when the bank records the check. Outstanding checks are determined by comparing the check disbursements on the books with the checks listed on the bank statement.

c. *Bank charges*
An expense for bank services that is listed on the bank statement but is not recorded on the company's books.

d. *Non-sufficient fund cheques (NSF cheques)*
A customer payment by cheque that has been recorded as a deposit on the books but was not collectible because of insufficient funds in the account of the customer.

Other terms are:

***Service charges** which may have been deducted by the ban. Such charges are usually not known to the company before the issuance of bank statement.*

Interest income: If any interest income has been earned by the company on its bank account, it is not usually entered in company's account before issuance of bank statement.

Answer 2

Company A
Bank Reconciliation
31 December, 2013

Balance as per Bank, Dec 31	*K24,594.72*
Add: Deposit in Transit	*400.00*
	K24,994.72

Less: Outstanding Cheques:		
No. 846 issued on Nov 29	*K320.00*	
No. 875 issued on Dec 26	*49.21*	
No. 878 issued on Dec 29	*275.00*	
No. 881 issued on Dec 31	*186.50*	
		830.71
Adjusted Bank Balance		***K24,164.01***
Balance as per Books, Dec 31		***K23,196.79***
Add:		
Interest Income from Bank	*K1,237.22*	
Note Receivable Collected by Bank	*500.00*	
Interest Income from Note Receivable	*50.00*	
Deposit Understated	*90.00*	
		1,877.22
		K25,074.01
Less:		
NSF Cheque	*850.00*	
Bank Service Fee	*50.00*	
Bank Collection Fee	*10.00*	
		910.00
Adjusted Book Balance		***K24,164.01***

Note: The reconciliation can start with balance as per Bank Statement and then reconcile towards obtaining an adjusted Cash Book balance or Balance per Cash Book (as adjusted) and reconcile towards getting a Balance per Bank Statement.

EXAMINATION TYPE QUESTION

(a) Trade Discount *and* Cash Discount

Trade Discount is a deduction in price given to a trade customer when calculating the price to be charged to that customer for some goods **1.** It does not appear anywhere in the accounting books and so does not appear anywhere in the financial statements **1**. On the other hand, a cash discount appears in income statement, with discount allowed (a deduction from the amount due given to customers who pay their accounts within the time allowed) appearing as an expense in the income statement **1.5** and discount received (a deduction from the amount due given to a business by a supplier when their account is paid before the

time allowed has elapsed) appearing as income in the income statement **1.5**. (Maximum **4 marks**)

(b) Bank Loan *and* an Overdraft (Bank Overdraft Facility)

Bank loan is an amount of money which a client advances from a bank that has a fixed (known or predetermined) rate of interest that is charged on full amount and is repayable on a specified future date (**0.5** mark each for'advances from a bank', 'predetermined rate', and 'specified future'=subtotal=**1.5** marks); overdraft is a facility granted by a bank that allows a customer holding a current account with the bank to spend more than the funds in the account. Interest is charged daily on the amount of the overdraft on that (given) date and the overdraft is repayable at any time upon request from the bank (**0.5** mark each for 'facility granted by a bank', 'customer holding a current account', 'interest is charged daily' and 'repayable on demand' = subtotal **= 2** marks). Also, **0.5** mark each for an example given in either case, subtotal **1** mark. Marks available are therefore 1.5+2+1= 4.5 marks, Maximum **4 marks**).

Chapter 7

Answer
A nominal ledger consists of a large number of coded accounts. Part of a nominal ledger might, for example, be as follows:

Account code	Account name
100200	*Plant and machinery (cost)*
100300	*Motor vehicles (cost)*
300000	*Total receivables*
400000	*Total payables*
500130	*Wages and salaries*
500140	*Rent and rates*
500150	*Advertising expenses*
500160	*Bank charges*
500170	*Motor expenses*
500180	*Telephone expenses*
600000	*Sales*
700000	*Cash*

Chapter 8

Answer

Various types of transactions are expected and their effect on capital will have to be explained.

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Attika Mwasera
Bank

	K		K	
(1)Capital	100,000	(25) Fatsani	10,700	**1**
(6)Cash	2,500	(29) Chelsea Motors	26,000	**1**

Cash

	K		K	
(2) Tatandala (loan)	4,000	(6) Bank	2,500	**1**
(24) Sales	700	(20) Purchases	2,200	**1**
(28) Capital	5,000	**0.5**		

Sales

		K
(8) Chazilala	1,800	**0.5**
(14) Moyenda	1,900	**0.5**
(14) Penyani	3,200	**0.5**
(24) Cash	700	**0.5**

Purchases

	K			
(3) Fatsani	8,400	**0.5**		
(3) Sokosa	36,000	**0.5**		
(21) Cash	2,200	**0.5**		

Return inwards

	K			
(12) Chazilala	400	**0.5**		
(26) Moyenda	300	**0.5**		

Return outwards

			K	
		(15) Fatsani	1,400	**0.5**
		(19) Sokosa	1,100	**0.5**

Van (or Srap van)

	K			
(17) Chelsea Motors	26,000	**0.5**		

Chelsea Motors

K			K			
	(29)	Bank	26,000	(17)	Van (or Scrap van)	26,000**1**

Office furniture

		K			K
(18)	Kalipentala	6,000	(2)	Kalipentala	1,600**1**

Kalipentala

		K			K
(27)	Office furniture	1,600	(18)	Office furn	6,000 **1**

Tatandala (Loan)

		K			
(2)	Cash	4,000 **0.5**			

Capital

		K			
			(1)	Bank	100,000 **0.5**
			(28)	Cash	5,000 **0.5**

Fatsani

		K			K
(12)	Returns	1,400	(3)	Purchases	8,000 **1**
(28)	Bank	10,700**0.5**			

Sokosa

	K		K	
(19) Returns	1,100	(3) Purchases	36,000	**1**

Moyenda

	K		K	
(14) Sales	1,900	(26) Returns	300	**1**

Chazilala

	K		K	
(6) Sales	1,800	(8) Returns	400	**1**

Penyani

	K	
(14) Sales	3,200	**0.5**

[TOTAL 20MARKS]

Chapter 9

Answer 1

Double entry book-keeping

The fundamental rule is that if there is an increase or decrease in one account, there will be equal decrease or increase in another account. There may be equal increases to both accounts, depending on what kind of accounts they are. There may also be equal decreases to both accounts. Accordingly, the following rules of debit and credit in respect to the various categories of accounts can be obtained. The rules may be summarised as below:

1. *Assets Accounts: debit increases in assets and credit decreases in assets*
2. *Capital Account: credit increases in capital and debit decreases in capital*
3. *Liabilities Accounts: credit increases in liabilities and debit decreases in liabilities*

4. *Revenues or Incomes Accounts: credit increases in incomes and gains and debit decreases in incomes and gains*
5. *Expenses or Losses Accounts: debit increases in expenses and losses and credit decreases in expenses and losses*

These five rules help learning about accounting entries.

Note: The trial balance would conveniently periodically be extracted after balancing off relevant accounts.

Chapter 10

Balancing off accounts and trial balance extraction

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Capital

	K		K
Balance carried forward	30,000	Cash	8,000
Bank	22,000		
30,000			
30,000			
		Balance brought down	30,000

Cash

	K		K
Capital	8,000	Rent	1,800
Carriage inwards	380		
		Balance carried forward	5,820
	8,000		**8,000**
Balance brought down	5,820		

Bank

	K		K
Capital	22,000	J Mwandama	5,300
S Chisale	3,400	P Gomani	2,130
		Rent	2,300
		Balance c/forward	15,670
	25,400		**25,400**
Balance brought down	15,670		

J Mwandama

	K		K
Bank	5,300	Purchases	6,100
Balance carried forward	800		
	6,100		**6,100**
		Balance brought forward	800

P Gomani

	K		K
Bank	2,130	Purchases	2,130

N Thindwa

	K		K
Balance carried forward	5,240	Purchases	5,240
	5,240		**5,240**
		Balance brought forward	5,240

Purchases

	K		K
J Mwandama	6,100	Balance carried forward	25,780
P Gomani	2,130		
N Thindwa	5,240		
K Mandala	2,910		
D Sokosa	9,400		
	25,780		**25,780**
Balance brought down	25,780		

Sales

	K		K
Balance brought forward	18,700	S Chisale	3,400
		G Lungumadzi	7,200
		F Bononwe	8,100
	18,700		**18,700**
		Balance brought forward	18,700

S Chisale

	K		K
Sales	3,400	Bank	3,400

G Lungumadzi

	K		K
Sales	7,200	Balance carried forward	7,200
	7,200		**7,200**
Balance brought down	7,200		

Rent

	K		K
Cash	1,800		
Bank	2,300	Balance C/f	4,100
	4,100		**4,100**
Balance brought down	4,100		

Carriage Inwards

	K		K
Cash	380	Balance carried forward	380
	380		**380**
Balance brought down	380		

K Mandala

	K		K
Balance carried forward	2,910	Purchases	2,910
	2,910		**2,910**
		Balance brought down	2,910

D Sokosa

	K		K
Balance carriedforward	9,400	Purchases	9,400
	9,400		**9,400**
		Balance brought down	9,400

F Bonongwe

	K		K
Sales	8,100	Balance carried forward	8,100
	8,100		**8,100**
Balance brought forward	8,100		

Trial Balance as at 31st May 2013

	Dr K	Cr K
Capital		30,000
Cash	5,820	
Bank	15,670	
Trade payables (800+5,240+2,910+9,400)		18,350
Inventories*	25,780	
Sales		18,700
Trade receivables (7,200+8,100)	15,300	
Rent	4,100	
Carriage inwards	380	
	67,050	**67,050**

**Note :The purchases (merchandise) go to inventories account since they are stocks in trade*

EXAMINATION TYPE QUESTION

(i) (1) Add up both sides of an account to find out their totals (nothing is written in the account as yet).

(2) Deduct the smaller total from the larger total to find the balance.

(3) Now enter the balance on the side with smaller total (This means that now the totals will be equal).

(4) Enter totals on level with each other.

(5) Now enter the balance on the line below the totals on the opposite side to the balance shown above the totals.

(ii) This is usually done at 'close off' of an account at month end, before 'opening' it the following month.

(i) It is because the balances are carried down/forward, and brought down/forward, accordingly.

Chapter 11

Answer 1

(a) *Bad debts*

2013		*2013*	
Dec 31 various	*540,000*	*Dec 31 Income Statement*	*540,000*

(b) Allowance for doubtful debts

Dec 31 Balance b/d	*310,000*	*Jan 1 Balance b/d*	*260,000*
		Dec 31 Income Statement	*50,000*
	310,000		*310,000*

(c) *Income Statement (extract)*

Bad debts	*540,000*
Allowance for doubtful debts	*50,000*

(d) *Statement of Financial Position*

Trade receivables	*6,200,000*
Less allowance for doubtful debts	*310,000*
	5,890,000

Answer 2

During the year, some debts will have been written off as bad. They will include debts from the previous year which last year's provision was intended to cover. If last year's estimate was correct, the accountant could add this year's bad debts to the change in the provision and the total would be the same as the total provision he/she wants to make this year, not just the difference between the two year's provisions (allowance or estimate). Son in effect, the accountant has converted last year's provision into this year's bad

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debts. All he/she need do now is adjust the balance on the provision for doubtful debts account to make it equal to the provision he/she wants to make against this year's closing trade receivables balance.

Chapter 12

Answer 1

	Machines		
	A	*B*	*C*
Bought 1 Jan 2011	*3,000,000*		
2011 Depn 10% for 12 months	*300,000*		
	2,700,000		
Bought 1 Apr 2012		*2,000,000*	
2012 Depn 10% x2,700,000	*270,000*		
Depn 10% for 9 months	*150,000*		
	2,430,000	*1,850,000*	
Bought 1 Jul 2013			*1,000,000*
2013 Depn 10% x2,430,000	*243,000*		
Depn 10% x1,850,000		*185,000*	
Depn 10% for 6 months			*50,000*
	2,187,000	*1,665,000*	*950,000*

2013 Total Depreciation Provision 243,000 + 185,000 + 50,000 = 478,00

Answer 2

Unit of output method of depreciation establishes the total units of output expected from the asset. Depreciation, based on cost less salvage value, is then calculated for the period's output over the life of the asset.

An instance of this could be a machine which is expected to be able to produce 10,000 widgets over its useful life. It has cost K6,000.000 with zero expected salvage value. In year 1 a total of 1,500 widgets are produced, and in year 2 the production is 2,500 widgets.

The depreciation per period is calculated as:

$$(\text{Cost} - \text{salvage value}) \times \frac{\text{period's production}}{\text{Total expected production}}$$

$$\text{Year 1 : K6,000,000} \times \frac{1,500}{10,000} = \text{K900,000 depreciation}$$

$$\text{Year 2 : K6,000,000} \times \frac{2,500}{10,000} = \text{K1,500,000 depreciation}$$

EXAMINATION TYPE QUESTION

(a) Machine traded in

	K
Cost	10,000,000
Depreciation (*W1*)	4,880,000
NBV	5,120,000
Proceeds	5,000,000
Loss	120,000

W1 Cost K10,000,000 Depreciation Year 1 2,000,000 (K10m x 20%)
Year 2 1,600,000 (K 8m x 20%)
Year 3 1,280,000 (K6.4m x 20%)
4,880,000

(b)

	K
Cost of assets (K70,000,000+20,000,000-10,000,000)	80,000,000
Depreciation to date:	
Opening balance (K70,000,000 – K50,000,000)	20,000,000
Eliminated	4,880,000
	15,120,000

Balance before current year charge
NBV = K80,000,000 – K15,120,000 = K64,880,000
Depreciation = NBV x 20% = charge 12,976,000

(c) (i)

Machinery Cost Account

	K		K
Balance brought forward	70,000,000	Disposal account (cost)	10,000,000
Disposal account proceeds	5,000,000		
Payables (K20m – K5m)	15,000,000	Balance carried forward	80,000,000
	90,000,000		90,000,000

(ii)

Accumulated Depreciation Account

	K		K
Disposal account	4,880,000	Balance brought forward	20,000,000
Balance carried forward	28,096,000	Depn charge account	12,976,000
	32,976,000		32,976,000

(d) Depreciation 12,976,000
Loss 120,000
13,096,000

(e) Non-Current Assets

Cost	80,000,000
Accumulated Deprecation	28,096,000
	51,904,000

**Accumulated depreciation is made up of:*

b/f	15,120,00
Charge	12,976,000

Current liabilities

Payables	15,000,000

i.e New machine cost K20m less trade-in value K5m

Chapter 13

Answer 1

Between receivables and bank.

Answer 2

Between payables and bank overdraft.

Answer 3

Ndazizwa Packaging materials account

for the year ended 28th February 2014

2014	K	2014	K
February 28 Bank	2,200,000	February 28 Inc Statement	1,800,000
		February 28 Inc Statement	400,000
	2,200,000		2,200,000
		March 1 Inventory b/d	400,000

Chapter 14

(a) Income statement for HKJ Trading for the year ending 30 November 2013

	K	K
Sales		820,000
Less: return inwards		(25,000)
		795,000
Less: Cost of goods sold		
Opening inventories	80,000	
Purchases	465,000	
Carriage inwards	15,000	
Return outwards	(30,000)	
Closing inventories	(90,000)	440,000
Gross profit		355,000
Less: Expenses		
Carriage outwards	40,000	
Salary and wages	60,000	
Insurance costs (20,000 + 6,000)	26,000	
Advertisements	60,000	
Rates	10,000	
Rent (35,000 – 5,000)	30,000	
Provision for doubtful debt	5,400	
Discount allowed	10,000	
Depreciation – Motor van	60,000	
– Equipments	30,000	331,400
Net profit		23,600

NOT FOR SALE

Chapter 15

(b) Balance sheet for HKJ Trading as at 30 November 2013

	K	K
Noncurrent assets		
Property plant and equipment		390,000
Current assets		
Inventories	90,000	
Receivables	174,600	
Prepayments	5,000	269,600
		659,600
Capital and Liabilities		
Capital		500,000
Profit		23,600
Drawings		(40,000)
		483,600
Liabilities		
Payables	120,000	
Bank	50,000	
Accruals	6,000	176,000
		659,000

Chapter 16

Inventory Valuation

(a) Value of inventories using FIFO & Average Cost

(i) FIFO

Date	Purchases	Issues	Balance c/d
1/10			2,000 @ K300 = 600,000
4/10	1,000 @ K320 = 320,000		1,000 @ K320 = 320,000
7/10		2,500 @K320	500 @ K320 = 160,000
10/10	3,000 @ K300 = 900,000		3,000 @ K300 = 900,000
15/10	1,000 @ K320 = 320,000		1,000 @ K320 = 320,000
20/10		2,000	1,500 @ K300 = 450,000
			1,000 @ K320 = 320,000
25/10	1,500 @ K330 = 495,000		1,500 @ K330 = 495,000
30/10		2,000	500 @ K320 = 160,000
			1,500 @ K330 = 495,000
			2,000 655,000

(ii) Average Cost

Date	Purchases	Issues	Balance		
			Units	Price	Amount
1/10			2,000	300	600,000
4/10	1,000 @ K320 = 320,000		3,000	307	920,000
7/10		2,500	500	307	153,500
10/10	3,000 @ K300 = 900,000		3,500	301	1,053,500
15/10	1,000 @ K320 = 320,000		4,500	305	1,373,500
20/10		2,000	2,500	305	762,500
25/10	1,500 @ K330 = 495,000		4,000	314	1,257,500
30/10		2,000	2,000	314	628000

Chapter 17

(a) Five errors which do not affect trial balance

(i) Error of principle – where an item is entered in the wrong class of account.

(ii) Error of commission – where an item is entered in the wrong personal account.

(iii) Error of omission – where a transaction has not been recorded in the books of accounts.

(iv) Error of original entry – where the original figure is incorrect, yet double entry still has been observed.

(v) Compensating error – where errors cancel out each other.

(vi) Complete reversal error – where the correct amount has been used but each item is shown on the wrong side of the accounts.

(vii) Transposition error – where the wrong sequence of individual characters within a number was entered but the double entry is done correctly.

(b) Journal entries to correct errors

			K	K
(i)	Dr	Suspense Account	18,000	
	Cr	Purchases Account		18,000
(ii)	Dr	Suppliers (Creditors) Account	30,000	
	Cr	Discount received account		30,000
(iii)	Dr	Cash book	40,000	
	Cr	Sales		40,000
(iv)	Dr	Customers control account	12,000	
	Cr	Cash book		12,000
(v)	Dr	Purchases	70,000	
	Cr	Fixed assets account		70,000
(vi)	Dr	Suspense account	60,000	
	Cr	Cash book		60,000
(vii)	Dr	Salaries account	65,000	
	Cr	Suspense account		65,000

Chapter 18

End of chapter questions

See text.

(a) Control accounts

(i) Receivable Control Accounts

Balance b/f	140,000	Bad debts	12,000
Credit sales	600,000	Control a/c	25,000
Interest on receivables	4,000	Cash	380,000
Dishonoured cheque	8,000	Discount	17,000
		Return inwards	11,000
		Balance c/d	307,000
	752,000		752,000
Balance b/d	307,000		

(ii)

Payable Control Account

Contra account	25,000	Balance b/f	90,000
Return outwards	14,000	Purchases	400,000
Cash	250,000		
Discount	10,000		
Balance c/d	191,000		
	490,000		490,000
		Balance b/d	191,000

(b) Differences in balances between payables ledger and suppliers statement.

(i) Goods in transit from supplier.
(ii) Payment made which has not yet been received by the supplier.

Goods returned outwards – returns to the supplier.

Chapter 19

End of chapter questions

See text.

Bank lodgments and direct debit

Bank lodgments refer to deposits which have been made on the date when the bank statement has been obtained and therefore not reflected in the statement received. Direct debits refers to transfers which are made by the bank directly from the account to the suppliers (payables).

(b) Updated cash book

Cash book

	K		K
Credit transfer	20,000	Balance b/f	38,000
Balance c/d	102,000	Bank charges	4,000
		Direct debit	25,000
		Returned cheque	45,000
		Standing order	10,000
	122,000		122,000

NOT FOR SALE

(c) Bank reconciliation statement

			K
Balance per updated cash book			(102,000)
Add: Unpresented cheques			
H Sitima	0024	30,000	
City rates	0026	18,000	
Kabula Pvt	0029	15,000	63,000
			(39,000)
Less: Bank lodgments			(15,000)
Balance per bank statement			(54,000)

Chapter 20

Answer 1

(a) PrEz

Partnership Appropriation Account for the year ended 31st July 2013

	Province	*Region*	*Zone*	*Total*
Interest on capital accounts (at 15%)	*120,000*	*90,000*	*60,000*	*270,000*
Salaries	*500,000*	*300,000*	*800,000*	*1,070,000*
Share of balance of profits (3,000,000 less 1,070,000i.e 1,930,000 3/6; 2/6; 1/6	*965,000*	*643,333*	*321,6671,*	*930,000*
	1,085,000	*1,233,333*	*681,667*	*3,000,000*

(b) (i) Combined PrEz Partners' Capital Accounts after admitting Tayanjana

	Province	*Region*	*Zone*	*Tayanjana*
Bal b/d	*1,085,000*	*1,233,333*	*681,667*	
Inventories	*60,000*	*40,000*	*20,000*	
Cash				*120,000*
	1,145,000	*1,273,333*	*701,667*	*120,000*

(ii) The capital accounts amounts are amounts that have been accumulated and shared from the previous partnership. That is the sharing of the total profit of K3 million.

EXAMINATION TYPE QUESTION

(a) Lovemore *and* Loveness

Income Statement (trading and profit and loss account) for the year ended 30th June 2013

	K000s	K000s	K000s
Sales			123,650
Less Cost of goods sold :			
Opening inventory		41,979	
Add purchases		85,416	
		127,395	
Less Closing inventory		56,340	71,055
Gross profit			52,595
Add Reduction in provision for doubtful debts			80
			52,675
Less Salaries and wages (18,917 + 200)		19,117	
Office expenses (2,416 + 96)		2,512	
Carriage outwards		1,288	
Discounts allowed		115	
Bad debts		503	
Loan interest		4,000	
Depreciation : Fixtures	770		
Buildings	1,000	1,770	29,305
Net profit			23,370
Add Interest on drawings : Lovemore			180
Loveness			120
			23,670
Less Interest on capitals : Lovemore		3,500	
Loveness		2,950	
Salary : Lovemore		800	7,250
			16,420
Balance of profits shared : Lovemore	8,210		
Loveness	8,210		16,420

(**20**entries, **0.5** mark each, i.e. excluding all (sub) totals = 10 marks, but maximum = **9 marks**)

(b)

Statement of Financial Position as at 30th June 2013 (all amounts are in K000s)

	Cost	Depn	NBV
Non- current assets			
Buildings	75,000	26,000	49,000
Fixtures	11,000	4,070	6,930
	86,000	30,070	55,930
Current assets			
Inventory			56,340
Trade receivables	16,243		
Less Provision for doubtful debts	320		15,923
Bank			677
			72,940
Less Current liabilities			
Trade payables	11,150		
Expenses owing	296	11,446	61,494
			117,424
Less Loan from First Merchant Bank			40,000
			77,424
Financed by			
Capitals : Lovemore 35,000			
Loveness 29,500			64,500

Current accounts	Lovemore	Loveness	
Balance 1.7.2012	1,306	298	
Add Interest on capital	3,500 **0.25**	2,950 **0.25**	
Add salary	800		
Add Balance of profits	8,210 **0.25**	8,210 **0.25**	
	13,816	11,458	
Less Drawings	6,400	5,650	
Less Interest on drawings	180 **0.25**	120 **0.25**	
	7,236	5,688	12,924
			77,424

21 entries, excluding (sub) totals at **0.5**mark each = **10.5** marks, add **0.25** x 6 i.e **1.5** marks indicated on the answer. Total is thus 12 marks, but maximum is **11 marks**.

[TOTAL 20MARKS]

Chapter21

Statement of profit or loss for the year ended

31 December 2012

Sales		480,000
Opening inventories	161,000	
Purchases	320,000	
Less Closing inventories	166,400	
Cost of goods sold		314,600
Gross profit		165,400
Administration expenses		
Insurance (5,600 – 3,200)		2,400
Rent17,600		
Wages (add 8,000 accrued)		60,000
Distribution expenses		
Depreciation (84,000 – 57,000)		27,000
Advertising 27,800		
Net profit for the year		30,600
Add balance brought forward		67,600
		98,200

NOT FOR SALE

Start by drafting a receivables account.

Receivables account

	Dr		Cr
	K		K
Balance b/d			
Balance b/d		Balance c/d	

Now fill in the figures that you have starting with opening and closing balances.

Receivables account

	Dr		Cr
	K		K
Balance b/d	29,100		
		Balance c/d	38,600
Balance b/d	38,600		

Now think about your sales ledger control account and enter the transactions.

Receivables account

	Dr		Cr
	K		K
Balance b/d	29,100	Cash received (381,600 +6,800)*	388,400
Credit sales	414,500	Irrecoverable debts	7,200
		Discounts allowed	9,400
		Balance c/d	38,600
	443,600		**443,600**
Balance b/d	38,600		

** the expenses paid out before the cash was banked reduced the amount banked overall. That means that the amount received from customers will be higher by K6,800.*

Total sales = credit sales K414,500 (above) + cash sales K112,900 (from the question) = K527,400

An alternative answer would include all cash received from customers which means including the cash sales as cash received. As you can see it gives the same overall answer.

Receivables account

Dr			Cr
	K		K
Balance b/d	29,100	Cash received (381,600 +6,800)*	501,300
Total sa	527,400	Irrecoverable debts	7,200
		Discounts allowed	9,400
		Balance c/d	38,600
	556,500		**556,500**
Balance b/d	38,600		

Notice that the only difference in the account in the inclusion of cash sales in cash received and the balancing figure is labelled total sales, credit and cash combined.

What figure should appear in Spencer's trading account for sales?

EXAM TYPE QUESTION

Answer 1K

A debit balance of MK39,500 i.e Sales		20,500
		36,000
		18,000
		74,500
Less: Bank	30,000	
Returns	5,000	35,000
		39,500

1 Mark

Answer 2

(a) It is known that : Cost of goods sold + Gross Profit = Sales **1**.

Mark-up can be used to find the profit thus: Cost of goods sold + Percentage mark-up =Sales **1**.
So: (Opening inventories + Purchases – Closing inventories *or*) 40,000 + 5,200,000 – 600,000 = **5,000,000** i.e Cost of goods sold **1.5**
And: 5,000,000 + 20% = Sales
Or 5,000,000 + 1,000,000 = **6,000,000 1.5**
Gross profit is then Sales – Cost of goods sold = 6,000,000 – 5,000,000
= **1,000,000 1**

Tayamba Kick Starters
Trading Account for the year ended 31st December 2013 **0.5**

	MK	**MK**
Sales		6,000,000 **0.5**
*Less*Cost of goods sold		
Inventories 01.01.2013	400,000	
Add purchases	5,200,000	
	5,600,000	
Less inventories 31.12.2013	600,000	5,000,000**0.5**
		1,000,000**0.5**

(8 marks)

(b) Total Creditors

	K		K
Cash and bank	1,727,000 **1**	Balance b/d	763,300 **0.5**
Balance c/d	628,900	Purchases (diff)	1,592,600 **1**
	2,355,900		2,355,900

Total Debtors

	K		K
Balance b/d	1,427,800 **0.5**	Balance b/d	3,174,500 **1**
Balance c/d	2,980,000 **1**	Purchases (diff)	1,233,300
	4,407,800		4,407,800

Gross profit: Given 25% as margin on sales, gross profit is thus 25% x K 2,980,000 = **K745,0001**
Cost of goods sold (unknown) + Gross Profit K745,000 = **K2,980,000 1**
Therefore cost of goods sold is K (2,980,000 – 745,000) = **K2,235,000 1**
Closing stock is thus the balancing figure, or opening inventory plus purchases less cost of goods sold i.e. K (1,248,000 + 1,592,600 – 2,235,000) = **K605,600** i.e. cost of goods stolen **2**

Scott Tabeledwa
Trading Account for the period 01st April to 20th August 2013

	MK	**MK**
Sales		2,980,000 **0.5**
*Less*Cost of goods sold		
Opening inventories	1,248,000	
Add purchases	1,592,600**0.5**	
	2,840,600	
Less closing inventories	605,600**0.5**	2,235,000
		745,000**0.5**

(12 marks)
[TOTAL 20MARKS]

PILOT PAPER

FORMAT AND STANDARD OF THE EXAMINATION PAPER

The paper will consist of two sections; section A and section B. **Section A** will be compulsory with one question. The question will be on **preparation of final accounts for various forms of businesses with some adjustments**. This section will carry 40 marks. **Section B** will have **4 questions,** each carrying 20 marks. Candidates will be required to answer **any three** questions from section B.

NOT FOR SALE

SECTION A (40 marks)

One compulsory question

Question 1

Mamangidwe Properties is a business that started with capital from the owner, Masa, who deposited K180,000 cash into the business account on 1st September 2013.

The following transactions took place during the month of September:
(1) 1 September purchased land and buildings for K141,000 paying cash.
(2) 3 September arranged for a fire insurance for K36,000, paying K15,000 cash and incurring a liability of K21,000.
(3) 10 September sold part of the land at a price equal to the cost of K11,000, collectible within three months.
(4) 14 September purchased office equipment on credit for K5,400.
(5) 20 September received K1,500 cash as partial collection of the K11,000 account receivable.
(6) 30 September paid K3,000 on accounts payable.

And the following transactions took place during the month of October:
(1) October 1 paid K360 cash for publication of newspaper advertisement for various houses offered for sale.
(2) October 2 earned and collected a commission of K2,250 in cash by selling a residence previously listed by a client.
(3) October 16 newspaper advertisement was purchased at a price of K270, a payment to be made within 30 days.
(4) October 20 a commission of K8,390 was earned by selling a client's residence. The sales agreement provided that the commission would be received in 60 days.
(5) October 31 paid salaries of K7,100 cash to employees for services rendered during October.
(6) October 31 a telephone bill for October amounting to K144 was received. Payment required by November 10.
(7) October 31 withdrawal by owner K1,800 cash for personal use.

Required:

(a) Prepare the Trial Balance for Mamangidwe Properties covering all the transactions that took place in September and October. **14½ Marks**

(b) You have further been given the following information:
(1) The fire insurance with an original cost of K36,000 covers 20 years.
(2) The office equipment with an original cost of K5,400 has a useful life of 10 years after which its residual value will be nil. Assume that the use of equipment in each month is equal.

Required:

Prepare the Statement of Profit and Loss for September and October, after including the adjusting entries relating to October. **5½ Marks**

(c) Draw a Statement of Financial Position as at 31st October 2013. . **5½ Marks** .

(d) Mgwazo, a competitor of Mamangwidwe Properties, has prepared the following statement of affairs as at 31st October 2012:

Statement of Affairs

2012		K		K
October 1	Trade payables	600,000	Office furniture	50,000
	Other payables	50,000	Inventories	200,000
Capital account			Trade receivables	450,000
	Being excess of		Other receivables	100,000
	assets over liabilities		Cash	150,000
	at this date	300.000		
		950,000		950,000

On 30 September 2013 Mgwazo's trade payables were K450,000 and other payables K70,000. His office furniture was valued at K45,000, inventories K150,000, trade receivables K530,000, other receivables K70,000, and cash was K80,000. His drawings during the period amounted to K45,000.

Required:

(i)Calculate Mgwazo's profit for the year ended 30th September 2013. **10 Marks**

(ii) Explain why it is advisable to estimate values of assets and liabilities at, or shortly after, the end of the year rather than later. **4½ Marks**

[TOTAL : 40 Marks]

SECTION B (60 marks)

Answer any three questions from four available

Question 2

Your organization has provided the following information for the month of November 2013.

	K'000
Purchases Ledger	
Balance at 1 November (cr)	8,900
Cheques paid to suppliers during the month	20,420
Purchases on credit from suppliers during the month	16,850
Sales Ledger	
Balance at 1 November (dr)	11,680
Credit sales during the month	30,980
Cash received from customers during the month	15,740

Required:

(a) Complete the Sales Ledger Control Account and the Purchases Ledger Control Account for the month of November, carrying down the balances at the end of the month. **7 Marks**

(b) State, giving brief reasons, where the following two accounts should appear in the ledger control accounts:
(i) return outwards;
(ii)return inwards. **4 Marks**

(c) Explain the main purpose of control accounts. **2 Marks**

(d) Giving examples, name accounting errors which do not affect the trial balance from balancing.**7 Marks**

[TOTAL 20 MARKS]

Question 3

You are given the following information for Paulendo Enterprises:

Cash Book

2013	K'000		K'000
May 1 Balance b/d	320	May 10 Cashflow	110
16 FerriesLimited	160	20 Thamangirani	90
24 Jets Limited	140	28 Couriers Trading	180
31 Coach Trains	470	30 Worldlinkers	200
31 Speedliners	90		

Bank Statement (amounts also in K'000)

2013	Withdrawals	Deposits	Balance
May 1 Balance b/d	-	-	320
12 000111	110	-	-
16 Deposit	-	160	-
23 000112	90	-	-
24 Deposit	-	140	-
28 Direct debit: Couriers Trading	180	-	-
31 Bank giro credit	-	90	-

Required:

(a) Balance off the cash book and explain what the balance means to Paulendo Enterprises. **4 Marks**

(b) Show the running balances on the bank statement and state what the balance as at 31st May 2013 means to the bank. **5 Marks**

(c) Prepare a bank reconciliation for Paulendo Enterprises as at 31st May 2013. **5 Marks**

(d) A new customer of Paulendo Enterprises, Miss Tafika, runs a fleet of minibuses and trades under the name Zobanguka Runners. Tafika issued a cheque, writing K55,000 in figures on the cheque, but writing it in words as fifty five thousand *five hundred* kwacha.

Required:

(i) Explain what the bank will most likely do with the cheque issued by Tafika. **1 Mark**

(ii) Show the accounting treatment of the cheque in the books of Paulendo Enterprises before and after the action by the bank, assuming that Zobanduka was owing Paulendo Enterprises K55,500. **5 Marks**

[TOTAL 20 MARKS]

NOT FOR SALE

Question 4

Set out below is a table giving details of purchases during year 2013 by Zida Zamakono Enterprises. Zida Zamakono Enterprises buys and sells modern farm carts throughout Malawi. It commenced operations on 1 January 2013.

Date	Quantity (Farm carts)	Cost per farm cart K
1 January	35,000	5,000
1 April	10,000	6,000
1 July	10,000	6,500
1 September	15,000	8,000

From 1 January to 30 June, 25,000 farm carts were sold at a price of MK12,000 each. In the second half of the year 35,000 farm carts were sold at K16,000 each leaving 10,000 farm carts in stock at 31st December 2013.

Required:

Calculate the gross profit for Zida Zamakono Enterprises and the value of its closing inventory as at 31st December 2013 under **each**of the following inventory valuation methods:

(a) First In First Out (FIFO)
(b) Last In First Out (LIFO)
(c) Average Cost (AVCO).

The average cost should be calculated once at the end of the year. **[TOTAL 20 MARKS]**

Question 5

(a) Explain the difference between a partnership and a private limited company in terms of legal personality and liability for debts. **4 Marks**

(b) Bweleka, Katapila and Kongoza are trading in partnership under the name Ngongole Partnership. You are given the following information for Ngongole Partnership for year ended 30th April 2014:

(1) Net profit after adding back partners' salaries K30,350.

(2) Fixed capital accounts: balances b/fwd: Bweleka K40,000, Katapila K30,000 Kongoza K18,000.

(3) Current accounts: debit balances b/fwd: Bweleka K1,860, Katapila K946, Kongoza K717.

(4) Salaries to be credited: Katapila K2,000; Kongoza K3,500.

(5) Profits to be shared: Bweleka 50%, Katapila 30%, Kongoza 20%

(6) Interest to be charged on capitals: Bweleka K2,000, Katapila K1,500, Kongoza K900.

(7) Interest to be charged on drawings: Bweleka K240, Katapila K180, Kongoza K130.

(8) Drawings: Bweleka K9,200, Katapila K7,100, Kongoza K6,900.

Required:

(i) Prepare the Profit and Loss Appropriation Account for Ngongole Partnership for The year ended 30 April 2014. **6 Marks**

(ii) Prepare the partners' current and capital accounts as at 30 April 2014. **10 Marks**

[TOTAL 20 MARKS]

End of question paper

SUGGESTED SOLUTIONS

SECTION A (40 marks)

Answer 1 (a) **TRIAL BALANCE**

	Dr	Cr
	K	
Cash	15,490	
Capital		180,000
Land & Buildings	130,000	
Insurance	36,000	
Accounts receivable	17,890	
Accounts payable		23,814
Office equipment	5,400	
Advertising expenses	630	
Sales Commission		10,640
Telephone expenses	144	
Salary expenses	7,100	
Drawings	1,800	
	214,454	214,454

12½ Marks from workings add 2 for the trial balance above = 14½ Marks

Workings

(i)Cash transactions	Add	Deduct	
Deposit	180,000		½
Land and buildings		141,000	½
Insurance		15,000	½
Land sale	1,500		½
Creditors		3,000	½
Newspaper advertising		360	½
Commission	2,250		½
Salaries		7,100	½
Drawing		1,800	½
	183,750	168,260	15,490 **1**

(ii) Land and buildings K141,000 – K11,000**1**

(iii) Accounts receivable

Land 11,000 less 1,500	9,500	**1**
Commission	8,390	½
	17,890	

(iv) Accounts payable

Insurance	21,000	½
Office equipment	5,400	½
Payments made	(3,000)	½
Advertisement	270	½
Telephone	144	½
	23,814	

(v)Advertising 360 + 270 = 630 **1**

(vi) Sales commission 2,250 + 8,390 = 10,640 **1**

(b) STATEMENT OF PROFIT AND LOSS

Mamangidwe Propeties Income Statement for the two months ended October 2013

K	K	
Revenue:		
Sales commissions earned		10,640 ¾
Expenses:		
Advertising expenses	630¾	
Salaries	7,100¾	
Telephone expenses	144 ¾	
Insurance expense (36,000 / (20x12)) x 2	300**1**	
Depreciation expense	45**1**	
Total expenses		(8,219)
Net Income		2,421 ½

5½ Marks

(c) STATEMENT OF FINANCIAL POSITION

Mamangidwe Properties Statement of Financial Position as at 31st October 2013

	K	K	K
Non-current assets	Cost	Depreciation	Net Book Value
Land & Buildings	130,000	-	130,000½
Office equipment	5,400	45	5,355**1**
			135,355
Current assets			
Accounts receivable	17,890 ½		
Prepaid insurance (238 of 240 months)	35,700 **1**		
Cash	15,490½		
	69,080		
Less: current liabilities			
Accounts payable	23,814½		45,266
			180,621

Capital		180,000 ½
Add Net income	2,421 ½	
*Less*Drawings	(1,800)½	621
		180,621

or

Assets			
Non current assets			
Land and buildings			130,000½
Equipment (5,400 – 45)			5,355 **1**
			135,355
Current assets			
Receivables		17,890½	
Prepayments (238 for 240 months)		35,700**1**	
Cash		15,490½	69,080
			204,435
Capital and liabilties			
Capital		180,000½	
*Add*Net income		2,421½	
			182,421
Less Drawings			1,800½
			180,621
Current liabilities			
Payables			23,814½
			204,435

(d) (i)

Statement of Affairs

2013		K		K
September	Trade payables	450,000 **1**	Office furniture	45,000**1**
	Other payables	70,000 **1**	Inventories	150,000**1**
	Capital account being excess of assets over liabilities at this date	355,000**1**	Trade receivables	530,000 **1**
			Other receivables	70,000**1**
			Cash	80,000**1**
		875,000		875,000

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Calculation of profit	K
Capital, 30 September 2013	355,000
Drawings for the year	45,000**1**
Capital, 1 October 2012	(300,000)**1**
	100,000

10 Marks

(ii) *Candidates were expected to be imaginative in their attempts to this question. Time interval and other accounting concepts would have been applied in the discussions.*

No great difficulty should be experienced in estimating values of the assets and liabilities at, or shortly after, the end of the period under review when the work of preparing the statement is undertaken shortly after that date. This is because the necessary material for the valuation will probably be still accessible, and memory on transactions made may still be fresh. The preparation of earlier statements may present more difficulty and the most searching enquiries may have to be made. Needless to say, this method of ascertaining results is most unsatisfactory and the trader should be advised to install double entry bookkeeping without delay.

4½Marks

[TOTAL 40 MARKS]

SECTION B (60 marks)

Answer 2 (a)

Purchases Ledger Control Account½

	K		K
Bank	20,420½	Bank/Cash (November)	8,900½
Balance c/d	5,330 **1**	Suppliers(November)	16,850½
	25,750		25,750
		b/d	5,330½

Sales Ledger Control Account½

	K			K	
b/d 1 November	11,680	½	Bank/Cash (November)	15,740	½
Credit sales (November)	30,980	½	c/d(November)	26,920	**1**
	42,660			42,660	
b/d	26,920	½			

(b) Return outwards represents an organization returning goods, previously purchased to a supplier. It should appear in the purchases ledger control account as a debit entry.**2**

Return inwards represents an organisation receiving goods back which had previously been sold, because they were faulty or inappropriate for some reason. It should appear in the sales ledger control account as a credit entry.**2**

(c) They represent the total for the detailed individual accounts and they make reconciliation of all the accounts easier and quicker. **2**

(d) Error of original entry	Invoice amount K5,350 recirded wrongly as K535 but double entry observed correctly throughout
Error of principle	K25,000 repairs to motor vehicle recorded in Motor vehicle account
Error of commission	Purchases of K1 m from X credited to Y's account
Error of omission	An entry totally omitted from the books such as K13,500 credit sale to Kim not debited to Kim nor credited to sales account.
Complete reversal of entries	Debit entry credited and credit entry debited
Compensation errors	Cast error of equal amount on both the debit and corresponding entry
Transposition error	Individual characters in a figure put in wrong Sequence but double entry correctly observed. K71,600 recorded as K61,700.

1 Mark each item, total 7

[TOTAL 20 MARKS]

Answer 3 (a) Paulendo Enterprises:

Cash Book

2013	K'000			K'000
May 1 Balance b/d	320		May 10 Cashflow	110
16 Ferries Limited	160		20 Thamangirani	90
24 Jets Limited	140		28 Couriers Trading	180
31 Coach Trains	470		30 Worldlinkers	200
31 Speedliners	90		31 Balance c/d	600**1**½
	1,180			1,180
June 1 Balance b/d	600 ½			

This means that Paulendo has K600,000 of cash resources in the company.**2**

(b)Bank Statement– Balances (K'000)

2013			
May 1	Balance b/d		320
12	Less 110½		210
16	Add 160	½	370
23	Less 90	½	280
24	Add 140	½	420
28	Less 180½		240
31	Add 90½		330

The balance of K330,000 implies that the bank is keeping this amount for its customer, Paulendo **1**.The amount is like a liability to the bank and is payable to the customer on demand **1**.

(a) Bank reconciliation as at 31 May 2013

	K'000	
Balance as per cash book	600	**1**
Add unpresented cheque	200**1**	
	800½	
Less Bank lodgement not on statement	(470)**1**	
Balance per bank statement	330	**1**

½ Mark for format/presentation

(b) (i)The cheque will be dishonoured by the bank/referred to the drawer. **1**

Zobanduka

	K		K
2013 Balance b/d	55,500 ½	2006 Bank	55,000 ½
		Balance c/d	500½
	55,500		55,500

Bank

	K		K
2013 Paulendo	55,500 ½		

After recording the dishonoured cheque, the accounts would be:

Zobanduka

	K		K
2013 Balance b/d	55,500 ½	2013 Bank	55,000 ½
		Balance c/d	500½
	55,500		55,500
Balance b/d	500½		
Bank: cheque dishonoured	55,000		

Bank

	K		K
2013 Zobanduka	55,500 ½	2013 Zobanduka	
		Cheque dishonoured	55,000 ½

Once again Zobanduka is showing as owing the business K55,500

[TOTAL 20 MARKS]

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ACCOUNTING 1 (TC1)
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