NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

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MODULE 1

UNIT 1 DEFINITION AND OBJECT OF BOOK-KEEPING

CONTENTS

1.0 INTRODUCTION

This is the first unit of this course - Introduction to Accounting and this will take you about one hour to study. In this unit, you will learn about the definition and objectives of book - keeping, need for keeping records and types of accounts - Personal accounts, Real accounts and Nominal accounts.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define book-keeping
- explain the objectives of book-keeping
- explain the need for book-keeping
- list and explain the three types of account i.e. Personal account, Real Accounts and Nominal accounts.

3.0 MAIN CONTENT

3.1 Definition and Objectives of Book-Keeping

3.1.1 Definition of Book-Keeping

Book-Keeping can be defined as "the Science of recording and classifying all the transactions of a business which involve the transfer of money or money's worth. So as to show, without undue delay, the financial position of the business in relation to itself, the owners or shareholders, and outside persons".

3.1.2 The Objectives of Book-Keeping

From the above definition; you should be able to understand the following objectives of book-keeping. The objectives of book-keeping can be concisely stated in a variety of ways. For examples, it is helpful to set them out as follows:

1. To show at any point of time the amount invested in the business by each owner or shareholder and the amount owing by the business to each outside person and to the business by each outside person.

2. To show at any point or time the value of the properties of all kinds belonging to the business; and

3. To show the income and expenditure and profit or losses of the business for a period of time.

SELF-ASSESSMENT EXERCISE 1

1. Define book-keeping.
2. Briefly explain the objectives of book-keeping.

3.2 Need for Book-Keeping

From the above definition and objectives of book-keeping, it is necessary for us to state the need for keeping records. You will agree with me that every individual person always keep records for many reasons. What are your own reasons for keeping records?

In every business, it is highly desirable and often legally necessary that certain records should be kept. Let us now look at those essential records which can be classified under five headings:

3.2.1 Capital

Every proprietor of a business has invested money in his business. This money is used to buy goods and services which he intends to sell at a later date and, very often, to buy the premises, fixtures, machinery, etc. required to carry on the business. The amount of money which he invests in his business is known as the 'CAPITAL'. Even when a business is owned and personally managed by one proprietor it is obviously desirable that, a record should be kept of the Capital he has invested in the business, but when a business is owned by more than one proprietor a record of the Capital investor by each is essential if justice and equity are to prevail.

As you understand that, nowadays, the greater part of business activity is carried on by corporate bodies, such as Cooperative Society and Joint Stock Companies. The Capital of these organisations is always contributed by more than one person.

These persons are called members of Cooperative Societies those of Joint Stock Companies are Shareholders and the Capital they contribute is called "Share Capital". You should note that one of the first essentials in such an organisation is for you to keep accurate records of the amount of share Capital contributed by each shareholders.

3.2.2 Amounts Owing by the Business (Liabilities)

Apart from the above record, we should also keep record for amounts owed by the business.

In most business, goods and services are bought on credit. The payment that has to be made for this is made at some future date. This is an essential feature of modern business activity for, in the absence of arrangements of this kind, business could not be run so smoothly. For example, it would be very inconvenient if a cooperative society had pay cash on delivery for all the goods it purchases. It is of the utmost importance that the amount which is owing to each person who has supplied goods and services to the business should be accurately recorded so that one can see at a glance the exact amount that has to be paid to each person.

Likewise, when a person loans money to a business it is essential to keep a record of the amount lent. You should note that these amount owing by a business on account of goods or services or money received are called "LIABILITIES": This term will be more fully explained later

3.2.3 Amounts Owing to a Business (ASSETS)

As discussed above, you should also note that, in the same way as businesses buy goods or services on credit, because it is convenient to them, they frequently sell goods or services on credit to suit the convenience of their customers.

And in the same way explained above, it is equally essential to keep a record of the amount owing to a business by each person (the Debtor) whom goods or services have been supplied. Note that all these amounts owing to a business formed part of the "Assets" of the business. This also will be more fully explained later.

As you understand that, nowadays, the greater part of business activity is carried on by corporate bodies, such as Cooperative Society and Joint Stock Companies. The Capital of these organisations is always contributed by more than one person.

These persons are called members of Cooperative Societies those of Joint Stock Companies are Shareholders and the Capital they contribute is called "Share Capital". You should note that one of the first essentials in such an organisation is for you to keep accurate records of the amount of share Capital contributed by each shareholders.

3.3.4 Property of All kinds belonging to a Business

Apart from the amounts owing to a business which formed part of the Asset, every business has properties of various kinds, e.g. land, buildings, machinery, furniture, stocks of goods for sale, cash etc. It is very desirable that records should be kept of these.

You should note that properties of all kinds as well as amounts owing to a business, are called "ASSETS".

3.3.5 Income and Expenditure

Every business sells goods or services. The value of these sales is said to be income of the business. The costs involved in purchasing, manufacturing, or providing these goods or services, or in preparing them for sale and distributing them are known as expenditure. For reason which will be given later, these costs are often termed revenue expenditure.

The amount by which the income of a business exceeds the expenditure during a given period is the "PROFIT" for the period. Note that sometimes the expenditure exceeds the income during a period, and the excess is a "Loss". It is essential that the profit or loss of a business for a trading period should be known, and for this purpose records of income and expenditure are kept.

SELF-ASSESSMENT EXERCISE 2

(a) Go through 3.3 and briefly explain the need for book-keeping.
(b) Apart from the points explained in 3.3, what are other need for book-keeping?

3.3 Types of Ledger Accounts

Ledger accounts can be classified into three- Personal, Real and Nominal Accounts.

It should be clear to you now what objectives of book-keeping are. If yes, how are the objectives of book-keeping achieved? A simple answer to this question is that the objectives are achieved through keeping appropriate ledger accounts.

Then what do you understand by ledger account?
Answer — Ledger account is a ledger record (in a summarised form) of all business transactions that have taken place with a particular person or things specified.

3.3.1 Personal Accounts

These are the accounts of individual persons, shareholders, registered business organisations etc. Personal account show at any point of time the amount invested in the business by each owner or shareholders and the amount owing by the business to an outside person and to the business by an outside person. From the above statement, there are three main classes of personal accounts:

1. Shareholders Accounts
2. Creditors Accounts and
3. Debtors Accounts

3.3.2 Real Accounts

These are accounts of tangible things. They show at any point of time the values of the properties of all kinds belonging to the business — e.g. those things we can see, touch and move — land, building, motor vehicle, machinery (Assets).

3.3.3 Nominal Accounts

Nominal accounts are accounts of intangible things e.g. income and expenditure, profit and losses of a business for a period of time.

As explained earlier, note that each of the above three objectives of book-keeping is achieved by keeping a different kind of ledger accounts.

SELF-ASSESSMENT EXERCISE 3

Mention three types of ledger accounts and state what they reveal.

4.0 CONCLUSION

In this unit you have learned the definition of book-keeping, objectives/or book-keeping and the types of ledger accounts which would be referred to in the subsequent units.

5.0 SUMMARY

We have successfully defined book-keeping in a simple way and mentioned the need for keeping records. In this unit, we also stated the objectives of book-keeping which can be more concisely stated as follows:

1. To show the capital, liabilities and assets with the business at anypoint of time and
2. To show the income and expenditure and profits and loses of the business for a period of time.

Apart from the objectives of book-keeping, we also mentioned and explained the three types of ledger accounts-

1. Personal
2. Real and
3. Nominal accounts,

6.0 TUTOR-MARKED ASSIGNMENT

Why is it necessary that a cooperative society should have a good system of book-keeping?

7.0 REFERENCES/FURTHER READING

Akinkuolie, L. *Questions and Answers in Cooperative Accounting.*

Etuk-Udo, J.S. *Principles of Account for West Africa,* Book One.

Frank Wood/Omuya, J.O. *Business Accounting l.*

Jacques, J. and Davies, H. *Cooperative Book-Keeping I.*

Ola, C.S. *Accountancy for Exams for Intermediate Professional Accountancy.*

UNIT 2 DEFINITION OF ACCOUNTING AND ACCOUNTANCY, AND IMPORTANCE OF ACCOUNTANCY

CONTENTS

1.0 INTRODUCTION

Accounting is often called the language of business. The basic function of any language is to serve as a means of communications. In this unit, the purpose of accounting is to communicate or report the results of business operations and its various aspects to interested users of accounting information.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define Accounting
- define Accountancy
- explain the relationship between the above definitions
- explain the importance of Accounting and describe the nature of information which such accounting records furnish to various categories of persons.

3.0 MAIN CONTENT

3.1 Definition of Accounting and Accountancy

3.1.1 Definition of Accounting

Though accounting has been variously defined, according to one commonly accepted definition.

Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions, an events which are, in part, at least, of financial character and interpreting the results thereof".

Another definition which is less restrictive interprets accounting as "the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of information".

3.1.2 Definition of Accountancy

One often hears the words "Accountancy" and "Accounting" as if they are one and the same thing. Of course there is some difference between them, at least in the United Kingdom to which the practice of accountancy in Nigeria is closely associated. Accountancy is the work or profession of an accountant

3.2 Importance of Accountancy

While discussing the definition of Accounting, you must have observed that accounting involves a series of activities linked with each other beginning with recording, classifying, summarising, identifying, measuring and finally communicating information to its users. Information has no meaning unless it is linked with a certain purpose. Accounting as a social science can be viewed as an information system since it has all the features of a system. If we consider accounting as an information system, then we are in a position to make some important observations. First, the goal of the system is to provide information which meets the needs of its users. Secondly, it is the output requirements that determine the type of data which would be selected as the inputs which would be selected as the inputs for processing into information output.

We shall now briefly discuss what the information needs of various users are.

3.2.1 Shareholders and Investors

Since shareholders and other investors have invested their money in a business enterprise, they are interested in knowing periodically about the profitability of the enterprise, the soundness of their investments and the growth prospects of the enterprise. Historically, business accounting developed to supply information to those who had invested their funds in business enterprises.

3.2.2 Creditors

Creditors may be short-term or long-term lenders. Short-term creditors include suppliers of materials, goods or services. They are normally known as trade creditors. Long-term creditors are those who have lent money for a long period, usually in form of secured loans.

The main concern of the creditors is focused on the credit worthiness of the firm and its ability to meet its financial obligations. They are, therefore, concerned with the liquidity of the firm, its profitability and financial soundness.

In order words, it can also be state that creditors are interested mainly in information which deals with solvency, liquidity and profitability so that they could assess the financial standing of the firm.

3.2.3 Employees

Employees are interested in the financial position of the business they serve particularly when payment of bonus depends upon the size of the profits earned.

3.3.4 Government

In a mixed economy, it is considered to be the responsibility of the Government to direct the operation of the economic system in such a manner that it subserves the common goal. Controls and regulations on the operation of private sector enterprises are the hallmark of mixed economy. Several government agencies collect information about various aspects of activities of business organisations.

Much of this information is a direct output of the amounting system. For example, levels of outputs, profits, investments, costs, and taxes etc. All this information is very important in evolving policies for managing the economy. The task of the Government in managing the industrial economy of the country is facilitated if amounting information is presented as far as possible, in a uniform manner. It is clear that if accounting information is distorted due to manipulations and window - dressing in the presentation of annual accounts, it will have ill — effects on the measures the government intends to take and the policies it wishes to adopt.

3.4.5 Management

Organisations may or may not exist for the sole purpose of profit. However, information needs of the managers of both kinds of organisations are almost the same. All these functions have one thing in common and it is that they are all concerned with making decisions which have their own specific information requirements. The emphasis on efficient and effective management of organisations has considerably extended the demands for amounting information.

3.4.6 Consumers

Consumers are interested in the establishment of good accounting control so that cost of production may be reduced with the resultant reduction on the process of goods they buy.

3.4.7 Research Scholars

The financial statements, being a mirror of the financial position of a firm are of immense value to the research scholar who wants to make a study into financial operations of a particular firm.

SELF-ASSESSMENT EXERCISE

1. Define Book-Keeping Accounting and Accountancy.
2. Apart from the points listed above in this unit, mention two other users of accounting information you know and explain the benefits they derive from this information.

4.0 CONCLUSION

In this unit, the discussion perhaps has indicated to you that the information needs of the various users may not necessarily be the same. Sometimes, they may even conflict and compete with each. In any case, the objective of accounting information is to enable information user to make optimum decisions.

5.0 SUMMARY

Accounting is an important service activity in business and is concerned with the collecting recording, evaluating and communicating the results of past events.

Accounting is the language .employed to communicate financial information to various categories of users (e.g. Shareholders, Creditors, Employees, Government, Management and consumers etc.) who are interested in such information.

6.0 TUTOR-MARKED ASSIGNMENT

1. State the group of persons having an interest in a business.
2. organisation and examine the nature of their information needs.
3. After going through the above unit and sonic of the recommended books, you are now in a position to describe as to who is an accountant.

7.0 REFERENCES/FURTHER READING

Akinkudie, L. *Questions and Answers in Cooperative Accounting*.

Frank Wood/Omuya, J.O. *Business Accounting l & 2.*

Ola, C.S. *Accountancy for Examinations for Intermediate Professional Accountancy.*

UNIT 3 PRINCIPLES OF ACCOUNTING CONCEPTS AND CONVENTIONS

CONTENTS

1.0 INTRODUCTION

This is the third unit among the units that make up the course — Introduction to Accounting. Any activity that you perform is facilitated if you have a set of rules to guide your efforts. Further, you find that these rules are of more value to you if they are standardised. When you are driving your vehicle, you keep to the right.

You are in act following a standard traffic rule. A similar principle applies to accounting. You should note that accounting is govern by a number of generally accepted concepts and conventions. If you are to understand and use accounting reports, you must be familiar with the rules and conventions behind these reports.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- understand the Generally Accepted Accounting Principles (GAAP)
- understand the importance and necessity for uniformity in accounting practices.

3.0 MAIN CONTENT

3.1 Accounting Principles

In unit 2, accounting is referred teas the language of business. To make the language convey the same meaning to all people, Accounts have agreed on a number of concepts and conventions.

3.2 Accounting Concepts

Below are the number of accounting concepts which the accountants try to follow:

3.2.1 Business Entity Concept

In accounting we make a distinction between businesses and the owner or owners. Every business unit is treated as an entity completely different from the owner. All the records are kept from the viewpoint of the business rather than from that of the owner or owners.

A business is an economic unit separate and apart from the owner or owners. As such, transactions of the business and those of the owners should be accounted for and reported separately. In recording a transaction the important question is how does it affect the business? For example, if the owners of a shop were to take cash from the cash box for their personal use, the accounts would show that cash had been, reduced. even though it does not make any difference to the owners.

3.2.2 Going Concern Concept

Accounting assumes that the business will continue to operate for a long time in the future to the contrary. The enterprise is viewed as a going concern, that is, a continuing in operation, at least in the foreseeable future. The owners have no intention to wind up or liquidate its operations.

The assumption that the business is not expected to be liquidated in the foreseeable future, in fact, establishes the basis for many of the Valuations and allocations in accounting.

For example, depreciation procedures rest upon this concept it is the assumption which underlies the decisions of investors to commit capital to business.

3.2.3 The Double-Entry Concept

Every transaction involves two entries and these are both recorded in the books of account. For every debit entry, there is a corresponding-credit entry. You will understand this principle better in the next unit. This will enable, you to, understand' the double aspect and effects of a business transaction.

3.2.4 Accrual Concept

The accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide.

This concept holds that profit is made or determined by including revenue and costs and they, are earned or, incurred and not as cash is received or paid. It is not necessarily correct that cash paid and received. During a particular period of time represents the time income and essentially that all transactions are accounted for e.g Electricity enjoyed but not yet paid for.

3.2.5 Cost Concept

The resources (land, buildings, machinery, furniture etc.) that a business owns are called assets. The money values that are assigned to assets are derived from the cost concept. This concept states that an asset is worth the price paid for or cost incurred to acquire it.

Thus, assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for the assets. The assets shown on the financial .statements do, not necessarily -indicate their present market worth or market values. The cost concept does not mean that all assets remain on the accounting records at their original cost for all time. The cost of an asset that has a long but limited life is systematically reduced during its life by a process called depreciation which will be discussed at some length in a subsequent unit.

3.3 Accounting Conventions

3.3.1 Convention of Conservatism

This convention, also known as the convention of Prudence is often stated as anticipate no profit, provided for all possible losses.

This means that an accountant should follow a cautious approach. This is a convention of caution or playing safe and is adhered to while preparing the financial statements. For example, closing stock is valued at cost or market price whichever is lower.

3.3.2 Convention of Full Disclosure

Note that apart from legal requirements, full disclosure of all significant information should be made in the financial statements. For example, the basis of valuation of fixed assets, investments and stock should be clearly stated in the Balance sheet. In other words, accounting statements should be honestly prepared.

3.3.3 Convention of Materiality

Whether something should be disclosed or not in the financial statements will depend on whether it is materials or not materiality depends on the amount involved in the transaction for example minor expenditure of N50 for the purchase of waste basket may be treated as an expenditure of the period rather than as an asset.

SELF-ASSESSMENT EXERCISE

1. "Accounting is governed by a number of generally accepted concepts and conventions". List and explain these concepts and conventions.
2. Briefly explain the following accounting concepts which are very fundamental to financial accounting:

a. Going concern concept;
b. Business Entity Concept;
c. Accrual concept;
d. Dual aspect concept or Double entry concept;
e. Cost concept

4.0 CONCLUSION

Accounting Principles are man made. They are accepted because they are believed to be useful in preparing the accounts of any business enterprise.

The Principle enjoys a wide measure of support of the accounting profession. That is why they are known as Generally Accepted Accounting Principles (GAAP).

5.0 SUMMARY

In this unit, you have now learnt the Principles of Accounting which can assist you in preparing the accounts of any business enterprise. The Principles of Accounting Concept and Conventions are both guidelines for general applications they permit a wide variety of methods and practices. The generally accepted accounting principles prescribe a uniform accounting practice.

6.0 TUTOR-MARKED ASSIGNMENT

A government contractor supplied some items to various government offices. Some bills amounting to N100,000 were still pending at the end of the financial period.

Should the businessman take the revenue as N10,000 into account for computing the Net Profit of the period?

7.0 REFERENCES/FURTHER READING

Akinkuolie, L. *Questions and Answer in Cooperative Accounting*.

Etuk-Udo, J.S. *Principles of Accounting for West Africa*.

Solomon, A.Z. and Babatunde, M.A. *Principle of Accounting.*

UNIT 4 DOUBLE-ENTRY SYSTEM OF ACCOUNTING

CONTENTS

1.0 INTRODUCTION

You will take about one hour to study this 4th unit of this course. In this unit, you will study the double entry system of accounting, in which the following points will be covered.

1. Double aspect of a business transaction
2. Double effect of a business transaction and
3. The essential rule of double entry system.

The above points will lead us to the treatment of the already mentioned three types of ledger accounts, in unit one i.e. Personal accounts, Real accounts and Nominal accounts.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- identify in a business transaction the double entries
- understand the double effect of a business transaction upon the finances of any party to it
- apply the essential rule of double-entry system of accounting in identifying the account to be credited in the two accounts involved in a business transaction.

3.0 MAIN CONTENT

3.1 Double-Entry System of Accounting

Double-Entry system is the system in Accounting whereby every transaction that has to be recorded gives rise to two entries, the first one a debit entry and the other a credit entry. It is in this double entry system that the Golden Rule of Double Entry System is used.

3.2 Double Aspect of Transaction

Every business transaction involves two persons, one who parts with something and one who receives it. For example, in every sales, a seller and buyer are involved. The seller parts with that which is sold, and the buyer receives it.

Similarly, when money is paid one person parts with it and another receives it. No matter what transaction is taken as an example it is always found that there are two parties, one who parts with something and one who receives it. For this reason it is said that every transaction has a double aspect; the aspect of one party parting with something and the aspect of the other receiving it.

3.3 Double Effect of a Transaction

Apart from the double aspect of a business transaction, what is more important still is that we should understand that every transaction has a double effect upon the finances of any single business which is a party to it.

Thus, if money is loaned to a business, an asset of a business, i.e. cash, is increased and the liabilities, i.e. the amounts owing by the business, are also increased. When property for use in the business is bought on credit, both an asset, e.g. buildings and the liabilities of the business are increased. When the property is paid for an asset, i.e. cash, and the liabilities of the business are both reduced. When goods or services are bought on credit, the expenditure of the business and its liabilities are both increased. When the goods and services are paid for, an asset of the business i.e. cash, and its liabilities are both reduced. Also, when goods or services are sold on credit, the income of the business Is increased and an asset, i.e. debts owing by customers, is also increased.

When the customer pays for the goods or asset, i.e. debts owing by customers, is reduced. Thus, in any business every transaction in which the business is involved has a double effect upon its finances. You should note that double-entry system of accounting is designed to record thus double effect.

Now, you should consider the follow examples:

S/N.	**Transaction**	One Effect	Another Effect
1.	Society bought books for resale on credit	Its expenditure increases	Its debt increases
2.	A cooperative Society pays for books bought	Its assets-cash decreases	Its debt decreases
3.	Cooperative society sold cocoa on credit	Its income increases	Amount owed to it increases
4.	Cooperative society receives money for cocoa sold	Its assets (cash) increases	

Apart from the above examples, no matter the example given, you will be able to state the double effect of the business transaction upon the finances of each of the parties to it.

3.4 Golden Rules of Double-Entry

In a double-entry system of accounting one aspect or effect of a transaction is always recorded by a debit posting to a ledger account, and the other aspect or effect is always recorded by a credit posting to another ledger account.

The essential rule of double-entry system of accounting known as Golden Rule of Double-Entry System of Accounting is that every transaction gives rise to both a debit and a credit entry, i.e. "for every debit entry, there must be a corresponding credit entry, and vice-versa, for every credit entry there must be a corresponding debit entry". Thus, the total debits and the total credits should always agree. The 'receiving' aspect of every transaction is always recorded by a debit entry in a ledger account and the "imparting" aspect is always recorded by a credit entry.

Thus, when a person parts with anything which is received by the business, the account for that person in.the books of the business must be credited and some other account in the books of the business must be debited. The account to be debited depends upon the nature of that which the business receives. When a person receives anything, with which the business has parted, the account of that person in the books of the business must be debited, and some other account in the books of the business must be credited. Again, the account to be credited depends upon the nature of that with which the business parts.

There are separate rules of the double entry system in respect of Personal Accounts, Real Accounts and Nominal Accounts which are discussed below:

1. Personal Accounts

As discussed earlier, these accounts record a business's dealing with persons or firms. The person receiving something is given debit and the person giving something is given credit. For example, if John sells goods to James on credit, James's Account will be debited (in John's book) as he is the receiver of goods and John's account will be credited (in James's book) as he is the giver of goods. When James makes the payment for these goods, John's Account will be debited in James's book as he is the receiver of the cash and James account will be credited in John's books as he is the giver of cash.

2. Real Accounts

These are the accounts of Assets. Assets entering the business is given debit and assets leaving the business is given credit. For example, when goods are sold for cash, Cash Account will be debited as cash comes in and Goods Accounts will be credited as goods goes out.

So, the rule is debit what comes in and credit what goes out.

3. Nominal Accounts

These accounts deal with expenses, incomes, profits and losses. Account of expenses and losses are debited and accounts of incomes and gains are credited. For examples, when rent is paid to the landlord, Rent account will be debited as it is an expenses and cash account (real account) will be credited as it goes out.

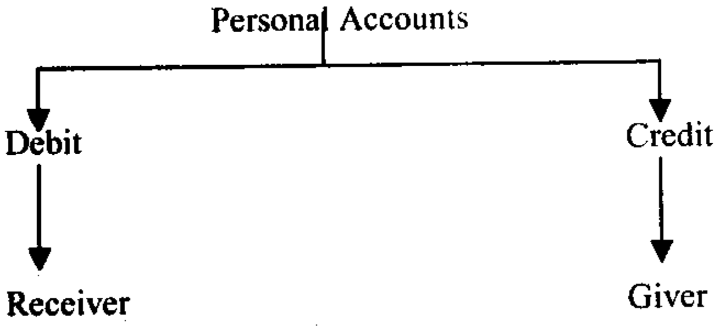
Similarly, when commission is received, cash account will be debited as cash is received and commission account will be credited as it is an income.

Thus, the rule is: debit all expenses and losses and credit all incomes and gains.

For more explanation, the rules of double entry system of accounting are shown in the following chart:

Rules of Double Entry

1.



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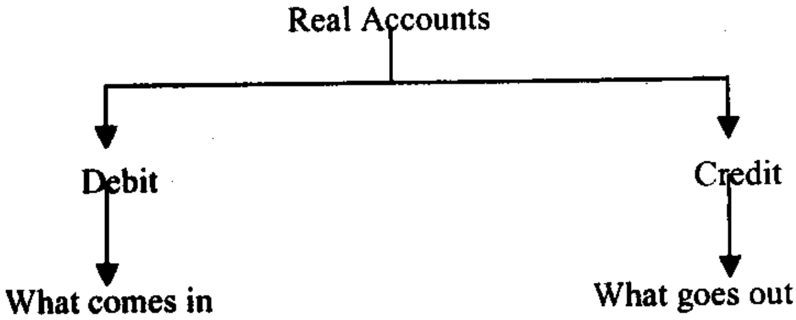

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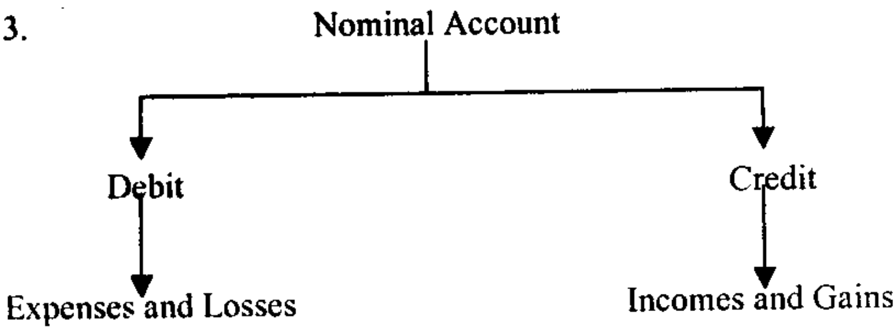

From the above chart, you will be able to identify accounts to be debited and those to be credited without any problem.

SELF-ASSESSMENT EXERCISE

1. Briefly explain:

a. double entry system of accounting.
b. double effect of a transaction upon the finances or assets of each of the parties to it.

2. Show the separate rules of the double entry System of accounting in respect of Personal, Real and Nominal Accounts.

4.0 CONCLUSION

In double entry system of accounting, two parties are involved in a business transaction. No matter the type of business one has to part with something and another person will receive it.

Similarly, we discussed the double effect of the transaction on the assets of the two parties involves in it. In order to keep proper books of accounts, the Golden Rule of Double Entry System of Accounting must be obeyed.

5.0 SUMMARY

In this unit, we have studied the double entry system of accounting. Every financial transaction involves a two-fold aspect, the person who parts with something and the person who received it. To have a complete record of each financial transaction, there must be a double entry in the books of accounts of the business. An entry being made in the receiving account and a similar entry in the giving account. The receiving account is termed as Debtor's Account and the giving account is called Creditor's Account. Thus, every debit entry must have a corresponding credit entry vice versa.

In this Unit, we also discussed the double effect of a financial transaction. Every transaction has a double effect upon the finances of each of the parties to it.

6.0 TUTOR-MARKED ASSIGNMENT

From the following transactions, identify the two accounts involved in each transaction and state which account is to be credited and the one to be debited.

1. Received cash from Mr. Ade
2. Paid in to Bank
3. Purchased goods on credit from cooperative Supply Association Ltd(CSA)
4. Sold goods on credit to John
5. Paid C.S.A Ltd by Cheque
6. Received cheque from Mr. Ade
7. Cash Sale
8. Paid cash to Landlord for Rent
9. Paid salaries by cheque
10. Received cash from John

7.0 REFERENCES/FURTHER READING

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UNIT 5 THE LEDGER

CONTENTS

1.0 INTRODUCTION

In Unit one, we defined Book-Keeping as the Science of recording and classifying all the transactions of the business which involve the transfer of money or money's worth, so as to show, without undue delay, the financial position of the business in relation to itself, the owners or shareholders, and outside persons.

For proper accounting record, all the business transactions are recorded in a special book of accounts known as Ledger.

The Ledger is the main or principal book of accounts having a number of pages which are numbered consecutively. One account is usually assigned on page in this book.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define a ledger
- explain the ledger as principal book of accounts
- explain the ruling of a ledger account
- explain the treatment of business transactions in the ledger book
- understand the posting of transactions in the ledger and how to balance the ledger accounts.

3.0 MAIN CONTENT

3.1 The Ledger

3.2 Definition

A Ledger account may be defined as a summary statement of all the transactions relating to a person, assets, expenses, or incomes which have taken place during a given period of time and show their net effect.

3.3 Ledger as a Principal Book of Accounts

The Principal Book of Accounts is known as the Ledger. Each of the business transactions is recorded in the form of an account in the Ledger. A Ledger has a number of pages which are numbered consecutively. One account is usually assigned on page in the Ledger.

However, if the transactions, pertaining to a particular account are more, it may be assigned more than one page in the Ledger. An index of various accounts opened in the ledger is given at the beginning of the ledger for the purpose of easy reference. You should note that ledger as the principal book of accounts helps us in achieving the objectives of accounting.

Ledger also gives answers to the following questions:

1. What are the total sales to an individual customer?
2. What are the total purchase from an individual supplier?
3. How much amount is owed by others?
4. How much amount is owed to others?
5. What is the amount of profit or loss made during a particular period?
6. What is the financial position of the firm on a particular date?

3.4 Specimen of a Ledger Account

DR Name of the Account CR

Date	Particulars	F	N K	Date	Particulars	F	N K
	Names of credit account				Names of Debit account		

The books required for a proper record of the transactions of a business is called the Ledger, though it will be shown later how the recording is assisted, in certain circumstances, by the use of other books.

The Ledger may be recognised by the ruling of its page, and a specimen page, unused, is shown above for this purpose.

EXPLANATION

From this above ruled ledger account, you should be able to see that it is divided into two equal sides by two vertical thin rules in the middle. The left-hand side of the ledger account is known as the receiving side and the right-hand side as the given side.

The technical terms for these are the Debit side (indicated by the abbreviation Dr.) and the Credit side (indicated by the abbreviation Cr.) respectively.

Each of the two sides is further divided into four columns for **date, particulars, folio and amount.** The first column is for the date of the transaction i.e. the month and day of the month on which a particular transaction occurred.

The second column is for the name of the corresponding account i.e. name of the second account involved in the transaction.

The third column is for the folio i.e. page where the subsidiary book corresponding ledger account in which one can find further information about the transaction in the particular column.

The last column i.e. forth column is for the amount involved in the transaction.

Formerly, debited entries were prefaced by the word .'To' and credit entries by the word 'By'.

This is no longer considered to be necessary.

3.5 Treatment of Business Transactions in the Ledger Account

Having made the above explanations, you are advised to have before you a properly ruled ledger paper and make the entries as each transaction is dealt with.

The following are a few simple transactions together with explanations as to their treatment in the ledger accounts.

1st Jan. 2002. Started business with N10,000

(The cash Account is debited with 44 10,000 and Capital Account is credited)

N K

2nd Jan. 2002. Paid into Bank……………………………….…. 2,000 : 00

(The Bank Account is debited and Cash Account Credited).

7th Jan. 2002. Sold goods on credit to Ade…………………… 800: 00

(Ade Account is debited and Sales Account is credited).

10th Jan.2002 Purchased goods from C.S.A. Ltd……………. 3,000 : 00

(Purchases Account is debited and C.S.A Ltd Account is credited)

15th Jan. 2002. Paid C.S.A Ltd by cheque………………….. 3, 000 : 00

(C.S.A Ltd Account is debited and Bank Account is credited)

21st Jan.2002. Received Cash from Ade……………………….800 : 00

(Cash Account is debited and Ade Account is credited)

28th Jan. 2002. Cash Sales……………………………………..1,000 : 00

(Cash Account is debited and Sales Account s credited)

30th Jan 2002. Paid rent to Landlord cash ……………………..25 0: 00

(Rent Account is debited and Cash Account is credited)

3.6 Postings into Ledger Accounts

You can now make necessary corrections if necessary in your prepared ledger paper from the following various ledger accounts.

Personal Accounts:

DR 1. Capital Account CR

Date	Particulars	F	₦ :K	Date	Particulars	F	₦ :K
				1-1-02	Cash	5	10,000: 00

DR 2. Ade Account CR

Date	Particulars	F	₦ :K	Date	Particulars	F	₦ :K
7-1-02	Sales		800: 00	21-1-02	Cash	5	800: 00

DR 3. C.S.A Ltd Account CR

Date	Particulars	F	₦ :K	Date	Particulars	F	₦ :K
15-1-02	Bank		3,000: 00	10-1-02	Purchases	6	3,000: 00

DR 4. Bank Account CR

Date	Particulars	F	N : K	Date	Particulars	F	N :K
2-1-02	Cash	5	2000:00	15-1-02	C.S.A Ltd	3	3,000:00

Real Account:

DR 5. Cash Account CR

Date	Particulars	F	N : K	Date	Particulars	F	N :K
1-1-02	Cash	1	10000:00	2-1-02	Bank	4	2,000:00
21-1-02	Ade	2	800:00	30-1-02	Rent	8	250:00
28-1-02	Sales	7	1500:00				

Nominal Accounts

DR 6. Purchases Account CR

Date	Particulars	F	N : K	Date	Particulars	F	N :K
10-1-02	C.S.A. Ltd	3	3000:00				

DR 7. **Sales Account** CR

Date	Particulars	F	N : K	Date	Particulars	F	N :K
	7-1-02 Ade		2 800:00				
	28-1-02 Cash		5 1500:00				

DR 8. Rent Account CR

Date	Particulars	F	N : K	Date	Particulars	F	N :K
30-1-02	Cash	5	250:00				

3.7 Balancing of Ledger Accounts

Various accounts in the ledger are balanced with a view to preparing the Final Accounts. The procedure of balancing accounts is as follows:

1. Take the totals of the two sides of the account concerned.
2. Ascertain the difference between the totals of two sides.
3. Enter the difference in the amount column of the side showing less total writing against the difference in the particulars column "To Balance c/d" (c/d means carried down) on the debit side of the account and "By Balance c/d" on the credit side of the account. Note that in this way, the totals of the two sides will agree.
4. The balance is brought forward at the beginning of the next business period if "To Balance c/d" is written on the debit side before balancing, it is brought forward on the credit side and "By balance b/d" (b/d means brought down) is written against the balance in the particular column and vice versa.

Note:

An account is said to have a debit balance if the total of its debit side is more than the total of its credit side. On the other hand, an account is considered to have a credit balance if the total of its credit side is more than the total of its debit side.

DR Cash Account CR

Date	Particulars	F	N :K	Date	Particulars	F	N :K
1-1-02	Capital	1	10,000 =	2-1-02	Bank	4	2,000 =
21-1-02	Ade	2	800 =	30-1-02	Rent	8	250 =
28-1-02	Sales	7	1,500 =	31-1-02	By Balance c/d		10.050 =
			12,300 =				12, 300 =
1-2-02	To Balance b/d		10,500=				

DR Sales Account CR

Date	Particulars	F	N :K	Date	Particulars	F	N :K
31-1-02	To Balance c/d		2,300 =	7-1-02	Ade	2	800
				28-1-02	Cash	5	1,500
			2,300				2,300
				1-2-02	By Balance b/d		2,300

The two accounts above are examples of balancing of edger accounts. In 3.5, Ade and C.S.A Ltd. Accounts are already balanced. The totals on both sides of the two accounts are equal. No figure is to be carried down on any of the two accounts at the end of the period.

SELF-ASSESSMENT EXERCISE

1. Define a ledger. Why is it known as the principal book of accounts? Also explain its ruling.
2. From the following transactions, identify the two accounts involved in each transaction and explain their treatment in the ledger accounts.

		N K
1.	Started business with N 100,000 =	
2.	Paid into Bank………………………………………..	80,000.00
3.	Purchased goods for cash……………………………	20,000.00
4.	Purchased goods on credit from C.S.A Ltd………….	30,000.00
5.	Sold goods to Alhaji Musa…………………………..	5,000.00
6.	Sold goods on credit to Mr. John……………………	1,500.00
7.	Paid C.S.A Ltd by Cheque…………………………..	30,000.00
8.	Received cash from John……………………………	1,000.00
9.	Received cheque from Alhaji Musa…………………	5,000.00
10.	Bought furniture for use……………………………..	20,000.00
11.	Drew cash for business use …………………………	20,000.00
12.	Cash sales…………………………………………….	7,000.00

3. Write up the cash account from the above transactions, open all necessary ledger accounts and balance them at the end of the period.

4.0 CONCLUSION

The two aspects of each transaction have been entered in the ledger accounts, you will have observed from this unit that the recording of the two aspects has involved a debit entry and a corresponding credit entry, but not in the same account.

An essential point to bear in mind again in this unit is that, every transaction must be entered in its two-fold aspect, and that this results in a debit entry and a corresponding credit entry in the ledger accounts.

The book-keeping record is made for reference purposes. The information contains in the ledger is readily available at any time. Total sales or total purchases, for example, for the period can be ascertained at once by making reference to the sales account or purchases account.

Again, the cash accounts gives full particulars of the cash received and the cash paid out and simple subtraction, it is possible to ascertain the amount of cash that should be in hand.

5.0 SUMMARY

In this unit, we have dealt with the definition of ledger and its rules. We also discuss the identification of the two accounts involved in a business transaction and their treatment in the ledger account.

Various ledger accounts are balanced at the end of the period by taking the totals of the two sides of each account in the ledger book. The difference between the totals of the two sides is entered in the amount column of the side showing less total.

In this way, the totals of the two sides will agree/balance.

6.0 TUTOR-MARKED ASSIGNMENT

From the following transactions, open all necessary ledger accounts and balance them at the end of the month.

Commenced business with N150,000= Year 2002.

March 4	Paid into Bank……………………………..	100,000
March 8	Purchased goods form national Supply Association for Cash…………………………………………..	20,000
March 12	Sold goods on credit to John………………….	1,000
March 14	Sold goods for cash …………………………. ….	800
March 18	Received cash from John…………………………	700
March 19	Bought furniture for use in the business (cash)	7,000=
March 21	Cash sales ……………………………………	2,500=
March 22	Cash sales Banked……………………………	3,000=
March 27	Drew cash for office use…………………….	4,000=
March 29	Paid cash for Rent…………………………..	500 =

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MODULE 2

UNIT 1 TRIAL BALANCE I (MEANING AND METHODS)

CONTENTS

1.0 INTRODUCTION

We know that the fundamental principle of Double Entry System of Accounting is that for every debit, there must be a corresponding credit. Thus, for every debit or a series of debits given to one or several accounts, there is a corresponding credit or a series of credits of an equal amount given to some other account or accounts and vice versa.

It follows, therefore, that the sum total of debit amounts should equal the credit amounts of the ledger at any date. But if the various accounts in the ledger are balanced, then the total of all debit balances must be equal to the total of all credit balances if the books of accounts are arithmetically accurate.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define a Trial Balance
- explain the main purpose of a Trial Balance in Book-keeping
- explain the Methods of preparing a Trial Balance.

3.0 MAIN TEXT

3.1 Trial Balance

3.2 Definition

A Trial Balance is the summary of all ledger balances existing at the balancing date. Or A Trial Balance is a list of balances extracted from the ledger accounts at the end of an accounting period or at stated interval {Monthly, quarterly e.t.c} in order to test the arithmetical accuracy of the book.

Note that at the end of the financial year or at any stated interval the balances of all the ledger accounts are extracted and are written up in a statement known as Trial Balance and finally totalled up to see if the total of debit balances is equal to the total of credit balances.

A Trial Balance can also be defined as a statement of debit and credit totals or balances extracted from the various accounts in the ledger in order to ascertain the corrections of all the entries in the ledger book.

3.3 Main Purpose of a Trial Balance

The main purpose of a trial balance in book-keeping is to ascertain the arithmetical accuracy of the postings in the ledger i.e. to test the corrections of all entries in the ledger.

The fact that the double-entry principles lead to a debit and credit entry for each transaction and that this permits the accuracy of the entries to be checked does not mean that the account is error free. A debit entry has a corresponding credit entry somewhere in the accounts for the trading period. A complete list of all the debits in the accounts should therefore, equal in total to a similar list of all the credits. Again, for the same reason, if the debits on each account are added and a list made of their totals, this should equal in amount a similar list of credit totals.

Sometimes, the totals do not agree; the debit column may be greater than the credit, or perhaps, the other way round. In either case there must be an error or errors in the ledger. The only way to detect this is through the preparation of a Trial Balance. Also, the only way to ascertain the correctness of the entries in the ledger is through the preparation of a Trial Balance.

The Trial Balance, as its name implies, is however, a trial of the balances of the accounts to check the accuracy of the entries.

3.4 Methods of Preparing Trial Balance

A trial balance can be prepared by the following two methods:

1. Total Method

In this method, the debit and credit totals of each account are shown in the two amount column {one for the debit total and the other for the credit total} against it.

2. Balance Method

In this method, the difference of each amount is extracted. If debit side of an account is bigger in amount than the credit side, the difference is put in the debit column of the Trial Balance and if the credit side is greater, then the balance of the amount being a credit balance is entered in the credit column of the Trial Balance. When all the balances are entered, the columns are added and the totals should agree.

Trial Balance can be prepared on a loose sheet having four columns. A specimen is given as follows:

TRIAL BALANCE OF………………AS AT………………….

Serial No.	Name of Account	L/F	Dr. Balance for Total} N= :K	Cr. Balance for Total} N= : K
1				
2				
3				
4				
5				

You should note that, sometimes the totals do not agree; the debit total may be greater than the credit, or perhaps, the other way round. In either case there must be an error or errors in the ledger, or in extracting balances from the ledger.

The errors, of course, must be found, and you would be well advised to locate the cause or causes of the disagreement in the two columns of the trial balance.

Of the two methods of preparation of trial balance, the second method i.e. balance method is usually used in practice because it facilitates the preparation of the final accounts.

SELF-ASSESSMENT EXERCISE 1

From the accounts prepared in unit 5 {the ledger} prepare a trial balance as at the end of the month.

SELF-ASSESSMENT EXERCISE 2

Write up the various accounts needed in the books of star cooperative Society Ltd. From the following transactions. Balance off the accounts at the end of January and then extract the trial balance on the same day.

		N :	K
			=
Jan 1	Commenced business with………	16,000	
2	Cash paid into Bank	10,000	
3	purchased Typewriter for cash	2,000	
6	Bought Furniture by Cheque	1,700	-
9	Purchased goods for cash	4,000	-
14	'SOld goods to Musa	1,000	=
17	Sold goods to John Okon	500	=
19	Received Cheque from John Okon	500	
22	Received cash from Musa	1,000	=
24	Withdraw cash for office use	8,000	=
27	Paid Rent to Landlord	1,000	=
29	Cash sales	1,500	=
30	Bought goods on credit from P.Z.	2,000	-
31	Paid P.1 Plc Cheque	1,500	=

SELF-ASSESSMENT EXERCISE 3

With the support of a specimen, briefly explain the balance method of preparing trial balance.

4.0 CONCLUSION

If the double entries principle have been completed and correctly applied, it is obvious that the total of all debit entries will be equal to the total of all credit entry. By extension, the total of the debit balances should be equal to the total of the credit balances. The list drawn up showing the balances extracted from all accounts is known as a trial ha lance.

The trial balance serves two purposes:

1. It serves as a check on the arithmetical accuracy of the entries and
2. It is the basis upon which the Trading and profit and loss Account and the balance sheet are drawn up.

5.0 SUMMARY

You have now learnt the importance of Trial Balance in Accounting. How to ascertain the correctness of all entries in the ledger accounts should not be a problem to you. You should now be able to construct a trial balance or extract balances from the ledger.

If there is an account whose debit side gives the same total as the credit side, such an account should be left out of the summary or trial balance.

Examinations questions are sometimes set asking for the preparation of a trial balances from a given list of balances. The balance method will apply here and the balances must first be clarified into debits and credits and the totals of

1 Assets, losses, and Expenses Accounts end in debit balances.
2 Liabilities, gains and profits accounts end up in credit balances. Thus equipment, rents, stationary and salary will be entered in the debit column of the trial balance while share capital {being liabilities}, interest on loan and fine will be entered on the credit side.

6.0 TUTOR-MARKED ASSIGNMENT

Write up the various accounts needed in the books of a Sole Trader from the transactions below. Balance off the accounts at the end of the month and prepare the trial balance as at date.

		N	:	K
Jan 1	Started business with…………………………….	6,000		=
“ 2	Paid into Bank……………………………………	5,000		=
“ 3	Bought adding machine by cheque for business use..	1,000		=
“ 3	Purchased office equipment on credit from Obi…….	500		=
“ 6	Withdraw N1,000.00 from Bank for business use			
“ 8	Purchased by cheque cooperative press shares…….	500		=
“ 9	Sold goods on credit to Musa………………………..	200		=
“ 14	Purchased goods on credit from Ade ……………….	1,000		=

" 16	Sold goods for cash…………………………………	300	=
" 18	Paid cash into Bank…………………………………	400	=
" 19	Bought furniture paying by cheque…………………	500	=
" 22	Paid Water rate by cash……………………………..	30	=
" 30	Paid Ade by cheque…………………………………	700	=
" 30	Cash sales……………………………………………	100	=
" 31	Paid Audit and Supervision fees (ASF) by cash……	20	=

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UNIT 2 TRIAL BALANCE II- ERRORS

CONTENTS

1.0 INTRODUCTION

Trial Balance is the statement of debit and credit totals or balances extracted from the various accounts in the ledger in order to ascertain the correctness of all the entries in the ledger book.

You should note that "the agreement of a trial balance is not a conclusive proof of the accuracy of entries made in the accounts". It only gives an indication of the arithmetical accuracy of the accounts. The trial balance may be some types of errors remaining undisclosed in the accounts. These types of errors are known as compensating errors or errors that will not affect the agreement of the trial balance.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the following compensating errors:

1. Errors of Commission
2. Errors of Omission
3. Errors of Principle

4. Errors of Duplication
5. Errors of original Entry
6. other compensating errors and
7. Complete reversal of entries.

- explain those errors that will affect the agreement of the trial balance
- explain the location of errors and its detection techniques
- explain suspense Account.

3.0 MAIN CONTENT

3.1 Trial Balance II - Errors

3.2 Compensating Errors

From the trial balance, the final Accounts {Trading and profit and Loss Accounts or the income and Expenditure Account} and the balance sheet are prepared. However, the trial balance is a proof only of the arithmetical accuracy of the postings in the ledger; it is merely prima facie evidence that the ledgers have been correctly made. Certain classes of errors cannot be revealed by the trial balance because the errors do not affect the totals used in drawing up the trial balance. These errors are known as compensating errors.

The following are examples of compensating errors, which are not revealed by a trial balance:

3.2.1 Errors of Commission

Where the correct amount is entered in the correct type of account but in the wrong account, e.g. N=200:00 paid for rent entered as repairs, or where a sale of N=450:00 to John entered in the account of Johnson. Both the accounts considered are personal accounts. With this error, the trial balance will still balance.

3.2.2 Errors of Omission

Where a transaction has been completely omitted from the books e.g. a sale of N=800:00 worth of goods to Musa was completely omitted from the books. No entry in sales account and Musa's Personal Account. This error will not affect the agreement of the trial balance.

3.2.3 Errors of Principle

Where an item is entered in the wrong class of account. The purchase of a fixed asset may be treated as a trading expense and therefore the profit will be incorrect and the balance sheet will not show the true position of the business e.g. the purchase of a duplicating machine N500:00 is debited to purchases account in error instead of being debited to a Duplicating Machine Account, this error will not affect the agreement of the trial balance.

3.2.4 Errors of Duplication

Where the same transaction is made twice or more times in the books.

3.2.5 Errors of Original Entry

Where the original figure is wrong. Wrong value for a transaction may be recorded on both side of the ledger accounts involved in the transaction, e.g. a sale of N=425:00 to L. Akin. Was entered in the books as N=524:00. The trial balance total will still agree with this error.

3.2.6 Other Compensating Errors

Errors made in the ledger accounts which balance out one another will not affect the agreement of the trial balance totals, e.g. if the capital account was overstated with N=150:00 and the purchases account was also overstated with N=150:00, then these two errors would not affect the trial balance.

3.2.7 Complete Reversal of Entries

If the correct accounts are used but items recorded on the wrong sides e.g. salaries paid by cash, N=1,800:00 was entered as salaries account credited N=1,800:00 and cash account debited N=1,800:00 instead of salaries account debited N=1,800:00 and cash account credited N=1,800:00.

3.3 Errors Affecting the Agreement of the Trial Balance

If the totals of a trial balance do not agree, it might be due to one or more of the following errors.

I. An item omitted to be posted from a subsidiary book into the ledger e.g. A purchase of N=1000:00 from a trader was omitted and not credited to his account.

II. Posting of a wrong amount to a ledger account e.g. a credit of N=2,000:00 to Olu was wrongly posted to his account as N=200:00.

III. Posting an amount to the wrong side of the ledger account e.g. N=50:00 discount allowed to a customer wrongly posted to the credit instead of the debit of the Discount Account.

IV. Wrongly additions or balancing of ledger accounts i.e. while balancing capital Account at the end of the financial year, credit balance of N89,000 = was wrongly taken as N9,000 =.

V. Omission of a balance of an account in the trial balance e.g. cash and Bank balances may have been omitted to be included in the trial balance.

VI. Balance of an account wrongly entered in the trial balance.

VII. Balance of an account entered in the wrong column of the trial balance.

VIII. An error in the totaling of the trial balance will bring the disagreement of the trial balance.

3.4 Location of Errors and Its Detection Techniques

Where a trial balance disagrees, the following steps would be taken to locate the causes of the differences:

I. Re-check the totals of the trial balance and ascertain the exact amount of difference in the trial balance.

II. Divide the difference of the trial balance by two and find out if there is any balance of the same amount in the trial balance. It may be that such a balance might have been recorded on the wrong side of the trial balance, thus causing a difference of double the amount.

III. If the mistake is not located by the above steps, see that the balances of all accounts including cash and bank balances have been included in the trial balance.

IV. See that the opening balances have been correctly brought forward in the current year's book.

V. if the difference is evenly divisible by 9, the error may be due to transposition or transplacement of figures. A transposition occurs when 57 is recorded as 75, or 197 as 791 and so on.

A transplacement takes place when digits of the numbers are moved to the left or right. When N 5,694 = is recorded as N56.94 or N 569.40=.

VI. If the above listed steps fail to detect the errors, check your work as follows:

a. Check the totals of the subsidiary books paying particular attention to "carry forwards".
b. Check the postings made from the journal or subsidiary books into the ledger.
c. Re-check the balances extracted from the ledger
d. Re-cast the list of balances.

You should note that if all these above efforts fail to locate the errors, the whole subsidiary books must be cast, and if necessary, all postings in the ledger must be re-checked.

3.5 Suspense Account In Connection with a Trial Balance

As the trial balance preparation is the first step in the preparation of annual accounts, no final accounts must be prepared unless the trial balance is balanced. In order to be able to prepare a draft annual account before the cause of disagreement of the two sides of the trial balance is discovered, it is made to balance by raising on the short side a SUSPENSE ACCOUNT.

The suspense account is raised by inserting the amount of the difference between the two sides of the disagreed trial balance and opening a suspense account in the ledger and either debiting or crediting it depending on which side of the trial balance is short.

EXAMPLE

TRIAL BALANCE OF………………AS AT…………………

Serial No.	Particulars	L/F	N :K Dr	44 :K Cr
	Total of all Accounts		6,800:00	6,200:00
	Suspense Account			600:00
			6,800:00	6,800:00

Dr Suspense Account Cr

			Difference in Trial Balance	N600:00

If the errors are not located before the final Accounts are prepared, the Suspense Account balance in this case N=600 = will be shown on the liabilities side of the balance sheet. If the Suspense Account has a debit balance it will be shown on the Assets side of the balance sheet.

The error must however be located and the Suspense Account eliminated if the figure is a material one. Where the errors are disclosed, they must be corrected, each one being supported by a Journal.

SELF-ASSESSMENT EXERCISE 1

In case of disagreement of the trial balance, in what procedure would you follow to locate the errors?

SELF-ASSESSMENT EXERCISE 2

Briefly explain the errors which are disclosed by the trial balance and give some examples to support your answer.

4.0 CONCLUSION

We must be conscious always of the fact that the agreement of a trial balance is not conclusive evidence that the ledger entries are correct.

The smallest difference between the totals of the trial balance should be investigated which may lead to the discovery of very great mistakes. There are ways whereby errors in the accounts can be detected, but it is best to ensure right from the outset that entries and postings are correctly made.

5.0 SUMMARY

In this unit, you should agree that the agreement of a trial balance is not an absolute proof of the correctness of all ledger postings because of the following compensating errors:

1. Errors of Commission
2. Errors of Omission
3. Errors of Principle
4. Errors of Duplication
5. Errors of Original Fran/
6. Other compensating errors and
7. Complete Reversal of Entries

If the totals, of a trial balance do not agree, it might be due to some errors. If those errors are not located before the preparation of the final

Accounts and balance sheet, a Suspense Account is raised by inserting the amount of the difference between the two sides of the disagreed trial balance and open a Suspense Account in the ledger and either debiting or crediting it depending on v. Inch side of the trial balance is short.

6.0 TUTOR-MARKED ASSIGNMENT

"The agreement of a Trial Balance is tot an absolute proof of the correctness of all ledger postings"
Discuss and give reasons for your answer.

7.0 REFERENCES/FURTHER READING

Frank Wood's/Omuya, J.O. *Business Accounting.*

Akinkuolie, L. *Questions and Answers in Cooperative Accounting*.

Johnson, J. E. *Questions and Answers in Accounting I for Nigerian Institute of Bankers*.

Etuk-Udo, J. S. *Principles of Accounts for West Africa* - *Book 1.*

UNIT 3 CONTROL ACCOUNTS

CONTENTS

1.0 INTRODUCTION

When a trial balance does not agree, this is an indication that error (s) have been made in the accounting entries.

Location of errors in small business concern is relatively easy because or the few number of transactions. But, in a big business where there is a large number of transactions, the accounting books and ledgers are many and sub-divided. Therefore, tracing the errors might be difficult and time consuming. This problem can be simplified by haying a system that makes it possible to localize the error{s} to specific ledger (s) *so* that such ledger{s} will be thoroughly checked to locate and correct error{s}. This need is met by having, a control account for each that shall act as a check on the accuracy of the entries in the ledger.

A ledger that has a control account is sometimes referred to as a self-balancing ledger.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define control Account
- explain Sales ledger Control Account
- explain Purchases ledger Control Account
- give the formats of control Accounts
- explain the Treatment of certain items in Control Accounts
- give the Advantages of Control Accounts.

3.0 MAIN CONTENT

3.1 Control Accounts

3.2 Definition

Control Accounts are accounts prepared to check the accuracy of some specified ledgers. They make use of total figures of items posted individually into the ledger accounts and are normally prepared for sales and purchases ledgers.

Control Accounts can also be defined' as accounts which contain the summary of total of entries in the individual accounts in the ledger.

In other words, control accounts are replica in summarized form of the accounts in the ledger to which they relate. It therefore follows that the balance, on these accounts will be equal to the total of all individual balances in the ledger. Where this is not so, it is an indication of errors in the ledger.

3.3 Sales Ledger Control Account

Sales ledger Control Account is also known as "Total Debtors Account". It is debited with the sum of all the items which have been debited in detail to various personal accounts in the sales ledger and credited with the total of all the items which have been credited to such accounts. The balance of the sales ledger control accounts should be equal to the total of the balances shown in the sales ledger.

In summary, the sales ledger control account which contains on the debit side, the totals of the following items:

A Opening debit balances
B Total sales made during the period
C Cash and cheques paid to debits

On the credit side it will contain the totals of the following items:

A Opening credit balances
B Cash and cheques received from debtors during the period
C Returns Inwards
D Bad debts written off
E Discount allowed to debtors.

3.4 Purchases Ledger Control Account

This is also known as "Total Creditors Account". It serves as a control account of the purchases ledgers and should show a balance equal to the total of all the balances of creditor's personal accounts in those ledgers. The following will be shown on the credit side of the accounts:

A Opening Credit balances
B Total Purchases during the period.

On the debit side, the following are shown:

A Opening debit balances
B Cash and cheques paid to customers during the period
C Discount received
D Returns Outwards

It should be noted that the entries in this account take the opposite form of the Total Debtors Account.

3.5 Formats of Control Accounts

3.5.1 Debtors Control Account/Sales Ledger

Dr Control Account Cr

	N			N
Balance B/D	x		Balance B/D	x
Credit Sales	x		Discount Allowed	x
Dishonoured Cheques	x		Bad Debts	x
Interest Charge To Customers	x		Bills Receivable	x
Bills Receivable Dishonoured	x		Cheques Received from Customers	x
Balance Carried Down (c/d)	X		Cash received from Customers	x
			Returns Inwards	x
			Balance C/D	x

	xx			xx
Balance B/D	x		Balance B/D	x

3.5.2 Creditors Control Account/Purchases Ledger Control Account

Dr Cr

	N			N
Balance B/D	x		Balance B/D	x
Discount Received	x		Credit Purchases	x
Bills Payable	x		Dishonoured Cheques	x
Cheques paid to suppliers	x		Bills Receivable	x
Cash paid to suppliers	x		Interest charge by	x
Returns Outwards	x		Billa payable dishonoured	x
Balance C/D	x		Balance CID	x
	xx			xx
Balance B/D	x		Balance B/D	x

3.6 Treatment of Certain Items in Control Accounts

3.6.1 Debtors Control Account

I Bills Receivable: Where bills receivable and bills receivable accepted are both given, the latter should be used because the obligation of the debtor on the bills arises only when he accepts the bill. However, where only bills receivable is given, it should be interpreted to mean bills receivable accepted.

II Bills receivable discounted should be disregarded.

III Bills receivable honoured should be disregarded.

IV Bad debt recovered: Should be ignored unless it had earlier been credited to the debtors control account, in which case it should be debited to the debtors control account.

V Provisions for bad/doubtful debt and provision for discount allowable should be disregarded.

VI Cash sales should be disregarded

3.6.2 Creditors Control Account

I Bills payable: The same rule as with bills receivable supplies.
II Bills payable honoured should be disregarded.
III Provision for discount receivable should be disregarded
IV Cash purchases should be disregarded.

3.7 Disadvantages of Control Accounts

1. Control Accounts make it possible to localize error{s} so that time is not wasted checking ledger{s} where there are no errors.

2. Because control accounts are normally put under the charge of a senior official, they serve as a check against fraud by junior accounting officials keeping the ledgers.

3. Control Account saves the time and effort of drawing up the schedules of debtors and creditors and thereby, aids the preparation of draft annual accounts.

4. They aid the preparation of interim final accounts since the balances of control accounts at any time represent the total of the balances in the individual accounts.

5. They can be used to detect missing figures.

SELF-ASSESSMENT EXERCISE

1. Briefly explain

a. Sales ledger control account
b. Purchases ledger control account

2. On 1st January 2001, the Sales ledger balance of Alhaji Musa Enterprises was N240 = debt while the purchases ledger balance was N90 = {Cr}. The following transactions took place in the month of January, 2001.

	N
Credit purchases…………………………………………	1,800 =
Returns Inwards…………………………………………	150 =
Credit sales………………………………………………	3,510 =
Dishonoured Cheques…………………………………	120 =
Bad debt………………………………………………..	80 =
Bills receivable……………………………………………	450 =
Cash received from debtors……………………………	1,560 =
Cash paid to creditors…………………………………	1,140 =

Discount allowed……………………………………….	40 =
Discount received……………………………………….	90 =
Cheques from debtors………………………………..	750 =
Bills payable ………………………………………..	210 =
Discount allowed but subsequently disallowed ……..	15 =
Discount received but subsequently withdrawn …….	14=

You are required to prepare

- Total Debtors Account {Sales ledger Control Account}
- Total Creditors Accounts or {purchases ledger Control Account}

4.0 CONCLUSION

When all the accounts were kept in one ledger a trial balance could be extracted as a test of the arithmetical accuracy of the account. It must be remembered that certain errors were not revealed by such a trial balance. If the trial balance totals disagreed, the number of entries for such a small business being relatively few, the books could easily and quickly be checked so as to locate the errors. However, when the firm has grown an the accounting work has been so subdivided that there are several or many ledgers, a trial balance the totals of which did not agree could result in a great deal of unnecessary checking before the errors were found. What is required in fact is a type of trial balance for each ledger, and this requirement is met by the control Account.

5.0 SUMMARY

In this unit, we have dealt with definitions of control account and we have also explained Sales Ledger Control Account, Purchases Ledger Account and the Treatment of certain items in Control accounts.

A Control Account for a sales Ledger could be known either as a sales ledger control account or as a total debtors account. Similarly, a Control Account for a purchases ledger could be known either as a Purchases Ledger Control Account or as a Total Creditors Account.

6.0 TUTOR-MARKED ASSIGNMENT

From the following balances, write up the Sales ledger and Purchases ledger Control Account.

Debit balances b/f in sales ledger	70,000 =
Credit balances b/f in sales ledger	2,600 =
Debit balances b/f in purchases ledger	1,900 =

Credit balances b/f in purchases ledger	81,100 =
Credit purchases	93,000 =
Cash purchases	14,000 =
Cash sales	13,500 =
Credit sales	66,000 =
Discount allowed	1,300 =
Discount received	1,700 =
Bad debts written off	600 =
Cheques payment to creditors	72,300 =
Receipts from debtors	68,700 =
Returns outward to creditors	9,800 =
Interest charged on overdue account	200 =
Provisions for Bad debts	1,000 =
Provisions for discount receivable	2,200 =
Debit balance transferred to purchases ledger	5,500 =
Debtors cheque returned unpaid	4,800 =

7.0 REFERENCES/FURTHER READING

Igben, O. Robert. *Financial Accounting Made Simple*.

Akinkuolie, L. *Questions and Answers in Cooperative Accounting.*

Frank Wood/J. O. Omuya. *Book-keeping and Accounting*.

UNIT 4 JOURNAL-MEANING, SPECIMEN AND TYPES OF A JOURNAL

CONTENTS

1.0 INTRODUCTION

Journal is derived from the French word "Jour" which means a day. Journal, therefore, means a daily record of business transactions. Journal is a book of original entry because transaction is first written in the Journal from which it is posted to the ledger at any convenient time.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define a Journal
- explain the specimen of a journal
- explain the types of journal
- explain the users of journal
- illustrate the style of the journal proper.

3.0 MAIN CONTENT

3.1 Journal-Meaning, Specimen and Types of Journal

3.2 Meaning of Journal

The journal is a book in which transactions are entered when they occur, and in the order in which they occur, so as to provide a suitable record from which the ledger entries can be made at some later and more convenient point of time.

The Journal is primarily a book of convenience, while the ledger is often described as a book of classification.

3.3 Specimen of a Journal

Date	Particulars/Narration	L/E	Amount to be debited N : K	Amount to be Credited N : K

The journal contains columns for the date, particulars of entry, ledger folio and debit and credit money columns.

Note:

I It will be observed that the rulings as shown above are exactly like one side of the cash book.

II The money columns are not for cash and bank accounts but for debit and credit according to the side a transaction will be posted in the ledger.

The style of the journal should be very carefully studied.

The following points should be noted.

1. The transactions are dated, and are entered in chronological order, i.e. date order.

2. The debit and credit entries are on successive lines.

3. The abbreviation "Dr" written after the name of the account to be debited and near the folio column.

4. The word "To precedes the name of the account to be credited.

5. The credit entry is indented i.e. a space is left somewhat similar to the commencement of a new paragraph. This placing of the credit entries further to the right hand side distinguishes them from the debit entries.

6. The figures in the folio column are the number of the account to which the items have been posted in the ledger.

7. There is a separate cash column for debit and credit entry for the same amount made in respect of each transaction. The total of the debit column must agree with total of the credit column.
8. Immediately below the entries, brief narration is given about the transactions.

Notes:

I. Although brief, this narration must be sufficient to convey all the essential particulars of the transaction, when it is read in conjunction with the entries to which it relates.

II. Note that all debit entries in the journal must be posted to the debit side of the appropriate ledger accounts while all credit entries must be posted to the credit side of the appropriate ledger accounts.

III. Note that there are other types of journal apart from the journal proper described above. These are known as subsidiary books of Accounts or entries, examples are:

(a) **Sales day book-** used to record goods sold on credit

(b) **Purchases day book-** used to record goods bought on credit

(c) **Returns outwards journal —** used for purchases returns i.e. used to record goods previously bought by the business, now return back to the seller as a result of one fault or the other.

(d) **Returns Inwards Journal —** used for sales returns i.e. used for recording goods already sold now return back to the business as a result of certain faults.

All these will be treated in details at a later unit.

(e) **Cash Journal or Cash Book:** The cash book which is book of original entry and part of the principal book of account ledger, is used for recording all cash transactions both cash receipt and cash spent.

You should note that these subsidiary books are also referred to as books of original entry. They are subsidiary to ledger hence why ledger is a principal book of account.

3.4 Illustration

Journalize the following transactions in the book of a sole trader.

			N
Feb.	1	Started business with cash	45,000 =
"	1	Paid into Bank	25,000 =
"	2	Goods purchased for cash	15,000 =
"	3	Purchased furniture by cheque	5,000 =
"	5	Sold goods for cash	6,000 =
"	8	Sold goods to Ayo	4,000 =
"	10	Goods Purchased on credit from C.S.A.	7,000 =
"	12	Goods returned to CSA	1,000 =
"	15	Sold goods to Alhaji Raji Bello for cash	2,500 =
"	18	Cash received from Ayo	4,000 =
"	21	Withdrew from Bank for private use	1,000 =
"	21	Drew from bank for business use	5,000 =
"	25	Paid Telephone bill	400 =
"	28	Cash paid to CSA	6,000 =
"	28	Paid cash for salaries	2,500 =

Solution:

Journal Entries

Date	Narrations	L/F	Dr N : K	Cr N : K
Year 2000 Feb. 1	Cash Account to Dr To Capital Account {Being cash brought into start a business}		45,000 =	44,000 =
Feb. 1	Bank Account Dr Cash Account {Being cash paid into Bank}		25,000 =	25,000 =
Feb. 2	Purchases Account Dr Cash Account {Being goods purchased for		15,000 —	15,000 =
Feb. 3	Furniture Account Dr Bank Account {Being purchase of furniture by cheque}		5,000 =	5,000 =
Feb. 5	Cash Account Dr Sales Account l Being goods sold for cash:		6,000 =	6,000 =

Feb. 8	Ayo Account Dr Sales Being goods sold to Ayo on credit:		4,000=	41000 =
Feb. 10	Purchases Account Dr C. S. A {Being credit purchases from C.S.A)		7,000 =	7,000=
Feb. 12	C. S. A. Account Dr Returns outwards {Being goods sold for cash)		1,000 =	1,000 =
Feb. 15	Cash Account Dr Sales {Being goods sold for cash}		2,500 =	2,500 —
Feb. 18	Cash Account Dr Ayo {Being cash received from Ayo		4,000 =	4,000=
Feb. 21	Drawings Account Dr Cash Account Dr Bank Account {Being cash withdrawn from bank for personal and business use.)		1,000 = 5,000 =	6,000 =
Feb. 25	Telephone bill Account Dr cash Account {Being payment of Telephone		400 =	400 =
Feb. 28	C. S. A Account Dr cash {Being payment of salaries by cash}		6,000 =	6,000 =
Feb. 28	Salaries Account Dr cash Account {Being payment of Salaries by cash		2,500 =	2,500 =
			N129,400	N129,400

SELF-ASSESSMENT EXERCISE

1. What do you mean by Journal?
   Why is it called the books of original entry?
2. Explain the rulings of a journal proper.
3. List and explain the commonly used subsidiary books of account.

4.0 CONCLUSION

In practice, transaction is first entered in the journal before it is posted to the ledger at any convenience time. So journal is a book of convenience and it can also be referred to as book of original entry.

5.0 SUMMARY

The Journal is a book in which transactions are entered when they occur, and in the order in which they occur. The Journal is primarily a book of convenience, while the ledger is often described as a book of classification.

Apart from the Journal proper, there are other types of Journal. These are known as subsidiary books of account, e.g. Sales day book, Purchases day book, Returns Outwards Journal, Returns Inwards Journal, and cash Journal. All these subsidiary books are also referred to as books of original entry.

6.0 TUTOR-MARKED ASSIGNMENT

Journalize the following transactions in the book of Maza-Maza Cooperative Society Ltd.

Year 2001			N
Jan.	2.	Received shares from Mr. Joseph	4,000 =
Jan.	3	Paid into Bank	2,950 =
“	3	Purchased goods on credit from Leventis	2,000 =
“	5	Sold goods on credit to Madam Janet	1,000 =
“	9	Paid Leventis by Cheque	1,500 =
“	10	Cash Sales	5,000 =
“	20	Paid into Bank	3,000 =
“	22	Received cash from Madam Janet	1,000 =
“	25	Share withdrawn by Mr. Joseph	2,000 =
“	30	Paid wages (cash)	1,000 =

7.0 REFERENCES/FURTHER READING

Jacques, J. and Davies, H. *Cooperative Book-keeping*.

Akinkuoli, L. *Questions and Answers in Cooperative Accounting*. Eleyele, Ibadan: Federal Cooperative College, P. M. B. 5033.

Favell. *Practical* Book-keeping and Accounts.

Etuk-Udo, J. S. *Principles of Accounts for West Africa.*

UNIT 5 JOURNAL – USES OF JOURNAL (PRIMARY AND SECONDARY USES)

CONTENTS

1.0 INTRODUCTION

In practice, it would be extremely difficult and in many cases quite impracticable to make the two ledger entries for a transaction immediately it occurs, because of the large number of accounts that have to be kept. As a general rule, the clerk responsible for the debits in respect of certain transactions is not always responsible for the credits. Another clerk is responsible for these, so that there is a check upon the work of clerk. The debit made by one must agree in total with the credits made by the other.

This division of the work of ledger posting further increases the difficulty of making ledger entries for a transaction immediately it occurs. It is, therefore, found to be convenient to enter the transactions in a Journal when they occur, and to post the ledgers from the Journal later.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the Primary uses of journal
- explain the uses of subsidiary books of account
- explain the secondary uses of the journal.

3.0 MAIN CONTENT

3.1 Journal - Uses of Journal

3.2 Primary Uses of Journal

In practice all transactions are first entered in the journal in the order in which they occur and from the journal they are posted to the respective accounts in the ledger. But this would involved a tremendous amount of work because each transaction requires a separate debit to the receiving account and a credit to the giving account to bring into record the two fold aspect of each transaction. A considerable saving of clerical labour's effort can be brought about if transactions of similar nature are recorded in separate journals so as to permit the sub-divisions of the journals. This would facilitate not only the division of the journal but it would also make easier the job of posting in the ledger, as the postings can then be made in the form of totals being transactions of similar nature.

These sub-divisions of the journals into various books recording transactions of similar nature are called subsidiary books. These subsidiary books are also known as books of original entry because transactions are first recorded in these books to be subsequently transferred to their respective accounts in the ledger.

In the last unit, we mentioned the types of subsidiary books and their uses. For more explanation, the various books in which the journal may be subdivided into are as follows:

1. Cash- book or cash journal. This book can be used to record cash receipt and payments
   Note that the cash book is a journal as well as a ledger.

2. Purchases day book or bought book or invoice book. It can be used for recording credit purchases of goods.

3. Sales day book. This can be used for recording all goods sold on credit

4. Purchases Returns book or Returns outwards book for recording all purchases returned to creditors.

5. Sales Returns book or Return inwards book for recording all sales returned by customers.

6. Bills receivable book used to keep a record of bills received from

customers.

7. Bills payable book used to keep a record of bill payable to creditors.

8. Journal proper used to keep a record of those transactions for which there is no separate book.

3.3 Secondary Uses of Journal

In modern practice the journal proper is used only for recording transactions which cannot conveniently be passed through other books or original entry already discussed under the primary uses of journal.

These include:

1. Opening entries
2. Closing entries
3. Entries relating to rectification of errors i.e. correction of errors.
4. Adjustment in account
5. Purchase and sales of fixed assets on credits
6. Transfer entries {transfer from one account to another}. e.t.c.

3.3.1 Opening Entries

If a trader commences business with various assets and perhaps liabilities or whether, for any reason a new set of books is being opened, the opening balances are usually journalized. The capital of the business is the excess of Assets over liabilities of such business at any date. If the business has no liabilities then the value of all the assets will be the capital of the business.

After ascertaining the capital in this way, Journal entries are made to show these assets, liabilities and capital at that date before the item are posted to the ledger.

Illustration:

On March 1st, 2000, the financial position of Tom Jones and Sons was as follows:

	N
Cash Balance	200 =
Bank Balance	15,000 =
Stock	7,500 =
Furniture	5,200 =
Debtors – Alhaji Musa	1,500 =

Mr. J. Okoro	2,000 =
Creditors Cooperative Bank Plc.	1,800 =
1st Bank Plc	10,000 =

You are required to show journal entries necessary to open the books

TOM JONES AND SONS
JOURNAL {OPENING ENTRIES

Date	Particulars	L/F	Debit	Credit
Year 2000			₦	₦
Mar. 1	Cash in hand Dr		200	
	Cash at Bank Dr		15,000	
	Furniture Dr		5,200	
	Stock Dr		7500	
	Alhaji Musa Dr		1,500	
	Mr. J. Okoro Dr		2,000	1,800
	Coop. Bank Plc.			10,000
	1st Bank Plc.			19,600
	Capital			
	{Being Assets, Liabilities and Capital of Tom Jones and Sons as at 1st march, 2000}.			
			31,400	**31,400**

IN THE LEDGER

Dr **FURNITURE ACCOUNT** Cr

	₦			₦
Balance B/D	5,200			

Dr **Stock Account** Cr

	₦			₦
Balance B/D	7,500			

Dr **Alhaji Musa Account** Cr

	₦			₦
Balance B/D	1,500			

Dr **Mr. J. Okoro Account** Cr

	₦			₦
Balance B/D	2,000			

Dr **CASH ACCOUNT** Cr

	₦			₦
Balance B/D	200			

Dr **BANK ACCOUNT** Cr

	₦			₦
Balance B/D	15,000			

Dr **COOPERATIVE BANK ACCOUNT** Cr

	₦			₦
			Balance B/D	1,800

Dr **1ST BANK PLC.** Cr

	₦			₦
			Balance B/D	10,000

Dr **CAPITAL ACCOUNT** Cr

	₦			₦
			Balance B/D	19,600

3.3.2 Closing Entries

At the end of the trading period of any business, there is bound to be closing stock or stock to end, if the goods purchased are not sold. In order not to overstate the loss or understate the profit, it is important to take the value of stock not sold into account. It should be noted that closing stock does not appear in the trial balance because the entries in respect of this stock are not made until the final account are prepared, which is after the trial balance is prepared.

In order to bring the value of stock into account, it is usually passed through the journal.

Illustration:

A. Closing entry for trading Account. The journal entries necessary to transfer opening stock, purchases, sales and Returns to the trading account are called closing entries, as they serve to close these accounts — These are as follows:

1. For transfer of opening stock. Net purchases and direct expenses to Trading Account.

	Trading Account Dr	xx	
	To Stock {opening} Account		xx
	To Purchases Account		xx
	To Direct Expenses Account		xx

2. For transfer of net sales and closing stock to Trading Account.

	Sales Dr	xx	
	Stock {closing} Account Dr	xx	
	To Trading Account		xx

3. For Profit

	Trading Account Dr	xx	
	To Profit and Loss Account		xx

4. For Loss

	Profit and Loss Account Dr	xx	
	To Trading Account		xx

B. Closing Entries for Profit and Loss Account

1. For transfer of Expenses to Profit and Loss Account

	Profit and Loss Account Dr	xx	
	To Trading Account		xx

2. For transfer of Income to Profit and Loss Account

	All Indirect Incomes Dr	xx	
	To Profit and Loss Account		xx

3. For Net Profit

	Profit and Loss Account Dr	xx	
	To Capital		xx

4. For Net Loss

	Capital Account Dr	xx	
	To Profit and Loss Account		xx

3.3.3 Other Examples

Other examples of secondary uses of journal will be discussed in the subsequent units. i.e

I. Ractification of errors {correction of errors}
II. Adjustments e.t.c

SELF-ASSESSMENT EXERCISE

Moon-light departmental stores started a new trading period on 1st January, 2002 with the following balances: Cash at bank N=80,000 =; Cash in hand N1,500 =; Debtors N4,000 =; Creditors N40,000 =; Bank Loan N10,000

The business transactions for the month were as follows:

		N
Jan. 2	Bought goods by cheque	10,000
" 4	Cash sales	4,000
" 6	Bought goods on credit from U.T.C.	10,000
" 10	Received cash from a Debtor	2,000
" 12	Sold goods on credit to John	1,000
" 18	Received cash from John	800
" 20	Paid U.T.C. by cheque	10,000
" 24	Paid rent by cash	1,500
" 27	Cash sales	1,000
" 30	Paid wages cash	1,500
" 31	Paid Electricity by cheque	700

You are required to show the opening balances through a journal, enter the transactions for the month into relevant ledger account.

4.0 CONCLUSION

In practice, all transactions are first passed through the journal so as to provide a suitable record from which the ledger entries can be made at some later and more convenient point of time.

The journal serves a number of useful purposes in Accounting.

5.0 SUMMARY

In this unit, we discussed the primary uses and secondary uses of journal. In practice, it would be extremely difficult and in many cases quite impracticable to make the two ledger entries for a transaction immediately it occurs because of the large number of account that have to be kept. So to facilitate the posting of ledger account at a later and more convenient time, all transactions are first entered in the journal, being a book of original entries.

Apart from using journal as book of original entry, journal has a secondary uses. It can be used for opening and closing entries, correction of errors, adjustment in ledger accounts e.t.c.

In summary, keeping of journals will be helpful to you and other students, provided you realize that, theoretically, the objectives of book-keeping can be achieved by keeping only ledger accounts, as discussed in units one of this course, and that although it is found convenient to keep journals in practice. These journals are drafted to suit the needs of each individual business.

6.0 TUTOR-MARKED ASSIGNMENT

On 1st April, 2000, Chief Tom Lar, a businessman in Jos, requested you to assist in opening a set of books under the double entry system, for his business.

He made the following disclosures.

Assets

	N
Land and Building	40,000
Cash in hand	5,000
Cash at Bank	14,000
Debtors	8,000
Stock	4,000

Liabilities

Creditors	12,000
Loan {Union Bank Plc}	6,000
Overdraft {National Bank}	4,000
Overdraft Interest Payable	500

You are required to carry out opening journal entries to reflect the Switch-over to the double entry system on 1St April, 2000. Post the journal into the ledger accounts.

7.0 REFERENCES/FURTHER READING

Carter. *Advanced Accounts*.

Jacques, J. and Davies, E.L. *Cooperative Book-keeping*.

Akinkuoli, L. *Questions and Answers in Cooperative Accounting.*

MODULE 3

UNIT 1 RECTIFICATION OF ERRORS

Contents

1.0 INTRODUCTION

Every concern is interested in ascertaining its true profit and financial position at the end of the trading year. But in spite of the best efforts of the book-keeper and the accountant, certain errors are committed in the recording of the transactions, which affect the final accounts of the concern. It, therefore, becomes utmost important for the book-keeper and the accountant to locate such errors and rectify them so that correct profit and financial position of the concern may be ascertained.

2.0 OBJECTIVES

In this unit, you are expected to:

1. Know all those errors that will not affect the agreement of the trial balance.
2. Correct these errors and support the corrections with journal.
3. Locate all those errors that will affect the agreement of the trial balance.
4. Make necessary corrections by raising a suspense account and insert the amount of the difference between the two sides of the disagreed trial balance in the side that is short.

3.0 MAIN CONTENT

3.1 Journal- Rectification of Errors

In Unit 6, we noted that the mere fact that a Trial Balance does balance is no conclusion proof of the correctness of the book-keeping. These, we agreed is because there are some errors that do not affect the agreement of the Trial balance totals.

These errors we learnt are errors of omission, errors of commission, errors of principle and compensating errors.

The other classes of errors are errors that affect the trial balance.

You should note that where errors occur, the only remedy is to carry out a careful and systematic check of all the postings with a view to locating the errors and effecting necessary corrections.

3.2 Rectification of Errors not affecting the Agreement of the Trial Balance

When errors falling under this class are located, the necessary correct entries must be made in the accounts. Full information as to the cause of the errors and their remedy must be recorded by a journal.

An example of each of these types of errors not affecting the agreement of the Trial Balance is shown below with the journal entry recording the correction.

3.2.1 Errors of Omission

A sale of N100 = worth of goods to Ade on 09/10/2001 was completely omitted from the books. This is corrected by debiting Ade account with N100 = and crediting sales account with N100.

The Journal

			N : K	N : K
9/10/01	Ade Account Dr To Sales (Being correction of error of omission)		100 : 00	100 : 00

3.2.2 Error of Commission

A sale of goods N50.00 to John on 12/10/01 was posted in error to Johnson Account. This is corrected by debiting John Account with

N50.00 and crediting Johnson Account with N50.00

The Journal

			N : K	N : K
129/10/01	John Account Dr Johnson Account (Being correction of wrong positing)		50 : 00	50 : 00

3.2.3 Error of Principle

The purchase of office equipment N1,000.00 is posted to office and General Expenses Account instead of Office Equipment Account. This is corrected by debiting Office Equipment Account (real account) and Crediting Office and General Expenses Account (Nominal Account).

The Journal

Date	Particulars		N :K	N K
9/10/01	Office Equipment Account Dr To Office and General Expenses (Being correction of purchase of fixed assets debited to expenses account)		1,000: 00	1,000: 00

3.2.4 Compensating Error

The sales and wages accounts are overcast by N400.00 each. This is corrected by debiting sales account with N400.00 and crediting wages account with N400.00.

The Journal

Date	Particulars		N K	N K
	Sales Account Dr To Wages Account (Being correction of overcastting of N400.00 each in the sales and wages accounts)		400 00	400 00

3.3 Rectification of Errors Affecting the Trial Balance

Apart from the errors that will not affect the agreement of the Trial Balance, there are other types of errors. These errors cause the disagreement of the Trial Balance totals with one another. These are mainly concerned with incorrect additions and where an entry is made by only one side of the book. A Trial Balance may not be balance for the following reasons:

1. Error in posting
2. Balance unextracted
3. Balance extracted but placed on the wrong side of the Trial Balance
4. Incomplete double entry of item or items.
5. Errors in the balancing of opening figures and
6. Errors in additions

As the Trial Balance preparation is the first stop in the preparation of annual accounts, no accounts may be prepared unless the Trial Balance is balanced. In order to be able to prepare a draft annual accounts before the cause of disagreement of the two sides of the Trial balance is discovered, it is made of balance by raising on the short side a **SUSPENSE ACCOUNT**.

The suspense account is raised by inserting the amount of the difference between the two sides of a disagreed Trial Balance and opening a suspense account in the ledger and either debiting or crediting it depending on which side of the Trial Balance is short. Efforts must be made to trace the errors before the preparation of final accounts.

Trial Balance as at 31st December, 2001

S/N	Particulars		N : K	N : K
	Totals of all Accounts		3,500 : 00	3,450 : 00
	Suspense Account			50 : 00
			3,500 : 00	3,500 : 00

Dr	Suspense Account	Cr
	Difference in Trial Balance	N50

If the errors are not found before the final accounts are prepared, the suspense account balance in this case N50.00 will be shown on the liabilities side of the Balance Sheet. If the suspense account has a debit balance, it will be shown on the asset side of the Balance Sheet. The error must, however, be found and the suspense account eliminated if the figure is a material one.

Where the errors are discovered, they must be corrected, each one being supported by a journal.

Assume that undercasting of sales N30.00 and omission of N20.00 cash received in Ola Account were responsible for the correction of Suspense Account N50.00 above. These errors were found on 2nd January, 2002. It will be created thus:

The Journal

			N :	N :K
2/1/02	Suspense Account Dr To Sales Account (Being undercasting of sales by N30.00 in last year's account)		30 : 00	 30 : 00
2/1/02	Suspense Account Dr To Ola Account (Being N20.00 omitted Ola Account)		20 : 00	 20 : 00

<u>Note:</u>

- That only those errors, which affect the agreement of the Trial Balance totals are corrected via the Suspense Account.

- An item of N40.00 has been posted as N4.00 from the debit of the Cash Book to the credit of a customer's account. The obvious amount of discrepancy is N36.00 (Short Credit).

			N : K	N : K
	Suspense Account Dr To Customer's Account (Being correction of error posted into the credit side of customer's account)		36 : 00	 36 : 00

3.2.1 Illustration

The Trial Balance shows the difference which was entered into suspense account. The difference is a result of the following errors:

July 2001

1st July purchased goods worth N500.00 from Alhaji Bello had been posted in error to Alhaji Bala.
4th I credit sales of goods valued N80.00 posted to the credit side of Mr. Okon account instead of debit.
6th July, purchase day book was undercast by N300.00.
14th July sale day book was undercast by N8.00.

15th July, machinery purchased for N50, 000.00 debited to purchases account.
You are required to make necessary corrections through journal entries.

Note:

That items 1 and 5 above do not affect the agreement of the Trial Balance totals. They are corrected by journal entries only while errors 2, 3 and 4 affect the agreement of the Trial Balance. The Trial Balance in order to balance must have a suspense account of N452.00 entered on the debit side. The amount of N452.00 needed to balance the Trial Balance is arrived at by considering the errors 2, 3 and 4 will have on the Trial Balance.

		N : K	N : K
2.	Short debit		160 : 00
3.	Short debit		300 : 00
4.	Short credit	8 : 00	
	Difference in Trial Balance	452 : 00	
		N460: 00	460 : 00

The Journal

Date	**Particulars**		**N : K**	**N :**
1/7/01	Alhaji Bala Dr		500 : 00	
	To Alhaji Bello			500: 00
	(Being correction of purchase of goods posted to Alhaji Bello Account in error)		160: 00	
4/7/01	Mr. Okon Account Dr			
	To Suspense Account			160: 00
	(Being correction of wrong posting)			
6/7/01	Purchase Account Dr			
	To suspense Account			
	(Being correction of undercasting of purchases day book		300 : 00	300: 00
14/7/01	Suspense Account Dr			
	To Sales Account			
	(Being correction of		8 :00	

	undercasting of sales day book)		8 : 00
15/7/01	Machinery Account Dr To Purchases Account (Being correction of cost of machinery debited to purchases account in error)	50,000 : 00	 50,000: 00

Dr **Suspense Account** **Cr**

Particulars	**N : K**	**Particulars**	**N : K**
Difference in Trial Balance	452 : 00	Mr. Okon	160 : 00
Sales	8 : 00	Purchases	300 : 00
	460 : 00		460 : 00

Exercises

1. What do you mean by Suspense Account? Why is it opened?
2. How would you rectify the errors of last year so that current year's profit may not be affected?
3. A Cooperative Book-keeper while balancing his book, found that there was a difference in the Trial Balance. Being required to prepare the Final Accounts, he entered this difference in a newly opened Suspense Account, which was carried forward to the next year when the following errors were discovered:

   - Goods purchased on credit from Cooperative Supply Association (CSA) amounting to N4,000.00 was credited in error to Cooperative Consumers Association (CCA).
   - The Purchases Account was undercast by N650.00
   - Bank charges of N250.00 was entered on the debit side of the cash book instead of credit side.
   - An item of N650.00 in the Sales Account was posted to the Customer's Account as N605.00.
   - Duplicating Machine purchased for N9,000.00 was overcast with N250.00.
   - A credit sales of N1,500.00 to John was completely omitted from the books.
   - Cash of N550.00 from a debtor was entered in the cash book only.

You are required to make Journal Entries and ascertain the total amount of the difference in the Trial Balance. Show the Suspense Account as opened by the Book-keeper and the subsequent to adjust entries made therein.

4.0 CONCLUSION

In Unit 7, we noted that the mere fact that a Trial Balance does balance is no conclusive proof of the correctness of the book-keeping. This we agreed is because of some compensating errors. Also in the this Unit (7), we discussed some errors that will affect the agreement of the Trial Balance. When any of the errors are located, the necessary correction must be made in the accounts and supported with journal.

5.0 SUMMARY

In this unit, we treated all those errors affecting the agreement of the Trial Balance and all those not affecting the agreement of Trial Balance. If the errors are not located before the preparation of the final accounts, in order to be able to prepare a draft of annual accounts before the cause of disagreement of the two sides of the Trial Balance is discovered, it is made to balance by raising on the short side. And this will be supported with journal.

6.0 TUTOR MARKED ASSIGNMENT

On taking out a trial balance, you discovered that there is in fact a difference which you enter in a suspense account to await further investigation and also to use a balancing figure for the trial balance.

Investigation locates the following errors:

1. A purchase of goods from C. Chukwu Ltd. has been credited in error to G. Chukwu Ltd. The amount is N3,000.00
2. A credit sales of goods, valued at N600.00 has been posted to the credit of L. Okonkwo Account instead of debit.
3. The purchase day book was undercast by N200.00
4. The sales day book was undercast by N80.00
5. Machinery purchased for N30,000.00 was debited to the purchases account.

You are required to make the correcting journal entries and show the suspense account with the entries therein.

7.0 FURTHER READING

Frankwood Business Accounting

UNIT 2: SPECIAL PURPOSE SUBSIDIARY BOOK (PURCHASES)

Contents

1.0 INTRODUCTION

In your previous studies, you have learnt that in any business, the number of cash and bank transaction is quite large. Hence, the firms always maintain a separate book called Cash Book to record them. Similarly, the transactions relating to purchase of goods are also large in number and they take place too frequently. It is, therefore, considered desirable to maintain separate book for purchases also. In this unit, you will learn how this book is kept.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain what is meant by purchases.
- Post transaction in various books relating to purchases.
- Prepare purchases and purchases return journal and post them into ledger.

3.0 MAIN CONTENT

3.1 Purchases Journal

The Purchases Journal (also called Purchases Book) is used for recording credit purchases of goods and raw materials. Note that the credit purchases of fixed assets like furniture, vehicles, etc are not recorded in this book. They are to be recorded in Journal proper about which you will learn in this Unit. The Purchases Journal is also called Purchases Book, Purchases Day Book and invoice Book. When goods are purchased on credit, you will receive a bill from the seller. Such a bill is called 'invoice'. It contains the details pertaining to the quantity, price, trade discount, total account, etc. It is generally prepared in duplicate. The original is given to the buyer and the duplicate is retained by the seller. The entries in the purchase journal are made on the basis of the purchase invoice received. Although the invoice bears a number but the buyer records his own serial number to all Inward Invoices for easy reference. It is this serial number which will be entered in the invoice number column of the purchases journal.

Purchases Journal

Specimen

Date	Name of Supplier	Invoice No	Folio	Amount	Remarks

The transactions recorded in the Purchase Journal are to be posted to their respective personal account in the ledger. When a purchase is made on credit, the supplier becomes the creditor to the firm. Hence, every credit purchase recorded in the purchases journal is posted on the credit side of the personal account of the supplier by writing ‘By Purchases Account’ in particulars column. The purchases journal is totalled periodically, say, weekly or monthly. This total is posted to the debit side of Purchases Account in the ledger by writing 'to sundries - as per Purchases Journal'. Thus you observe that posting of Purchases Journal involves two steps:

i) Posting each purchase to the credit of the respective personal accounts of suppliers and respective personal accounts of suppliers; and
ii) Posting the total purchases to the debit of the Purchases Account. With this, the double entry for credit purchases is complete.

3.2 Purchases Returns Journal

In any business, sometimes goods purchased may have to be returned to the supplier either partly or fully. This may become necessary when they are found to be defective, damaged in transit, inferior quality, short weighed, received too late or not in conformity with the order given. If the number of such returns is small they can be recorded in the journal itself. But, if it is large, a separate book called "Purchases Return Journal" should be used for recording these transactions. This book is called "Return Outwards Journal" or "Purchases Returns Book". The proforma of a Purchases Returns Journal is given below

Purchases Return Journal

Specimen

Date	Name of Supplier	Debit Note No	Folio	Amount	Remarks

When goods are returned to the supplier, a statement called 'Debit Not' is sent to him intimating that his account has been debited on account of the goods returned. The debit note also contains particulars and the value of goods returned. It is also prepared in duplicate. The original sent to the supplier and the duplicate is retained by the firm. The entries in the Purchases Return Journal are made on the basis of the copies of debit notes issued.

The debit notes bear a serial number which is duly recorded in the third column of the Purchases Return Journal. While recording the amount of purchases return, you must remember that if the original purchases involve some trade discount, it is also adjusted in the value of goods returned. The transactions recorded in the Purchases Return Journal are to be posted to their respective personal accounts in the ledger. Separate account in the name of each supplier already exists in the ledger (opened at the time of purchase). The entries made in the purchase return journal will be posted to the debit of each suppliers account by writing `To Purchases Return Account'. The total of the Purchases Return Journal is posted to the credit side of the 'Purchases Return Account' in the ledger by writing 'By Sundries — as per Purchases Return Journal'.

Exercise

Write up the Purchases Day Book of Mensha for the following transactions:

April 1	Bought goods on credit from Idowu N40.00
April 2	Sold goods on credit to Dada N20.00
April 2	Bought goods on credit from Dupe N50.00
April 3	Sold goods on credit to Wale N60.00
April 4	Bought goods on credit fro Idowu N40.00
April 5	Bought goods on credit from Kemi N60.00
April 5	Sold goods on credit to Wale N45.00
April 6	Sold goods on credit to Joke N30.00

4.0 CONCLUSION

Firms generally maintain four separate books for recording credit transactions relating to goods, among these books are Purchases Journal and Purchases Return Journal. These books are dealt with in this unit, we shall be dealing with the rest later.

5.0 SUMMARY

Like the Sales Day Book, Purchases Day Book could be called Purchases Book or Purchases Journal. It is used to collect purchases of goods on credit till the end of the set time interval when the total figure for purchases will be debited to the Purchases Account in the general ledger. The individual accounts of the supplier are credited with their respective credits.

The ruling is similar to that of the Sales Day book and entries are made there in like manner but from the Sales Invoice of the supplier, it is only purchaser of goods that keeps Purchases Day Book.

6.0 TUTOR MARKED ASSIGNMENT

From the credit purchases of transactions below, prepare the Purchases Day Book of Trivalade Ltd for the month of May 1981

May 2 Akiika, Invoice No. 5.414, NI, 500.00
May 6 Okoro Ltd, Invoice No. A4/90, N4, 000.00
May 12 Liberty Ltd, Invoice No. 3461, N3, 000.00
May 24 Tanko Ltd, Invoice No. 744, N7, 000.00

7.0 FURTHER READING

Frankwood: Business Accounting

UNIT 3: SPECIAL PURPOSE SUBSIDIARY BOOK (SALES)

Contents

1.0 INTRODUCTION

In your previous studies, you have learnt that in any business, the number of cash and bank transaction is quite large. Hence, the firms always maintain a separate book called Cash Book to record them. Similarly, the transactions relating to sales of goods are also large in number and they take place too frequently. It is, therefore, considered desirable to maintain separate book for sales also. In this unit, you will learn how transactions relating to sales are recorded in the book of original entry.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain what is meant by Sales
- Prepare Sales and Sales Returns Journals and post them into ledger.

3.0 MAIN CONTENT

3.1 Sales Journal

The Sales Journal is used for recording the credit sales of goods only. The credit sales of items, which do not constitute goods are not to be recorded in this book. The Sales Journal is also called 'Sales Day Book'.

The ruling of the Sales Journal is similar to that of the Purchases Journal. The difference is only with regard to the second column. In purchase journal, the second column is used for recording the name of the supplier. But, in the case of the Sales Journal, it is used for writing the name of the customer.

You know goods are sold on credit, an Invoice is given to the buyer. The seller generally has a bound invoice, which contains consecutively numbered invoices in duplicate. While the original copy is given to the buyer, the duplicate remains in the book itself The entries in the Sales Journal are made with the help of the duplicate copies of the invoices issued.

The customer to whom the goods are sold on credit becomes debtor to the firm. Hence, cash sales recorded in the Sales Journal is posted to the debit of the personal account of the customer column. The total of the Sales Journal is posted on the credit side of the Sales Account by writing 'By Sundries — as per Sales Book'.

3.2 Sales Returns Journal

When customers return goods to the business, it is normally recorded in a separate book called 'Sales Returns Journal'. If, however, the number of such returns are small, they can be recorded to in the Journal itself The Sales Return Journal is also called 'Returns Inwards Journal' or Sales Return Book'. Its ruling is more or less similar to that of Purchases Returns Journal. The second column of the Sales Return Journal is used for recording the name of the customer and the third column for credit note number, while in Purchases Return Journal, they are used for recording the name of the supplier and debit note number respectively.

When customer returns goods to the business, statement called 'credit note' is issued to him. It contains particulars and value of goods returned by him. The entries in Sales Return Journal are made with the help of credit notes issued. While recording the account of sales returns, you must remember that if the original sales involve some trade discount, it is also adjusted in the value of goods returned. The transactions recorded in the Sales Returns Journal are posted to the respective personal accounts in the ledger. Separate accounts in the name of each customer already exist in the ledger (opened at the time of sale). Credit the customers' account individually by writing 'By Sales Returns Account' and then post the total of the Sales Returns Journal to the debit side of the Sales Returns Account, by writing 'To Sundries — as per Return Journal'.

Look at the illustration and study how credit transactions relating to goods are recorded in various special purpose subsidiary books and postings made in various special purpose subsidiary books and posting made in the ledger.

Illustration

Enter the following transactions in proper subsidiary books of Chekra Enterprises and show their postings into ledger.

1987		N
Aug 1	Sold goods to Ram Singh	2,550.00
Aug 2	Brought goods from Dhillon	1,220.00
Aug 3	Sold goods to Gopinath	2,500.00
Aug 4	Purchased goods from Habeeb	3,600.00
Aug 5	Ram Singh returned goods	350.00
Aug 6	Goods returned to Dhillon	250.00
Aug 9	Gopinath returned goods	150.00
Aug 10	Return goods to Habeeb	260.00
Aug 12	Bought goods from Sanyal	4,750.00
Aug 13	Sold goods to Sailo	6,200.00
Aug 14	Sold goods to Michael	4,350.00
Aug 15	Purchased goods from Anthony	3,940.00
Aug 18	Returned goods to Sounyal	320.00
Aug 19	Sailo returned goods	230.00
Aug 22	Michael returned goods	150.00
Aug 25	Returned goods to Anthony	250.00
Aug 27	Sold goods to Solanki	5,340.00
Aug 28	Purchased goods from Gopinath	4,670.00
Aug 29	Sold goods to Harbinder Singh subject to trade discount of 5%	2,000
Aug 30	Purchased goods from Bhandari subject to trade discount of 10%	1,000

Solution

Purchases Journal

Date	Name of Supplier	Invoice No	Folio	Amount	Remarks
1987				₦	
Aug 2	Dhillon			1,200.00	
Aug 4	Habeeb			3,600.00	
Aug 12	Sanyal			4,750.00	
Aug 15	Anthony			3,940.00	
Aug 28	Gopalan			4,670.00	
Aug 30	Bhandari			4,670.00	
Aug 31				**19,060.00**	

Purchases Returns Journal

Date	Name of Supplier	Debit Note No	Folio	Amount	Remarks
1987				₦	
Aug 6	Dhillon			200.00	
Aug 4	Habeeb			260.00	
Aug 12	Sanyal			320.00	
Aug 15	Anthony			250.00	
Aug 31				**1.030.00**	

Sales Journal

Date	Name of Customer	Invoice No	Folio	Amount	Remarks
1987				₦	
Aug 1	Ram Singh			2,550.00	
Aug 3	Gopinath			2,500.00	
Aug 13	Salio			6,200.00	
Aug 14	Michael			4,850.00	
Aug 27	Solanki			5,340.00	
Aug 29	Harbinder Singh			1,900.00	
Aug 31				**23,340.00**	

Sales Returns Journal

Date	Name of Customer	Credit Note No	Folio	Amount	Remarks
1987				₦	
Aug 5	Ram Singh			350.00	
Aug 9	Gopinath			150.00	
Aug 19	Salio			230.00	
Aug 22	Michael			150.00	
Aug 31				**880.00**	

Purchases Account

Dr **Cr**

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 31	To Sundries – as per Purchases Journal	19,060.00			

Dhillion's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 6	To Purchases Returns Account	200.00	Aug 2	By Purchases Account	1,200.00

Habeeb's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 10	To Purchases Returns Account	260.00	Aug 4	By Purchases Account	3,600.00

Sanyal's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 18	To Purchases Returns Accounts	320.00	Aug 12	By Purchases Accounts	4,750.00

Anthony's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 25	To Purchases Returns Accounts	250.00	Aug 15	By Purchases Account	3,940.00

Gopalan's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
			Aug 28	By Purchases Account	4,670.00

Bhandari's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
			Aug. 30	By Purchases Account	900.00

Purchases Returns Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
			Aug. 31	By Sundries – as per Purchases Return Journal	1,030.00

Sales Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
			Aug. 31	By Sundries – as per Sales Journal	23,340.00

Ram Singh's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 31	To Sales Account	2,550.00	Aug 5	By Sales Returns Account	350.00

Gopinath's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 3	To Sales Account	2,500.00	Aug. 9	By Sales Returns Account	150.00

Sailo's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 13	To Sales Account	6,200.00	Aug. 19	By Sales Returns Account	230.00

Michael's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 14	To Sales Account	4,850.00	1987 Aug 22	By sales Return Account	150. 00

Solanla's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 27	To Sales Account	5,340.00			

Harbinder Singh's Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 29	To Sales Account	1,900.00			

Sales Account

Dr Cr

Date 1987	Particulars	Amount ₦	Date	Particulars	Amount ₦
Aug 31		880.00			

Exercise

Enter the following transaction in Sales Journal and post them into ledger

1988

Jan 5 Sold to Ray Kalmar of Lagos
50 metres coating @ N110.00 per metre
200 metres putplin @ N7 per metre
Less 5% trade discount

Jan 18 Return by Ray Kumar of Lagos
40 metres purplin @ N7 per metre
Less 5% trade discount

Jan 25 Sold to Mohan & Co. Kano
100 metres artificial sill @ N12 per metre
75 metres voil @ N18 per metre
Less 10% trade discount

Jan 20	Sold to Gopal Brothers, Jos 100 metres shirting @ N15 per metre 60 skirts @ N70 per skirts Less 10% trade discount
Jan 30	Returned by Mohan & Co, Kaduna 20 metres artificial silk @ N12 per metre Less 10% trade discount

Answer: Sales Book Total - N13,980.00, Sales Returns Book Total — N482.00)

4.0 CONCLUSION

Sales Day Book or Sales Journal is a book of prime entry to which sales of goods on credit are recorded and where they are posted in total (either weekly, monthly or at reasonable interval) to the Sales Account in the Sales Ledger.

5.0 SUMMARY

When goods are sold on credit, the individual accounts of the customers are debited with their respective debts but the corresponding credit in the Sales Accounts is deferred and collected in the Sales Book in data order till the end of the approved time interval when they are added up and the total posted to the credit of sales account in the sales ledger. When this has been done, the double entry in the ledger has been effected in that the individual debits to the personal accounts are balanced by the total credit to the sales ledger.

6.0 TUTOR MARKED ASSIGNMENT

In August 1991, the following Credit Sales were made by Kobomoje Limited.

Aug 4	Balogun Ltd, Invoice No. 1460, N3,600.00
Aug 6	Kolade Ltd, Invoice No. 1474, N6,000.00
Aug 10	Audu and Sons, Invoice No. 1490, N10,000.00
Aug 15	Aduke and Sons Invoice No. 1496, N3,000.00
Aug 25	Afotech Ltd. Invoice No. 1498, N5,000.00

Required:

Record the transactions in the Sales Day Book of Kobomoje Limited and write up the relevant ledger accounts.

7.0 FURTHER READING

Frankwood: Business Accounting I

UNIT 4: CASH BOOK

Contents

1.0 INTRODUCTION

As the business grows in volume and the transactions increase in number, a greater demand is made on the book-keeper to keep the accounts entered day-by-day. Some suitable schemes have been devised to sub-divide the work, but the use of one ledger only for all accounts set a limit to any scheme, as the ledger cannot be used by more than one person at a time.

A step in the direction of sub-division of duties is to place one person in charge of Cash and Bank Accounts, and for his convenience and the general convenience of the staff, to separate these two accounts from the other accounts in the main ledger.

The Cash and the Bank Accounts in such circumstances are kept in the Cash Book — a book bound separately from the Ledger purely as a matter of convenience in the internal organization of the business. The accounts are still Ledger Accounts and the separation does not affect the double entry principles already discussed in Unit 4.

2.0 OBJECTIVES

On completion of this Unit, you should be able to:

1. Understand the objectives of book-keeping
2. Explain the role played by cash-book in accounting
3. Understand the three types of Cash Book and record transactions in them.

3.0 MAIN CONTENT

3.1 The Cash Book

This is a book bound separately from the Ledger purely as a matter of convenience. It is the combination of Cash Account and Bank Account in the Ledger.

3.2 Objectives of the Cash Book

The objectives of the Cash Book is to keep a daily record of the transactions relating to receipts and payments of cash. The number of transaction relating to cash are usually large because most of the business dealings ultimately resolve themselves into cash transactions, so it is necessary to keep a separate book for cash transactions' . If every cash transactions were recorded in the Journal, a tremendous amount of work will be involved in debiting or crediting Cash Account every time cash is received or paid. If the Cash Book is maintained, the botheration of posting every item of receipt or payment of cash individually to Cash Account in the Ledger is avoided.

3.3 The Role Played by Cash-Book in Accounting

Cash Book plays dual role as a book of original entry as well as a ledger. It is a subsidiary book because all cash transactions are first recorded in the Cash Book and then from Cash Book posted to various accounts in the ledger.

The recording of transactions in the Cash Book takes the shape of Ledger Account as receipts of cash are entered on the debit side and payments of cash on the credit side, so there is no need of Cash Account in the Ledger. Therefore, Cash Book serves the purpose of a ledger account.

From the above, you should be able to understand that Cash Book fulfils the functions of both subsidiary book and ledger.

3.4 Types of Cash Book

The following are the three types of Cash Book

1. Simple Cash Book
2. Cash Book with two columns.
3. Cash Book with bank and discount columns

Explanation

3.4.1 Simple Cash Book

This type of Cash Book makes a record of all the receipts and payments of cash. All cash received in the form of coin, notes, cheques, postal orders, bank drafts will be recorded on the debit side and payments on the credit side. The ruling of this type of Cash Book is as follows:

Receipts **Simple Cash Book** **Payments**

Date	Particulars	L/F	N : K	Date	Particulars	L/F	N : K

From the above specimen, you should note that when Cash is received, it is entered on the debit side of the Cash Book in the amount column along with the name of the party paying the cash in the particulars column. Similarly, cash paid is entered on the credit side of the Cash Book. Each payment must be supported by a voucher and voucher number is entered in the V.N (Voucher Number) column if provided beside the Ledger Folio (L/F) on the credit side of the simple Cash Book. Also R. N. (Receipt No.) is written in Receipt Number Column beside the Ledger Folio column on the debit site of this book.

At regular periodic intervals, preferably daily, Cash Book should be balanced like other ledger account and the balance shown by it should be equal to cash in hand, If no mistake or fraud has been committed. The Cash Book should always show a debit balance (i.e. cash in hand) because total cash paid can never exceed the opening balance plus cash received.

Posting of transactions into Simple Cash Book.

Opening balance appearing on the debit side of the Cash Book is not posted to any account in the ledger as it comes in the Cash Book from the opening entry recorded in the journal proper. The other transactions recorded on the debit side of the Cash Book are posted to the credit side of the respective accounts in the ledger to complete the second aspect of the entry as the first aspect of the transactions has been covered by giving debit to Cash Account in the Cash Book itself. Similarly, the entries appearing on the credit side of the Cash Book are posted to the debit of the respective accounts in the ledger.

3.4.2 Cash Book with Bank Columns or Two-Column Cash Book

In the Cash Book with bank columns, the amount column on each side of the Cash Book is divided into two, one for cash transactions and the other for bank transactions. All cash received are entered in the cash column, debit side and all cash payments are entered in the cash column credit side. All the cheques received and lodged with the bank and all cash paid into bank are entered in the bank column debit side, and all payments by cheque are entered in the bank column credit side.

If you compare the above with those postings in the Cash Account and Bank Account in Unit 4 already discussed, you will agree that the Cash Book has fulfilled the functions of the ledger.

Dr Specimen of Cash Book with Bank Column Cr

Date	Particulars	CRN/ L/F	Cash N : K	Bank N : K		Date	Particulars	PV/ L/F	Cash N : K	Bank N : K

"Contra Entries"

As a general rule, a business does not keep much cash on hand. Cash not required for immediate use is paid into bank. Similarly, when business runs short of cash, it can get cash from the bank by drawing a cheque. Cash and Bank columns in the above specimen of Cash Book are treated in effect as two ledger accounts, one for cash and the other for bank, and the double entry for transactions between them is completed in the cash book. To indicate that the double entry for an item is on the opposite side of the cash book and that no posting to the ledger is required the word "CONTRA" or "C" should be entered on the folio against entries on both sides of the books. When we pay cash into Bank we debit bank column and credit cash column because cash is the giver and bank is the receiver. When we draw cash from the bank for office or business use, we debit cash column and credit bank column because bank is the giver and cash is the receiver.

3.4.3 Cash Book with Bank and Discount Columns or Three-Column Cash Book

The third type of Cash Book is the Three-Column Cash Book or Cash Book with Bank and Discount columns is provided on each side of the Cash Book, it is known as Three Column Cash Book. Discount column on the debit side represents Cash Discount Allowed to customers and on the credit of this column indicates Cash Discount Received from creditors.

You should note that Cash and Bank columns are balanced like other ledger accounts but discount column are not balanced but totalled.

Each item of discount allowed appearing on the debit side of the Cash

Book will be posted to the Credit of respective personal account and total of discount column should be posted to the debit side of Discount Account with the words "To Sundry Accounts' or "Amount as per Cash Book". Similarly, on the credit side of the cash book, the discounting column will be posted to the debit of respective personal account and total of discount received column should be posted to the credit of Discount Account with the words "By Sundry Accounts" or "Amount as per Cash Book".

Below is the specimen of Three-Column Cash Book:

Dr **Cr**

Date	Particulars	R.N	L/F	Disc	Cash N : K	Bank N : K		Date	Particulars	P.V	L/F	Disc	Cash N : K	Bank N : K

Exercises

1. Define a Cash Book. Is it a subsidiary book or a principal book of accounts? Give reasons.
2. What do you mean by Three Column Cash Book? Give a specimen of it. Also explain the meaning of Contra entry by giving examples.
3. Write up a two-column cash book of Freeland Cooperative Society Ltd from the following transactions.

Balance off the Cash Book at the end of the month, 31st January, 2002.

		N : K
1/1/2002	Started business with	60,000 : 00
3/1/2002	Paid into Bank	45,000 : 00
7/1/2002	Purchased office furniture by cheque	4,000 : 00
13/1/2002	Purchased goods for cash	8,000 : 00
20/1/2002	Withdrew cash for office use	10,000 : 00
21/1/2002	Sold goods for cash	1,000 : 00
22/1/2002	Cash sales banked	2,500 : 00
24/1/2002	Drew cash for personal use	3,000 : 00
28/1/2002	Paid cash for rent	550 : 00
28/1/2002	Paid stationery by cash	1,500 : 00
29/1/2002	Paid cash for telephone bill	700 : 00
31/1/2002	Paid wages by cash	1,800 : 00

4.0 CONCLUSION

As already discussed in this Unit, Cash Book plays double role in accounting. It is a principal book of accounts as ledger and also a subsidiary book.

With the development in the banking industry and other business organizations, many payments are made and received through cheques. In such a case, the Cash Book should have a bank column in addition to the Cash and discount columns to have a record of Bank Account in the Cash Book.

5.0 SUMMARY

In this unit, we have successfully explained the object of Cash Book, and the functions of the three types of Cash Book, that is,

1. Simple Cash Book, which has the same ruling as Cash Account in the ledger;
2. The Two-column Cash Book, i.e. Cash Book with bank column, which is the combination of Cash and Bank Accounts in the ledger; and
3. The Three-column Cash Book or Cash Book with Bank and Discount Columns. As already explained that, the number of transactions relating to cash are usually large because most of business dealings ultimately resolve themselves into cash transactions, so it is necessary to keep a separate book for cash transactions.

If any of the above Cash Books is maintained in the business, the botheration of posting every item of receipt or payment of cash individually to cash account in the ledger is avoided.

6.0 TUTOR MARKED ASSIGNMENTS (T.M.A)

Question:

You are required to prepare a Three-Column Cash Book from the following information; balance the book at the end of the month and show the relevant discount accounts as they would appear in the Ledger.

February, 2002	N : K
Feb 1 Balance brought forward	
- Cash in hand	1,256 : 00
- Bank balance	78,600 : 00
Feb 4 Purchased goods for cash	1,000 : 00
Feb 5 Cash withdrawn for office use	20,000 : 00
Feb 6 Purchased office furniture on credit from F.F. Furniture	7,000 : 00
Feb 8 Sold goods on credit to Taiwo, N250; John N400; Okon N200; and Musa N800	
Feb 11 Cash sales banked	4,000 : 00
Feb 14 Paid F.F. Furniture by cheque less 5% discount	
Feb 15 Drew cash from bank for personal use	500 : 00
Feb 20 The following persons settled their accounts by Cheques in each case deducting 5% discount 1. Taiwo and 2. John	
Feb 22 Okon and Musa settled their accounts by cash After deducting 5% discount	
Feb 23 Cash sales	2,500 : 00
Feb 28 Purchased goods for cash, discount received N80	720 : 00

7.0 FURTHER READINGS AND REFERENCES

- Cooperative Book-Keeping 1 by J. Jacques and H. Davies
- Business Accounting 1 by Frankwood / J. O. Omuya
- Questions and Answers in Cooperative Accounting by L. Akinkuolie Advanced Accountancy by S. P. Jain and K. L. Narang.

UNIT 5: PETTY CASH BOOK

Contents

1.0 INTRODUCTION

In this unit, you shall learn about Petty Cash Book, the Imprest System and how recording and posting in the petty cash book are made.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain petty cash book
- Explain imprest system
- Prepare petty cash book and post it into ledger.

3.0 MAIN CONTENT

3.1 Petty Cash Book

You have so far learnt that all cash receipts and payments are recorded in the cash book. In practice, you will find that almost in every business there are many small payments in cash such as stationery, postage, telegrams, cartage, conveyance, etc. If all these small payments are also recorded in cash book, the cash book will become bulky, and the cashier will also be overburdened with work. In order to reduce the burden on the cashier, a separate book called Petty Cash Book is maintained for recording all such small payments. A petty cashier is appointed for this purpose. He is paid a certain sum in advance. He keeps on making small payments out of this advance and records them in the Petty Cash Book. The amount of money given to petty cashier is called petty cash.

3.2 Imprest System

Generally, petty cash book is maintained on Imprest System. Under this system an estimate is made of the amount required for small payments for a certain period, say, a week or a month and this amount is paid to the petty cashier in advance. The petty cashier makes the small payments and records them in the Petty Cash Book. All such payments are supported by vouchers or receipts. At the end of the period, the petty cashier submitted the account to the Chief Cashier. The Chief Cashier examines the account and pays to the petty cashier the amount spent by him so that at the beginning of the next period again he has the same amount as he had in the beginning. This system of advance is called the "Imprest System" and the amount given is known as the Imprest Money'. For example, on April 1, N300 is given as advance to the petty cashier. He spends N260 during the month and submitted to the account along with the vouches to the Chief Cashier. After verifying the account, the Chief Cashier pays him N260. Thus, on May 1, the petty cashier again has N300 with him. The amount to be given to the petty cashier, that is, imprest Money, should be carefully determined. It should neither be too large nor too small, it should be sufficient to make small payments for the fixed period.

3.3 Recording and Posting the Petty Cash Book

As you will observe in the illustration 1, the Petty Cash Book has a number of columns. The extreme left-hand column records the receipts of cash. But on the payment side a separate column is provided for each expense, such as postage, telegrams, stationery, cartage, wages, conveyance, etc. This facilitates the analysis of payments under different headings and also helps in posting to the concerned accounts. The number of columns depends upon the nature and size of the business. The columns provided for different expenses generally are: (i) Printing and Stationery, (ii) Postage and Telegrams, (iii) Cartage (iv) Conveyance, (v) Entertainment and (vi) Sundry Expenses.

When the petty cashier receives money from the Chief Cashier, he records it in the particulars column of the Petty Cash Book by writing "To Cash Account" (if he receives cash) or "To Bank Account" (if he receives a cheque) and records the amount in receipts column. When payment is made, it is entered in the particulars column by writing the name of the expenses incurred. The amount is first recorded in the 'total payment' column and then in the relevant column provided for it. The Petty Cash Book is balanced periodically. The difference between the total receipts and total payments is the balance with the petty cashier. This balance is carried to the next period and the petty cashier is paid the amount actually spent by him. Thus, you will note that the procedure of balancing the Petty Cash Book is the same as you have adopted in the case of ordinary cash book.

A 'Petty Cash Account' is opened in the ledger. It is debited with the amount given to petty cashier. When Petty Cash Book is balanced, each expense account is individually debited with the periodic total as per the respective column by writing 'To Petty Cash Account' and the 'Petty Cash Account' is credited with the total expenditure incurred during the period by writing 'By Sundries as per Petty Cash Book'. The Petty Cash Account is then balanced. It normally shows a debit balance, which will be equal to the actual cash with the petty cashier.

Look at illustration 1. It shows the recording of Petty Cash Book and post them into ledger.

1988	***N***	***:***	***00***
Jan 1 Received cash from Chief Cashier	300	:	00
Jan 2 Paid for postage	25	:	20
Jan 3 Paid stationery	10	:	50
Jan 5 Paid conveyance to clerk	10	:	20
Jan 6 Paid telegram	12	:	40
Jan 8 Paid for ink	6 :		10
Jan 9 Paid for tea for customers	5	:	00
Jan 10 Stamps purchased	13	:	00
Jan 12 Purchased pens	20 :		00
Jan 14 Paid for trunk calls	27 :		00
Jan 15 Paid cartage	8	:	00
Jan 16 Paid for taxi fare	43 :		00
Jan 17 Purchased soap	5	:	60
Jan 18 Paid for typewriting paper	40 :		00
Jan 19 Cartage paid	10	:	00
Jan 20 Bus fare paid to clerk	8	:	20
Jan 21 Paid to coolie	10	:	50
Jan 22 Tips to peon	5	:	00
Jan 23 Purchased registers	20 :		00
Jan 28 Rickshaw charges	2		: 50
Jan 30 Paid for cold drink for customers	7		: 50

Solution

Petty Cash Book

Date	Receipts	Date	Particulars	V. No	Total	Stationery	Postage & Telegram	Cartage	Conveyance	Entertainment	Sundry Expenses
	₦	1988			₦	₦	₦	₦	₦	₦	₦
	300.00	Jan 1	To Cash A/C								
		Jan 2	Buy postage		25.20		25.20				
		Jan 3	Buy Stationery		10.50	10.50					
		Jan 5	Buy Conveyance		10.20				10.20		
		Jan 6	Buy Telegrams		12.40		12.40				
		Jan 8	Buy Ink		6.10	6.10					
		Jan 9	Buy Tea Expenses		5.00					5.00	
		Jàn 10	Buy Stamps		13.00		13.00				
		Jan 12	Buy Pens		20.00	20.00					
		Jan 14	Buy Trunk Call		27.50		27.50				
		Jan 15	Buy Cartage		8.00			8.00			
		Jan 16	Buy Taxi Fare		43.50				43.50		
		Jan 17	Buy Soap		5.60						5.60
		Jan 18	Buy Typewriting Paper		40.00	40.00					
		Jan 19	Buy Cartage		10.00			10.00			
		Jan 20	Buy Bus Fare		8.20				8.20		
		Jan 21	Buy Coolie		10.50			10.50			
		Jan 22	By Tips		5.00						5.60
		Jan 23	Buy Register		20.00	20.00					
		Jan 28	Buy Rickshaw		2.50				2.50		
		Jan 30	Buy Cold Drinks		7.50					7.50	
					290.70	96.60	78.10	28.50	64.40	12.50	10.60
		Jan 31	By balance c/d		9.30						
			Total		300.00						
	9.30	Feb 1	To Balance b/d								
	290.70	Feb 1	To Cash A/C								

LEDGER

Petty Cash Account

Dr Cr

1988		N	1988		
Jan 1	To Cash A/C	300.00	Jan 31 Jan 31	By Sundries as per Petty Cash Book By Balance c/d	290.70 9.30
		300.00			300.00
Feb 1 Feb 1	To Balance b/d To Cash A/C	9.30 290.70			

Stationery Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	96.60			

Postage & Telegram Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	78.10			

Cartage Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	28.50			

Conveyance Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	64.40			

Entertainment Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	12.50			

Sundry Expenses Account

Dr Cr

Date 1988	Particulars	Amount ₦	Date	Particulars	Amount ₦
Jan 31	To Petty Cash Account	10.60			

Exercise

1) Explain the term 'Imprest System

2) Discuss the double entry system applicable to the petty cash book.

3) Enter the following transactions in Petty Cash Book of Larry with analysis columns headed up for travelling expenses, motor expenses, stationery, general expenses and ledger accounts. The record is kept on the imprest system whereby the amount spent is usually reimbursed on the last day of every month.

1985		N : K
June 1	Received opening cash float	6,500 : 00
June 1	Stamps	216 : 00
June 1	Writing pads	152 : 00
June 2	Paid for intra-city transport	40 : 00
June 3	Akande — Ledger Account	165 : 00
June 4	Taxi fare	190 : 00
June 5	Kola — Refreshment	108 : 00
June 6	Account clerk — stationery	50 : 00
June 7	Petrol	50 : 00
June 7	Engine oil	45 : 00
June 8	2 reams of paper bought @ N300	600 : 00

June 9 Cleaning of office	10 :	00
June 10 Petrol	55 :	00
June 11 Paid wages	140 :	00
June 11 Carbon papers	60 :	00
June 11 Electricity	100 :	00
June 12 Car Wash	36 :	00
June 12 Air travel	1,200 :	00
June 15 Musa creditor	100 :	00
June 16 Biros and pencils bought	55 :	00
June 17 Envelopes	20 :	00
June 17 Stamps	50 :	00
June 18 Entertainment of customer	60 :	00
June 18 Parcel registered	135 :	00
June 20 Journey by rail — Aduke	30 :	00
June 24 Tunde — Wages	82 :	00
June 27 Dauda's account settled	66 :	00
June 28 Registration of letters	90 :	00
June 30 Letter headings printed	1,200 :	00

4.0 CONCLUSION

All cash transactions are recorded in the Cash Book. There are various types of Cash Books, they are (i) Single Column Cash Book (ii) Double-Column Cash Book (iii) Three-Column Cash Book and (iv) Petty Cash Book.

The transactions made by the Petty Cashier are recorded in a multi-column cash book that analyses the nature of the expenses or payments made by the cashier. This type of Cash Book is called an Analytical Petty Cash Book or simply Petty Cash Book.

5.0 SUMMARY

A Petty Cash Book can also be prepared for recording payments of various petty expenses. Petty Cash Book is maintained on Imprest System, which means advancing of fixed amount to the petty cashier.

The maintenance of Petty Cash Book saves a lot of labour and time.

6.0 TUTOR MARKED ASSIGNMENT

The petty cashier of Oakland Enterprises obtained a float of N2,300,00 on 1st January, 1992. The following is the record of payments made by him during the month.

1992

Jan 1 Postage Stamps N10, Carbon Papers N65
Jan 3 Engine oil N100

Jan 7 Ajibade - traveling expenses N45
Jan 10 Cleaning expenses N120, Petrol N300
Jan 18 Gbadegesin — refreshment N220
Jan 25 Stamps N15, Foolscap papers N350
Jan 28 Alade — medical bill N200
Jan 29 Settles Wale's account N500
Jan 30 The imprest was restored with the amount spent.

Required:

Prepare a Petty Cash Book for the period ended 31st January, 1992 with the analytical columns for postages, stationeries, motor expenses, general expenses and ledger accounts.

7.0 Further Reading

Introduction to Account - L. Akinkuolie
Business Accounting I – Frankwood

MODULE 4

UNIT 1 BANK AND CHEQUE INTRODUCTION TO ACCOUNTING

CONTENTS

1.0 INTRODUCTION

A business man will usually have a bank account and when he receives cash, he will pay it into his account. When he needs cash he will withdraw it from his bank account. He pays cash into his bank account by completing a paying slip and withdraws cash by drawing a cheque on his account. In this Unit you will learn about things peculiar to the bank as an institution.

2.0 OBJECTIVES

At the end of this unit you should be able to:

- explain what a bank is
- explain everything peculiar to the bank e.g cheque, stale cheque, crossed cheque, open cheque, and bank charges.

3.0 MAIN CONTENT

3.1 Bank

A comprehensive term for a number of Institutions carrying on certain kinds of financial business, several types of bank are to be found in Nigeria:

i. Savings Banks, which accept deposits,

ii. Commercial (or joint-stock) banks which do most kinds of banking business- accepting deposits, allowing customers the use of cheques, granting credit by loan or overdraft, discounting bills of exchange, foreign exchange transactions, acting as agents for customers in the sale or purchase of stock exchange securities, acting as executors or trustees and providing safe custody by valuables.

iii. Merchant banks which still to a considerable extent specialize in business connected with bills of exchange, especially the acceptance of foreign bills,

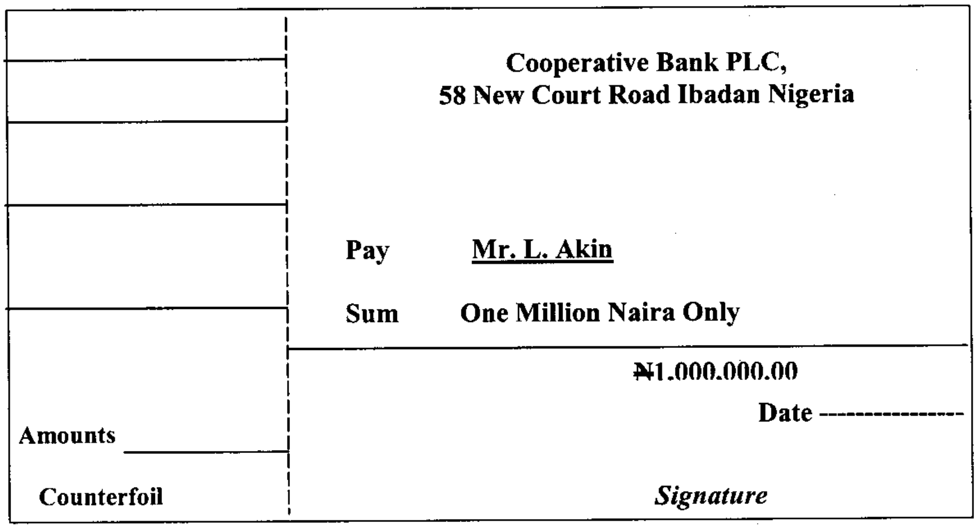
iv. Central banks, the main business• of which is to carry out a country's monetary policy. There are also

v. Investment banks but this have never been popular in Nigeria. They acquire shares in limited company on their own account and act merely as agents for their customers. Sometimes banks are established to undertake specialized banking functions for particular industries, as in Nigeria where there is Agricultural bank. There are also a number of firms which describe themselves as Industrial bankers, although most of them understand some ordinary banking business, they are primarily finance houses whose main concern is with the financing of hire purchase.

3.2 Cheque

A cheque is an order in writing addressed to a banker asking the banker to pay a certain sum of money to the person named in the cheque or to the order of that person, or to the bearer of the cheque. The essential ingredients of a cheque are:

- The cheque must be an order in writing and the banker must comply except in certain circumstances.
- It must be in writing and not verbal, but the writing need not be on special paper, though almost all banks issue standard cheque forms for convenience.
- The sum to be paid must be certain. It is not enough to write "pay some naira to John" it should be "Pay N20 to John
- There must be a payee (person to whom the money will be paid) who may be the person name in the cheque or the person to whom the person named has ordered to be paid. The payee may in fact be the person in possession of the cheque.
- There must be three parties to a cheque, viz the drawer, the drawee and the payee. The drawer (usually the owner of the cheque) is the person who draws a cheque on the drawer bank. The drawee is the bank to whom an order to pay is given. The payee is the person to whom the money would be paid. Below is a specimen "Cheque"



(Please see a Life Sample)

To file a cheque is a very simple thing but care must be taken to ensure that the figure and words are properly written to make alternation very difficult. All that the drawer does is to write the name of the payee (except where bearer is the payee), the amount to be paid and sign his usual signature. Of course, the date should also be written. The main part of the cheque is then torn off along the dotted line and handed to the payee. The payee presents the cheque, as soon as possible, to the drawer bank and gets the sum stated therein.

The remaining part of the cheque, variously called counterfoil or stub is retained in the cheque book for record purposes. It is not a strict requirement that the purpose of the payment should be state in the counterfoil. It is only intended to facilitate accurate accounting and the practice is today almost universal.

3.3 Stale Cheque

As defined by the bill of exchange Act (1882) a cheque is "Stale" if its date shows it to have been in circulation for 'an unreasonable time', the exact period of time never having been legally defined. Most banks regard as 'Stale' cheques presented six months after date. Such cheque being required to be confirmed by the drawer, though some banks take no action unless a cheque has been drawn twelve months.

When the drawer return a cheque on the condition that the cheque is 'Stale' the accounting treatment for such a cheque will be

Debit the cash book for the sum
Credit the account of the payee.

Note: the cash book has been credited when the cheque was first drawn and given to the payee. Then also the account of the payee in the ledger was debited. Thus the reverse entry now.

3.4 Dishonour Cheque

Ordinarily, the bank should pay a cheque presented to it. There are however, instances when the bank refuses to pay a cheque. In this case, the cheque is said to be dishonoured and subsequently returned to the drawer. Such instances are:

- Where the drawer has not enough money in his account with the bank to cover the amount on the cheque.
- Where the cheque has no date or has a future date.
- Where the drawer's signature is different from the specimen with the bank.
- When the amount in figure differs from the amount in words.

It is the practice of the bank to specify the reason for the dishonour, on the face of the cheque before returning it to the drawer. Words such as these are used.

- to drawer RID
- Uncleared effect U/E
- No funds N/F
- Insufficient funds I/F

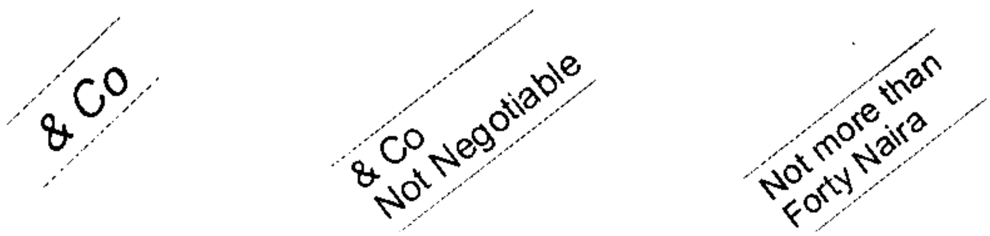
A dishonoured cheque may be represented to the bank for payment when the reason for the dishonoured is settled.

3.5 Crossed Cheque

A crossed cheque is one that has two parallel lines drawn across its face either with or without the words `&. Co. as was mentioned before, the holder of a crossed cheque cannot receive cash over the counter. The sum specified in the cheque must be paid into his/her bank account. sometimes, the holder of a crossed cheque has no account with the drawee bank and to receive payment becomes a real problem. He may do one or two things. He may pay in the cheque into his account in another bank if he/she has such account, or where this is not possible, endorse the cheque to person who has a bank account. If he succeeds, the endorse (the person to whom he/she endorsed the cheque) will then pay him cash equal to the sum state in the cheque.

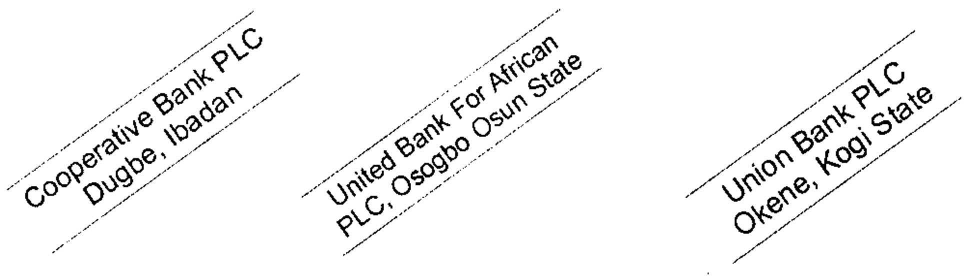
A crossed cheque may be either general or special. It is general when it has on its face two parallel lines with or without the words "& Co". Some crossed cheques may bear such expressions as "Not negotiable" and "A/C payee only" such expression are additional safe guards adopted by drawers of cheques, to ensure that cheques are not cashed by unauthorized person.

Specimen General Crossings



A cheque is said to be specially crossed when it specifies the name of a bank at which payment will be made. The effect of this is that the holder of the cheque cannot receive payment except from the specified bank

Specimen special crossings.



3.6 Open Cheque

An open cheque is a cheque that is not crossed. Crossing means having two parallel lines across the face of the cheque either with or without the words "& Co". An example of an open cheque is the specimen cheque no 997029 made in the name of Mr. Adeola Kupoluyi for the sum of one million Naira (N10,000,000).

All that the holder i.e. the payee of an open cheque need to do, is to present it to the drawer bank and receive cash over the counter. Here lies difference between the open cheque and the crossed cheque. The holder of a crossed cheque cannot receive cash over the counter. The sum specified in the cheque must be paid into his bank account.

3.7 Bank Charges

For services render by the bank, banks usually charge some fee for the services. This item included charges for cheque books, for keeping current account (charges on turnover), for discounting bills, for issuing drafts. And nowadays many is not all commercial banks charge certain amount the tellers but the sum charged varies from bank to bank. Such expenses are losses and are, therefore, debited to profit and loss account.

SELF-ASSESSMENT EXERCISE

1. What are the essential ingredients of a cheques?
2. What is the difference between?

a. An open cheque and a crossed cheque?
b. General crossing and special crossing?

3. What is a counterfoil. What purpose does it serve?
4. Define: (a) Drawer
   (b) Drawee
   (c) Payee.

4.0 CONCLUSION

You must understand how bank operates thus the reason for this Unit because the operation of banks in relation to its customer has an important implication on the transactions engaged in by the banks customers. Without which a true financial position of the organization concerned cannot be ascertained.

5.0 SUMMARY

Having a bank account by an organization involves using cheques for withdrawal, using teller for payment with the bank, this the need to be able to differentiate from open cheque which value can be obtained for, on the counter and crossed cheque which has to go through a bank account before value can be obtained for it. There is also a time limit within which value could be obtained for a cheque on expiry of this time the cheque is said to be stale for all this services bank do debit its customer account for the services rendered, this is known as bank charges. This charges are debit item in profit and loss accounts.

6.0 TUTOR-MARKED ASSIGNMENT

1. For what reasons may a bank dishonour a cheque?
2. Can a dishonoured cheque be presented again to the bank for payment?

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting 1.*

UNIT 2 BANK RECONCILIATION STATEMENT

CONTENTS

1.0 INTRODUCTION

Whenever a businessman in an organization opens a current account with a bank, the services that are rendered by the bank include receiving deposits from his debtors and paying money to his creditor on his behalf. Periodically, a bank issues a bank statement to the business man, showing the transactions undertaken so far by the bank on his behalf. More often than not, the bank balance in the cash book disagrees with that in the bank statement. Before drawing up a trial balance at the end of an accounting period, however, there is a need to reconcile the two balances. The Statement prepared to bring the bank balance in the cash book into agreement with that in the bank statement is called Bank reconciliation statement. In this unit you will learn how to prepare that statement and the adjustment required in the cash book.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Prepare a bank reconciliation statement
- Adjust the cash book balance
- Appreciate Bank reconciliation statement.

3.0 MAIN CONTENT

3.1 Causes of Difference

The main causes that lead to disagreement in the balances of the cash book and the pass book or the bank statement are as follows:

3.1.1 Cheques Issued but not yet Presented for Payment

Whenever a payment is made by cheque, the businessmen immediately records it in his cash book. But, the bank debit's the firm's account only when the cheques are presented for payments. You know that there is always a time lag between the issue of cheques and its presentation for payment and so the date on which it will be recorded by the bank will always be later than the date of its recording in the cash book. It is quite possible that on a particular date when the bank submits the statement of account, there may be some cheques which have been issued but not yet presented for payment and so not recorded by the bank. Consequently, the balance shown by the pass book or bank statement will be higher than the balance shown by the cash book. For example, a firm issued a cheque for N3000.00 in favour of a creditor on December 28, 1987 which is presented to the bank for payment on January, 2, 1988. the firm would record it in the cash book on December 28, 1987 whereas the bank would record it on January, 2 1988. When the firm would receive the pass book or the bank statement completed up to December 31, 1987 they would find the balance shown by the pass book or bank statement is different from the balance shown by the cash book. The pass book or bank balance statement would be higher by N3000.

3.1.2 Cheques Deposited into the Bank but not yet collected

When payment is received by cheque, the firm sends it to the bank for collection and records it immediately on the debit side of the cash book. This increases the bank balance as per cash book. But the bank will not credit the firm's account till the cheque is actually collected. So the balance in the pass book or bank statement remains unaffected till the proceeds of the cheque are collected and credited.

Thus, on a particular date, it is possible that certain cheques which were sent for collection might not have been collected by the bank and so not shown in the pass book or the bank statement. All such cheques pending collection would make the cash book or bank statement balances different from that of the cash book. For example the firm sends a cheque of 442000 on June 28 to bank for collection. The cheque is collected on July 6, now if the balance as on June 30 are compared, they will be different because the credit of 442000 will not appear in the pass book or bank statement.

3.1.3 Bank Charges

The bank usually charges some amount from their customers for various services provided by them. They may charge for collection of outstanding cheques, for making or collecting payments on standing instructions, and so on. The bank debits the customers account for such charges from time to time. However, the firm will know about these charges only when it goes through the pass book or bank statement. So, on the date of reconciliation the pass book or statement may differs from the balance as per cash book.

3.1.4 Interest Allowed by the Bank

The banks normally do not allow any interest on the current account balances. But if such interest is allowed, the bank credits it to the customer's account. This increases the balance in the pass book. The bank would pass the corresponding entry in the pass book only when it receives the instruction from the bank or when it notices it in the pass book or the bank statement. Hence, the cash book balance will be lower till such entry is made or pass.

3.1.5 Interest on Overdraft

When the businessman requires more funds he may request the bank for overdraft facility which means permitting him to draw more than the amount available in his account. When the businessman actually withdraws more than the available amount, he is said to have utilized the overdraft facility.

The bank charges interest on the amount overdrawn and debits the same to his account periodically. The firm records the corresponding entry on overdraft only when the pass book is received. Hence, the balance in the two books would differ till the entry is passed in the cash book.

3.1.6 Amount Collected by Bank on Standing Instructions

The businessman often issues standing instructions authorizing his banker to collect on his behalf certain amount due to him such as interest, dividends, etc. the bank credits the customer's account as at when he collect such amounts and sends the necessary instructions to him. The firm will pass the corresponding entry in the cash book when it receives such instructions or when it notices it in the pass book. Thus, as on the date of reconciliation, the balance as per cash book may be lower than the balance as per pass book.

3.1.7 Payments Made by the Bank as Per Standing Instructions

The businessman may also issue standing instructions to his banker to make certain payments on his behalf such as insurance premium, rent, etc. When the banker makes such payments, he would immediately debit the customers account. So, the balance in the pass book would get reduced. If the corresponding entries for such payments have not been recorded in the cash book, the balance as per cash book would remain unchanged.

3.1.8 Direct Payments into the Bank Made by Firm's Customers

Sometimes, a customer may directly deposit an amount into the firm's account. The firm shall record it in the cash book only when it learns about such deposit. But, the pass book would show the entry on the date of deposit itself if by the date of reconciliation, such entry has not been passed in the cash book, the balance shown by pass book will be higher than the balance as per cash book.

3.1.9 Dishonour of Cheques or Bills

As already stated when cheques are sent to the bank for collection, they are entered in the cash book immediately. But no entry appears in the pass book, till they are collected by the bank. Sometimes, for one reason or the other, the cheques are dishonoured. In that case the bank will not make any entry in its books and returns such cheques to the firm. The same thing applies to the bills receivable sent for collection to the bank. On receiving the dishonoured cheques or bills the firm has to pass reverse entry in the cash book. But, till such entry is passed the balance show by the cash book and the pass book would differ.

3.1.10 Errors

It is quit possible that while recording the transactions in the cash book some errors might have been committed by the firm. For example, a cheque deposited in the bank may not be recorded at all, or is recorded on the wrong side in the cash book. Similarly, the bank may also commit some errors while recording entries in the customer's account. For example, a cheque collected on behalf of a customer is entered in some other account. Such errors would also lead to the disagreement of the balances in the cash book and the pass book.

3.2 What is Bank Reconciliation Statement?

By comparing the entries in the cash book with those in the pass book you can easily ascertain the exact causes of difference between the balance as per cash book and the balance as per pass book. In order to reconcile these balances every firm prepares a statement showing all the causes of differences. This statement is called bank Reconciliation Statement and is prepared periodically. The main objective of preparing such a statement is to account for the difference between the cash book and the pass book balances and pass the necessary correcting entries in the books of the firm.

Thus, Bank Reconciliation Statement can be defined as a statement which reconciles the balance as per cash book and the balance as per pass book showing all causes of difference between the two.

3.3 Preparation of Bank Reconciliation Statement

The Bank Reconciliation Statement is prepared at the end of a quarter, half year or a year as the firm may consider desirable and convenient. It can be prepared in two ways.

(i) take the balance as per cash book as the starting point, adjust the effect of each item causing the difference, and arrive at the balance as per pass book or Bank statement.
(ii) Take the balance as per pass book as the starting point, adjust the effect of each item causing the difference, and arrive at the balance as per cash book.

Whatever be the method. First of all you must analyse the effect of each item on the balance of the book which you are using the starting point. In order words, whether it has led to a higher balance or a lower balance in that book. This helps you to decide whether a particular item is to be added to or subtracted from such a balance.

Suppose you start with cash book balance as the base and the item causing the difference is the bank charges of N100. This item appears in the pas book but not in the cash book. The bank charges would appear in the withdrawals column of the pass book which means that the pass book balance had decreased by NI00. Since it has not been shown in the cash book, the cash book balance remained unaffected, it did not decrease. Hence the cash book balance would be higher than the pass book balance by 4100. If we now subtract this amount from the cash book balance it will reconcile with the pass book balance. Take another example; the bank collected 4500 as interest on securities on behalf of the firm. But, the same had not been recorded in the cash book. This item would appear in the deposit column of the pass book which means the pass book balance had increased by 4500.

Since it had not been shown in the cash book, the cash balance remained unaffected, it did not increase. Hence the cash book balance would be lower than the pass book balance by N500. If we now add this amount to the cash book balance it will reconcile with the pass book balance.

If you were to start with pass book balance as the base you would do just the reverse of what you did when you started with cash book balance as the base. You will add N100 relating to the item of bank charges because it leads to a lower balance in the pass book and subtract N500 relating to interest on securities collected by the bank because it had increase the pass book balances.

Generally, the firms adopt the first method because the bank Reconciliation statement is prepared primarily for the verification of the bank balance as shown by the cash book. From the above examples it should be clear to you that in case you start with cash book balance you should add all those items which have been responsible for lower balance in the cash book and subtract those which have been responsible for a higher balance. Let us, for convenience lists the items which would generally be added and subtracted when cash balance is used as the starting point to be added.

1. Cheques issued but not yet presented
2. Interest allowed by the bank
3. Interest and dividends collected but not recorded in the cash book
4. Direct deposits by customers in the firm's bank account.

To be Subtracted

1. Cheques deposited but not yet collected
2. Bank Charges
3. Interest on overdraft
4. Amounts paid by the bank understanding instructions but not recorded in the cash book.
5. Cheques dishonoured but no entry made in the cash book for the dishonour.

If the pass book/bank balance is taken as the starting point, just reverse the above process. Add those which are to be subtracted from the cash book balance as per the above list and subtract those which are to be added to the cash book balance as per the above list.

The above analysis will help you to prepare Bank Reconciliation Statement correctly. Look at illustration 1 and study how a Bank Reconciliation Statement is prepared with cash book balance as the starting point. On December 31, 1990 Deola's book showed a debit balance of 47, 800. The balance as per pass book was 410, 300. On comparing the cash book with the pass book, the following discrepancies were found:

1. Two cheques for N1, 600 and 42, 000 issued on December 23 have not been presented to the bank for payment.

2. A cheque for N1, 200 was deposited in the bank on December, 29, but it was credited by the bank on January 5, 1988.

3. There was a credit entry in the pass book for 4520 in respect of dividend received by the bank on behalf of Deola. This had not been recorded in the cash book.

4. N300 was deposited by a customer directly into the bank.

5. The bank charged 460 as their commission for collecting an outstanding cheque. No entry for this appear in the cash book.

6. A cheque for N500 received from Gbenga and deposited in the bank was dishonoured but no entry was recorded in the cash book for the dishonour.

7. A cheque for N160 was entered in the cash book but it was not sent to the bank for collection.

Solution:

<u>Bank Reconciliation Statement as On December, 31, 1990</u>

Particulars	**N**	N
Balance as per cash book		7,800
Add: cheques issued but not yet presented for payment	3,600	
Dividends collected by bank but not yet recorded in the cash book.	520	
Amount deposited by a customer directly in the bank	300	4,420

		12,220
Less: cheque deposited but not collected by bank	1,200	
Bank charges debited by bank but not yet recorded in the cash book.	60	
Cheque dishonoured but no entry made in cash book for the dishonour.	500	
Cheques received from a customer entered in the cash book but not sent to the bank for collection.	160	1,920
Balance as per Pass Book.		410,300

Note: The statement bears a heading "Bank Reconciliation Statement" and mentions the date for which reconciliation is done. So, whenever you prepare a Bank Reconciliation Statement, make sure that it bears this heading along with the date of reconciliation.

The Bank Reconciliation Statement can also be prepared by 'plus and minus method'. In that case you will have two separate amount columns, one for additions and the other for subtraction. The first column is called 'plus column' and the second column is called 'minus column'. The bank Reconciliation Statement prepared according to this method will appear as follows:

<u>Bank Reconciliation Statement as on December 31, 1990</u>

Particulars	Plus Column ₦	Plus Column ₦
Balance as per cash book	7,800	
1. Cheques issued but not yet presented for payment	3,600	
2. Cheque deposited but not yet collected by Bank		1,200
3. Dividends collected by bank, not yet recorded in the cash book.	520	
4. Amount deposited by a customer directly in the Bank.	300	
5. Bank charges debited by bank but not yet recorded in the cash book.		60
6. Cheque dishonoured but no entry mad in cash book for the dishonour.		500
7. Cheque received from the customer entered in the cash book not sent to bank for collection		160
	₦12,200	₦1,920
Balance as per pass Book (₦12,220 – ₦1,920)	₦10,300	

Now, look at illustration 2 and study how a Bank Reconciliation Statement will be prepared with pass book balance as the starting point.

Illustration 2:

From the following, prepare a Bank Reconciliation Statement of Laide Adeosun as on March 31, 1988. Balance as per pass book as on March 31, 1988 was N22, 000.

1. Cheques amounting to N9,000 were deposited in the bank during March, but credit was given only for N7,000.
2. The bank paid insurance premium of N300 on March 20, but it was not entered in the cash book.
3. A discounted bill receivable for N1, 500 was returned dishnoured to the bank on March 27, but the corresponding entry in the cash book was made in April.
4. A cheque for N800 received on March 29 was entered in the cash book, but it was sent to bank on April
5. The cheques amounting to N3, 000 issued to creditors, the cheques for N1, 800 only were presented for payment.
6. The bank charges debited in the pass book amounted to N50.
7. The interest on securities collected and credited by the bank

amounting to Ni, 000 was not entered in the cash book.

Particulars	Plus Column ₦	Minus Column ₦
Balance as per Pass Book	22,000	
1. Cheques deposited but not yet collected	2,000	
2. Insurance premium paid by bank but not yet recorded in the cash book	300	
3. B/R dishonoured but not yet recorded in the cash book.	1,500	
4. Cheque received from a customer entered in the cash book but not yet sent to the bank for collection.	800	
5. Cheques issued but not yet presented for payment.		1,200
6. Bank charges debited by bank not yet recorded in the cash book.	50	
7. Interest on securities collected by bank but not yet recorded in the cash book.		₦1,000
	₦26,650	**₦2,200**
Balance as per cash book (₦26,650 – ₦2, 200)	**₦24,450**	

You have learnt the method of preparing a Bank Reconciliation Statement when the firm has a favourable balance in the bank. Let us now study how Bank Reconciliation Statement will be prepared when the firm has an unfavourable balance (an overdraft).

You know when the firm has a favourable balance the cash book shows a debit balance. But when the firm has an overdraft, it will show a credit balance because, in such a situation, the bank is a creditor for the firm. As for the pass book, when the firm has favourable balance it shows a credit balance and when the firm has an overdraft it will show a debit balance, because for the bank, the firm is a debtor when there is an overdraft. In other words it can be stated that when cash. book shows a credit balance or, when pass book shows a debit balance, the firm has an overdraft.

The preparation of the Bank Reconciliation Statement does not differ much whether there is a favourable balance or an overdraft. Especially, if you follow the 'plus and minus method'. You know when the firm has a favourable balance, it is shown in plus column of the Bank Reconciliation Statement. But, if there is an overdraft it will be shown in the minus column. This is the main point you have to remember while preparing a Bank Reconciliation Statement when there is an overdraft. The treatment with regard to causing difference between the balances of two books remains the same.

If however, you do not follow the plus and minus method you will have to analyses first the effect of each discrepancy on the overdraft and then decide whether the amount involved is to be added or subtracted. When you make such analysis you will observe that the effect of each discrepancy on overdraft will be just the reverse of what it would be on a favourable balance. For example, if bank charges are found to be unrecorded in the cash book which shows a favourable balance, this omission is considered responsible for a higher balance in the cash book and so, while preparing Bank Reconciliation subtracted from the balance. But in case of an overdraft omitting to record the bank charges would mean lower amount of overdraft in the cash book and so, while preparing the bank Reconciliation Statement it will have to be added. Thus, you will find that when you prepare a Bank Reconciliation Statement with an overdraft as per cash book as the starting point you will have to add all items which were subtracted when you started with a favourable balance as per cash book and vice-versa. This makes the preparation of the bank Reconciliation quite complicated. Hence you are advised to follow plus and minus method.

In that case by simply showing the overdraft in the minus column you will automatically have the desired effect of each item duly adjusted in the overdraft.

3.4 Adjusting the Cash Book Balance

When you look at the various items that normally cause the difference between the cash book balance and the pass book balance, you will find a number of items which appear only in the pass book. Why not record such items in the cash book before preparing the Bank Reconciliation Statement. This shall reduce the number of items responsible for the difference. So, as soon as the pass book is received, the firm may record all those items in the cash book which appear only in pass book and work out a fresh balance of the cash book. This is called 'adjusted balance' or 'corrected balance' as per cash book. Similarly, it may also pass correcting entries for the errors committed in the cash book and adjust the cash book balance. When you work out an adjusted balance of the cash book as above, the Bank Reconciliation Statement may be prepared with the adjusted balance. This would reduce the number of items shown in the Bank Reconciliation Statement. As a matter of fact this is exactly what is done in practice.
The items which can usually be adjusted in the cash book are:

(1) Interest allowed by Bank
(2) Amounts collected by bank as per standing instruction
(3) Payments made by bank as per standing instruction
(4) Bank charges
(5) Interest on overdraft
(6) Direct deposits by customers.
(7) Dishonoured cheques or bills receivable
(8) Errors committed in the cash book.

3.5 Advantages of Bank Reconciliation Statement

The main purpose of preparing Bank Reconciliation Statement is to account for the difference between the cash book and the pass book balances. This would ensure that accuracy of entries made in the cash book as well as those in the pass book. Regular comparison of these two books is necessary for preparing the Bank Reconciliation Statement. This helps in the detection of errors and taking timely action to correct them. It is quite possible that the bank wrongly debits firm's account for cheques drawn by someone else. If reconciliation is not done, such mistakes will not be detected. Preparation of Bank Reconciliation Statement also help in preventing frauds in banking transactions. The cashier, for example, may omit to deposit some bearer cheques in the bank and encash them himself such fraud is sure to be detected at the time of reconciliation when it is investigated as to why certain cheques remained uncollected. Thus, it acts as a moral check on the staff to refrain from indulging in such activities.

Bank Reconciliation Statement is also required for audit purposes. The auditor has to verify the bank balance before he would certify the accounts. For this he would insist on the Bank Reconciliation Statement and ensure that the bank balance shown in the cash book is correct.

SELF-ASSESSMENT EXERCISE

1. What is bank Reconciliation Statement?
2. Give two examples of items which are usually recorded first in the cash book and later in the pass book.
3. Give two examples of items which are usually recorded first in the pass book and later in the cash book.
4. From the following particulars ascertain the balance as would appear in the bank pass book of Dapo Adeola on May 31, 1989. The cash book showed a credit balance of N8, 200.

1.	Cheques issued but not cashed by May 31, 1989	2,300
2.	Cheques paid into bank but not cleared by May 31, 1989	3,000
3.	Interest charged on overdraft appeared in the pass book only	120 50
4.	Bank charges debited by bank, but not recorded in the cash book	600
5.	Interest on debentures collected by bank but not recorded in the cash book.	
6.	Bank paid insurance premium as per standing instructions	220
7.	A customer paid into firm's bank account directly Conclusion	1,000

4.0 CONCLUSION

When the businessman receives the Bank Statement or the pass book from the bank, he compares it with the cash book. Normally, entries in the cash book would tally with those in the pass book and the balances shown by both the book should also be the same. But in practice they generally differ. This happens if there are some entries which have been recorded in the cash book but they do not appear in the pass book. Similarly, there may be some entries which have been recorded in the pass book but they do not appear in the cash book. The difference can also arise on account of errors committed either by the firm or by the Bank in recording of various transactions.

5.0 SUMMARY

When cash book and the pass book or bank Statement are compared, it is often found that the balances shown by these two books differs. There may be many causes leading to difference. A Bank Reconciliation Statement is prepared to explain the causes of difference and take the necessary follow up action. It can be prepared either by taking cash book balances as the starting point or by taking pass book balance to the starting point. It can also be prepared by taking the adjusted balance of the cash book as the starting point. The adjusted balance of the cash book is arrived at by passing corresponding entries in the cash book for items which appeared in the pass book or bank statement only.

6.0 TUTOR-MARKED ASSIGNMENT

The pass book of Leke showed a credit balance of N12, 000 on March 31, 1997, while the bank column of his cash book showed an overdraft of N9, 000. Starting with the pass book balance, prepare the Bank Reconciliation Statement using the following information.

1. Of the cheques amounting to N8, 000 deposited in the bank up to March 31, 1997, a cheque of Ni, 800 was collected by the bank on April 3, 1997.

2. Cheque of N 2,500 issued to Niyi was wrongly entered twice in the cash book.
3. Cheques issued during the month amounted to N8, 000 of which cheques for Ni, 000 were not presented to the bank up to March 31, 1997.
4. The pass book showed a credit of N100 as interest for which there was no entry in the cash book.
5. The pass book showed a payment of N500 as life insurance premium for which no entry was made in the cash book.
6. The pass book showed a direct deposit of N10, 000 from Demola on March 28, 1997. It was entered in the cash book only on April 2, 1997.
7. A cheque for N3, 100 issued to a creditor was entered in the bank column of the cash book for N13, 000
8. The bank debited Leke's account with a cheque for 4200 received from Ajayi which had been returned dishonoured. No entry for dishonour was passed in the cash book.

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting I.*

UNIT 3 FINAL ACCOUNTS I- TRADING, PROFIT AND LOSS ACCOUNT (FOR TRADING ORGANIZATION)

CONTENTS

1.0 INTRODUCTION

Final Accounts are prepared to achieve the objectives of Book-keeping. In order to know the profit or loss earned by a firm, Trading and Profit and Loss account is prepared (as one Account) balance sheet or position Statement will portray the financial position of the business on particular date. The two statements, i.e. the Trading and Profit and Loss Account and balance sheet are prepared to give the final results of the business that is why both are collectively called final Accounts and Balance Sheet.

The Balance sheet is not an account but has to be drawn up along with the final accounts in order to make them meaningful. The final accounts would indicate the result of operations for the accounting period whereas the Balance sheet would show the financial position as at the end of that period.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- understand the meaning of final accounts
- prepare Trading Account
- prepare Profit and Loss Account.

3.0 MAIN CONTENT

3.1 Final Accounts - Trading and Profit and Loss Account

In this Unit, we are going to study the joint account separately. As the name of this account itself indicates, it is made up of two accounts, i.e. Trading Account and Profit and Loss Account. Trading concerns i.e. those business which purchase goods from one market and sell it in another market prepare this account.

3.2 Trading Account

As the name implies, the Trading Account is an account and could be prepared in the 'T' form as a normal account. As a matter of fact, it is part of the double entry system. Nominal accounts which are trading account items are debited or credited (as the case may be) to close them off and the corresponding entries would appear in the trading account.

On the debit side of the trading account are recorded the following, the opening stock to which is added net purchases to get total goods available for sale throughout the period. The Net purchases is arrived at by adding cost of carriage inward to the purchases cost and deducting from this sum, the value of returns to suppliers. For the purpose of calculating cost of goods sold, we take into consideration opening stock, purchases, and direct expenses on purchasing and closing stock. The difference between the sales and cost of goods sold is gross profit or gross loss and is transferred to the profit and loss account.

The specimen proforma of a Trading Account is given as under:

Dr. Trading Account for the Year Ended 31/12/2001

Particulars	₦ : K	Particulars	₦ : K
Opening Stock	xx	Sales xx	
Add Purchases	xx	Less Sales Returns x	xxx
	xx		
Less Purchases Returns	- xx	Closing Stock	xx
	xx		
Add Direct Expenses on Purchases		(Gross loss if any)	
Carriage Inwards	xx		
	xxx		
Wages	xx		
Import duties etc.	xx		
	xxx		
Gross Profit (Surplus)			
	xxxx		xxxx

OR

Calculation of cost of goods sold:

Trading Account for the Year Ended 31st Dec. 2001

Particulars		₦ : K	Particulars		₦ : K
Opening Stock		xx	Closing stock	xx	
Purchases	xx		Less Sales Returns	xx	
Less Purchases Returns	x	xx			xx
Add Carriage Inwards		xx	(Gross Loss if any)		
		xxx			
Less Closing Stock		xx			
Cost of goods sold		xxx			
Add other direct expenses on Purchasing					
Wages		xx			
Import duties		xx			
Royalty etc.		xx			
Gross Profit (surplus) c/d		xx			
		xxxx			Xxxx

3.2.1 Detailed Study of the Items Posted to the Debit side of Trading Account

1. **Opening Stock:** This is the amount of goods in hand at the beginning of the period for which the trading account is prepared. This figure is available from the Trial Balance. There will be no opening stock in case of a new business.

2. **Purchases:** It includes both cash and credit purchases of good which are for resale purposes. Purchases returns if any should be deducted from purchases in the inner column and only net purchases are shown in the outer column.

3. **Direct Expenses:** These include all expenses which have been incurred before the goods become ready for sale and are shown on the debit side of Trading Account

Examples of direct expenses are: wages, carriage, import duty, royalties etc.

3.2.2 Detailed Study of the Items Posted

To the credit side of Trading Account:

1. Sales- Sales should include both cash and credit sales of those goods which were purchased for resale purposes. Some customers might return the goods sold to them (called sales returns) which are deducted from the sale in the inner column and net amount is shown in the outer column.
2. Closing Stock - It is the amount of goods in hand at the end of the trading period.

Generally the closing stock is given outside the Trial balance, but when purchases arc adjusted through opening and closing stock, in that case closing stock will have debit balance in the trial balance. If given outside the trial balance it will be credited to the Trading Account but if it is given in the trial balance, then it appears as asset in the Balance Sheet.

3.2.3 Gross Profit or Gross Loss

The difference between the sales and cost of goods sold is gross profit. For the purpose of calculating cost of goods sold, we take into consideration the following items:

i. Opening stock;
ii. Purchases;
iii. Direct expenses on purchasing and closing stock.

The balance of this account represents gross profit or loss and this is transferred to the profit and Loss Account.

SELF-ASSESSMENT EXERCISE 1

From the following list of balances, prepare the Trading Account for the year ended 31st December, 2000.

i.	Stock on 1lst January	-	860
ii.	Purchases in the year	-	3,400
iii.	Stock on 31/12/2000	-	600
iv.	Returns on purchases	-	78
v.	Carriage Inwards	-	42
vi.	Sales	-	6,000
vii.	Returns on Sales	-	300

3.3 Profit and Loss Account

This account is prepared to calculate the Net profit (Net surplus) of the business. There are certain items of incomes and expenses of the business which must be taken into consideration for calculating Net profit of the business. These are of indirect nature, i.e. concerning the whole business and relating to various activities which are done by the business for the purpose of making the goods available to the consumers. Indirect expenses may be selling and distribution expenses, management expenses, financial expenses, extraordinary losses and expenses to maintain the assets into working order.
This account is prepared from Nominal Accounts and its balances transferred to capital account as the whole profit or less will be that of owner and it will increase or decrease his capital.

In cooperative organization, the net surplus (profit) will be transferred to the profit and loss Appropriation Account. Let us now consider a comprehensive example involving the preparation of Trading, and profit and Loss Account. (a joint Account).

Illustration:

From the following list of balances, prepare Trading, and profit and Loss Accounts for the year ended 31st December, 2001.

	N
Purchases	84,380
Sales	139,420
Returns Inwards	2,220
Returns Outwards	3,330
Discounts Allowed	440
Discount Received	350
Stock (1-1-2001)	5,550
Carriage outwards	2,100
Wages and Salaries	7,890
Rates and Insurance	1,230
Carriage on Purchases	3,450
Telephone and Postage	1,110
Electricity and Water	650
Bad debts written off	660
Rent Income	2,820
Commission Received	3,110

The following additional information is relevant:

(a) Provide 20% depreciation on cars and lorries valued at N13,100
(b) Expenses due but unpaid by 31st Dec. 1989 Salaries N410 Telephone N125

(c) Expenses paid in advance: Insurance N110, Postage N10.
(d) Rent received in advance N280
(e) Commission accrued but not received by 31st Dec. 1989 N390.
(f) Stock on 31st Dec. 1989 was valued at N1, 890.

Solution

Trading and Profit and Loss Account for the Year ended 31st Dec. 89

		₦			₦
Opening Stock	₦	5,550	Sales	139,420	
Purchases	84,380		Less returns inward	2,220	137,200
Add. Carriage Inward	3,450				
	87,830				
Less returns outward	3,330				
Net Purchases		84,500			
Goods available		90,050			
Less Closing Stock		1,890			
Cost of goods sold		88,160			
Gross profit c/d		49,040			---------
		₦137,200			₦137,200
Discounts Allowed		440	Gross Profit b/d		49,040
Carriage on Sale		2,100	Discounts Received		550
Wages and Salaries	7,890		Rent (income)	2,820	
Add Accrued	410	8,300	Less Advance	280	2,540
Sales & Insurance	1,230		Commission Recd.	3,110	
Less Prepayment	110	1,120	Add due but unpaid	390	3,500
Telephone and Postage	1,110				
Add Accrual	125				
	1,235				
less prepaid	10	1,225			
--	--------				
Electricity & water		650			
Bad debt		660			
Depreciation on: Cars and Lorries		2,620			
Total Expenses		17,115			
Net Profit		38,515			
		₦55.630			₦55,630

SELF-ASSESSMENT EXERCISE 2

1. Why are final accounts prepared?
2. Distinguish between Trading and profit and loss Accounts.
3. Give a specimen of profit and loss account.
4. From the following list of balance, prepare Trading, and profit and loss Account for the year ended 31st December, 2001

	N
Stock on Jan. 1	500
Purchases	19,500
Wages	1,400
Insurance	550
Carriage Inwards	400
Commission (Dr)	400
Interest on Capital	350
Stationery	225
Returns Inwards	650
Commission (Cr.)	200
Returns Outwards	250
Trade Expenses	100
Office fixtures	500
Cash in Hand	250
Cash at Bank	2,375
Rent & Rates	550
Carriage Outwards	725
Sales	25,000

Note: The closing stock was valued at N12, 500

4.0 CONCLUSION

After preparing the Trial Balance, it is necessary to prepare the final account at the end of business period in order to determine the Net Profit or Net Loss of the business.

5.0 SUMMARY

In this unit, we discussed the joint account of Trading and Profit and Loss Account. All the direct expenses were entered on the debit side of the Trading account, while this account is credited with all direct incomes. The difference between the sales and cost of goods sold is Gross profit.

The profit and Loss Account is debited with all the indirect expenses and credited with all indirect incomes. The excess of indirect incomes over indirect expenses is the Net Profit.

6.0 TUTOR-MARKED ASSIGNMENT

From the following list of balances, prepare Trading, Profit and Loss Account for the year ended 31st December 1989.

	N
Purchases	84,380
Sales	139,420
Returns Inwards	2,220
Return Outwards	3,330
Discounts Allowed	440
Discounts Received	550
Stock 1/1/89	5,550
Carriage on Sales	2,100
Wages and Salaries	7,890
Rates and Insurances	1,230
Carriage on purchases	3,450
Telephone and Postage	1,110
Electricity and Water	650
Bad debt written off	660
Rent Income	2,820
Commission Received	3,110

Additional Information:

(a) Provide 20% depreciation on cars and lorries valued at N13,100
(b) Expenses due but unpaid by 31“ Dec. 1989, Salaries N410, Telephone N125
(c) Expenses paid in Advance - Insurance N110, Postage N10.
(d) Rent received in advance N280
(e) Commission accrued but not received by 31" Dec. 1989- N390
(f) Stock on 31" Dec. 1989 was valued at N1, 890.

7.0 REFERENCES/FURTHER READING

Akinkuolie, L. *Questions and Answers in Cooperative Accounting*.

Frank Wood. *Business Accounting I*.

UNIT 4 FINAL ACCOUNTS II - INCOME AND EXPENDITURE ACCOUNT AND PROPOSED PROFIT AND LOSS APPROPRIATION ACCOUNT (OR SURPLUS APPROPRIATION ACCOUNT

CONTENTS

1.0 INTRODUCTION

In a profit - making business the income and expenditure Account is generally called a Profit and Loss Account, but in a non-profit making business such as a cooperative society, the term "Income and Expenditure Account is more appropriate

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- describe this account as the equivalent of Profit and Loss Account
- transfer the balances from the Nominal accounts in the ledger to this income and expenditure account
- ascertain the correct Net Surplus or Net Loss (Net Profit or Net Loss) for a certain period
- show the treatment of the surplus of income over expenditure in accordance with the cooperative Laws and Regulations.

3.0 MAIN CONTENT

3.1 FINAL ACCOUNT II - Income and Expenditure Account, and Proposed Profit and Loss Appropriation Account (or Surplus Appropriation Account)

3.2 Explanation of Income and Expenditure Account

This may be described as the equivalent of Profit and Loss Account drawn up for Non-trading concern. It performs the same function with the Profit and Loss Account and is compiled and constructed on the same principles. It is a Nominal Account recording losses and expenses on the debit, and gains on the credit. Like the Profit and Loss Account, all expenditures relating to the period both paid and accrued are recorded on the debit side, while the credit side receives all incomes relating to the period whether actually received or not.

The balance of the income and expenditure account shows the excess of income over expenditure (Net Surplus) or deficiency of income over expenditure (Net Loss).

The income and expenditure accounts are suitable for cooperative thrift and credit societies and cooperative thrift and Loan societies.

Note: That the income and expenditure is similar in form to the Profit and Loss Account. They are both used to ascertain the Net surplus of a business or organization for a certain period. They are also prepared in the same manner. The only difference is the nomenclature. So if you can prepare a Profit and Loss Account, you can also prepare an income and expenditure account. All you have to do is to change the name of the account to income and Expenditure Account and debit all those items which ought to be debited in a Profit and Loss Account and credit all those items which ought to be credited in a Profit and Loss Account.

3.2.1 Specimen of an Income and Expenditure Accounts

Income and Expenditure Account of NOUN Cooperative Society Ltd. For the Period Ended 31st March 2003

Expenditure	N : K	Income	N : K
Annual subscription to Union	xx	Entrance Fees	xx
Affiliation fees	xx	Loan Interest	xx
Audit and supervision Fees (ASF)	xx	Bank Interest	xx
Fares and Transports	xx	Investment Interest	xx
Salaries and Wages	xx	Fines	xx
Rent and Rates	xx	Development levy Rcd.	xx
Postage and Stationery	xx	Donation Received	xx
Entertainment	xx	Grant Received	xx
Cooperative bank Loan Interest	xx	P.O.S.B. Interest	xx
Development Levy Paid	xx	Sundry Income	xx
General Expenses	xx		
Donation paid	xx		
Net Surplus	xx	(Net Deficit if any)	
	xxx		**xxx**

3.2.2 Treatment of Surplus of Income over Expenditure

This is treated the same way with a Net surplus derived from Profit and Loss Account. The Net surplus is either appropriated or carried to the balance sheet at the date when the books are closed. If there is a deficiency, the deficiency (Loss) is carried to the asset side of the Balance Sheet.

3.3 Proposed Profit and Loss Appropriation Account

In cooperative organizations, the Net Surplus transferred to the Profit and Loss Appropriation Account. The aim of this account is to show the disposal If the Surplus (profit) of the society for the current financial period. The proposed Appropriation must be in accordance with the cooperative Law and Regulations.

This account does not apply to the accounts of the Sole Trader. The various Cooperative Societies Laws make provisions for the appropriation of Surplus. Allocations made under these provisions are known as authorized allocations and therefore do not require the consent of members. The cooperative Laws of each State in Nigeria provides that 25% (i.e one quarter) of the Surplus of a Cooperative Society must be allocated to a reserve Fund, between 5% - 10% of the Surplus will be allocated to the Education Fund.

Apart from the statutory allocations, all other allocations of Surplus must be made with the consent of members.

These allocations are credited4 to the relevant accounts. After meeting all the statutory provisions, the remaining surplus be return to the members that made them possible in accordance with the services rendered or patronage made by them. This could be achieved through some non statutory allocation listed below:

i. Bonus on patronage
ii. Interest on share capital
iii Committee Bonus
iv. Secretary honorarium
v. Provision for Entertainment
vi. General Reserve e.t.c

Note: That reserve fund is part of allocation of surplus of a registered cooperative society to meet unforeseen contingencies. It is created only if there is surplus, in other words 'no surplus, no Reserve fund'. It is a way of plugging back part of the surplus of the society while making provisions for a rainy day.

Also note that Education find is for continuous education of members and is also for the prevision of cooperative awareness to the men¯ibers and general public. This could be achieved through seminars, symposia, trainings, film shows etc. These programmes are expected to be met from Education fund.

General Reserve: Any balance left from the Net Surplus is passed into this account.

3.3.1 Specimen of Proposed Profit and Loss Appropriation Account

Dr. **Cr.**

	₦		₦
Net Deficit b/f if any		Bal. b/f from last period if any	xx
Net Loss (if any)			xx
From profit & Loss A/C		Surplus for current period.	
Reserve Fund (25%)	xx		
Education fund (10%)	xx		
Provision for members	xx		
Credits	xx		
Proposed Dividend	xx		
General Reserve			
	xxx		**xxx**

3.3.2 Illustration

Oji - Rever Cooperative Investment and Credit Society Ltd. Made a surplus of 459, 063 = during last financial period.

Prepare the society's proposed Appropriation Account for the period in accordance with the cooperative law and regulations.

Proposed Profit and Loss Appropriation Account

Reserve Fund (25%)	14,766	Net Surplus	59,063
Education Fund (10%)	5,906		
Committee Bonus	5,000		
Provision for Members credits	21,694		
Provision for Entertainment	9,500		
Secretary Honorarium	2,000		
General Reserve	197		
	59,063		**59,063**

The above appropriation account when approved, by the Director of cooperatives becomes operational and ledger accounts will look thus:

SELF-ASSESSMENT EXERCISE 1

Dr. Reserve Fund A/C CR

	₦		₦
		By Appr.	14,766

Dr. Education Fund A/C CR

	₦		₦
		By Appropriation	5,905

Dr. Committee Bonus A/C CR

	₦		₦
		By Appropriation	5,000

Dr. Provision for Members' Credit A/C CR

	₦		₦
		By Appropriation	21,694

Dr. Provision for Entertainment A/C CR

	₦		₦
		By Appropriation	9,500

Dr. Secretary Honorarium A/C CR

	₦		₦
		By Appropriation	2,000

Dr. General Reserve A/C CR

	₦		₦
		By Appropriation	197

SELF-ASSESSMENT EXERCISE 2

1. What is the main purpose of an income and Expenditure Account?
2. Among which class of account would you look for the balances from which to compile an income and Expenditure Account?
3. A registered cooperative society made a Surplus of N 90,000 during last business period. Prepared the Society' proposed Appropriation Account for the period in accordance with the cooperative Bye-Laws.

Note: reserve Fund- 25%, Education Fund 10%, members' Credit - $2^1/_2$%, Committee Bonus 1%, Entertainment - 1,500, Secretary honorarium - 1,000

4.0 CONCLUSION

If you can prepare a Profit and Lost Account, you can also prepare and Income and Expenditure Account. All you have to do is to change the name of the account to Income and Expenditure Account.

The Net Surplus (Profit) of a cooperative organization is transferred to the proposed Profit and Loss Appropriation Account. This Surplus is disposed in accordance with the cooperative Law and Regulations.

5.0 SUMMARY

In this unit, we treated the preparation of Income and Expenditure Account of a non-trading concern. It is also stated that the Income and Expenditure Account is similar to the Profit and Loss Account. The only difference is the nomenclature.

We also treated the disposal of Surplus of a cooperative organization in accordance with the cooperative bye-Laws.

6.0 TUTOR-MARKED ASSIGNMENT

Sabo Cooperative Investment and Credit Society Ltd. Made a Surplus of N85,000 during last business period.

You are required to prepare the Society's proposed Appropriation Account for the period in accordance with the Cooperative Law and Regulations.

Note: Committee Bonus- N8,000, Members Credit - 10%, Secretary honorarium N2,000, Entertainment - N9,500, Share Capital - 5%.

7.0 REFERENCES/FURTHER READING

Akinkuolie, L. *Questions and Answers in Cooperative Accounting*.

Jacques, J. and Davies, H. *Cooperative Book-Keeping and Accounting*.

UNIT 5 BALANCE SHEET

CONTENTS

1.0 INTRODUCTION

After all the nominal accounts have been closed by transferring the balances to trading and Profit and Loss Account, the only balances remaining in the books will be those of personal and real accounts, representing the assets and liabilities of the business at the date of the Balance Sheet.

The balance Sheet is not an account. It is merely a statement of ledger balances. It differs from the Income and Expenditure Account in this respect.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- give the meaning of Balance Sheet
- explain a Balance Sheet as a financial Statement and not as an account
- give the specimen of a Balance Sheet in the Cooperatives
- give the classification of Assets and liabilities
- give the arrangement of Balance Sheet in order of Liquidity and Permanency.

3.0 MAIN CONTENT

3.1 Balance Sheet

3.2 Meaning of Balance Sheet

A Balance Sheet is a statement in summary form of the balances remaining in the ledgers, after all the nominal accounts have been closed.

The Balance sheet is therefore a statement of the balances remaining in the ledgers after the Income and Expenditure Account is closed, because this account is the nominal account in which all the existing nominal account balances have been collected. The Surplus Account balance and all the real and personal account balances are summarized in the Balance sheet.

Before the balance sheet is prepared all the ledger account which have not been closed, must now be closed and the balances carried down.

When the balances are carried to a new page, instead of being entered immediately below the totals c/f (carried forward) and b/f (Brought forward) are generally used instead of c/d (carried down) and b/d (brought down). Balances c/d or /c/f should bear the date of the last day in the account period, and the "Balance b/d or b/f should bear the date of the first day in the new accounting period.

3.3 Explanation of Balance Sheet as a Financial Statement

The Balance Sheet is not an account. It is merely a statement of ledger balances. It defers from the Income and Expenditure Account. In this respect, when the Various Nominal Account were closed, corresponding entries were made in the Income and Expenditure Account. When the Real and Personal Accounts were closed the corresponding entries were made by carrying down the balances of each account immediately below the totals of the account. The Balance Sheet is simply a Statement of the balances remaining in the books after the Income and Expenditure Account has been closed. The debit balances or Assets are put on the right hand side of the Balance Sheet and the credit balances. i.e, Capitals, liabilities, and Surplus, are put on the left-hand side. It should be very carefully observed, then, that the items in the Balance sheet are placed on the opposite sides to that on which they would have been placed if the balance Sheet had been an account and the items had been corresponding entries arising out of the closing of the ledger account.

A format of the Balance Sheet of a Sole Trader

Balance Sheet of …….as at 31st December……….

Liabilities		₦	Assets		₦
Capital	xx		Fixed Assets		
Add Net Profit	xx		Premises		xxx
	-------				
	xxx		Furniture	xxx	
Less Drawings	xx	xxx	Less Depreciation	- xx	xxx
	--------			-------	
Long Term Liabilities			Motor vehicle	xxx	
Long Term Loan		xx	Less Depreciation	- xx	xxx

Current Liabilities			Current Assets		
Creditors	xx		Stock		xx
Accruals	xx		Debtors	xxx	
Bank Overdraft	xx	xxx	Less Bad Debt	xx	xxx
			Prepayments		xx
			Cash at Bank		xx
			Cash in Hand		xx
		xxxx			xxxx

From the above Balance Sheet, there are a number of points relating to style that deserve your careful attention:

1. It should be observed that the Balance Sheet gives the financial position at a given date, i.e. the last day of the accounting period, whereas an Income and Expenditure Account gives the income and expenditure for a period of time, i.e. the whole of the accounting period.

2. It is customary to lead the left hand side "liabilities" and the right-hand side "Assets", although strictly speaking all the items on the left-hand side are not liabilities.

3. The omission of "Dr." and "To" on the left-hand side, and "Cr" and "By" on the right-hand side should be observed. These are omitted because the Balance Sheet is not an account.

4. The use of the words "Debtors" and "Creditors" should be noted. These terms are used rather than the names of the individual debtors and creditors, because in practice there would be too many for them to be specified individually in the Balance Sheet. The Balance Sheet must be a concise statement of ledger balances, therefore balances of the same nature are given in one total.

5. Like the Trial Balance, the two sides of the Balance Sheet must be equal.

3.4 The Specimen of the Balance Sheet in the Cooperatives

Liabilities	₦	Assets		₦
1. **Creditors**		1. **Cash:**		
Credit Union	xx	In hand		xx
Coop. Union	xx	At Bank		xx
Others.	xx	In Credit Union		xx
2. **Members Savings:**		2. **Loan:**		
Thrift	xx	To Members		xx
Special	xx			
Deposit	xx	3. Investments		xx
3. Provision				
Unexpended	xx	4. Sundry Debtors		
4. Share Capital	xx			
5. **Reserves:**		5. Interest Due		
Reserve Fund	xx			
Education Fund	xx	6. Equipment	xx	
General Reserve	xx	Less Depreciation	xx	xxx
Appropriation A/C				
B/F	xx	Appropriation		
Net Surplus	xx	Account B/F.		xx
		Net Deficit (if any)		
	----------			-------------
	xxxx			xxxx

3.5 Arrangement of Balance Sheet

There are two orders in which the items in the Balance Sheet may be arrange.

i. The order of permanency and
ii. The Order of Liquidity.

3.5.1 Order of Permanency

In this order, the most permanent asset is written first and the least permanent asset is written last. It follows that Fixed Assets appear before Current Assets. Under the Sub-heading "Fixed Assets" the assets that is likely to stay longest with the business is written first, followed by a comparatively less permanent asset, followed by another which is even less permanent and so on. Under the sub-heading. "Current Assets", cash being the most liquid asset is written last, preceded by an asset which is expected to be liquidated (i.e converted into cash) very soon.

Balance Sheet of …………………as at 31st December 2001

Liabilities	₦	Assets	₦
Liabilities		**Ficticious Assets:**	
Capital xx		Goodwill	xx
Less Drawings xx		Patents and Trade	
xx		Marks	xx
Add Net Profit xx	xxx		
Long Term Liabilities:		**Fixed Assets:**	
Long Term		Land & Buildings	xx
Loans etc.	xx	Plant & Machinery	xx
		Fixtures & Fittings	xx
Current Liabilities:		**Current Assets:**	
Sundry Creditors	xx	Stock-in-Trade	xx
Short Term loans etc.	xx	Sundry Debtors	xx
		Cash at Bank	xx
		Cash in Hand	xx
	----------		----------
	xxx		xxx

The above Balance Sheet shows the arrangement in order to permanency.

3.5.2 Order of Liquidity

The most liquid asset is shown first and the most permanent asset is shown last. Current Assets precede long term liabilities. Capital appears last. Order of Liquidity is exactly the opposite of order of permanency.

One point should be carefully noted. If the balance sheet is being arranged in the order of Liquidity both the assets and liabilities sides should be written in the order of liquidity Likewise, if the balance sheet is being arranged in the order of permanency, both the asset and liabilities sides should be written in the order of permanency. It is wrong to arrange one side in the order of permanency and the other side in the order of liquidity.

Arranging in order of Liquidity:

Balance Sheet of …………As at 31st December, 2001

Liabilities	₦	Assets	₦
Liabilities:		**Current Assets:**	
Short term loan	Xx	Cash in hand	xx
Sundry Creditors	Xx	Cash at Bank	xx
		Sundry Debtors	xx
Long Term Liabilities:		Stock in-Trade	xx
Long Term Loan	xx	**Fixed Assets:**	
		Fixtures & Fittings	xx
Net Profit	xx	Plant and Machinery	xx
		Land & Building	xx
Capital	xx		
		Ficticiou Assets:	
		Patents & Trade Marks	
		Goodwill	
	----------		-------------
	xxx		xxx

3.6 Classification of Assets & Liabilities

ASSETS:

i. Fixed Assets

Those assets which are acquired and held permanently in the business and are used for the purpose of earning profits are called Fixed Assets. Land and Buildings, Machinery Furniture and fixtures are some examples of these assets.

ii. Current Assets

Those assets such as cash, debtors and stock that can be realized and readily available to discharge liabilities are called current assets.

iii. Fictitious Assets

e.g. Net Loss, Goodwill, patents and Trade Marks.

iv. Wasting Assets

Firewood, Fuel and Gas - Assets which are consumed in the process of operation e.g. mines and quarries.

v. Liquid Assets

These are cash or such items as marketable securities which can be converted into cash quickly.

3.6.2 Liabilities

A liability is the amount which a business is legally bound to pay.

i. Fixed Liabilities

These are those liabilities which are payable only on the termination of the business such as capital which is a liability to the owner.

ii. Long Term Liabilities

Those liabilities which are not payable within the next accounting period but will be payable within next five to ten years.

iii. Current Liabilities

Those liabilities which are payable within the next accounting period usually a year or already due. Sundry creditors, overdraft.

SELF-ASSESSMENT EXERCISE

1i. What is a Balance Sheet?
ii. Why is it prepared?
iii. Give a Specimen of Balance Sheet.

2. What do you understand by:

(a) Fixed Assets
(b) Current Assets
(c) Long Term Liabilities
(d) Short Term Liabilities.

4.0 CONCLUSION

As discussed in this Unit, you should note that Balance Sheet is not an account, but, is the financial statement of a business. From the balance sheet, we can easily calculate the working capital of a business as below:

Working Capital = Current Assets Less Current Liabilities.

5.0 SUMMARY

In summary, a Balance sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date. The financial position of a concern is indicated by its assets on a given date and its liabilities on that date.

Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a business. A Balance Sheet is also described as a Statement showing the "Sources and Application of Capital". A properly drawn up balance sheet gives information relating to

i. The nature and value of assets.
ii. The nature and extent of liabilities
iii. Whether the business is solvent
iv. Whether the business is overtrading

6.0 TUTOR-MARKED ASSIGNMENT

Rearrange the following balance sheet which is obviously incorrect and poorly arranged. You may arrange the items in order to liquidity.

Tom Jones and Sons

Balance Sheet as at 31/12/99

Liabilities	**N**	**N**
Capital		10,000
Current liabilities:		
Cash in hand	100	
Creditors	2,200	
Rent Payable	500	
2 years Loan from M. Bank	2,500	5,300’

Long Term Liabilities	₦	₦
Building	7,500	
10 years Loan on Building	3,500	11,000
		26,300
Fixed Assets:		
Overdraft	1.100	
Furniture	3,200	4,300
Current Assets:		
Debtor	4000	
Stock	5000	9,000
		13,300

7.0 REFERENCES/FURTHER READING

Fave1. *Practical Book-Keeping and Accounts.*

Frankwood. *Business Accounting.*

MODULE 5

UNIT 1 MANUFACTURING ACCOUNT

CONTENTS

1.0 INTRODUCTION

Manufacturing Accounts are prepared by manufacturers to determine the cost of manufacture. Although, no hard and fast rules are laid down for this. In this unit, you will learn about those expenses that make up the cost of manufacture, and the importance and usefulness of this accounting information to the manufacturer.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the meaning of manufacturing
- explain the types of cost in manufacturing accounts
- distinguish between direct and indirect expenses of production
- prepare Manufacturing, Trading, Profit and Loss Account.

3.0 MAIN CONTENT

3.1 Manufacturing

Manufacturing is the process of taking raw materials which nature or some primary industry like agriculture, has provided and turning them into more sophisticated and useful products. Thus, the Steel Industry converts iron to steel, and the oil industry converts crude oil to petrol and other products.

The textile industry takes raw cotton, an agricultural product and converts it into cloth and clothing. These activities are at the roof of much of our national wealth, and the accounting activities connected with them are of great importance. Much of these accounting activities are in the specialized field of cost accounting, which is chiefly concerned with controlling costs to eliminate wasteful activities and keep our goods competitive in price on world markets.

3.2 Types of Cost in Manufacturing Accounts

In the preparation of Manufacturing Accounts, it is necessary to discover the total cost of manufacturing goods. The costs are categorized into two main groups, each of which has several alternative names.

3.2.1 Prime Cost or Direct or Variable Cost

The first group of costs, that is, 'Prime Cost' is concerned with those costs, which are directly embodies in the product. Raw materials are typical costs in this first group, as are wages of workers employed in the actual manufacturing process. If I is called Prime Cost — meaning 'first', Direct cost — since the cost is directly associated with the product. A third name is variable cost since it varies fairly directly with the output. For example, if we double the output of cars on a production line, we shall double the quantity of sheet of steel used.

3.2.2 Overheads or Secondary Costs

The second group of costs are not directly embodied in the product, but are necessary to the production process just the same. These are the costs of running the factory, they include such items as factory power light, heat, rent, rates, depreciation, machinery and internal factory transport. Overheads are also called Factory or Works Expenses. They are also called Indirect Costs, since they do not vary with output. Thus a manager's salary will not be doubled just because output is doubled, he will be expected to supervise the factory activities whatever the output may be.

3.2.3 Gross Cost of Manufacture

Prime cost plus overheads gives the gross cost of manufacture

3.2.4 Net Works Cost of Manufacture

Net works cost of manufacture is obtained by adding the Gross Cost of Manufacture to Opening Work-in-Progress and then deduct Closing Work-in-Progress,

i.e. <u>Gross Cost of Manufacture + Opening Work-in-Progress</u>

x x x x x x x x x x x x x x x

- Closing Work-in-Progress

= Net Works Cost of Manufacture

3.3 Stocks in Manufacturing

In manufacturing, there will be stocks of raw materials at the start of the process and stocks of finished goods at the end, but there will also be stocks of work-in-progress or partly-finished goods going through the production lines as well. It always require some calculation to decide the value of this work in progress. The accountant will have to decide what value to place upon it and whether to include overhead charges as well as prime cost in the calculation.

It is probably most common to value the work-in-progress at 'factory cost' that is, to say at prime cost (raw materials, labour and other variable costs) plus overheads (a proportion of total overhead costs being added). If this procedure is adopted, the work-in-progress will appear in the second part of the Manufacturing Account, that is, in the cost of Manufacturing Goods Section.

Illustration I

Kupson Ltd. is a Manufacturing Company and the following details from the Year 1996 are extracted from its books.

	N
Stock of raw materials January 1996	11,464
Stock of raw materials 31 December, 1996	12,162
Stock of manufactured goods 1 January 1996	14,881
Stock of manufactured good 31 December 1996	14,238
Work-in-progress 1st January, 1996	18,291
Purchases of raw materials	115,826
Rent Rate of office	3,000
Manufacturing wages	71,342
Sales	28,436

Factory expenses	19,324
Rent, rates of factory	6,000
General administration expenses	21,642
Salesmen's salaries	6,162
Motor expenses (for delivery to customers)	3,984
Other selling expenses	7,046
Depreciation: Plant and Machinery	8,000
Motor Van	1,800
Work-in-progress 31 December 1996	19,941

You are asked to prepare a Manufacturing Account Trading and Profit and Loss Account for 1996. You should indicate the significance of sub-totals and of balances carried down.

Comments

1) You are required in this problem to identify separate items, which should be debited to Manufacturing Account, Trading Accounts and Profit and Loss Account.
2) From the working of the question, it may be logical to show in sub-totals in the Profit and Loss Account, the administrative expenses as distinct from the distribution expenses.
3) The sub-totals in the Manufacturing Account must be shown as percentages on the cost of manufacture to show at a glance the shares of each aspect of costs.

Those in the Trading and Profit and Loss Account are shown as percentages on sales so that the percentage income reduced by each aspect of trading and selling and administrative costs can be identified.

Answer

Manufacturing, Trading and Profit and Loss Account for the Year Ended 31st December 1996

	₦	₦		₦
Stock of raw materials 1st January	11,464		Cost of manufacture transferred to Trading Account	218,047
Purchase of raw Materials	115,826			
	127,290			
Less stock of raw Materials 31 Dec	12,162			
		348		
Raw materials used	115,128			
Manufacturing wages	71,242			
Prime cost (85.5%)		186,370		
Depreciation of Plant and machinery	8,000			
Rent, rates of factory	6,000			
Factory expenses	19,324			
Factory overheads (15.3%)		33,324		
Gross Cost of Manufacture		219,694		
Add work-in-progress 1 January	18,294			
Less work-in-Progress 31 Dec	19,941	(1,647)		
		₦218,047		₦218,047

	₦	₦	₦
Stock of finished goods 1st January	14,881	Sales	284,369
Cost of Manufacture b/d	218,047		
Less closing stock	232,928		
of finished goods	14,238		
Cost of goods sold (77%)	218,690		
Gross profit (23%)	65,679		
	₦284,369		₦284,369

Administrative Expenses	3,000		Gross Profit b/d (23%)	65,679
General Administration Expenses (9%)	21,642	24,642		
Selling and Distribution Expenses				
Salesmen's Salaries	6,162			
Selling expenses	7,046			
Depreciation of Delivery van	1,800			
Motor expenses (7%)	3,984	18,992		
Net profit (8%)		22,045		
		65,679		65,679

Note the effect of approximations:

Indicate the significance of the sub-totals and balances carried down as follows:

1) In the Manufacturing Account reduce the various sub-totals as percentages of the total cost of manufacture. This will indicate the percentage share of each aspect of costs.

- Prime cost $= \frac{186,370}{218,047} \times \frac{100}{1}$
  $= 85.5\%$ approx.

- Factory Overheads $= \frac{33,324}{218,047} \times \frac{100}{1}$
  $= 15.3\%$.

Prime cost plus factory overheads gives 100.8% excess represents the excess of closing work-in-progress over the opening work-in-progress.

2) In the Trading, Profit and Loss Accounts, the various costs are placed over the Net Sales multiplied by 100.

SELF-ASSESSMENT EXERCISE

1) What is 'Prime Cost' in Manufacturing Account?
2) Describe how Gross Cost of Manufacture is obtained.
3) List three expenses that are included in the Indirect Cost of Overheads.
4) Oakland Ltd is a manufacturing company and the following

details for the Year 1999 are extracted from its books:

	N
Stock of raw materials 1st January 1999	5,275
Stock of raw materials 31 December, 1999	4,385
Stock of manufactured goods 1 January 1999	17,350
Stock of manufactured good 31 December 1999	16,000
Work-in-progress 1st January, 1999	3,800
Work-in-progress 31st December, 1999	3,250
Purchases of raw materials	13,850
Manufacturing wages	12,725
Sales	48,000
Factory expenses	2,500
Rent, rates of factory	1,500
Rent, rates of office	500
General administration expenses	3,250
Salesmen's salaries	1,750
Motor expenses	550
Other selling expenses	340
Depreciation: Plant and Machinery	500
Motor Van	400

Required:

Draw up the Manufacturing Account, Trading Account and Profit and Loss Account for Oakland Ltd. for the ending December 31 1999.

4.0 CONCLUSION

In Manufacturing, the manufacturer may determine the gross profit on manufacture by deducting his cost of manufacture from what the goods would have cost if obtained from other sources. Such gross profits are transferred to the credit of the Profit and Loss Account, while the goods are transferred to the Trading Account at the market value.

Where a manufacturer does not prepare a Manufacturing Account, all such items that are normally included in the Manufacturing Account are included in the Trading Account. Thus factory rent, depreciation of a manufacturer's machinery, etc. are regarded as a cost of bringing the goods into a saleable condition and should be debited to the Trading Account.

5.0 SUMMARY

When preparing Manufacturing Account, distinction must be made between factory wages and factory salaries. Factory wages are direct wages of workers engaged in the production line. Factory salaries are salaries paid to workers such as foremen who, although they work in the factory, are not in the production line. They merely supervise the direct workers to see that production is carried out on time and according to specification. The volume of their work does not necessarily vary with the volume of production. Factory salaries are normally specified as indirect costs and included in overheads.

6.0 TUTOR-MARKED ASSIGNMENT

Bigdan Ltd. is a Manufacturing Company and the following details for the Year 1986 were extracted from its books:

	N
Stock of raw materials lst January 1986	16,249
Stock of raw materials 31 December, 1986	18,216
Stock of manufactured goods 1 January 1986	19,241
Stock of manufactured good 31 December 1986	17,485
Work-in-progress 1st January, 1986	22,706
Work-in-progress 31st December, 1986	23,298
Purchases of raw materials	144,252
Manufacturing wages	88,264
Sales	366,487
Factory expenses	21,826
Rent, rates of factory	10,000
Rent, rates of office	4,500
General administration expenses	24,269
Salesmen's salaries	7,836
Motor expenses (for delivery to customers)	4,367
Other selling expenses	7,602
Depreciation: Plant and Machinery	9,000
Motor Van	2,200

Required:

Prepare Bigdan's Manufacturing Account. Trading and Profit and Loss Account for the Year 1986.

7.0 REFERENCES/FURTHER READING

Douglas Garbutt: *Carter's Advanced Accounts*.

Fayell A. J.: *Book-keeping Stage*.

Frankwood: *Business Accounting II*.

UNIT 2 DEPRECIATION - MEANING AND CAUSES

CONTENTS

1.0 INTRODUCTION

Fixed assets are those assets, which are of material value having long life and are held to be used in business and are not primarily for resale or for conversion into cash. Usually, with the exception of land, fixed assets have a limited number of years of useful life. Motor Vans, Machines, Buildings and Fixtures, for instance, do not last forever. Even land itself may have all or part of its usefulness exhausted after a few years. Some types of lands used for quarries, mines or land of another sort of wasting nature would be examples.

When a fixed asset bought is put out of use by the firm, that part of the cost that is not recovered on disposal is called depreciation.

It is obvious, that the only time that depreciation can be calculated accurately is when the fixed asset is disposed off and difference between the cost of its owner and the amount received on disposal is then ascertained. If a motor van was bought for N300,000.00 and was sold five years later for N6,000.00, then the amount of depreciation is N300,000.00 — N6,000.00 = N294,000.00.

Depreciations thus that part of cost of the fixed asset consumed during its period by the firm. Therefore, it has been a cost for services consumed in the same way as costs for items as wages, rent, lighting and heating, etc.

Depreciation is, therefore, an expense and will need charging to the

Profit and Loss Account before ascertaining Net Profit or Net Loss.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define Depreciation;
- explain the main causes of depreciation
- explain the need for providing depreciation
- explain the provision for depreciation as apportionment of cost.

3.0 MAIN CONTENT

3.1 Depreciation - Meaning and Causes

3.2 Definition of Depreciation

Some definitions given by prominent authors or Institutes of Accountancy are given below:

1) Depreciation may be defined as the permanent and continuous diminution in the quality, quantity or value of an asset. *Pickles*
2) Depreciation is the gradual and permanent decrease in the value of an asset from any cause — carter.
3) Depreciation may be defined as a measure of the exhaustion of the effective life of an asset from any cause during a given period.

   Spicer and Pegler
4) Depreciation is the diminution in intrinsic value of asset due to use or the lapse of time.
5) Depreciation represents that part of the cost of a fixed asset to its owner, which is not recoverable when the asset is finally put out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the assets and is not dependent upon the amount of profit cleared.

   Institute of Chartered Accountants in Austria

In simple words, we can define depreciation as a permanent, continuing and gradual shrinkage in the book value of a fixed asset.

3.3 Main Causes of Depreciation

The following are the main causes of depreciation:

1. Physical deterioration

2. Economic Factors
3. Time Factor
4. Depletion

Explanation

1. **Physical Deterioration**

This is caused mainly from wear and tear when the asset is in use and from erosion, rust and decay from being exposed to wind, rain, sun and other elements of nature.

2. **Economic Factors**

These may be said to be those that cause the asset to be put out of use even though it is in good physical condition. These arise due to obsolescence and inadequacy. Obsolescence means the process of becoming obsolete or out of date. An old machinery though in good physical condition may be rendered obsolete by the introduction of new machinery, which produces more than the old machinery. Inadequacy refers to the termination of the use of an asset because of growth and changes in the size of the firm. But obsolescence and inadequacy do not necessarily mean that the asset is scrapped. It is merely put out of use by the firm. Another firm will often buy it.

3. **Time Factors**

There are certain assets with a fixed period of legal life such as lease, patents and copyrights. For instance, a lease can be entered into for any period while a patent's legal life is for some years but on certain grounds this can be extended.

4. **Depletion**

Some assets are of a wasting character perhaps due to the extraction of raw materials from them. These materials are then either used by the firm to make something else or are sold in their raw state to other firms. Natural resources such as mines, quarries and oil wells come under these headings.

3.4 Need for Providing Depreciation

You should note that the need for depreciation arises because of the following reasons:

1. To know the correct Profit

We have seen that depreciation like other expenses is an expense. Thought it is not visible expense like other expenses and never paid to the outside party. Yet it is desirable to charge depreciation on the reasoning that since assets are used for earning purposes so its depreciation must be deducted out of the income, which has been earned from its use in order to calculate Net Profit or Net Loss.

2. To Show Correct Financial Position

Financial condition can be studied from the balance sheet and for the preparation of the balance sheet, fixed assets are required to be shown at their correct and true value. If assets are shown in the balance sheet without any charge made for its use or depreciation, then their value must have been overstated in the balance sheet and will not reflect the true financial condition, it is necessary that the depreciation must be deducted from the assets and then at such reduced value these may be shown in the balance sheet.

3. To make Provision for Replacement of Assets

If deprecation is not provided, the profits of the concern will be overstated and can be distributed to the shareholders as dividend. After the end of the working life of the asset, there will be no provision or funds at the disposal of the concern and has to borrow for purchasing new assets.

Provision for depreciation is a source of fund as fund is created by charging depreciation to Profit and Loss Account, but actually, depreciation is not paid and the amount of depreciation thus accumulated during the working life of the asset provides funds at the end of the working life of the asset for its replacement.

SELF-ASSESSMENT EXERCISE

1) What do you understand by depreciation?
2) Explain the main causes of depreciation.

4.0 CONCLUSION

Depreciation is a part of the cost of fixed asset employed in the business. It is charged against the revenue of the accounting period during which the asset is employed so that the revenue of each period is charged in proportion to the benefit from the assets, which are consumed in earning that revenue.

In short, depreciation is the gradual reduction in the value of a fixed asset from the following causes:

- Wear and tear due to use
- Decay - in case of assets made of wood being exposed to rain.
- Obsolescence - Machine becomes obsolete as new and more efficient machine is invented and brought into use
- Passage of time and
- Sinking

You should note that Accountants lay great emphasis on depreciation because of the above causes so as to ascertain the true value of the assets at the end of an accounting period, and also provide sufficient funds for the replacement of the assets and to know the amount to be charged in the case if such asset is to be sold in future.

5.0 SUMMARY

In this unit, we have dealt with some definition of depreciation. We also discussed the cases of depreciation and the need for providing depreciation, that is:

(i) to know the correct profits;
(ii) to show correct financial position of the business; and
(iii) to make provision for replacement of assets.

If depreciation is not provided, the profits of the concern will be overstated and can be distributed to the shareholders as dividend.

6.0 TUTOR-MARKED ASSIGNMENT

1) Why do accountants lay great emphasis on depreciation of fixed assets?
2) Briefly explain the following causes of depreciation of a fixed assets:

a) Physical Factors; and
b) Economic Factors

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting.*

Igben, O. Robert: *Financial Accounting Made Simple.*

Jain, S. P and Narang, K. L: *Advanced Accounting.*

UNIT 3 DEPRECIATION METHODS

CONTENTS

1.0 INTRODUCTION

Different methods of calculating provision for depreciation are mainly accounting customs, which may be used by different concerns; taken into consideration their individual peculiarities.

The following are the main methods of providing depreciation:

i) Fixed Installment Method or Straight Line Method
ii) Diminishing Balance Method or Reducing Balance Method
iii) Annuity Method
iv) Revaluation Method
v) Insurance Policy Method
vi) Depreciation Fund Method
vii) Sums of the Digits Method
viii) Depletion Method
ix) Machine Hour Rate Method

Note that each method will be discussed in details later.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- understand all the methods of depreciation
- explain all the methods
- do some calculations or workings
- give some important advantages and disadvantages of some of the methods.

3.0 MAIN CONTENT

3.1 Depreciation Methods

The following are the main methods of providing depreciation.

3.2 Fixed Installment Method or Straight Line Method

This method is also known as fixed percentage on original cost. Under this method, a fixed percentage of the original value of the asset is written off every year so as to reduce the asset account to nil or to its scrap value at the end of the estimated life of the asset. To ascertain the annual charge under this method, all that is necessary is to divide the original value of the asset (minus its residual value, if any) by the number of years of its estimated life i.e.

$$\text{Depreciation} = \frac{\text{Cost Price of Asset - Scrap Value}}{\text{Estimated Life of Asset}}$$

$$\text{Annual Depreciation} = \frac{\text{Cost Price of Asset - Scrap Value}}{\text{Number of years}}$$

If for example, a machine costing N1l,000 is estimated to have a life of 10 years and the scrap value is estimated to N1,000 at the end of its life, the amount of depreciation would be

$$\frac{\text{N}11{,}000 - \text{N}1{,}000}{10} = \text{N}1{,}000$$

Having done this, the depreciation account is debited with the amount so obtained and credited the particular asset.

If the charge of depreciation is plotted annually on a graph paper and the points joined together then, the graph will reveal a straight line, that is why it is also called a straight line method.

Illustration 1

A Block Industry purchased a machine worth 440,000.00 for cash on 2"d January, 1995 and put it into use immediately. The machine was expected to have a useful life of 10 years at the end of which it will have an estimated residual value of N5,000.00. From above information, you are required to show how you would provide the annual depreciation on the machine.

Solution

		N
Cost of Machine	=	40,000.00
Residual Value	=	5,000.00
Life Span	=	10 years
Annual Depreciation	=	$\frac{\text{CP — SV}}{\text{No of years}}$
	=	$\frac{40{,}000 — 5{,}000}{10}$
	=	$\frac{35{,}000.00}{10}$
	=	N3,500.00 per year

3.3 Diminishing Balance Method or Reducing Balance Method

Under this method, depreciation will be calculated at a certain percentage each year on the balance of the asset which is brought forward from the previous year. You should note that every year the installment of depreciation will reduce as the beginning of balance of the asset in each year will reduce. It is usually adopted for plant and machinery.

The advantages of this method are:

- It tends to give a fairly even change of depreciation against revenue each year.
- When additions are made to the asset, fresh calculations of depreciation are not necessary.

Illustration 2

New Town Cooperative Society Ltd, purchased a duplicating machine for the sum of N12, 500.00. It has all estimated life of 4 years and a scrap value of N5, 120.00.

Calculate the depreciation for each year, using the Reducing Balance Method with a rate of 20 per cent.

Duplicating Machine Account

Dr		₦			₦ Cr
1st Year Jan	Cash	12,500	Dec	Depreciation	2,500
				Balance c/d	10,000
		12,500			12,500
2nd Year Jan	Balance b/d	10,000	Dec	Depreciation	2,000
				Balance c/d	8,000
		10,000			10,000
3rd Year Jan	Balance b/d	8,000	Dec	Depreciation	1,600
				Balance c/d	6,400
		8,000			8,000
4th Year Jan	Balance b/d	6,400	Dec	Depreciation	1,280
				Balance c/d	5,120
		₦6,400			₦6,400
5th Year Jan	Balance b/d	**5,120**			

3.4 Annuity Method

Under this method, amount spent on the purchase of an asset is regarded as an investment. Such investment is assumed to earn interest at a certain rate. Every year, the asset account is debited with the amount of interest and credited with the amount of depreciation. This interest is calculated on the debit balance of asset account at the beginning of the year.

You should note that the depreciation will be different according to the rate of interest and according to the period over which the asset is to be written off. The fixed amount of depreciation as well as the rate of interest is so adjusted that at the end of the working life of the asset, its book value is reduced to zero or to its break-up value, if any.

3.5 Revaluation Method

Under this method, the assets are revalued at the end of the accounting period and this value is compared with the value of the asset at the beginning of the year. The difference is treated as depreciation. Where purchase of asset is also made during the year, then assets are valued at the start of the period; the additions increase the value and then the assets are revalued at the end of the period. The amount of decrease in value which the amount by which the asset is deemed to have depreciated.

3.6 Insurance Policy Method

Under this method, arrangements are made with an insurance company, which will receive premiums annually and pay at the end of the fixed period, the required amount. Premiums have to be paid at the beginning of each year.

3.7 Depreciation Fund Method

Under all the above methods, ready cash may not be available when the time of replacement comes because the amount of depreciation is retained in the business itself in the form of assets not separate from other assets, which cannot be readily sold. You should note that the amount written-off as depreciation should be kept aside and invested in readily saleable securities. The securities accumulate and when the life of the asset expires, the securities are sold and with the sale proceeds a new asset is purchased.

3.8 Sum of the Digits Method

This is a variant of the reducing installment or diminishing balance method. Under this method, depreciation is calculated by the following formula:

Depreciation = Amount to be x Number of Years of the remaining
life written off <u>of the asset including the current year</u>
The total of all the digits representing
The assets (in years)

Suppose machinery was purchased for N45,000.00 on 1st January, 1995 and depreciation was charged following the sums of the digits method assuming the useful life to be 5 years. Depreciation for five years will be calculated as follows:

1st year = $\frac{5}{5+4+3+2+1} \times \frac{45,000}{1}$ = N15,000.00

2nd year = $\frac{4}{5+4+3+2+1} \times \frac{45,000}{1}$ = N12,000.00

3rd year = $\frac{3}{5+4+3+2+1} \times \frac{45,000}{1}$ = N9,000.00

4th year = $\frac{2}{5+4+3+2+1} \times \frac{45,000}{1}$ = N6,000.00

5th year = $\frac{1}{5+4+3+2+1} \times \frac{45,000}{1}$ = N3,000.00

3.9 Depletion Method

This method is mostly used in case of mines, quarries, etc. from which a certain quantity of output is expected to be obtained. The value of mine depends only upon quantity of minerals that can be obtained. When the whole quantity is taken, the mine looses its value. The rate of depreciation is worked out only so much per ton. It is obtained by dividing the cost of the mine by the total quantity of the minerals expected to be available.

Illustration

A mine was acquired at a cost of N2,000,000.00 on 1st July 1995. It was expected it would yield N200,000 tons; 1996 — 40,000 tons and 1997 - 320,000 tons.

Write up the mine account for the above years using depletion method of charging depreciation.

Solution

Rate of Depreciation = $\frac{\text{Cost of Mine}}{\text{Estimated Quantity to be raised}}$

= $\frac{\text{N2,000,000.00}}{\text{200,000 tons}}$ = N10per ton

Dr **Mines Account** **Cr**

Date	Particulars	₦	Date	Particulars	₦
1995 July 1	Bank	2,000,000	1995 Dec 31	Depreciation	100,000
				Balance c/d	1,900,000
		2,000,000			2,000,000
1996 Jan 1	Balance b/d	1,900,000	1996 Dec 31	Depreciation	400,000
				Balance c/d	1,500,000
		1,900,000			1,900,000
1997 Jan 1	Balance b/d	1,500,000	1997 Dec 31	Depreciation	320,000
				Balance c/d	1,180,000
		₦1,500,000			₦1,500,000
1998 Jan 1	Balance b/d	**1,180,000**			

3.10 Machine Hour Rate Method

This method is useful in case of machines. The life of the machine is fixed in terms of hours. Hourly rate of depreciation is worked out by dividing the cost of the machine by the total number of hours for which the machine is expected to be used. Depreciation to be written off in a year will be ascertained by multiplying the hourly rate of depreciation by the number of hours that the machine actually runs in the year.

Illustration

A machine was acquired on 1st April 1996 at a cost of N100,000.00. It is expected that its total life will be 20,000 hours. During 1996, it worked for 5,000 hours and during 1997 for 8,000 hours. Write up the machinery account for 1996 and 1997.

Solution

$$\text{Machine Hour Rate} = \frac{\text{Cost of the Machine}}{\text{Estimated total hours of life}}$$

$$= \frac{N100{,}000}{20{,}000} = N5 \text{ per hour}$$

Dr **Machinery Account** **Cr**

Date	Particulars	₦	Date	Particulars	₦
1996 April 1	Bank	100,000	1995 Dec 31	Depreciation	25,000
				Balance c/d	75,000
		100,000			100,000
1997 Jan 1	Balance b/d	75,000	1997 Dec 31	Depreciation	40,000
				Balance c/d	35,000
		75,000			75,000
1998 Jan 1	Balance b/d	**35,000**			

SELF-ASSESSMENT EXERCISE

1) List eight methods of depreciation and explain any six.
2) By the use of straight line method, how will you provide for depreciation on the machinery purchased on 1^{st} of January, 1990 for N60,000.00 by Standard Cooperative Gari Processing Industry Ltd.

Assume the expected life of the asset is 10 years and scrap value is N5,000.00. Show how the entries will appear in the Asset (Machinery) Account.

4.0 CONCLUSION

In this unit, we have explained some methods used in keeping intact the capital invested in depreciable assets and to make provision for replacement, modernization and expansion on most favourable terms. Depreciation is a process of allocation and not that of generation. The provision of depreciation helps the management to retain this amount of profit in the business which otherwise would have gone to the government in the form of taxes or to the shareholders in the form of dividend. The change of depreciation is also necessary to determine the correct Net Income and financial position of a concern so that financial statements may give a true and fair view of the state of affairs of the business.

5.0 SUMMARY

In this unit, we have discussed different methods of calculating provision for depreciation. Each method has its own advantages and uses. Under the straight line method, it makes calculation of depreciation simple and can write down as asset to zero at the end of its working life. The Reducing Balance Method tends to give a fairly even charge of depreciation against revenue each year. Under the Annuity Method, amount spent on the purchase of an asset is regarded as an investment. Such investment is assumed to earn interest at a certain rate, and this will be regarded as the amount to be charged as depreciation.

Revaluation Method is used in case of bottles, crates, loose tools, packages, etc. while Depletion Method is mostly used in case of mines and quarries. Under the Depreciation Fund Method, ready cash will be available at the time of replacement. And the Machine Hour Rate Method is useful in case of machines. The life of the machine is fixed in terms of hours.

6.0 TUTOR-MARKED ASSIGNMENT

A company purchased a machine for the sum of N12, 500.00. It has all estimated life of 4 years and a scrap value of N5, 120. Calculate the depreciation for each year, using:

a) The Straight Line Method; and
b) The Reducing Balance Method with a rate of 20 per cent

7.0 REFERENCES/FURTHER READING

Akinkuolie, L.: *Questions and Answers in Cooperative Accounting.*

Jain, S. P. and Narang, K. L.: *Advanced Accountancy*.

UNIT 4 VALUATION OF STOCK

CONTENTS

1.0 INTRODUCTION

At the end of any financial period, it is necessary to value the stock in hand, which will be handed on by the current period to the next period at the agreed valuation. The purchase of stock during the year is a revenue expenses, because it is the purchase of goods for resale, but at the end of the year, the balance in hand has, for a few hours, to be capitalized and handed on to the next year as an asset of the business. As soon as the business commences on the first day of the new period, the customers start once again to purchase the goods and the revenue activities of selling goods and replacing them with new stock begins again, for a further trading period.

The process of valuing stock is one, in which adjustments have to be taken into account at the end of the financial year. These are dealt with more fully in this unit.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the methods of valuing stock
- compute the value of stock at the end of the accounting year using variation methods.

3.0 MAIN CONTENT

3.1 Valuation of Stock

The method used in valuing the close-of-period stock that is brought into the Trading Account is extremely important because of the effect it has on the gross profit. An over valuation has the effect of increasing the gross profit and thereby creating a distorted image of the financial position of the business. Under-valuation has the reverse effect of reducing the gross profit margin.

The question then is: What price should be placed on the unsold goods at the close of the period?

The first logical answer that comes to mind is to value the unsold goods at what the businessman paid for their purchase (i.e. at cost). This means that if 15 articles were unsold at the end of the season and the articles cost N3 each, the value of the unsold stock is (15 x N3) = N45.00. For this method to be useful, the unsold stock must be physically counted and compared with the figures on the stock card. This is very important because the stock card may show 15 articles as unsold when in fact only 13 are left in the warehouse. This later figure is the one that goes into the Trading Account so that the stock will be (13 x N3) = N39.00 and not N45.

Another method of valuing stock is to think of the price the stock would fetch on the last day of the period in the ordinary course of business (i.e. the market value). If this price is considered less than the cost prices, it should be value of stock for the purpose of the Trading Account.

If using the previous example, the 15 articles can fetch N2.50 each, the stock value should be N37.50. If, on the other hand, the articles can fetch N3.25 each, stock should be valued at cost, i.e. N3.00 each.

The principle established by this is that valuation should be based on lower of ''cost' or ''market value'.

The estimation of the possible market value is definitely not the responsibility of a clerk in the office. The proprietor of the business must decide what price he thinks the remaining goods can realize if sold on the last day of the period.

A third method of valuing stock is to think of the price, which the proprietor will pay if he were to buy similar goods to replace the unsold ones. This is called the 'replacement price' If this price is lower than both the cost price and the 'market value', then stock should be valued at it.

Illustration 1

No. of Articles	Cost Price	Market Value	Replacement Price	Correct Valuation (i.e. the lowest of the values)
	N	N	N	N
20	40	38	41	38
40	80	83	81	80
25	79	75	82	75
50	120	119	128	119
160	2,080	2,200	2,000	2,000
200	6,000	6,050	6,500	6,000

What is being advised in the final analysis is that stock should be valued at a price which reflects prudence and helps in making the accounts give a true and fair view of the trading results of the period under review.

In a fluctuating market, prices vary constantly where there is an inflationary trend, prices tend to rise. Under such circumstances, price paid for the same items vary several times during the trading period. Faced with this difficulty of changing prices, the trader would be in difficulty on how to value his closing stock, since it will not be possible to identify prices paid for individual items, all of which look alike.

Therefore, the cost to be placed on such stock can be any of the prices paid during the year. There are three main methods of valuing closing stock in these circumstances. These are:

1) First In, First Out Method (FIFO)
2) Last In, Fist Out Method (LIFO)
3) Average Stock Method

1) First In First Out Method (FIFO)

This method implies that earlier goods purchased are the first to be sold. Using this method, the closing stock represents the most recent purchases, and the cost price would be related to current values. This method is most factual, and is used by many businesses. It is most suitable in cases of perishable goods.

Illustration 2

A. Dapo, who makes up his account on 31m December, made purchases as follows during December.

i.	10th December	700 items at N1.00k each
ii.	21st December	200 items at N1.25k each
iii.	38th December	200 items at N2.00k each

On 31st December, his closing stock was 300. Show the valuation to be included in his account under the above method.

Computation of Closing Stock under FIFO

	Stock	U/Price	Value
		N	N
Purchases on 28th Dec. i.e.	200	2.00	400.00
Purchases on 21st Dec. i.e.	100	1.25	125.00
	300	1.75	525.00

Using this method, the purchases of 10th December, i.e. 700 items and 100 items of those purchased 21st December had been sold off (i.e. 800 items).

2. Last In Fist Out Method (LIFO)

This method assumes that the latest items purchased are the first to be sold. This method is used by those who advocate the principle that cost should relate as closely as possible to current price levels. Therefore, cost of sales should be at current prices.

Computation of Closing Stock under FIFO (Using the above illustration)

Using this method, the purchases made on 28th and 21st December of 200 items each have been sold off Also, 400 of the items purchased on 10th December have also been sold, making a total of 800 items sold. Therefore, the balance of 300 items unsold relate entirely to the purchases of 10th December at N1.00 each. Valuation of closing stock i.e. 300 @ N1.00 = N300.00. Computation under (1) and (2) above have assumed that items were sold after the last purchase.

Average Stock Method

Under this method, upon the purchase of new items, a new value is computed by adding the total items purchased to the total of old stock with their monetary values. The resultant quantity is used to divide the resultant value to obtain the new unit price. The advantage of this method is that the valuation lies somewhere between two extremes of FIFO and LIFO, and is more realistic. However, complicated computations (involving fractions) are involved in using this method. Before computing under this method, it is necessary to state the sales made with dates. Items sold would be deducted to arrive at a balance to which purchases would be added.

Assuming the following sales:

12th December	200
23rd December	300
29th December	300

Date	Narration	Quantity	Unit Price	Value
			₦	₦
10th December	Purchases	700	1.00	700
12th December	Sales Cost	200	1.00	200
12th December	Balance	500	1.00	500
21st December	Purchases	200	1.25	250
	(i)	700	1.07	750
23rd December	Sales (Cost)	300	1.07	321
		400	1.07	429
28th December	Purchases	200	2.00	400
	(ii)	600	1.38	829
29th December	Sales (Cost)	300	1.38	414
	Balance	300	1.38	₦415

Note that (i) and (ii) above give new valuation of N1.07 and N1.38 respectively arrived on the purchase of new items on 21st and 28th December, which represents "new cost' of sales on those respective days. The realistic value of closing stock under this method is N415, and lies between FIFO and LIFO methods.

The various computations are as follows:

1)	FIFO Method	N525
2)	LIFO Method	N300
3)	Average Stock Method	N415

The highest valuation is obtained by FIFO Method while the lowest is obtained by the LIFO Method.

SELF-ASSESSMENT EXERCISE

1) On what basis is stock valued at the end of the financial year?
2) Daniel Shoes had on January 1st 1999, a stock of 4,000 pairs of shoes valued at cost N2 each. During January, he sold 1,800 pairs

and bought 2,500 pairs at N2.30 each. In February, he brought a further N2,500 at N2.20 each and sold 3,000 pairs. At the end of February, he still has 100 pairs of the January 1st stock unsold and the shoes bought in February have not yet been offered to his customers. Calculate the value of his stock if the current selling price of these shoes is N3.25 per pair on February 28th

3) What is the usual basis for stock valuation of the end of the financial year?

4.0 CONCLUSION

The situation of each type of stock unit can be likened to reservoirs in which the opening account is mingled with the year's purchases. The stock remaining at the end of the year cannot, in theory, be allocated to a particular batch. Therefore, the cost to be placed on this stock can be any of the prices paid during the year.

5.0 SUMMARY

There are various methods of valuing stock. The most popularly used are FIFO (First In First Out). Under this method, it is assumed that the goods remaining in our store represent those goods that were lately bought. LIFO (Last In First Out), Under this method, it is assumed that the goods in our store represent those of earlier purchases and Average Stock Method were it is assumed that the goods in our store represent goods from all our purchases at different prices thus, the price of all our purchases is computed and an average is taken.

6.0 TUTOR-MARKED ASSIGNMENT

A trader had in stock on May 1st 8,000 articles at N0.15 each. During May, he purchased a further 16,000 costing N0.16 each, but was given an allowance of N0.05 each on 2,000 of these, as they arrived in a damp condition. His sales during the month were 1,400 articles at N0.25 each. Gods are disposed of under the 'first in first out' rule. The current replacement price of similar articles was N0. 18 on May 31st. In view of this, he intends to sell in future at N0.26 each but will dispose of the rest of the damaged items at only N0.10 since they are the more seriously damaged of the batch. Show the Trading Account of the trader for the month ended May 31st.

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting*.

UNIT 5 ADJUSTMENTS IN FINAL ACCOUNT

CONTENTS

1.0 INTRODUCTION

It was mentioned in the earlier Unit that the only way a business can ascertain its profit and loss during a given period is to prepare final accounts. These take into account the goods that were purchased and the goods sold, and the income that came in and the expenses that went out during the period. The relationship between income, expenses and time is very important. If income was due in a particular period but payment was not received, the accounts of that period would not reflect the true financial position unless the accrued income was taken into account. The same thing applies to expenses. In this unit, we are going to examine what are called 'adjustments'.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the Meaning of Adjustments in Final Accounts
- give the full list of adjustment items
- compute relevant adjustment accounts.

3.0 MAIN CONTENT

3.1 Adjustments in Final Accounts

There are two guiding principles in the preparation of Final Accounts.

These are:

1) Every Trading Account and every Profit and Loss Account must be prepared accurately, so that the correct profit for the period is obtained. This can only be achieved if the accounts carry every kobo of the losses for the year, and include every kobo of the profits earned.
2) Every Balance Sheet must give a 'true and fair view' of the affairs of the business, showing the assets and the liabilities at their 'true' values.

In order to achieve these two aims, the accountant must take into account many matters, which require adjustment. For example the Wages Account may include some wages given in advance for next year to an employee who has requested an advance of salary to help him meet some domestic difficulty. This amount must be removed from the wages bill to be charged to the Trading Account; if it is not removed the Trading Account for this year will be carrying next year's losses. Similarly, a commission earned for selling a piece of property for a client may not have been paid yet although it is definitely due from the customer. If it is omitted from the Profit and Loss Account, this year's profits will be understated and next year's profit will be exaggerated. A full list of adjustments includes:

1) Payments in advance by the firm
2) Payments in advance to the firm
3) Payments accrued due by the firm
4) Payments accrued due to the firm
5) Bad debts and provisions for bad debts
6) Provisions for discounts
7) Closing stock adjustments
8) Depreciation of assets
9) Appreciation of assets
10) Amortization of leases
11) Depreciation of goodwill

3.1.1 Payments in Advance by the Firm

Certain payments are always made in advance. This includes rents, licensing, trade subscriptions and insurance. Where the period covered by the payment does not coincide with the trading year the unexpired portion of such payments must be carried forward to the following year so that the debit to the Profit and Loss Account would represent the amount that relates to the accounting period.

The best example is insurance payments. For, until the first premium is paid, the Insurance Company will not offer any cover. It follows that whenever we make out the Final Accounts of the business there is usually some balance of insurance cover due which has been paid for already but the protection afforded will carry over into the next year. Consider the Insurance Account shown below.

Insurance Account **L015**

1988		**N**
Jan 1	Motor Vehicle A (Bank A/C)	175.50
April 1	Motor Vehicle B (Bank A/C)	66.00
June 30	Motor Vehicle C (Bank A/C)	156.00
Sept. 30	Fire Insurance (Bank A/C)	25.00

Fig 1:

Clearly the premium paid on January lst has given cover for a whole year by December 30 and its protection has been fully enjoyed. The whole of this **N175.50** is a loss chargeable to this year's Profit and Loss Account. The other items are not fully used. One-quarter of the April P^{t} payment is still to be enjoyed and it will give protection until March 31St next year. Half of the June payment and three quarter of September payment similarly represents unexpired benefits to be enjoyed in the coming year. It follows that the true charge to the Profit and Loss Account for insurance this year is as follows:

		N
a)	The whole of the January payment	175.00
b)	Three-quarters of the April payment	49.50
c)	Half of the June payment	78.00
d)	One-quarter of the September payment	6.25
	Charge to Profit and Loss Account	**309.25**

The transfer of this charge to Profit and Loss Account is shown in the Journal entry below:

The Correct Charge for Insurance for the Year **J20**

1988			N	N
Dec 31	Profit and Loss Account Dr	L097	309.25	
	Insurance Account	L015		309.25
	Being transfer of correction portion of insurance paid to Profit and Loss account			

Fig 2:

Insurance Account

1998		₦	1998		₦
Jan 1	Motor Vehicle A (Bank Account)	175.50	Dec 31	Transfer to Profit and Loss Account J20	309.25
April 1	Motor Vehicle B (Bank Account)	66.00	Dec 31	Balance c/d	113.25
June 30	Motor Vehicle C (Bank Account)	156.00			
Sept 30	Fire Insurance (Bank Account)	25.00			
		₦422.50			₦422.50
Dec 31	Balance b/d	113.25			

Fig 3: A Nominal Account that has temporarily become an Asset Account

Balance Sheet as at 31st December, 1998

	N	
Current Asset		
Premium in Advance	113.25	

Fig. 4: The Temporary Asset on the Balance Sheet

Note: All payments in advance or purchase of such things, as postage stamps, advertising, brochures and stationery in advance should be carried forward to the next year.

3.1.2 Payments in Advance to the Firm

If payments can be made in advance by firms then clearly some other firms will be receiving them in advance. The insurance premium referred to in the last section will be part of mass of premium revenue received by the Insurance Companies, much of which represents a liability for cover in the New Year. Where an insurance company still owes clients protection in the early months of the year ahead, it will not be able to treat these sums as revenue income for the year that has passed. It will instead carry them forward as a liability for the coming year.

Premium Received Account

Date	Particulars	₦	Date	Particulars	₦
1988			**1988**		
Dec 31	Profit & Loss A/C	850,000	Jan-Dec	Sundry Cash Items	
Dec 31	Balance c/d	575,254			1,375,254
		₦1,375,254			₦1,375,254
			1999 Jan 1	Balance c/d	525,254

Fig. 5: Payments in Advance to the Firm

Balance Sheet as at 31st December, 1998

		N
	Current Liability Premium in Advance	525,254

Fig. 6: A Temporary Liability on the Balance Sheet

3.1.3 Payments Accrued Due by the Firm

At the end of a financial year there are invariably some payments due, which will not be paid until the next financial period. These are often called `acruals' that is, debts which have been collected and are due for payment, for example arrears of rent, electricity, water and telephone bills due but not yet paid. The adjustment would be effected by debiting the Appropriated Account and crediting the Sundry Creditors Account. For example P.S.G. Ltd, which usually closes its accounts on 31S` March each year, discovers that it has not paid electricity bills totaling i^{3}4246.00 due on 3l st March. In order to reflect this in the accounts, the following adjustments would be made:

a) Debit the Electricity Account N246.00 and
b) Credit the Sundry Creditors Account 246.00

Thus, all the cost of electricity used during the accounting period would be charged to the account for the period. Alternatively, the amount outstanding may be carried down in the Nominal Account as follows:

Illustration 3.1

Electricity Account

Date	Particulars	Amount	Date	Particulars	Amount
		N			N
Mar 31	Cash	1,300.00	March 31	Profit & Loss A/C	1,546.00
	Balance c/d	246.00			
		1,546.00			1,546.00
			April 1		246.00

When the outstanding bill is paid during the following accounting year, it will be debited to the Electricity Account and will be offset by the balance carried down. So that the account of each year bear the expenses incurred during that year. The balance on the electricity account is a liability and would appear as such in the Balance Sheet.

3.1.4 Payments Accrued Due to the Firm

Just as debts can collect which are due for payment by the firm, it is also possible for firms to collect due to the firm. Income due but not yet received or accrued income includes, rent, fees, interests, dividends due, etc. These payments although not yet collected should be credited to the appropriate accounts in order to reflect the correct amount due as income, etc, for the accounting period.

Illustration 4.1

On 31 March, the books of Shallom Properties Ltd showed that rental income due for March from sundry tenants totaling N5,000.00 had not been received. The necessary adjustment would be as follows:

a) Debit the Sundry Tenants Account N5,000.00 and
b) Credit the Rental Income due but not yet paid N5,000.00

The Rental Income Account would be as follows:

Rental Income Account

Date	Particulars	Amount	Date	Particulars	Amount
		N			N
Mar 31	Profit and Loss A/C	105,000.00	Mar 31	Receipts	100,000.00
				Tenants	5,000.00
		N105,000.00			N105,000.0
April 1	Balance b/d	5,000.00			

3.1.5 Bad Debts and Provisions for Bad Debts

It is an established accounting principle that whilst losses should be anticipated, gains or profits should not. At the close of any accounting period, therefore, all expected, anticipated or known losses should be provided for in the accounts. Trading transactions involve the use of credit facilities. When debtors are unable to pay their debts, the debts become bad and are of no value to the creditors. As bad debts occur in the ordinary course of carrying on the business, the loss must be treated as an expense incurred in running the business.

The procedure is to debit the Bad Debts Account with the amount of the bad debts and credit the accounts of the debtors, thus reducing the amount of debtors at the date of Balance Sheet.

Illustration 5.1

Total debtors of Ben Ltd. as at 31 March amounts to N200, 000.00 and debts known to be bad were N2, 000.00. The adjustment should be made as follows:

a) Debit Bad Debts Account N2, 000.00 and
b) Credit the Sundry Debtors Account N2, 000.00

Bad Debts Account

Date	Particulars	Amount	Date	Particulars	Amount
		₦			₦
Mar 31	Adewale	2,000.00	Mar 31	Profit and Loss A/C	2,000.00
		₦2,000.00			₦2,000.00

Adewale's Account

Date	Particulars	Amount	Date	Particulars	Amount
		₦			₦
Mar 31	Balance b/d	2,000.00	Mar 31	Bad Debts A/C	2,000.00
		₦2,000.00			₦2,000.00

This accounting process is known as Bad Debts written off However, in a situation where bad debts cannot be written off at once, the accountant shall provide for these bad debts by setting aside an agreed percentage of the total debtor's figure in a special account coiled The Provision for Bad Debts Account.

This account represents some of the owner's profits tucked awn in the

Provision for Bad Debts Account as profit for the year.
The journal entry and accounts are shown in **Illustration 5.2.**

Journal

Date	Particulars	Folio	Amount ₦	Date	Particulars	Folio	Amount ₦
Mar 31	Profit & Loss A/C		1,000.00		Provision for Bad Debts A/C (Being profits set aside equal to 5 per cent of the debtor's figure at this date		1,000.00
			₦1,000.00				₦1,000.00

Illustration 5.2 providing for future bad debts.

Profit and Loss Account **L70**

Date	Particulars	Folio	Amount ₦	Date	Particulars	Folio	Amount ₦
Mar 31	Provision for Bad Debts	J1	1,000.00		Bal. C/d		1,000.00
			₦1,000.00				₦1,000.00

Provision for Bad Debts Account **L69**

Date	Particulars	Folio	Amount ₦	Date	Particulars	Folio	Amount ₦
					Provision for Bad Debts A/C		1,000.00
							₦1,000.00

3.1.6 Provision for Discounts

A cash discount is an allowance given to a customer for the settlement of debt within the agreed credit terms. As this represents an expense of carrying on a business, it should be provided in the cash discounts if profits are not to be overstated. Cash discounts are generally allowed / received on a percentage basis of debts outstanding. Debts known to be bad and doubtful should be excused in calculating provision for cash discounts.

For this purpose, a Discount Account should be opened in the ledger, which will be debited with discounts allowed and credited with discounts received. The balance of this account, which will be transferred to the Profit and Loss Account.

Illustration 6.1

For Kupson Ltd., owed to debtors at March 31 amount to N50,000.00 and total owed to creditors N35.000.00 A discount of 5% is provided on both debtors and creditors.

LEDGER

Dr Creditors Cr

Mar 31	Provision receivable	₦1,750.00			

Dr Debtors Cr

			Mar 31	Provision allowance	₦1,750.00

Dr Provision for Discount Allowance Account Cr

Mar 31	Debtors	₦2,500.00	Mar 31	Profit & Loss A/C	₦2,500.00

Dr Provision for Discount Receivable Account Cr

Mar 31	Profit & Loss A/C	₦1,750.00	Mar 31	Creditors	₦1,750.00

Dr Profit and Loss Account Cr

Mar 31	Provision allowance	₦1,750.00	Mar 31	Provision receivable	₦1,750.00

Balance Sheet

Entries to be made on liabilities side:

	N
Sundry Creditors	35,000.00
Less: Provision for Discount	1,750.00
	33,250.00

Entries to be made on assets side:

	N
Sundry Debtors	50,000.00
Less: Provision for Discount	2,500.00
	47,500.00

3.1.7 Closing Stock Adjustments

In real life we rarely sell everything that we purchase in the trading period. Instead we still have in stock at the end of the year (or whatever period for which we are trying to discover the profits) some of the goods purchased.

The issue of closing stock is of great importance in accounting since without proper and accurate counting of the remaining stock (stock-taking) at the end of the accounting period we cannot arrive at a perfect figure for the cost of sales hence, the proper figure for gross profit will not be known.

To discover the gross profits of the business, we must take away from the net purchases figure any closing stock, which we have not yet sold, and this stock will become the opening stock for the new period when the time comes to decide the profits of that period.

SELF-ASSESSMENT EXERCISE

1. The Trial Balance extracted from the books of Laide & Sons Ltd. at December 31st 19 ... includes the following debit balances:

Rent paid	N 750.00
Rates	N 500.00
Wages	N36, 000.00
Interest on loan	N 100.00
Insurance	N 120.00

The following adjustments have to be made before the preparation of the Final Accounts.

Rent outstanding	N250.00
Rates paid in advance	N125.00
Wages accrued due	N500.00
(Interest on loan unpaid)	N100.00
Insurance paid in advance	N 30.00

Show the ledger accounts from which the Trial Balance was prepared, give the closing entries and bring down all balances.

2. At December 31st 1989, a firm's debtors totaled N2, 670 and its provision for Bad Debts Account from January 1st 1989 amounted to P4140. It was decided to write off as irrecoverable debts of N130 and to carry forward a provision of 5 per cent of the debtors.

   Prepare the Provision for Bad and Doubtful Debts Account, the entries in the Profit and Loss Account and the entry for debtors on the Balance Sheet at December 31st 1989.

4.0 CONCLUSION

Adjustments in Final Accounts are made in order to reveal the true and fair position of the business in the Balance Sheet. This means an extra account inserted in the ledger of section of accounts to make it self-balancing.

Items are posted to the Individual Ledger Accounts in the usual way but when the postings are complete, the total is posted to the opposite side of the adjustment account.

5.0 SUMMARY

There are various adjustments items in accounting. Items like payments and receipt, creditors and debtors discount provisions, bad debts written off and provisions and stock left at the end of the trading period have to be properly accounted for before the Final Accounts can be made.

6.0 TUTOR-MARKED ASSIGNMENT

Here is the Trial Balance of Sarah Adeosun on December 31st 1981. You are required to prepare her Trading Account and Profit and Loss Account for the year, and her Balance Sheet as at the date, bearing in mind the adjustments given below the Trial Balance.

Trial Balance as at December 31st 1981

	Dr ₦	Cr ₦
Cash in Hand	27	
Cash at Bank	2,465	
Purchases and Sales	8,248	13,612
Returns In and Out	112	48
Stock (as at January 1st 1981)	780	
Wages (Trading Account)	450	
Salaries	580	
Lights and Heat	420	
Commission Received		650
Rent Received		100
Telephone Expenses	120	
Insurance	250	
Motor Vehicle	250	
Land and Buildings	4,000	
Plant and Machinery	1,400	
Loan from Cooperative Bank		2,000
Interest Paid	150	
Capital		2,812
Debtors and Creditors	3,250	4,280
Drawings	1,000	
	23,502	23,502

Notes:

1) At December 31 1981 stock was valued at N1,250.
2) Debtors include a debt of N150 which is regarded as definitely bad.
3) It is decided to provide for future bad debts at 10 per cent of the remaining debtors, and then to provide for discount at 5 per cent on the outstanding balance.

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting.*

MODULE 6

UNIT 1 PROVISIONS AND RESERVES

CONTENTS

1.0 INTRODUCTION

There are many risks and uncertainties in business and in order to save the business from such happenings and events, it is necessary to make provisions and reserves in every business. Provisions and Reserves are used in different senses in accounting terminology.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- know the meaning of Reserve and Provision
- classification of Reserve:

i. Capital Reserve
ii. Revenue Reserve

- distinction between Provisions and Reserve
- explain Secret Reserve.

3.0 MAIN CONTENT

3.1 Provisions and Reserves

3.2 Meaning

3.2.1 Provision

The term 'Provision' means any amount written off or retained by way of promising depreciation, renewals or diminution in the value of assets or retained by way of providing for any known liability the amount of which may not be determined with substantial accuracy. If the amount of such liability can be ascertained it will be a liability and not a provision. Provisions for depreciation for repairs and renewals, provision for contingencies are some examples of provisions. It is a charge to Profit and Loss Account.

3.2.2 Reserve

Any sum which is appropriated out of Profit and Loss Appropriation Account and is not meant to cover up any liability, contingency, commitment, or reduction in the value of an asset is a reserve. It is provided for meeting prospective losses or liabilities, creation of reserves increase the working capital in the business and strengthen its financial position. Sometimes the amount is not kept in the business as additional working capital but is invested in the purchase of outside securities, then it is called reserve fund and not a reserve. Reserve may be (i) Capital Reserve and (ii) Revenue Reserve.

i. Capital Reserve

Any reserve which is created out of capital profits and is not readily available for distribution as dividend among the shareholders is called Capital Reserve. Profits prior to incorporation, premium on the issue of shares or debentures, profit on the reissue of shares, profit on redemption of debentures, profit on the sale of undertaking or a part of it and profit of abnormal nature which is not meant for distribution as dividend to shareholders are examples of such reserves.

ii. Revenue Reserve

Any Reserve which is available for distribution as dividend to the shareholders is called revenue reserve. General Reserve, dividend equalization reserve, staff welfare reserve, investment fluctuation reserve and contingency reserve are some of examples of such reserves.

3.3 Distinction between Provision and Reserve

From the meaning of Provision and Reserve stated above, you can easily distinguish between them.

The following are the main points of distinction between a provision and a reserve.

1. Provision is a charge to profit and loss account whereas reserve is an appropriation of profit. Thus provision must be charged to Profit and Loss Account before calculating the Net Profit or Net Loss, but Reserve can be made only when there is profit.
2. Provision is made because of legal necessity but creating a reserve is a matter of financial prudence and to save the business from prospective losses and liabilities.

3.4 Types of Reserves

3.4.1 Secret Reserves

A Secret Reserve is a reserve the existence and or the amount of which cannot be disclosed in the Balance Sheet. Secret Reserves are created in those concerns where public confidence is required for its working like banking companies, insurance companies and electricity companies. Such reserves are created by showing the assets at a lower figure and liabilities at higher figure.

Some of the ways for creating secret reserves are given as under:

i) by charging excessive depreciation
ii) by undervaluing stock in trade and goodwill.
iii) by creating unnecessary provisions for bad debts and other contingencies
iv) by charging capital expenditure to profit and loss account
v) by suppressing the sales
vi) by showing a contingent liability as a real liability
vii) showing asset as a contingent asset.

<u>Advantages of Secret Reserve:</u>

The following are main advantages of Secret Reserve:

1. It increases the working capital of the concern and also

strengthens its financial position without disclosing this fact to the shareholders.

2. It discourages competition by not disclosing the larger profits made by a concern in a particular line of business and industry.
3. It enables the directors to tide over unfavourable times. As and when there is less profit, the directors can maintain the rate of dividend by utilizing the secret reserve and without disclosing this fact to the shareholders.

Disadvantages of Secret Reserves:

The following are the main objections raised against the secret reserves:

1. The balance sheet will not disclose a true and fair view of the state of affairs of the business.
2. Sometimes the directors make use of such reserves for their personal benefits.
3. The company worse position can be concealed by the directors for sometime by making the use of secret reserve.
4. When secret reserves are created, the assets are shown at less value in the balance sheet. The concern will not get full claim for loss by fire of the assets as and when such assets are destroyed by fire.

3.4.2 General and Specific Reserves

1. General reserves are those reserves which are not created for any specific purpose and are available for any future contingency or expansion of the business. These are created to provide additional working capital and strengthening the financial position of the concern.
2. Specific Reserves are those reserves which are created for a specific purpose and can be utilized only for that purpose. Dividend equalization reserve and debenture redemption reserve are good examples of such reserves.

3.5 Sinking Funds

Sinking Funds are created to have ready money after a particular period either for the replacement of an asset or for the repayment of a liability. Every year some amount is charged or appropriated from the profit and loss account and is invested in outside securities with the idea that at the end of the stipulated period money will be equal to the amount we need.

Distinction between a Sinking Fund to replace a wasting asset and sinking fund to repay a liability:

The following are the main differences:

1. The annual installment in case of sinking find to replace a wasting asset is really depreciation and is a charge against profit and loss account while in case of sinking fund to repay a liability, it is an appropriation of profit.
2. At the end of the working life when the asset is to be replaced, sinking fund is utilized for writing off old asset account but in other case it is closed by transferring the balance to general reserve as the annual charge was on the profit and loss appropriation.

3.6 Nature of Reserves

Reserves are shown on the liabilities side of the balance sheet and by virtue of this, some persons understand reserve as a liability but this is wrong. You should note that Reserve is not a liability in the real sense. It represents accumulated divisible profit which belongs to the shareholders just like capital and not have been distributed as dividend as yet, that is why it is shown on the liabilities side of the balance sheet. Moreover, Reserve represents a portion of the asset which is free to be utilized by the business as it likes i.e. assets equal to reserves are not meant to meet any liability of the business.

SELF-ASSESSMENT EXERCISE

1. Distinguish between

a) Provision and Reserve
b) Capital Reserves and Revenue Reserve
c) General and Specific Reserve.

2i) What is a Secret Reserve?
ii) What objectives are raised against the creation of such reserves?

4.0 CONCLUSION

Reserves are part of the profit of any business set aside to meet unforeseen contingencies. In cooperative, the law made this mandatory that at least 25% of the net surplus be earmarked for this purpose as previously mentioned.

While Provision is also part of the profit withheld for a particular purpose. You should note that provision is created before profit or surplus is realized. It is charged to Profit and Loss Account or Income and Expenditure Account. Whereas Reserve is created if there is profit. No profit, no reserve.

5.0 SUMMARY

In this unit, we explained the meaning of Provision and Reserve. Provision means any amount written off by way of providing for depreciation or diminution in the value of assets. While Reserve means any amount which is appropriated out of Profit and Loss Appropriation Account. No profit, no reserve. Note that reserve is not really a liability, but it represents accumulated profit which belongs to the shareholders just like the capital.

6.0 TUTOR-MARKED ASSIGNMENT

Is reserve fund a liability in the real sense of the term? If not, why is it shown on the liabilities side of the Balance Sheet?

7.0 REFERENCES/FURTHER READING

Frankwood/J.O. Omuya: *Book-Keeping and Accounting*.

St. Jain and Narang, K.L.: *Advanced Accountancy*.

UNIT 2 DISTINCTION BETWEEN CAPITAL AND REVENUE

CONTENTS

1.0 INTRODUCTION

You know that a firm prepares Profit and Loss Account for ascertaining the net result of business operations and the balance sheet for determining the financial position of the business. These are prepared with the help of trial bah¯ which shows the final position of all ledger accounts. All items appearing in the Trial Balance are transferred either to the profit and loss account or to the Balance Sheet. As per rules, the items of revenue nature are taken to the profit and loss account and the items of capital nature are shown in the Balance Sheet. In other words whether an item appearing in the Trial Balance is to be taken to the Profit and Loss Account or the Balance Sheet depends upon the capital and revenue nature of the item. If any item is wrongly classified i.e., if an item of revenue nature is treated as a capital item or vice verse, the Profit and Loss Account will not reveal the correct amount of profit and the Balance Sheet will not reflect the true and fair view of the affairs of the business. It is therefore necessary to determine correctly whether an item is of capital nature or revenue nature and record it in the books accordingly. There are certain rules governing the allocation of expenditures and receipts between capital and revenue which should be clearly understood. In this unit you will learn about all these.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the importance of distinction between capital and revenue
- identify correctly whether an expenditure or receipt is of a capital or revenue nature.

3.0 MAIN CONTENT

3.1 Capital and Revenue Expenditures

You incure expenditure on various items every day. You buy food items, stationery, cosmetics, utensils, furniture, etc. Some of the items are consumables and some are durables. The benefit of expenditure on consumable like stationery, cosmetics, etc is derived over short period. But in case of durables like furniture, utensils etc the benefit spread over a number of years. Same is true of business also. In business you incure expenditure on two types of items: (i) routine items like stationery, and (ii) fixed assets like machinery, building, furniture, etc. whose benefit is available over a number of years. In accounting terminology the first category of expenditure is called revenue expenditure and the second one is called capital expenditure. Let us now study the exact nature of capital and revenue expenditures.

3.2 Capital Expenditure

As stated above, when the benefit of an expenditure is not exhausted in the year in which it is incurred but is available over a number of years it is considered as capital expenditure. The following expenditure are usually treated as capital expenditure.

- Any expenditure which results in the acquisition of fixed assets such as land, buildings, plant and machinery, furniture and fixtures, office equipment, copyright, etc, you should note that such capital expenditure include not only purchase price of fixed assets but also the expenses incurred in connection with their acquisition. Thus, the brokerage or commission paid in connection with the acquisition of an asset the freight and cartage paid for transportation of machinery, the expenses incurred on its installation, the legal fees and registration charges incurred in connection with purchase of land and building are also treated as capital expenditure.

- Any expenditure incurred on a fixed asset which results in (a) its expansion (b) substantial increase in its life, or (c) improvement in its revenue earning capacity. Improvement in the revenue earning capacity can be in the form of (i) increased production capacity, (ii) reduced cost of production, or (iii) increase in sales of the firm. Thus, cost of making additions to building and the amount spent on renovation of the old machinery are also regarded as capital expenditures. If you have a second hand machinery and incur heavy expenditure on reconditioning it, such expenditure is also to be treated as capital expenditure. Similarly, expenditure on structural improvement or alterations to existing fixed assets whereby their revenue earning capacity is increased, is also treated as capital expenditure.

- Expenditure incurred, during the early years, on development of mines and land for plantations till they become operational.

- Costs of experiments which ultimately result in the acquisition of a patent. The cost of experiments which are not successful is not to be treated as capital expenditure. It is treated as a deferred revenue expenditure which is written off within two to three years.

- Legal charges incurred in connection with acquiring or defending suits for protecting fixed assets, rights, etc.

3.3 Revenue Expenditure

When the benefit of an expenditure is not likely to be available for more than one year, it is treated as revenue expenditure. So all expenses which are incurred during the regular course of business are regarded as revenue expenditures. The example of such expenses are:

- Expenses incurred in day-to-day conduct of the business such as wages, salaries, rent, postage, stationery, insurance, electricity, etc.

- Expenditure incurred for buying goods for resale or raw materials for manufacturing.

- Expenditure incurred for maintaining fixed assets such as repairs and renewals of building, machinery, etc.

- Depreciation on fixed assets. This can also be termed as revenue loss.

- Interest on loan borrowed for running the business. You should know that any interest on loan paid during the initial period before production commences, is not treated as revenue expenditure. It is treated as capital expenditure.

- Legal charges incurred during the regular course of business such as legal expenses incurred on collection from debtors, legal charges incurred on defending a suit for damages, etc.

3.4 Deferred Revenue Expenditure

Sometimes, certain expenditure which is normally treated as revenue may be unusually heavy and its benefit is likely to be available for more than one year. In such a situation, it is considered appropriate to spread the cost of the expenditure over a number of accounting years. Hence, it is capitalized and only a portion of the total amount spent is charged to Profit and Loss Account of the current year. The balance is shown as an asset which will be written off during the subsequent accounting years. Such expenditure is called a Deferred Revenue Expenditure because its charge to Profit and Loss Account has been deferred to future years. Some example of such expenditure are:

- Expenditure incurred on advertising campaign to introduce a new product in the market.
- Expenditure incurred on formation of a new company (preliminary expenses).
- Brokerage charges, underwriting commission paid and other expenses incurred in connection with the issue of shares and debentures.
- Cost of shifting the plant and machinery to a new site which may involve dismantling, removing and re-erection of the plant and machinery.

Let us take the case of expenditure on advertising campaign. It is not a routine advertisement and the amount involved is unusually heavy. Its benefit will not completely exhaust in one accounting year but will continue over two to three years. Hence, it is not proper to charge such expenditure to the Profit and Loss Account of one year. It is better to distribute it carefully over three years. So, in the first year we may charge one-third of the amount spent to the Profit and Loss Account and show the balance in the balance sheet as an asset. In the second year again we may charge a similar amount to the Profit and Loss Account and show the balance as an asset. In the third year we may charge this balance to the Profit and Loss Account. Every expenditure which is regarded as deferred revenue is treated in this way in the final accounts.

3.5 Capital and Revenue Receipts

Receipts refer to amounts received by a business i.e. cash inflows. Receipts may be classified as Capital Receipts and Revenue Receipts. It is necessary to note this distinction clearly because only the revenue receipts are taken to the Profit and Loss Account and not the capital receipts.

- **Capital Receipts**

Capital Receipts are the amounts received in the form of (a) additional capital introduced in the business. (b) Loans received, and (c) sales proceeds of fixed assets. You are aware that a loan taken by the business is repayable sooner or later. Similarly, additional capital received represents an increase in the proprietor's claim over the business assets. Thus these two items represent increase in liabilities of the business and obviously are not incomes or revenues. These are capital receipts and should be treated as such. The sale proceeds of a fixed asset are also treated as a capital receipt because the amount received is not revenue earned in the normal course of business. The capital receipts increase the liabilities or reduce the assets. They do not affect the profit or loss.

- **Revenue Receipts**

Revenue receipts are the amount received in the normal and regular course of business. They take the form of (a) sale proceeds of goods and (b) incomes such as interest earned, commission earned, rent received, etc, these receipts are on account of goods sold or some services rendered by the business and as such they are not repayable. All revenue receipts are treated as incomes and shown on the credit side of the Profit and Loss Account.

SELF-ASSESSMENT EXERCISE

State whether the following statements are true or false

1. Every expenditure of large amount is capital expenditure.
2. An expenditure incurred on acquisition of a fixed asset is a capital expenditure.
3. Cartage paid on the new machine is a revenue expenditure.
4. Depreciation on fixed assets is a capital expenditure.
5. Cost of goods purchased for resale is a capital expenditure.
6. Heavy expenditure on advertising campaign is a deferred revenue expenditure.
7. Money received from the sale of goods is a capital receipt.
8. Expenditure is not the same thing as payment. 4.0 Conclusion
   It is important to distinguish between capital and revenue otherwise the ascertainment of profit and loss and the financial position of the business will be incorrect. There are certain rules which guide us to determine whether a particular expenditure or receipt is of a capital nature or of a revenue nature.

5.0 SUMMARY

Capital Expenditure consist of expenditure the benefit of which is not fully consumed in one period but spread over several periods, and Revenue expenditure consists of expenditure incurred in one period of account, the full benefit of which is consumed in that period. We also have Deferred Revenue Expenditure this is expenditure which would normally be treated as revenue expenditure which is not written off in one period. Exceptional expenditure on an advertising campaign might be treated in this way.

6.0 TUTOR-MARKED ASSIGNMENT

State whether the following items of expenditure would be treated as:

a) Capital expenditure
b) Revenue expenditure
c) Deferred revenue expenditure.

1. Carriage on goods purchased N25
2. N2, 000 spent on repairs of machinery.
3. N5, 000 spent on white washing.
4. N8, 000 paid for import duty and cartage on the purchase of machinery from West Germany.
5. N25, 000 spent on issue of equity shares.
6. N14, 000 spent on spreading new tiles on factory floors.
7. N4, 000 spent on dismantling, transportation and reinstalling plant and machinery to new site.
8. N60, 000 spent on construction of railway siding.
9. N20, 000 spent on some major alterations to a theatre which made it more comfortable and attractive.
10. A second hand machine was bought for N10, 000 and an amount of N6, 000 was spent on its overhauling.

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Account I.*

UNIT 3 INCOMPLETE RECORDS

CONTENTS

1.0 INTRODUCTION

The objectives of this unit is to consider the problem of preparing an Income Statement and Balance Sheet in circumstances when a business has not kept complete records leading to a Trial Balance, and what must be done to carry out the conversion to double entry.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the meaning of Incomplete Records
- prepare final accounts from an Incomplete Record.

3.0 MAIN CONTENT

3.1 Meaning of Incomplete Records

Any kind of books-keeping which falls short of double entry is "Incomplete" and wherever possible should be completed. Exercises on this theme are valuable in leading students to a clear apprehension of the double-entry principle.

3.2 Causes of Incomplete Records

A trader may perhaps keep a cash-book which he writes up but does not post to a ledger. His takings are partly in cash, but he does not pay the full amount of cash received into the bank, since he pays an assistant's wages, and draws his own living expenses, first of all. He too, as a shopkeeper, he takes goods out of stock for private use.

At some time in the year he may introduce further capital, or perhaps buy a motor van out of his own resources, for business use.
This state of affairs may persist until an assessment for Income Tax is made which he would like to dispute. He is then compelled to call upon the services of an accountant to help him to prepare proper accounts.

3.3 Stages of Completion of Records

The stages of this preparation of account are as follows:

- Prepare an opening statement of Affairs, showing the trader's assets and liabilities at the beginning of the period under review. This will be inform of a Balance Sheet, and it will now be picked up in the ledger through a journal entry, the cash balance being posted to the cash book, and the other items to such accounts as freehold shop, furniture and fittings, stock, debtors and creditors. The balancing figure is taken as capital and posted to that account.
- Prepare a Bank Reconciliation Statement covering the period since the date of the opening statement of affairs, to make sure that the cash book is correct.
- Analyse both sides of the cash book under suitable headings and post the totals of the analysis columns to Ledger Accounts.
- Be especially careful to post cash paid to creditors and cash received from debtors to their respective total accounts.
- Find out, by examining carefully the accounts, the amount of the Debtors and Creditors at the beginning and end of the
- period. This has been partly done already, for the opening statement of affairs. The absolute importance of the last two
- stages can be seen thus:

Total Debtors

	N		N
Opening balance b/f	250	Cash received	2,300
Sales Less Returns	2,425	Closing balance c/d	375
	2,675		**2,675**
Balance b/d	375		

Total Creditors

	N		N
Paid cash	1,970	Opening balance b/f	120
Closing balance c/d	180	Purchases Less Returns	2,030
	2,150		**2,150**
		Balance b/d	180

From your knowledge of control accounts you will remember that the entry for total sales journal is:

Debit Total Debtors
Credit Sales.

And that the entry for total purchases from the Bought Journal is

Debit Purchases
Credit Total Creditors

Because the records are incomplete, we have to work backwards, as it were. A Trading Account cannot be prepared until the amount of sales and purchases has been established.

- Find out by questioning the proprietor of the business

- How much cash he has kept back from the cash takings, and what it has been used for from the point of view of the business i.e
  Wages
  Business expenses
  Private drawings.

The double entry must now be completed:

Debit Wages
  " Expenses
  " Drawing
Credit Cash Sales

- How much he has drawn "in kind" from the business (at cost price). Again the double entry must be completed:

  Debit Drawings
  Credit Purchases

- If he has brought any further capital into the business other than in cash (which would have been seen in the cash book analysis):

  Debit Asset Account
  Credit Capital

- The amount of the opening and closing stocks. The opening stock was required for the opening statement of affairs, and the closing stock is required in order to make the appropriate adjustment. Note carefully that if the closing stock is understated by the proprietor it results in the profit for the year also being understated.

- See that all postings have been made and then extract and balance off the Trial Balance.

- Make all adjustments for accrued charges, closing stock and payments in advance.

- Prepare Trading Account, Profit and Loss Account, and Balance Sheet at the closing date.

In examination questions you will find that a certain amount of information is "given" such as opening statement of affairs. There is no need to do again what has already been done, but you will find that it is good policy to make out a working sheet for at least some ledger accounts and the copy up your answer rapidly but in good style.

3.4 Single Entry

It is sometimes the case that no records at all have been kept, or the information available is so fragmentary that completion of double entry over a period is virtually impossible. This result in what is termed "pure single entry" and the only thing to do is to prepare two statements of affairs in the form of a Balance Sheet, by comparison of which the state of the capital account at the beginning and the end of the period can be observed. The difference, if upward is assumed profit, and if downward, is assumed loss. The later result would not be accepted without careful enquiry, if all the outward signs of the business point to a far different conclusion.

The Statement of Affairs are often accompanied by a Statement of Profits, which is in the following form:

Statement of Profits

	N		N
Opening Capital	3,000	Drawings	400
Introduction of further		Balance c/d	3,800
Capital	1,000		
Provisions c/d	200		
	4,200		**4,200**
Balance b/d	3,800	Provision b/d	200
Net Profit	1,000	Balance, closing	
		Capital c/d	4,600
	4,800		**4,800**

In effect the statement of profits does nothing more than put the meager information in double-entry form.

SELF-ASSESSMENT EXERCISE

1. When answering a question on incomplete records, why is it desirable to begin with an opening statement of affairs.
2. What part does the Bank statement play in the process of completing records.
3. How do you estimate the sales and purchases? What kind of questions would you address to the proprietor?
4. What do you understand by "pure single entry?"

4.0 CONCLUSION

The objectives of this unit is to consider the problems of preparing an Income Statement and Balance Sheet in circumstances when a business has not kept complete records leading to Trial Balance, and what must be done to carry out the conversion to double entry.

5.0 SUMMARY

It is very essential for all the transactions of every business unit to be kept in proper records. This is commonly and traditionally presented in double entry. However, this is not always the case, especially in small business units that employ incompetent book-keepers to man the recording of the business activities. What is common as such is keeping the records by entering the transactions once only-single entry. As a result, some items of transactions may be missing thereby making the records incomplete. This therefore brings about incomplete records. This record have to be completed in stages before final accounts can be prepared.

6.0 TUTOR-MARKED ASSIGNMENT

J. Johnson is the proprietor of the "Wayside Restaurant", all his takings are in cash which he pays into his bank account after deducting (a) 412 per week for his drawings and (b) wages and expenses also met in cash out of takings, and for the financial year ended November 30 19x7 these were:

	N
Waitresses' and Staff Wages	1,925
Cleaners' Wages	350
Cash Purchases	389
Sundry expenses	51

A summary of the Bank Account for the year revealed the following:

	N		N
To Balance, Nov 30-19x6	1,260	By Rent	500
Paid in: Restaurant		Rates	450
Takings	25,240	Lighting and heating	220
Receipt from Premium Bond	1,000	Telephone	40
		Advertising	180
		New equipment	500
		Insurance	50
		Repairs	280
		Trade purchases	21,500
		Deposition private house	750
		Income Tax	250
		Hire of Juke Box	120
			24,840
		Balance, Nov 3019x7	2,660
	N27,500		**N27.500**

Additional Information:

Equipment at cost on November 30 19x6 was N400; depreciation of equipment is to be provided at one-tenth of cost.

	N		N
Trade creditors Nov 30	1,500	Nov 30 19x7	1,800
Unpaid electric bill Nov. 30 19x6	30	Nov. 30 19x7	40
Rates unexpired, Nov. 30 19x6	125	Nov. 30 19x7	150
Due to members of Xmas Club (including in takings)	-	Nov. 30 19x7	189
Stock of Provisions etc Nov. 30 19x6	450	Nov. 30 19x7	325

Johnson is to be charged **N** 104 for the year for rent, rates etc for rooms he occupies over the restaurant and **N** 3 per week is estimated as the value of meals etc supplied to him and his family.

Required:

Prepare from the above information J. Johnson's Trading and Profit and Loss Account for the year ended November 3, 19x7 and the Balance Sheet on the closing date.

7.0 REFERENCES/FURTHER READING

Frankwood: *Business Accounting 1.*

UNIT 4 LIQUIDATION/REALISATION ACCOUNTS

CONTENTS

1.0 INTRODUCTION

The procedure for liquidation of cooperative societies is prescribed by the cooperative societies law applicable to each State of Nigeria.

The Director by order in writing may cancel the registration of a cooperative society.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define liquidation
- explain the types of liquidation
- give the conditions or causes of liquidation
- explain the duties of liquidation
- explain the steps to be taken in preparing the liquidation accounts.

3.0 MAIN CONTENT

3.1 Liquidation/Realisation Accounts

3.2 Definition

The Advanced Learner's Dictionary defined liquidation as bringing a business to an end by dividing up its property to pay debts.
Therefore liquidation of a cooperative society is referred to as winding up of affairs of a registered society or dissolution of registered society at a particular date.

Liquidation of a cooperative society is the process of winding up a cooperative society thereby bringing to an end its cooperate life.

3.3 Types of Liquidation

3.3.1 Voluntary Liquidation

The winding up order is made by Director of cooperative societies on the application of members of the society. Procedure for making such application is prescribed by the law.

3.3.2 Compulsory Liquidation

Here the director of cooperative societies decides that the society must be wound up and consequently issues a winding up order on the society. Conditions for making such orders are also prescribed by the law.

3.4 Conditions for Liquidation

The following may be one of the conditions for liquidations:

1. The society has not commenced working.
2. The society has ceased working
3. The membership has fallen below the statutory minimum (i.e. 10).
4. Receipt of an application made by three fourth of the members of a registered society to the Director for the liquidation of their society.

3.5 Duties of the Liquidator

You should note that after the cancellation of the certificate of a registered cooperative society, the Director may appoint a suitable person from his office as a liquidator. The purpose of liquidation is to realize the assets of the society and apply the proceeds to the settlement of the society's liabilities.

3.5.1 Commencement

The liquidator on commencement of his job is provided a statement of the society's affairs by the Board or Executive Committee. If the books were not written up as at the date of commencement, the liquidator updates the accounts and prepares the final accounts and Balance Sheet. The Liquidator having taken over the assets, books and records of the society now takes necessary steps to realize the assets on best possible terms. Realizable values, under liquidation circumstances may be very much less than book values or going concern value.

3.5.2 Disposal of Assets

Having realized the assets of the society, the funds of the society are applied to the payment of liquidation expenses, discharge of the society's liabilities and for such other payments permitted by the cooperative law.

The cooperative law has established the following priorities for the disposal of funds of a society under liquidation:

First	-	The cost of liquidation
Second	-	Secured creditors if the asset mortgaged will realize more than the loan obtained with it. Third Wages of staff of the society.
Fourth	-	Other creditors (unsecured) including members savings and deposits.
Fifth	-	The share capital
Sixth	-	Dividend, interest on savings/deposit or bonus in certain circumstances.
Seventh	-	An object of local or public utility or tending to promote cooperation.

3.5.3 Calls

Where the assets realized are less than the book value, and the funds available are insufficient to meet the liabilities, members may be called upon to contribute up to their maximum liability and no more.

3.5.4 Liquidation Accounts

Steps to be taken:

Step 1: Open a Realisation Account.
Debit this account with all the assets of the society except bank and cash balances.

Step 2: Open a Share Account:
Transfer shares in the Balance Sheet to this account. It is always a credit balance.

Step 3: Open Sundry Members Account:
Transfer members savings and deposits to this account. It is a credit balance.

Step 4: Open an account for wages and salaries of staff: Transfer accrued wages to this account. It is also a credit balance.

Step 5: Open an account for secured creditors if applicable: Transfer the accounts of secured creditors to this account. It is also a credit balance.

Step 6: Open an account for other creditors: Transfer to the credit of this account the balances of accounts of their creditors.
Step 7: Open a summary of Reserves Account: Transfer the Reserves and Provisions unexpended, unappropriated profit to credit of this account. Transfer Net Loss to the Debit side of this account if any.

Step 8: Open a New Cash Book and bring down the cash and bank balances to the debit side of this new cash book and also debit it with the amount realized on the disposed assets.
Step 9: Credit the Realisation Account with value realized from the disposed asset.

Step 10: Credit the cash book with liquidation expenses and debit the realization account.

Step 11: Balance the Realisation Account.

Step 12: Transfer loss on realization debit to the side of summary of reserves, provisions etc. Account and the profit on realization to the credit side of this account.

After taking all the above steps, balance the summary of reserves, provisions etc account. If the credit side is more than the debit side, it means that the society has enough resources to settle its liabilities. If the reverse is the case, it means that the society does not have enough cash to meet its liabilities.

Distribution of Fund:

Having balanced the summary of Reserves Account, pay off the balances on creditors accounts, share capital account etc. by crediting the cash book and debiting each account. Any surplus cash remaining should be applied in payment of interest of savings and deposits, unpaid dividend and for any other purpose approved by the Director.

3.6 Illustration

The liquidation of Defunct Cooperative Society Ltd. Commenced on 1st February, 2001. The following Balance Sheet was extracted by the Liquidator on that date.

Balance Sheet of Defunct Cooperative Society Ltd. As at 1/2/01.

Liabilities	**N**	Assets	**N**
Share Capital	450	Office Equipment	70
Special Savings	110	Building	600
Thrift Savings	500	CCB shares	100
Accrued Wages	100	Stock	700
Bank loan	800	Debtors	300
Sundry creditors	100	Cash at Bank	820
Reserve Fund	200	Cash in Hand	36
General Reserve	146		
Unexpended provisions	120		
Net surplus	100		
	N2,626		**N2,626**

The assets were realized as follows:

Equipment	60
Building	650
Debtors	260
CCB shares	100
Stock	350
Liquidation Expenses -	25

You are required to prepare the Liquidation Accounts as at that date.

Solution:

DR. **Realisation Account** **CR.**

	₦		₦
Office Equipment	70	CCB shares	100
Building	600	Equipment	60
CCB shares	100	Building	650
Stock	700	Stock	350
Debtors	300	Debtors	260
Liquidation Expenses	25	Loss on Realisation	375
	₦1,795		**₦1,795**

DR. **Shares Account** **CR.**

	₦		₦
Cash	450	Bal. b/d	450

DR. **Sundry Members Account** **CR.**

	₦		₦
Cash	110	Special Savings	110
Cash	500	Thrift Savings	500
	₦610		**₦610**

DR. **Creditors Account** **CR.**

	₦		₦
Cash	100	Wages	100
Cash	800	Bank loan	800
Cash	100	Sundry creditors	100
	₦1,000		**₦1,000**

DR. Summary of Reserves, Provisions etc Account CR.

	₦		₦
Loss on Realisation	375	Reserve fund	200
Balance c/d	191	General Reserve	146
		Provision unexpended	120
		Net surplus	100
	566		**566**

DR. Liquidation Expenses Account CR.

	₦		₦
Cash	25	Realisation Account	25

DR. New Cash Book CR.

Particulars	Cash	Bank	Particulars	Cash	Bank
	₦	₦		₦	₦
Balance b/d	36	820	Liquidation Exp.	25	
CCB shares	100		Wages	100	
Building	650		Shares	450	
Stock	350		Special Savings	110	
Debtors	260		Thrift savings	500	
Equipment	60		Bank loan		800
			Sundry Creditors	100	
Bank	20		Cash		20
			Balance c/d	191	
	₦1,476	₦820		₦1,476	₦820

SELF-ASSESSMENT EXERCISE

1. What is liquidation under the cooperative society law?

2. Briefly explain the process and conduct of liquidation in accordance with the provision of cooperative societies law.
3. You were appointed as a Liquidator by the Director of cooperatives in your State to liquidate 'ABC' Cooperative Society Ltd:
4. Prepare all necessary liquidation accounts, showing the realization account and settlement of liabilities from the following balance sheet of the society as at 31st March, 2000.

Balance Sheet of 'ABC' Coop. Society Ltd., as at 30 March, 2000.

Liabilities	N	Assets	N
Share capital	6,000	Landed property	10,000
Thrift savings	1,500	Adding Machine	300
Special savings	700	Stock	900
Creditors	500	Investment	400
Loan (Coop. Bank)	1,900	Sundry Debtors	600
Reserve Fund	1,400	Cash at Bank	1,500
General Reserve	550	Cash in Hand	200
Provision unexpended	450		
Net Profit	900		
	N13,900		**N13,900**

Assets were realized in cash as follows:

	N
Adding machine	180
Investment	400
Landed property	12,500
Stock	500
Sundry Debtors	545

Liquidation Expenses amounted to N450 and was paid in cash.

4.0 CONCLUSION

After cancellation of the certificate of registration of a cooperative society, the appointed liquidator shall be subject to the guidance and control of the Director of cooperative societies and to any limitations imposed in accordance with the provision of the law.

5.0 SUMMARY

In this unit, we defined liquidation as winding up of affairs of a registered society thereby bringing to an end its cooperate life. Also discussed in this unit are the types of liquidation i.e. voluntary and compulsory liquidation; causes of liquidation or conditions for liquidation; duties of a liquidator; and the preparation of liquidation accounts.

6.0 TUTOR-MARKED ASSIGNMENT

The liquidation of a cooperative society commenced on 1S**t** January, 1999 under the order of the Director of cooperative societies of your State.

The following balance sheet was extracted by the liquidator.

Liabilities	₦	Assets	₦
Share capital	14,780	Building	5,000
Reserve fund	2,500	Farm Tractor	11,080
Education fund	480	Equipment	1,700
Unappropriated surp.	316	Investment	2,800
Coop. Bank loan	3,200	Shares in Coop. Bank	3,000
Creditors	5,700	Members loans	2,752
Members savings	4,600	Investment interest receivable	150
Accrued salary	500	Stock	5,200
Accrued water rate	70	Cash at Bank	400
Net surplus	136	Cash in Hand	200
	32,282		**32,282**

The assets were realized in cash as follows:

		N
Building	-	8,000
Equipment	-	2,600
Tractors	-	10,500
Investment	-	2,800
Shares in Coop. Bank	-	3,000
Members loans	-	2,752
Investment interest receivable	-	150
Stock	-	5,300

Liquidation Expenses amounted to N650 and was paid in cash.

You are required to prepare all necessary accounts on the liquidation of the society.

7.0 REFERENCES/FURTHER READING

Akinkuolie, L.: *Questions and Answers in Cooperative Accounting*.

Jain, S.P and Narang, K.L.: *Advanced Accountancy*.

UNIT 5 AMALGAMATION ACCOUNTS

CONTENTS

1.0 INTRODUCTION

Sometimes companies carrying on similar business combine with each other to obtain the economies of large scale production or to avoid the disastrous results of cut-throat, competition. This combination of two or more business may be done by amalgamation.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define Amalgamation
- explain Purchase Consideration
- calculate Purchase Consideration by using lump sum payment method
- calculate Purchase Consideration by using Net Worth Basis
- give some illustrations in order to explain the calculation of purchase consideration.

3.0 MAIN CONTENT

3.1 Amalgamation Accounts

3.2 Definition

When two or more companies or cooperative societies carrying on similar businesses go into liquidation and a new company is formed to take over their businesses, this is called AMALGAMATION.

You should note that from the above statement, it is clear that there are two types of companies i.e. Purchasing Company and Liquidating Company or companies. The purchase price of the company that goes into liquidation may be paid fully or partly by issuing share or debenture to the purchasing company. The shareholders or members of liquidating company who do not like to purchase the share of the purchasing company have the right of requiring the liquidator to purchase their shares at a price to be determined by the agreement.

3.3 Purchase Consideration

Before accounting entries, the books of the purchasing company or liquidating company will be discussed, it is necessary to understand "Purchase Consideration".

Purchase consideration is the amount which is paid by the purchasing company for the purchase of the business of the liquidating company.

The calculation of purchase consideration is very important and may be calculated in the following ways:

3.3.1 A Lump Sum Payment

When the purchasing company agrees to pay a lump sum amount to the liquidating company, it is called a LUMP SUM PAYMENT of purchase consideration. For example, "ABC" Nigeria Ltd purchases the business "XYZ" and agrees to pay N1,500,000.00 in all. This is called a lump sum payment.

3.3.2 Net Worth Basis

According to this method, the purchase consideration is calculated by calculating the net worth of the assets taken over by the purchasing company. The net worth is arrived at by adding the agreed value of assets taken over by the purchasing company less value of liabilities to be assumed by the purchasing company.

3.3.3 Accounting Entries

Illustration I

Balance Sheet of "XYZ" Coop. Society Ltd as at 31/12/90

Liabilities	N	Assets	
Share capital	6,000	Goodwill	2,800
Loan from Bank	1,000	Land	1,600
Creditors	600	Machinery	2,800
Gen. Reserve	400	Preliminary	200
Net Profit	2,000	Stock	1,600
		Debtors	800
		Cash	200
	N10,000		N10,000

Suppose i) 'ABC' Coop. Society Ltd. takes over the business of `XYZ' Coop Society Ltd.

ii) The value agreed for various assets:

	N
Goodwill	2,200
Land	2,500
Machinery	2,400
Stock	1,300
Debtors	800

iii) "ABC" Coop. Society Ltd does not take over cash but agrees to pay creditors which actually comes to $500.00.

You are required to calculate the purchase consideration of `XYZ' Coop. Society Ltd.

Solution:

The calculation of purchase consideration of "XYZ" Cooperative Society Ltd will be as follows:

<u>Value of Assets taken over by 'ABC' Coop. Society Ltd.</u>

	N
Debtors	800
Stock	1,300
Machinery	2,400
Land	2,500
Goodwill	2,200

Total value of Assets taken over			9,200
Less liabilities taken over	500		
Purchase Consideration		8,700	

While calculating purchase consideration

1. Only agreed value of those assets are added which have been taken over by the purchasing company.

2. Fictitious assets and expenses not written off as debit balance of profit and loss account, preliminary expenses, discount or commission on the issue of shares or debentures will not be taken over by the purchasing company and therefore not added. Goodwill is an intangible asset and its agreed value is added, if taken over by the purchasing company.

3. Only agreed value of those liabilities is deducted which are assumed by the purchasing company.

4. Undistributed profits like credit balances of profit and loss account, reserve fund, general reserve, sinking fund, share premium, capital reserve are not deducted.

SELF-ASSESSMENT EXERCISE

1. What do you understand by amalgamation?
2. Distinguish between a lump sum payment and net worth basis methods of calculating purchase consideration.

4.0 CONCLUSION

Amalgamation can only take place between two companies carrying on similar business. Shareholders of liquidating company who do not like to purchase the share of the purchasing company have the right to do so. The amount paid by the purchasing company to liquidating company is known as "Purchase Consideration".

5.0 SUMMARY

In this unit, we discussed the definitions of Amalgamation, purchase consideration. The amount paid by purchasing company for purchasing the business of a liquidating company is known as purchase consideration, and this can be calculated by using lump sum payment method or net worth basis method.

6.0 TUTOR-MARKED ASSIGNMENT

The Moon Cooperative Society Ltd and Rising Star Cooperative Society Ltd have agreed to amalgamate. A new society, Sunshine Cooperative Society Ltd has been formed to take over the business of the two amalgamated societies on I[S'] November, 1999. After all necessary negotiation, the assets of the two societies have been agreed as shown in the following Balance Sheet, and the new society only agreed to pay the sundry creditors of Moon Cooperative Society Ltd and Rising Star Cooperative Society Ltd which amounted to N800.00 and N500.00 respectively.

Balance Sheet of the Moon Coop. Society Ltd as at 1/11/99

	₦		₦
Capital	10,000	Landed Property	5,000
Sundry Creditor	800	Plant & Machinery	2,000
P & L Account	500	Share in Coop. Bank	1,100
		Sundry Debtors	1,200
		Stock	1,500
		Cash at Bank	500
	₦ 11,300		₦11,300

Balance Sheet of Rising Star Coop. Society Ltd as at 1/11/99

	₦		₦
Capital	5,000	Landed Property	3,000
Sundry Creditors	500	Plant & Machinery	2,500
Reserve Fund	500	Share in 1st Bank	500
Net Profit	500	Sundry Debtors	200
		Stock	200
		Cash at Bank	100
	₦6,500		₦6,500

You are required to use Net Worth Basis method 'n calculating the Purchase Consideration of the two amalgamated societies and prepare the amalgamated Balance Sheet of the new society.

7.0 REFERENCES/FURTHER READING

Akinkuolie, L.: *Questions and Answers in Cooperative Accounting.*

Jain, S.P. and Narang, K.L.: *Advance Accountancy.*