NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF BUSINESS AND HUMAN RESOURCES

COURSE CODE:ACC203

COURSE TITLE:FINANCIAL ACCOUNTING

COURSE
GUIDE

ACC203
FINANCIAL ACCOUNTING

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Introduction

The course Financial Accounting (ACC203) is a core course which carries two (2) credit units. It is prepared and made available to all students who are taking the Degree (BSc) programme in Accounting and other related programmes. This programme is tenable in the School of Business and Human Resources Management. The course will be useful to you in your academic pursuit as an Accountant as well as in your workplace as a middle level manager, accountant or tax officer. This course will broaden your perspective on basic issues in Financial Accounting and stimulate your interest in accounting, generally.

What You Will Learn in the Course

This course is made up of sixteen units, covering areas such as: the Trial Balance; Trading, Profit and Loss Account; The Balance Sheet; Adjustments in the Final Accounts; Depreciation of Fixed Assets and Manufacturing Accounts. Others are Accounts of Non-Trading Organizations; Single Entry and Incomplete Records; Preparation of Final Accounts from a Set of Incomplete Records: Conversion of Single Entry to Double Entry; Self-Balancing Ledgers and Control Accounts. Also, Joint Venture Accounts; Consignment Accounts; Container Accounts; Bills of Exchange and Application of Computer in an Accounting Environment have also been discussed.

The course Guide is meant to provide you with the necessary information about the course, the nature of the materials you will be using and how to make the best use of the materials towards ensuring adequate success in your programme as well as acquainting yourself with basic financial accounting principles. Also included in this course guide are information on how to make use of your time and information on how to tackle the tutor-marked assignment (TMA) questions. There will be tutorial sessions during which your instructional facilitator will take you through your difficult areas and at the same time you will have meaningful interactions with your fellow students.

Course Aims

The overall aim of this course on Financial Accounting is to expose you to how accounting information is generated. The course also aims at acquainting you with the contending issues in the preparation of accounts and financial statements. The aims of the course will be achieved by:

i. Familiarizing yourself with the Trial Balance;
ii. Explaining final accounts;
iii. Discussing provisions, reserves, depreciation and other necessary adjustments to final accounts;
iv. Explaining with practical illustrations the Accounts of Non-Trading Organizations;
v. Explaining the key issues in Single Entry and Incomplete Records and demonstrating the conversion of Single Entry to Double Entry and subsequently, the preparation of Final Accounts from a set of Incomplete Records;
vi. Explaining critically, miscellaneous accounts such as Self-Balancing Ledgers/Control Accounts, Joint Venture Accounts, Consignment Accounts, Container Accounts and Bills of Exchange;
vii. Demonstrating how Accounts of Non-Trading Organizations are prepared and Application of Computer in an Accounting Environment.

Course Objectives

To achieve the aims set out above, overall objectives were set. In addition, each unit has specific objectives. The unit objectives are always included at the beginning of the unit. You are advised to refer to them as you study each unit both at the beginning and at the end to ensure that you check your progress and that you have done what is required of you by the unit.

Below are broader objectives of the course. By meeting these objectives, you should achieve the aims of the course as a whole.

On successful completion of this course, you should be able to:

1.0 Extract a Trial Balance and give its definition concisely;
2.0 Discuss , the preparation of final accounts;
3.0 Discuss the rules and principles of preparing manufacturing accounts;

4.0 Explain the uniqueness of preparing accounts of non-profit organisations;
5.0 Discuss and prepare miscellaneous accounts.

Working through This Course

To complete this course, you are required to read the study units and the recommended textbooks and explore more current materials on the internet. In this course, each unit consist of exercises such as self assessment exercises to test your understanding from time to time. At a point in your course, you are required to submit assignments for assessment purposes. At the end of the course a final examination will be written.

Below, you will find a list of all the components of the course, what you have to do, and how you should allocate time to each unit in order to complete the course successfully and on time.

Course Materials

Major components of the course are:

- Course Guide;
- Study Units;
- Textbooks; and
- Assignment Guide.

Everything is contained in each unit except the Test Books which you may have to acquire. You are advised to source for current materials on the net and avail yourself of practicing questions of recognized Accountancy and other Bodies. You may contact your facilitator where you run into problem about recommended Text Books.

Study Units

There are sixteen units in this course, broken into three modules, which should be studied carefully. The units are as follows:-

Module 1

Unit 1	The Trial Balance
Unit 2	Trading, Profit and Loss Account
Unit 3	The Balance Sheet

The first unit simply presents the Trial Balance and a general overview of Double Entry Bookkeeping. The second and third units discuss the Final Accounts of a Sole Trader which covers the trading, profit and loss account and the Balance Sheet with special reference to financial reporting. The next two units discuss adjustments to final accounts in relation to provisions, reserves, prepayments and accruals, and depreciation of fixed assets. The next unit describes the basis of ascertaining cost of production for a manufacturing concern by way of preparing manufacturing accounts. This also forms part of final accounts. The next unit explains how accounts of non-profit making organizations are prepared. The next two units explain single entry/incomplete records and how it can be converted to double entry for the preparation of final accounts. Unit ten and eleven discuss self-balancing ledgers and control accounts. The next four units discuss accounting records of some miscellaneous accounts that have to do with either single transactions or single items. These include: joint venture accounts; consignment accounts; container accounts and bills of exchange. Unit sixteen, which is the last unit, deals with application of computer in an accounting environment.

Each study unit will take at least two hours, and it includes the introduction, objectives; main content, self-assessment exercises, conclusion, summary and tutor – marked assignment questions as well as references or further readings. Some of the self assessment exercises will necessitate contacting your facilitator or you to consult the recommended texts.

The textbooks under references are necessary materials that will help you to get more practicing questions for your studies and perhaps, overcome any difficulty. They are meant to give you additional information if only you can lay your hands on some of them. You are strongly advised to practice the self – assessment exercises and attempt the tutor – marked assignment questions for greater understanding of the course. While practicing the self – assessment exercises that have to do with computations, you may consult similar illustrations in the study units and any of the recommended texts in case of any difficulties. You may sometimes observe that the illustrations provided give you more insight than may have been originally conveyed.

Textbooks and References

There is no compulsory Text Book for this course. However, as you go through the course, you will observe that some Text Books are recommended more often. This shows that it is crucial to a number of units. Please try and consult these Books. Moreover, each unit has its own assigned texts. You should also lay your hands on these texts for further understanding of the course.

Assignment File

There are many assignments on this course and you are expected to do all of them by following the schedule prescribed for them in terms of when to attempt them and submit same for grading by your facilitator.

Tutor-Marked Assignments

Each unit in this course has two TMAs attached to it. In attempting the Tutor – Marked Assignments (TMAs), you are to apply your transfer knowledge and what you have learnt in the contents of the study units. These assignments which are many in number are expected to be turned in to your facilitator for grading. These assignments constitute 30% of the total score for the course.

Final Examination and Grading

At the end of the course, you will write the Final Examination. This Final Examination will attract the remaining 70% and this makes the total final score of 100%.

Course Assessment

Your assessment for this course is made up of two components. They are:-

viii. Tutor – marked Assignment
ix. Final examination.

The self – assessment exercises are not part of your formal assessments, but it is important to complete all of them. If you do the self – assessment exercises, they will facilitate your understanding of the subject matter or unit and your tutor – marked assignments.

Breakdown of Activities

Unit	**Title of Work**	**Weekly/ Daily Activity**	**Assessment**
	Course Guide		
	Module 1		
1	The Trial Balance	2 Days	
2	Trading, Profit and Loss Account	5 Days	
3	The Balance Sheet	3 Days	
4	Adjustments in the Final Accounts	1 Day	
5	Depreciation of Fixed Assets	1 Day	
6	Manufacturing Accounts	2 Days	
	Module 2		
1	Accounts of Non-Trading Organizations	1 Weekly	
2	Single Entry and Incomplete Records	1 Week	
3	Preparation of Final Accounts From a Set of Incomplete Records: Conversion of Single Entry to Double Entry	1 Week	
4	Self-Balancing Ledgers	3 Days	
5	Control Accounts	4 Days	
	Module 3		
1	Joint Venture Accounts	3 Days	
2	Consignment Accounts	4 Days	
3	Container Accounts	4 Days	
4	Bills of Exchange	3 Days	
5	Application of Computer in an Accounting Environment	1 Week	

Conclusion

Financial Accounting is an interesting course. The course exposes you to some of the Basic and Essential Topics in Accounting. On the successful completion of this course, you would have been acquainted with the principles and practice of Financial Accounting.

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COURSE AIMS

1. To impact the basic principles of Financial Accounting in you;
2. To equip you with the basic technical knowledge for preparing accounts and financial statements.

COURSE OBJECTIVES

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

- extract a Trial Balance and give its definition clearly
- discuss clearly, the preparation of final accounts
- discuss the rules and principles of preparing a manufacturing account
- explain the uniqueness of preparing accounts of non-profit organisations
- discuss and prepare miscellaneous accounts.

MODULE 1

UNIT 1 THE TRIAL BALANCE

CONTENTS

1.0 INTRODUCTION

After the ledger has been prepared, the balances brought down are used to prepare a statement called a "Trial Balance. Assets are usually entered on the debit side of an account, and the liabilities on the credit side, it is expected that the total of the debits would equal the total of the credits. This is true because the total assets are equal to the liabilities plus the capital (L + C = A). Also, each subsequent transaction involved one entry on the debit side, and an equal entry on the credit side. It follows that the total debit entries are still equal to the total credit entries provided no mistake has been made. It is impossible to guarantee that no mistake will ever be made. Therefore, as soon as all transactions are double- entered in the accounts, it is usual to make a preliminary check upon the accuracy of the entries by taking out a "Trial Balance" to see if the total of all debit entries is equal to that of all the credit entries in each.

2.0 OBJECTIVES

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

- define a Trial Balance
- extract the Trial Balance
- discuss Rules of a Trial Balance.

3.0MAIN CONTENT

3.1 Definition

Trial Balance can be defined as a schedule or list that shows the debit and credit balances extracted from the ledgers, to show the arithmetical accuracy of the ledgers. The technique ensures that debit and credit balances as displayed in the ledgers are compiled (Longe & Kazeem, 2006: 68). The objective of the Trial Balance is to prove the accuracy of the book- keeping. All the ledger accounts must be balanced off and entered in the Trial Balance.

3.2 Uses of Trial Balance

The main uses of the trial balance are:

a. It helps in testing the accuracy of the double entry;
b. Helps in the preparation of financial statements;
c. Assist in detecting errors of posting that can easily be identified by the trial balance.

3.3 Rules of the Trial Balance

In preparing or extracting a Trial Balance from a list of extracted balances, the following items are recorded:

- Capital or Share Capital, including retained profits, should be entered in the credit column of the trial balance;
- Drawings, including accumulated losses, should be entered in the debit side of the trial balance;
- All assets, both fixed and current, should be entered in the debit column of the trial balance;
- All expenses, including purchases and stationery, should be entered in the debit column of the trial balance;
- All liabilities, including debentures, should be entered in the credit column of the trial balance;
- All reserves and provisions, including depreciation, should be entered in the credit column of the trial balance;
- All revenue, including sales and bad debt recovered, should be entered in the credit column of the trial balance.

3.4 Format of Trial Balance

The format of the trial balance is given below. It has columns for particulars, debit and credit sides. Because of the principle adopted, it must balance.

ABC LTD

TRIAL BALANCE AS AT 31ST DECEMBER, 2008

	Dr	Cr
	₦	₦
Capital		*
Plant and Machinery	*	
Freehold Premises	*	
Stock at beginning purchases	*	
Sales		*
Rent and Rates	*	
Wages and Salaries	*	
Advertisement	*	
Sundry expenses	*	
Cash in hand	*	
Bank overdraft		*
Debtors and creditors, respectively	*	*
Furniture and fittings	*	
Bad debts	*	
Provision for doubtful debts		*
Depreciation: Furniture and fittings		*
Motor van	*	

Carriage outwards	*	
Carriage inwards	*	
Returns inward and outward, respectively	*	*
Lighting	*	
Telephone	*	
Discount received		*
Discount allowed	*	
Drawings	*	
Loan/Debentures		*
	=	=

EXAMPLE 1

Accomaeco Ltd has the following transactions for the first week of January 2006.

1 Started business with cash at N500, 000
1 Bought delivery van from SCOA motors N350, 000 and paid cash of N50, 000 as deposit.
3 Purchased goods of N50, 000 in cash and that same date purchased goods worth N200, 000 on credit from modern stores.
1 Paid rent of N120, 000 in cash
2 Purchased office furniture in cash N20, 000
4 Sold goods to Kim & sons N300, 000
5 Sold goods in cash N150, 000
6 Kim & Sons returned goods of N30, 000
7 Cash sales N40, 000
7 Paid wages N8, 000
7 Paid SCOA motors N150, 000

You are required to journalize the above transactions, post to the ledger and extract a trial balance.

SUGGESTED SOLUTION TO EXAMPLE 1

In the books of Accomaeco Ltd
Sales Journal (SJ)

Date	Particulars	Folio	Details	Total
Jan			₦	₦
4	Kim & Sons			300, 000
7	Transfer to the credit Side of sales account			
				300, 000

Sales Returns Journal (SRJ)

Date	Particulars	Folio	Details	Total
Jan			₦	₦
5	Kim & Sons			30,000
7	Transfer to the debit Side of sales Returns account			
				30, 000

Purchases Journal (PJ)

Date	Particulars	Folio	Details	Total
Jan			₦	₦
2	Modern Stores			200,000
7	Transfer to the debit Side of sales Returns account			
				200, 000

General Journal (GJ)

Date	Particulars	Folio	DR	CR
Jan			₦	₦
2	Delivery Van		350,000	
7	To cash			50,000
	SCOA motors			300,000
	Being purchased of an Asset on credit & depositing 50,000 ₦ immediately			

Cash book for the Month of January, 2006

DR **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
1	Capital		500,000	2	Delivery Van		50,000
5	Sales		150,000	2	Purchases		50,000
7	Sales		40,000	3	Rent		120,000
				3	Office Furniture		20,000
				7	Wages		8,000
				7	SCOA Motors		150,000
				7	Balance	c/d	292,000
			690,000				**690,000**
7	Balance	b/d	292,000				

THE LEDGER ACCOUNTS

Capital Account

DR CR

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
			₦	Jan			₦
				1	Cash		500,000

Sales Account

DR CR

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
7	Balance	c/d	490,000	5	Cash		150,000
				7	Cash		40,000
					Sundries		300,000
			490,000				**490,000**
				7	Balance	b/d	490,000

Delivery Van

DR CR

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
2	SCOA Motors		350,000	5	Balance	c/d	350,000

			350,000				**350,000**
7	Balance	b/d	350,000				

Purchases Account

DR **CR**

Date	**Particular**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Jan			₦	Jan			₦
2	Cash		50,000	7	Balance	c/d	250,000
7	Sundries	PJ	200,000				
			250,000				**250,000**
7	Balance	b/d	250,000				

Rent Account

DR **CR**

Date	**Particular**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Jan			₦	Jan			₦
3	Cash		120,000				

Office Furniture Account

DR **CR**

Date	**Particular**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Jan			₦	Jan			₦
3	Cash		20,000				

Wages Account

DR **CR**

Date	**Particular**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**
Jan			₦	Jan			₦
8	Cash		8,000				

SCOA Motors Account

DR **CR**

Date	**Particular**	**Folio**	**Amount**	**Date**	**Particulars**	**Folio**	**Amount**

Jan			₦	Jan			₦
2	Cash		50,000	7	Delivery Van		350,000
7	Cash		150,000				
7	Balance	c/d	150,000				
			350,000				**350,000**
				7	Balance	b/d	150,000

Return Inward Account

DR **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
8	Kim and Sons	SRJ	30,000				

Kim and Sons Account

DR **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
4	Sales		300,000	5	Returns		30,000
				7	Balance	c/d	270,000
			300,000				**300,000**
7	Balance	b/d	270,000				

Modern Store Account

DR **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
Jan			₦	Jan			₦
				2	Purchases		200,000

ACCOMAECO LTD

Trail Balance as at 7/01/2003

Particulars	Folio	Dr.	Cr.
		₦	₦
Capital			500, 000
Sales			490, 000
Delivery van		350, 000	
Purchases		250, 000	
Rent		120, 000	

Office furniture		20, 000	
Wages		8, 000	
SCOA Motors			150, 000
Returns inwards		30, 000	
Kim & Sons		270, 000	
Modern Stores			200, 000
Cash		292, 000	
		1,340,000	**1,340,000**

4.0CONCLUSION

Entries are usually made in the Trial Balance either directly from the ledger accounts or from a list of extracted balances brought down. When a Trial Balance is prepared directly from the ledger accounts, only balances brought down are considered. In carrying out this exercise, a debit balance brought down is entered in the debit column of the Trial Balance while a credit balance brought down is entered in the credit column of the Trial Balance. Any self- balanced account is ignored.

SELF ASSESSMENT EXERCISE

Enter the following transactions in the cash book of Boko Haram, a sole trader, for the month of January 2009:

		₦
January: 1	Started business with cash	72,000
	Bought goods for cash	18,000
	Sold goods for cash	4,400
	Paid carriage	800
8	Paid advertising account	800
9	Okon paid cash on account	3,400
13	Lent Jane Oladele	8,000
17	Cash sales	8,500
19	Purchased goods by Cash	16,000
25	Paid wages	1,800
28	Cash sales	7,600
29	Jane Oladele paid on account	4,000

30	Paid rent	10,000

Required
Open ledger accounts and extract the Trial Balance on 31st January 2009

5.0 SUMMARY

This study unit has:

- Defined a Trial Balance;
- Itemized the uses of a Trial Balance;
- Discussed the guiding rules to be observed in preparing a Trial Balance;
- Extracted a Trial Balance.

6.0 TUTOR-MARKED ASSIGNMENT

1. B. Bobby, a client of yours, with whom book keeping is not a strong point, asked you to audit his accounts for the year ended 31/12/2004. As a basis for your audit, Bobby furnishes you with the following statement.

Trial Balance as at 31st December 2004.

		Dr	**Cr**
		₦'00	**₦'00**
B. Bobby, Capital	-		1556
B. Bobby, Drawings	-	564	
Leasehold Premises	-	741	
Sales	-		2756
Due from Customers	-		530
Purchases	-	1268	
Purchases Returns	-	264	
Loan by a Bank	-		250
Owings to Suppliers	-	528	
Trade Expenses	-	784	
Cash at Bank	-	142	
Bills Payable	-	100	
Salaries & Wages	-	598	

Stock (1st January)	-		264
Rent, Rates, etc	-	465	
Sales Returns	-		98
Discount Received	-	60	
Discount allowed	-		60
Carriage Outwards	-	10	
Carriage Inwards	-		25
Writing off debt of a bankrupt	-	5	
Bad debts Provision	-	25	
Bad debts recovered	-		15
		5,554	5,554
		=====	====

If you do not approve this statement, amend it.

2. Ashilla Ltd has the following transactions for the first Week of January 2009:

1	Started business with cash at N250,000
1	Bought delivery van from UTC motors N175, 000 and paid cash of N25, 000 as deposit.
3	Purchased goods of N25, 000 in cash and that same date purchased goods worth N100, 000 on credit from Rocklinks stores.
2	Paid rent of N60, 000 in cash
3	Purchased office furniture in cash N10, 000
4	Sold goods to Pam & sons N150, 000
5	Sold goods in cash N75, 000
6	Pam & Sons returned goods of N15, 000
7	Cash sales N20, 000
7	Paid wages N4, 000
7	Paid UTC motors N75, 000

You are required to journalize the above transactions, post to the ledger and extract a trial balance.

7.0 REFERENCES/FURTHER READING

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UNIT 2 TRADING, PROFIT AND LOSS

CONTENTS

1.0 INTRODUCTION

Accounting deals with the process of identifying, analysing, recording, classifying, summarizing, communicating and interpreting financial information for use by interested parties. Preparation of simple final accounts of a sole trader covers the preparation of the trading, profit and loss account and the balance sheet. In this study unit, the final accounts of a trader who deals in the buying and selling of goods are discussed. The final account of a sole trader who is involved in the manufacturing of products is discussed in the next unit.

2.0 OBJECTIVES

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

- explain the trading, profit and loss account and the balance sheet
- identify items that will appear in the trading, profit and loss account and the balance sheet
- make adjustments before preparing the trading, profit and loss account
- prepare a trading and profit and loss account and the balance sheet.

3.0 MAIN CONTENT

3.1 The Trading Account

The main objective of preparing the trading account is to determine the gross profit or gross loss for the period. It is also in this account that the cost of obtaining the goods (cost of goods sold or cost of sales) is calculated. It is usually prepared to conform to the rules of double entry. Since it contains the results of operation of a business over a period, the heading should be Trading, Profit and Loss Account for the Year Ended……...

The account looks at the difference between the sales and the cost of goods sold. It is a revenue account which follows the double entry principle. On the debit side are recorded stocks at the beginning, purchases less returns outwards and the closing stocks deducting from the cost of goods available for sales. On the credit side are recorded sales less return inwards. The difference between the cost of goods and net sales is the gross profit. The "T– Method" and "Vertical Method" are respectively shown below:

TRADING ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER, 2009

	₦		₦
Opening Stock	X	Sales	X
Add Purchases	X	Less Returns Inwards	X
Add Carriage Inwards	X	Net Sales	X
	X		
Less Returns outwards	X		
	X		
Less goods withdrawn for own use	X		
Cost of goods available for sale	X		
Less closing stock	X		
Cost of goods sold	X		
Gross profit	X		
	X		X

TRADING ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER, 2009

	₦		₦
Opening Stock	X	Sales	X
Add Purchases	X	Less Returns Inwards	X
Add Carriage Inwards	X	Net Sales	X
	X		
Less Returns outwards	X		
	X		
Less goods withdrawn for own use	X		
Cost of goods available for sale	X		
Less closing stock	X		
Cost of goods sold	X		
Gross profit	X		
	X		X

Among the two formats above, 'Vertical method' is more preferable.

3.2 Definition of Technical Terms

(i) **Purchases:** These are goods bought for resale. It is the sum total of cash and credit purchases. It however, excludes purchases of fixed assets.

(ii) **Sales:** This is the addition of cash and credit sales during the trading period. Sales exclude the sale of fixed assets.

(iii) **Opening Stocks:** These are the stock of goods for sale at the beginning of the accounting year.

(iv) **Closing Stocks:** These are the balance of the stock of goods available for sale at the end of the trading period.

(v) **Returns Outwards:** These are goods returned to the suppliers of such goods as a result of the goods either being not to specification, damaged, obsolete, late delivery, and some other genuine reasons. Returns outwards must be deducted from purchases of the period.

(vi) **Returns Inwards:** These are goods returned by customers of a trading concern. For example, goods below standard, wrong goods supplied to customers, inability of organization to meet with the terms of the supply, etc. This must be deducted from sales for the period.

(vii) **Carriage Inward:** This is the cost of transporting goods into the company. This must be added to the cost of purchases as it is incurred in order to bring the goods into a condition that is necessary for its sale. Hence, it is charged to the trading account.

(viii) **Carriage Outwards:** This is the cost of transporting goods to customers. That is, the cost of transport that a trading concern incurs in moving goods meant for resale out of a firm. Carriage outwards is a profit and loss account item and for that reason is not included in the calculation of gross profit in the trading account. It is seen as expenses on sales and as a result is debited in the profit and loss account.

(ix) **Cost of Goods Available for Sale:** This figure is derived by adding the opening sock and purchases.

(x) **Cost of Goods Sold or Cost of Sales:** This represents the cost of the goods that were actually sold. It is arrived at by deducting closing stocks from the cost of goods available for sales.

(xi) **Gross Profit:** This is the excess of sales (less returns) over the cost of goods sold. This could also be defined as profit before expenses are deducted.

(xii) **Net Profit:** This is the profit figure arrived at after deducting all expenses incurred during the trading period.

(xiii) **Goods Withdrawn for Own Use:** The use of products or goods by a proprietor is usually termed stock drawings. The goods withdrawn by the owner of the business is deducted from the purchases in the trading account. In the balance sheet, it must be added to drawings.

(xiv) **Goods Stolen or Destroyed:** This is deducted from cost of goods available for sale or purchases and posted to the expenses side of the profit and loss account. That is:

Dr : Profit and Loss A/c
Cr : Purchases Account.

3.3 The Profit and Loss Account

The main function of the profit and loss account is to determine the net profit or net loss resulting from the trading operations of the accounting period. Incomes or gains are credited, while expenses are debited. The gross loss (if any) from the Trading Account is debited while gross profit (if any) from the Trading Account for the period is credited. The net profit or loss from this account will be taken to the capital account.

3.3.1 Profit and Loss Format

The profit and loss account will appear thus:

	₦		₦
Expenses		Gross Profit b/d	X
Wages and Salaries	X	Discounts received	X
Telephone	X	Bank Interest received	X
Bad Debts	X	Reduction in provision for bad debts	X
Increase in provision for bad debts	X	Commission Received	X
Motor expenses	X	Profit on sale of assets	X

Stationery	X	Recovery of bad debts	X
Bank charges	X	Rents	X
Loss on sale of assets	X		
Advertising	X		
Lighting and heating	X		
Repairs	X		
Postages	X		
Rent	X		
Rates	X		
Discount allowed	X		
Depreciation	X		
Directors Fee	X		
Travelling expenses	X		
Carriage outwards	X		
Loss by fire	X		
Loss by defalcations	X		
Personal income tax	X		
Net Profit	X		
	XX		XX

The vertical format can also be used for the presentation of the profit and loss account as can be seen under:

PROFIT AND LOSS ACCOUNT

	₦	₦
Gross Profit		X
Add other incomes (e.g. investment income, miscellaneous incomes)		X
		X
Less Expenses:		
Establishment charges (e.g. rent, rates, lighting and heating, etc)	X	
Administration expenses (e.g. clerical wages, salaries, etc.)	X	
Selling and Distribution expenses (e.g. advertising, travelling, commissions, carriage outwards, packing materials, etc)	X	
Other expenses (e.g. loan interest, bank charges, etc)	X	
Personal income tax	X	X
Net Profit		XX

Note that the profit and loss account must not be prepared in isolation. It must be prepared with the trading account. Also note that Net profit is usually added to capital in the balance sheet and Net loss deducted from capital.

3.3.1 Procedure for Preparing the Trading, Profit and Loss Account

(a) Record revenue earned as sales on the credit side less returns inwards.

(b) Compute cost of sales by adding opening stock to purchases and deducting closing inventory.

(c) The cost of goods is deducted from sales to get the intermediate or the gross profit.

(d) Deduct operating expenses from gross profit to determine the net income or net profit or net loss.

EXAMPLE

From the following trial balance of Masco Max, draw up a trading profit and loss account for the year ended 31st December, 2009.

	Dr	**Cr**
	₦	₦
Capital		226,360.00
Stock	23,680.00	
Carriage outwards	2,000.00	
Carriage inwards	3,100.00	
Returns inwards	2,050.00	
Sales		18,600.00
Purchases	118,740.00	
Return outwards		8,220.00
Salaries and wages	38,620.00	
Rent	3,040.00	
Insurance	780.00	
Sundry expenses	6,640.00	
Advertising	2,160.00	
General expenses	4,800.00	
Land and Buildings	50,000.00	
Furniture & Fittings	18,000.00	
Motor Car	3,500.00	
Debtors	38,960.00	
Bank	104,820.00	
Creditors		17,310.00

Drawings	12,000.00	
	432,890.00	432,890.00

Stock as at 31st December 2009 was ₦30,000.00.

SUGGESTED SOLUTION

MOSCO MAX
Trading, Profit and loss account for the year ended 31st December, 2009.

	₦	₦		₦	₦
Opening stock		23,680	Sales		186,000
Add purchases	118,740		LessReturns		2,050
Add carriage inwards	3,100				183,950
	121,840				
Less returns outwards	3,220	118,620			
		142,300			
Less closing stock		30,000			
		112,300			
Gross profit		71,650			
		183,950			183,950
Expenses:			Gross profit (b/d)		71,650
Carriage outwards		2,000			
Salaries & wages		38,620			
Rent		3,040			
Insurance		780			
Sundry expenses		6,640			
Advertising		2,160			
General expenses		4,800			
Net Profit		13,610			
		71,650			71,650

SELF ASSESSMENT EXERCISE

1. The trial balance of Mr. Gubuchi Oyebuchi, a sole trader as at 31st December, 2005 was as follows:

	₦	₦

Land	27,080	
Motor vehicle repairs	692	
Bank Loan		9,500
Furniture	12,380	
Debtors	4,619	
Creditors		8,536
Electricity	774	
Drawings	1,820	
Office Equipment	14,463	
Bank overdraft		703
Sales		45,038
Salaries	2,840	
Capital		69,791
Stock on 1st Jan.2005	1,372	
Insurance	828	
Purchases	38,510	
Discount received		206
Miscellaneous expenses	1,795	
Returns inward	962	
Discount allowed	648	
Carriage outwards	538	
Cash in hand	1,163	
Stationery	574	
Returns outwards		579
Motor Vehicles	23,295	
	N134, 353	N134, 353

The following additional information is also given:

1) Miscellaneous expenses of N550 are yet to be paid
2) Interest is due on the bank loan at the rate of 5 percent
3) The stock on 31st December, 2005 was N639

You are required to prepare:

Mr. Gubuchi Oyebuchi's Trading, Profit and Loss Account for the year ended 31st December, 2005

2. The following is the Trial Balance of Asibi Trading Company as at 31st December, 2006.

	Dr	Cr
	₦	₦
Capital		40,000
Fixed Assets	60,000	

Debtors and Creditors	10,100	18,000
Stock at 1st January 2006	1,800	
Purchases and Sales	50,000	87,000
Depreciation on Fixed Assets		4,630
Discounts	200	1,000
Returns	1,200	2,400
Drawings	4,500	
Salaries and Wages	10,500	
General Expenses	8,500	
Provisions for doubtful debts		600
Cash in hand	5,300	
Bad Debts	1,530	
	N153,630	N153,630

The following additional information is given: Stock in hand on 31st December 2006 was N2,000.

Required: Prepare Trading, Profit and Loss Account for the Year Ended 31st December, 2006.

4.0 CONCLUSION

The ultimate objective of preparing a trading, profit and loss accounts is to enable the management of an organization or individual to determine the results of its operations during a given period. Live all accounting reports, the form of the accounts will vary according to the type of business and the requirements of management, but the sequence of sub-heads remains unchanged. The trading and profit and loss account must be drawn up for a period which is usually a year.

5.0 SUMMARY

This study unit has provided an:

- explanation of the trading account
- demonstrate the format of the trading account
- defined key and technical terms
- discussed the profit and loss account
- shown the profit and loss account format
- shown the preparation of the trading, profit and loss account

6.0 TUTOR-MARKED ASSIGNMENT

1. From the following Trial Balance of Alh Sule Ahmed as at 31st December, 2003, you are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December, 2003:

Trial Balance as at 31st December, 2003

	Debit	Credit
	₦	₦
Mallam Ahmed's Capital Account		80,000
Mallam Ahmed's Drawing Account		6,000
Plant and Machinery (Balance 1st Jan. 2003)	20,000	
Plant and Machinery (Additions on 1/7/03)	5,000	
Stock on 1st January 2003	15,000	
Purchases	82,000	
Returns Inwards	2,000	
Sundry Debtors	20,600	
Furniture and Fixtures		5,000
Freight and Duty	2,000	
Carriage Outwards	500	
Rent, Rates and Taxes		4,600
Printing and Stationery	800	
Trade Expenses	400	
Sundry Creditors		10,000
Sales	120,000	
Returns Outwards		1,000
Postal and Telegrams	800	
Provision for Doubtful Debts		400
Discounts Received		800
Rent of Premises Sublet for one year to 30th June 2004		1,200
Insurance Charges	700	
Salaries and Wages	21,300	
Cash in Hand	6,200	
Cash in Bank	20,500	
	213,400	213,400
	=======	=======

Adjustments:

1) Stock on 31st December, 2003 was valued at N14,600
2) Write off N600 as bad debts
3) The provision for Doubtful debts is to be maintained at 5 per cent on Sundry Debtors.
4) Provide for Depreciation and Fixtures at 5 percent per annum and on Plant and Machinery at 20 percent per annum.
5) Insurance prepaid was N100.

6) A fire occurred on 25th December, 2003 in the stores and stock of the value of N5,000 was destroyed. It was fully insured and the Insurance Company admitted the claim in full.

2. The following is the trial balance of Ofedo Ibanga as at 31st December 2004

	₦	₦
Office Equipment	218,000	
General Expenses	3,920	
Motor Vehicles	275,000	
Electricity	13,520	
Furniture & Fixtures	380,000	
Stationery	4,350	
Rent	63,600	
Capital		1,659,520
Salaries and wages	81,500	
Insurance	3,480	
Freehold Premises	704,000	
Sundry Creditors		69,250
Sundry Debtors	57,330	
Bank Balance	56,180	
Transportation	7,740	
Stock on 1st January 2004	14,960	
Sales		525,840
Purchases	350,870	
Discounts	8,060	6,130
Drawings	12,500	
Bad Debts	9,280	
Sales and Purchases Returns	3,870	7,420
	N2,268,160	N2,268,160

You are given the following additional information:

1. The stock on 31st December, 2004 was N38,130
2) Total Rent paid is for the fifteen months ending 31st March, 2006
3) An employee who ran into some financial problems was given a two month salary advance. His monthly salary is N2,800.
4) Part of the Freehold Premises valued at N20,000 was sold for N25,000 but no entries have been made in the books.
5) A fire disaster destroyed some furniture valued at N3,500
6) Office equipment costing N15,000 was supplied to the business but this has not been recorded in the books. No payment has been made for the equipment.

7) A loan of N300,000 taken on 1st June, 2004 at an annual interest rate of 12 percent was mistakenly credited to the capital account. The interest has not been paid.
8) Depreciation is to be written off the balances of all fixed assets except free hold premises at the rate of 5 percent.

You are required to prepare a Trading, Profit and Loss Accounts of Ofedo Ibanga for the year ended, 31st December, 2004.

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UNIT 3 THE BALANCE SHEET

CONTENTS

1.0 INTRODUCTION

Owners, managers, suppliers, granters of credit and others interested in a business enterprise are generally confronted with financial statements prepared by accountant. These include the balance sheet, showing the firm's condition on the last day of the accounting period, among others. This study unit discusses the balance sheet, format of the balance sheet and components of the balance sheet.

2.0 OBJECTIVES

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

- define and explain the balance sheet
- identify items that will appear in the balance sheet
- prepare a balance sheet
- make appropriate adjustments to the balance sheet.

3.0 MAIN CONTENT

3.1 The Balance Sheet Defined

A balance sheet is the financial statement showing the assets, liabilities and owners' equity of an enterprise on a specific date (Okwoli, 1993:94). Lange and Kazeem (2006:162) defined the balance sheet as the statement that shows the presentation of the summary of assets and liabilities in a well arranged form, so that the financial position may be clearly ascertained. The balance sheet is not an account; it is a statement showing the balance remaining in the books. For instance, the balance sheet must be headed as 'The balance sheet as at 31st December, 2008.

The balance sheet of a business just like a coin consists of two sides – the asset side and the liabilities and owners equity side. All assets have sources represented by liabilities and equities. Because all assets are financed by liabilities and owners equity, the two sides must balance-hence, the term balance sheet, and the balance sheet equation: Assets = Liabilities +Owners' equity.

The assets are usually set out in order of permanence or liquidity. To comprehend the rules of balance sheet, the various components must be adequately analysed.

3.2 Components of the Balance Sheet

3.2.1 Assets

3.2.1.1 Fixed Assets

These are tangible assets, which have a relatively long life (more than one year), are relatively fixed (in size, shape, or form), are permanent in nature and used by a business in its operation. These assets are held with the main aim of earning or creating revenue and not for the purpose of sale in the normal course of business.

Examples of fixed assets are land, buildings, motor vehicles, office equipment, furniture and fittings, premises, etc. The fact that the life of fixed assets extends over many accounting periods makes it necessary to allocate the cost of the asset to current and future operations on some rational basis. This allocation is called depreciation. Hence, fixed assets are generally valued at cost less provisions for accumulated depreciation that is sufficient to reduce the carrying or book value of the asset to its salvage or scrap value by the end of its useful working life.

3.2.1.2 Current Assets

These are assets that are acquired and held for resale, and not as agents of production, but for the purpose of eventual conversion into cash (ATSWAt, 2009:218). They are therefore not permanent in nature, but are continually changing in the ordinary course of business. Examples are debtors, stock in-trade, bills receivable, cash in hand, cash at bank, prepaid expenses, marketable securities, etc. that can easily be realized and are therefore readily available to discharge liabilities.

The same assets may be either fixed or current according to the nature of the business. Thus, investments would be a current asset to a stock broker, but a fixed asset to an ordinary trader. Similarly, machinery would be a fixed asset to an ordinary manufacturer, but a current asset to a machinery trading company. It also depends on whether the asset is held merely for the purpose of sale, or is intended to be kept in the business.

3.2.1.3 Fictitious Assets

These are merely debit balances not written off, items of expenditure of unusual character which are not recoupable. Examples are preliminary expenses, formation expenses, and losses which have been carried forward from one period to the next.

3.2.1.4 Intangible Assets

These are assets that cannot be seen and touched, although they may have value (Garbutt, 1982:0213). Examples of intangible assets are goodwill, patents, copyright, trademark, etc.

3.2.1.5 Liquid Assets

These are cash or items such as debtors, marketable securities, etc, that can easily be converted into cash.

3.2.1.6 Wasting Assets

These are fixed assets that depreciate through wear and tear, as for example, plant and machinery; those whose value expires with lapses of time, such as patents and leases; also those that become exhausted or consumed through being worked, such as mines, quarries, etc.

3.2.2 Liabilities

These are obligations or indebtedness of a business enterprise to outsiders. A liability is any amount, which a business is legally bound to pay. It is a claim by an outsider on the assets of a business. The best method of arranging liabilities in the case of an old trader is in order of permanence. The usual groupings are as follows:

- Long-term liabilities
- Current or short-term liabilities.

3.2.2.1 Long Term Liabilities

These are obligations that will mature in the future. That is, not within the next accounting period. Examples are Debentures, Long-term loans, and Mortgage loans.

3.2.2.2 Current or Short-term Liabilities

These are liabilities payable within a short period of time, usually within one year. They are events that require the enterprise to pay money and provide goods or perform services, which are already due. Examples are creditors, Bank overdraft, Short-term loans and accrued expenses, etc.

3.2.3 Capital

Capital represents the contribution of the proprietor of a business to the assets that the firm has acquired. That is, the owner's interest in the assets of the business. This is usually referred to as owner's equity or proprietorship.

3.2.4 Working Capital

This is the excess of the current assets over the current liabilities. That is, current assets – current liabilities.

3.2.5 Capital Employed

This is a total asset less current liabilities.

3.2.6 Overtrading

This is a situation whereby a firm has no working capital. The firm cannot meet its current liabilities and it may become bankrupt. In this position, the firm is very vulnerable, and could be forced into bankruptcy if its creditors loss faith in its ability to pay.

3.3 **Balance Sheet Format Balance Sheet as at __________**

	₦	₦		₦	₦
Capital		X	Fixed assets Goodwill		X
Add Net Profit		X	Land and building	X	
		X	Less Depreciation	X	X
Less Drawings		X	Plant & Machinery	X	
		X	Less Depreciation	X	X
Long-term liabilities:			Furniture & Fitting		X
% Debentures		X	Motor Van		X X
Current Liabilities			Current Assets		
Loan	X		Stock	X	
Creditors	X		Debtors	X	
Accrued expenses	X		Payment in advance	X	
Bills payable	X		Bills Receivable	X	

Income in advance	X	X	Income in arrears	X	
			Bank	X	
			Cash in hand	X	X
		X			**X**

The balance sheet can also be presented in a vertical form. This is given below:

Balance sheet of XYZ as at 31st December, 2009

	₦	₦	₦
Fixed Assets			
Motor Van		X	
Plant and Machinery	X		
Less depreciation	X	X	
Furniture and fitting		X	X
Current Assets			
Stock		X	
Payment in advance		X	
Income in arrears		X	
Cash in hand		X	
Cash at bank		X	X
Less Current Liabilities:			X
Loan		X	
Bank Overdraft		X	
Creditors		X	
Bills Payable		X	
Income in advance		X	
Expenses accrued		X	**X**
Representing:			
Capital			X
Add Net Profit			X
			X
Less Drawings			X **X**

EXAMPLE

Prepare Gani Fawemi's Balance from the figures given in his list of balances as at 31st December, 19 x 09.

	Dr	Cr
	₦	₦
Capital		12,000

Land and buildings	9,235	
Mortgage on premises		5,545
Drawings	1,500	
Profit and Loss account balance		1,800
Furniture and fittings	2,560	
Motor Vehicles	1,731	
Closing Stock	1,500	
Debtors	5,737	
Creditors		**3,677**
Cash book balance	759	
	23,022	23,022

Required:

(a) Show the balance sheet in all its forms; and
(b) Answer the following questions from the above data:

(i) What is the capital invested in the above balance sheet?
(ii) What is the capital owned?
(iii) What is the capital employed?
(iv) What is the working capital?

(i) Order of Liquidity Approach

Gani Fawemi
Balance sheet as at 31st December, 19 x 09

	₦	₦		₦	₦
Current Liabilities			Current Assets		
			Cash	759	
Creditors		3,677	Debtors	5,737	
Long Term Liabilities			Stock	1,500	7,996
Mortgage premises		5,545	Fixed Assets		
Capital	12,000		Motor vehicles	1,731	
Add Profit	1,800 13,800		Furniture and fittings	2,560	
Less drawings	1,500	13,300	Land and building	9,235	13,526
		₦21,522			₦21,522

(ii) Order of permanence approach

Gani Fawemi
Balance sheet as at 31st December, 19 x 09

	₦	₦		₦	₦
Capital	12,000		Fixed Assets		
Add profit	1,800 13,800		Land & buildings	9,235	
Less drawings	1,500	12,300	Furniture and Fittings	2,560	
Long Term Liabilities			Motor vehicle	1,731	13,526
Mortgage premises		5,545	Current Assets		
Current Liabilities			Stock	1,500	
Creditors		3,677	Debtors	5,737	
			Cash	759	7,996
		₦21,522			₦21,522

(iii) The Vertical Approach

Gani Fawemi
Balance sheet as at 31st December, 19 x 09

	₦	₦
Capital	12,000	
Add net profit	1,800 13,800	
Less drawings	1,500	12,300
Long Term Liabilities		
Mortgage premises		5,545

Fixed Assets:		
Land and buildings	9,235	
Furniture and fittings	2,560	
Motor vehicles	1,731	13,526

Current Assets:		
Stock	1.500	
Debtors	5,737	
Cash	759 7,996	
Less current liabilities		
Creditors	3,677	
Working capital		4,319
		₦17,845

(b) ₦ ₦

(i)	Capital Invested	=	Original Capital			12,000
(ii)	Capital owned	=	Capital at beginning		12,000	
			Add net profit		1,800	
					13,800	
		Less drawings			1,500	
(iii)	Capital employed	=	Capital owned		12,300	
		Add Total Liabilities:				
		Long-Term Liabilities		5,545		
		Current Liabilities		3,677	9,222	
					21,522	
(iv)	Working Capital =	Current Assets		7,996		
		Current Liabilities		3,677	4,319	

SELF ASSESSMENT EXERCISE

(a) Is it correct to define a picture of the dynamic process of a business?
(b) Outline the major components of a balance sheet.

4.0 CONCLUSION

A balance sheet always show the business as being in a condition of equality: what it owns equals to what it owes to either its creditors or its owners. This can be expressed in the form of as equation:

Assets = Liabilities + owners equity.

This relationship does not of itself imply that the business is in a satisfactory financial condition as the equality may have been preserved by treating a loss as a fictitious asset or deducting it from the owners equity.

5.0 SUMMARY

This study unit has:

- Defined a balanced sheet
- Discussed the major components of a balance sheet
- Gave the main formats for preparing a balance sheet
- Demonstrated how a balance can be prepared.

6.0 TUTOR-MARKED ASSIGNMENT

1. Prepare Mallam Labaran's balance sheet, using vertical method, from the figures given below:

Mallam Labara Trial Balance as at 31st March, 2009.

	Dr.	Cr
Capital		20,000
Furniture and Fittings	5,000	
Drawings	1,000	
Profit and Loss Accounts		5,000
Motor Vehicles	9,000	
Premises	10,000	
Debtors	2,000	
Closing Stock	1,000	
Creditors		5,000
Cash	2,000	
	30,000	30,000

2. Prepare Gwom Fwil's Balance sheet, using T-Method, from the figures given in his list of balances as at 31st December, 2009.

	Dr ₦	Cr ₦
Capital		120,000
Land and buildings	92,350	
Mortgage on premises		55,450
Drawings	15,000	
Profit and Loss account balance		18,000
Furniture and fittings	25,600	
Motor Vehicles	17,310	
Closing Stock	15,000	
Debtors	57,370	
Creditors		**36,770**
Cash book balance	7,590	
	230,220	230,220

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UNIT 4 ADJUSTMENTS IN THE FINAL ACCOUNTS

CONTENTS

7.0 References/Further Reading

1.0 INTRODUCTION

Many changes in a company's economic resources and obligations occur continuously. Other resources and obligations such as employee salaries originate as service is rendered, with payment to follow at specified dates. The end of the accounting period generally does not coincide with the receipts or payments of cash associated with all the types of resource changes. Adjusting entries are therefore, used to record such resource changes to ensure the accuracy of the financial statements. This study unit considers some of the adjustments most commonly used in the preparation of the final accounts, also, the treatment of such adjustments in both the profit and loss account and the balance sheet.

2.0 OBJECTIVES

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

- explain why adjusting entries are necessary
- explain and pass entries in respect of provisions
- explain and pass entries with respect to reserves
- explain and pass entries in respect of accruals and prepayments
- record increases and decreases in provisions and reserves
- calculate and make entries with respect to discounts received or given
- prepare profit and loss account and balance sheet showing the treatment of bad; debts, provision for doubtful debts, depreciation and provision for discount on debtors and creditors.

3.0 MAIN CONTENT

3.1 Provisions, Reserves, Accruals and Prepayments

One of the basic tenets of accounting is that proper provision should be made for known losses, but no profit should be assumed until it has been realized. In order to prevent higher profits than justified being assumed and then distributed to the owners of the business, entries in the revenue accounts should be made to reflect this conservative approach. These fall into two main groups – the creation and maintenance of provisions and the creation and maintenance of reserves.

Provisions are debited to the profit and Loss account while reserves are debited to the Appropriation Account. There has always existed some confusion as to the precise distinction between provisions and reserves, but the fact is that a provision means any amount written off or retained by way of providing for depreciation, renewals or diminution of assets or retained by way of providing for any liability of which the amount cannot be determined with substantial accuracy. While reserve shall include any amount written off or retained by providing for any known liability or any sum set aside for the purpose of it being used to prevent undue fluctuations in charges for taxation.

3.1.1 Provisions

The most common reasons for creating provisions are to allow for expected losses, such as bad debts and to provide for depreciation. The provision accounts should be designated with their purpose (for example, Provision for Depreciation, etc) and deducted in the balance sheet from the asset concerned.

Provision for Bad debts is created and maintained to recognize that it is unlikely for all the debtors to pay. The method of deciding on the proportion varies from business to business. Where there are a large number of relatively small value debtors, the easiest method is to fix the level of the provision for bad debts at a predetermined percentage of the total debtors figure. As the debtors figure alters, so will the provision for bad debts, debiting or crediting the profit and loss account as appropriate. The percentage figure chosen will be established in the light of experience, and will be based on the debtors figure after bad debts have been identified and transferred to the bad debts account.

Where the number of debtors is small but the amounts are large, the provision may be reached after reviewing each debtor in turn and deciding if there is any risk of loss. Banks use this method for the larger borrowers.
It is important to appreciate that when a bad debt is incurred, it is usual to debit it to the Profit and Loss Account (via Bad Debts Account) and not the provision for Bad Debts Account. At first thought this seems illogical but it should be remembered that the level of provision for bad debts have been excluded, and so it is consistent with the general policy of taking a conservative view of the state of the business. In any event, from a purely mathematical standpoint, if the provision for Bad Debts Account were debited with bad debts, the amount of these would be reflected in the larger amount which would have been charged to the Profit and Loss Account to restore it to its proper level.

Methods of showing provisions in the Balance sheet (Assets portion)

	₦	₦
Machinery at cost		70,000
Less: Depreciation at the beginning of the year	7,000	

Depreciation for the year	3,500	10,500
Net Book Value (NBV)		59,500
Sundry Debtors	30,000	
Less: Provision for bad debts	1,500	28,500

3.1.2 Reserves

These are created to conserve liquidity, for example, General Reserve, and to enable the business to repay a long-term liability such as a debenture or capital such as redeemable preference shares. The reserve account is not of course a source of liquid funds but merely denotes the extent to which past profits have been left with the business to finance the various assets shown in the balance sheet.

3.1.2.1 Types of Reserves

General Reserve – will probably have been built up over a number of years by appropriation of profits, which could otherwise have been distributed. In times of low profitability, it is quite in order to transfer from the General Reserve so that a dividend distribution can be maintained.

Capital Reserve - an indication that such monies may not be distributed as a dividend. Any profit arising on a revaluation of property, for example, will be treated as a capital reserve, such profit not being available for dividend purposes until it is actually realized.

Share Premium Account – arises when a company issues shares at a price which is higher than their nominal value. This 'profit' cannot be distributed as a dividend but can be used to meet the expenses arising from the issue of shares and other purposes. The share Premium Account is regarded as a capital Reserve.

Fund and Sinking Fund – the word Fund should be restricted to those reserves which have specific investment, made outside the business. A sinking Fund describes a fund, which increases annually as appropriations of profit and investment are made according to a predetermined plan by fixed installments.

Methods of showing reserves on the balance sheet (shareholders interests section)

	₦	₦
Issued share capital		80,000
Capital Reserves-		
Capital Reserves	20,000	
Share Premium Account	10,000	

Sinking Fund Reserve Account	1,000	31,000
Revenue Reserves –		
General Reserve	27,500	
Profit and Loss Account	6,500	34,000

3.1.3 Accruals and Prepayments

The main purpose of preparing annual final accounts and balance sheets is to provide the owners of the business with a record of the way in which the business is proceeding. At the date chosen for producing the figures, the income and expenditure accounts (that is, Revenue Accounts) are ruled off and the amounts transferred to the profit or loss for the period concerned. If this is to be accurate, it must be arrived at using figures for expenses and income, which relate to the current period only. It is very seldom that items such as rates, rent and insurance premiums relate exactly to the financial year for the business and so adjustments have to be made to ensure that the charge to profits reflects the actual cost for the period concerned. This involves carrying forward into the next period any payments, which may have been made in advance, or making adjustments in respect of expenses which have not been paid.

Whilst from a mathematical standpoint, it might appear that a business can add to its profits and income which is accrued but not received, the prudent business will not do this unless the income will definitely be received. Where doubt exists, the appropriate provision will be made for the accrual.

EXAMPLE 1

Gatti Distributes Mattresses. During the four years ended 31st December 2003, 2004, 2005 and 2006, the following debts were written off as bad:

	₦
July 2003	1,700
June 2004	800
September 2005	750
November 2006	1,250

On 31st December 2003, the total debtors remaining was ₦17,000. It was decided that provision should be ₦355.

On 31st December 2004, the total debtors was ₦25,000. The provision was ₦680.

On 31st December 2005, the total debtors remaining was ₦33,000. The provision was to be ₦530.

On 31st December 2006, the total debtors remaining was given as ₦35,000. The provision was estimated to be ₦750.

You are required to prepare the necessary accounts

1. Using method 1: Where provision for doubtful debt is created.

SOLUTION TO EXAMPLE 1

Dr. Bad Debts Account Cr

		₦			₦
2003			2003		
Dec. 31	Sundries	1,700	Dec. 31	P & L	1,700
2004			2004		
Dec. 31	Sundries	800	Dec. 31	P & L	800
2005			2005		
Dec. 31	Sundries	750	Dec. 31	P & L	750
2006			2006		
Dec. 31	Sundries	1,250	Dec. 31	P & L	1,250

Dr Provision for Doubtful Debts Account Cr

		₦			₦
2003			2003		
Dec 31	balance c/d	355	Dec 31	P & L a/c	355
2004			2004		
Dec 31	balance c/d	680	Jan 1	balance b/d	355
			Dec. 31	P & L a/c	325
		680			680
2005			2005		
Dec 31	balance c/d	530	January1	balance b/d	680
Dec 31	P & L a/c	150	Dec 31	P & L a/c	680
		680			
2006			2006		
Dec 31	balance c/d	750	January 1	balance b/d	530
			Dec 31	P & L a/c	220
Dec 31	P & L	750			750

Dr	Profit and Loss Account		Cr
2003	₦		₦
Bad debts	1,700	2003	
Provision for bad debts	355	Reduction in provision	
		For Bad debts	150
2004			
Bad debts	800		
Provision for bad debts	325		
2005			
Bad debts	750		
2006			
Bad debts	1,250		
Provision for bad debts	220		

Dr	Balance Sheet Extract		Cr
		₦	₦
	2003		
	Debtors	17,000	
	Less provision for bad debts	355	16,645
	2004		
	Debtors	25,000	
	Less provision for bad debts	680	4,320
	2005		
	Debtors	33,000	
	Less provision for bad debts	530	32,470
	2006		
	Debtors	35,000	
	Less provision for bad debts	750	34,250

Method 2

In this method, the adjustments for provisions are made on the debit of the Bad debts account. There is no separate account for provision for doubtful debts. It is carried down as a credit balance in the bad debts account.

The following accounts must be prepared:

1. Bad debts account
2. Profit and loss account
3. Balance sheet

Using the question above, the ledger entries are as follows:

Dr — Bad Debts Account — Cr

2003	₦	2003	₦
Dec 31 Sundries	1,700	Dec 31 P&L a/c	2,055
Dec 31 provision for doubtful debts	355		2,055
	2,055	2004	
2004		Jan 1 Provision for Doubtful Debts b/d	355
Dec 31 Sundries	800	Dec. 31 P & L a/c	1,125
Dec 31 provision for doubtful debts	680		1,480
	1,480	2005	
2005		Jan 1 Provision for doubtful debts b/d	680
Dec 31 Sundries	750	Dec 31 P & L a/c	600
Dec 31 provision for doubtful debts	530		1,280
	1,280		
2006		2006	
Dec 31 Sundries	1,250	Jan 1 Provision for doubtful debts b/d	530
Dec 31 provision for doubtful debts	750	Dec 31 P & L a/c	1,470
	2,000		2,000

Dr — Profit and Loss Account — Cr

	₦	
2003 Bad debts	2,055	
2004 Bad debts	1,125	
2005 Bad debts	600	
2006 Bad debts	1,470	

Dr **Balance Sheet Extract** **Cr**

		₦	₦
	2003		
	Debtors	17,000	
	Less provision for bad debts	355	16,645
	2004		
	Debtors	25,000	
	Less provision for bad debts	680	24,320
	2005		
	Debtors	33,000	
	Less provision for bad debts	530	32,470
	2006		
	Debtors	35,000	
	Less provision for bad debts	750	34,250

EXAMPLE 2

Jakande John Ltd has paid rates in advance for six months from 1 October, 2006. The Company's financial year ends 31 December, 2006.

The rates paid were N3,000
Show the rate for the whole financial year assuming that rates are paid on 1 April and 1 October each year and have not been altered for the past two years.

SOLUTION TO EXAMPLE TWO

In the Books of Jakande John Ltd

DR ***RATES ACCOUNT*** **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
2005			₦	2006			₦
Dec. 31			1,500	Dec. 31	Profit & Loss		6,000
2006	Balance	c/d					
Apr.1	Bank		3,000				
Oct.1	Bank		3,000		*(rates in advance to 31/3/2007)*		
				Dec. 31	Balance	c/d	1,500
			7,500				**7,500**
Dec. 31	Balance	b/d	1,500				

DR ***RENTS ACCOUNT*** **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
			₦				₦
Mar. 3	Bank		5,000	Dec. 31	Profit & Loss		20,000
Jun 31	Bank		5,000				
Sept.31	Bank		5,000				
Dec.31	Balance	c/d	5,000				
			20,000				**20,000**
				Dec. 31	Balance	b/d	5,000

DR **LOAN INTEREST RECEIVED ACCOUNT** **CR**

Date	Particular	Folio	Amount	Date	Particulars	Folio	Amount
2006			₦	2006			₦
Dec. 31	Balance	b/d	5,000	Jan. 31	Paule Ltd.		6,000
2006							
July 31	Paule Ltd *(Interest Due)*		6,000	Dec. 31	*(Interest Due)* Profit & Loss A/c)		12,000
Dec.31	Balance	c/d	5,000				
			17,000				**17,000**
Dec. 31	Balance	b/d	5,000				

As you can see, the payment made in advance is carried and brought down as a balance on the account and so, the correct amount is charged to Profit and Loss A/c as Rates for the financial year.
The same idea is shown in the two following examples. Due to an oversight, the same company has not paid the one-quarter's rent due on its premises up to 31 December, 2006. Rent is N20,000 per annum payable on the last day in each quarter. Show the Rent Account.

Jakande John Ltd has made a fixed loan of N12,000 to Paule Ltd, an associate company, and interest at 10 percent per annum is payable in arrears every six months on 31 January and 31 July. Jakande John Ltd prepares its annual accounts to 31 December each year. *Show the income account for the relevant period.*

The balance sheet for the year 2006 will show the accrued items in the following way:

<u>JAKANDE JOHN LTD</u>

Balance sheet as at 31 December 2006

Sundry Creditors:	₦	*Sundry Debtors:*	₦
Rent due	5,000	Rates in advance	1,500
		Interest accrued	5,000

SELF ASSESSMENT EXERCISE

1. Yohanna Ltd has paid a twelve months rent with effect from 1 October, 2006. The Company's financial year ends 31 December, 2006. The rent paid was N12,000

Show the rent for the whole financial year assuming that rent is paid on regular basis by every 1 October each year and have not been altered for the past two years.

2a) What is provision?
b) Differentiate between reserves and provisions
c) State the divisions of reserves
d) What is bad debts?
e) Define provision for doubtful debts

4.0 CONCLUSION

Accountants rely on two principles in the adjusting process – revenue recognition and matching principles. The revenue recognition concept requires that revenue be reported when earned, not before and not after. Revenue is earned for most firms when services and products are delivered to customers. The matching principle on the other hand, aims to report expenses in the same accounting period as the revenues that are earned as a result of incurring these expenses. The matching of expenses with revenue is a major part of the adjusting process.

5.0SUMMARY

This unit has discussed in details the following among others:

- The need for adjusting entries;
- Computing and making entries for provisions;
- Calculated and recorded reserves;
- Computed and recorded prepayments, accruals and discounts;
- Showed how these adjustments are treated in profit and loss account and the balance sheet including adjusting entries.

6.0 TUTOR-MARKED ASSESSMENT

1. A trader's books (Mr. Handsome Ada) show the following balances for the year ended 2005, 2006:

Year ended	Provision for Discount Allowed	Provision for Discount Received
	₦	₦
2005	1,500	3,000
2006	2,000	4,000

On 31st December 2005, the total debtors were ₦15,000 and creditors ₦17,000.
On 31st December 2006 the total debtors was ₦20,000 and creditors ₦18,000.
You are required to prepare the necessary accounts.

2. Celestine distributes Adidas football. During the four years ended 31st December 2003, 2004, 2005 and 2006, the following debts were written off as bad:

	₦
July 2003	1,700
June 2004	800
September 2005	750
November 2006	1,250

On 31st December 2003, the total debtors remaining was ₦17,000. It was decided that provision should be ₦355.
On 31st December 2004, the total debtors was ₦25,000. The provision was ₦680.
On 31st December 2005, the total debtors remaining was ₦33,000. The provision was to be ₦530.
On 31st December 2006, the total debtors remaining was given as ₦35,000. The provision was estimated to be ₦750.
You are required to prepare the necessary accounts

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UNIT 5 DEPRECIATION OF FIXED ASSETS

CONTENTS

1.0 INTRODUCTION

Fixed assets are assets of a permanent nature and they create revenue for the business. Fixed assets of a business lose value or are said to depreciate with usage.

In the same way that a business has to pay for the cost of heating, lighting and power, so it must reflect in its calculation of profits and losses the use of the fixed assets employed. The charge for this is depreciation and should be calculated by one of the recognized methods set out in International Accounting Standard and the Statement of Accounting Standard (SAS 9) according to the circumstances of the business. You should appreciate that there is no statutory requirement to charge for depreciation; neither, when it is charged, is there a set of rules stipulating how the annual charge is to be calculated. However, the overriding factor is that for a limited company, Companies and Allied Matters Act (CAMA) 1990 requires the annual accounts and balance sheet to reflect a true and fair view of the company's affairs. The Institute of Chartered Accountants of England & Wales (ICAE&W) makes recommendations and these give guidance in deciding how a company should achieve the "true and fair view.

The annual charge for depreciation decided upon by a business is an attempt to reflect the fall in value of a fixed asset because of wear and tear, the passage of time, or some other factors. Generally, land is not depreciated, although there may be exceptions as in the case of say a gravel quarry.

It is very rare that the depreciated value of a fixed asset as shown in a balance sheet correctly reflects the current resale value of that asset. This may seem to be a contradiction of the requirement to present a 'True and Fair View' but it should be remembered that the fixed assets exist to enable the business to earn profits and are not held for the purposes of resale. Fluctuations in the value of the fixed assets are usually ignored unless they are of a permanent nature as this would lead to an erratic profits record not truly reflecting the trading performance of the business.

2.0 OBJECTIVES

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

- define Depreciation and explain why accountants provide for depreciation in the final accounts
- explain the causes of depreciation

- outline methods of depreciating fixed assets
- calculate depreciation using the various methods.

3.0 MAIN CONTENT

3.1 Definition of Depreciation

The process of recognizing the loss in the value of fixed assets is called depreciation. The Ghana National Accounting Standards (GNAS 10) defines depreciation as: "the allocation of the depreciable amount of an asset over its estimated useful life". The Nigerian SAS No. 9 states that deprecation "represents an estimate of the portion of the historical cost or re-valued amount of a fixed asset chargeable against operations during an accounting period". The standard also recognizes the fact that depreciation for the accounting period is charged to income, either directly or indirectly. This definition implies that depreciation is effectively an accrual technique, which matches the cost of a fixed asset with the benefits, which are derivable from the asset (ATSWA, 2009: 153).

Unless assets are depreciated, their value may sometimes be overstated on the balance sheet. Assets such as plant and machinery are held for the purpose of earning income, and the loss arising on those assets through wear and tear is undoubtedly an expense against such income. If depreciation was not provided for by charges against profits, additional capital would have to be raised whenever the necessity for replacing the asset arose. Three factors contribute in deciding on the amount of depreciation to be charged in the final accounts:

(i) Original or historical cost of the asset;
(ii) Estimated life of the asset;
(iii) Estimated scrap, residual or break-up value of the asset.

3.2 Causes of Depreciation

1. **Physical deterioration**
2. **Wear and Tear:** An asset may depreciate in quantity, quality and value as a result of constant usage. Physical factors like erosion, dampness, rust and decay can cause an asset to reduce in value;
3. **Obsolescence:** An asset can become obsolete due to changes in technology. When this occurs, it is due for replacement. A very good example is the steam engine train;
4. **Passage of time:** Depreciation occurs in some assets with the effusion of copy rights;

5. **Depletion:** Some natural resources like gold, oil or tin deposits become worthless when the deposits have been depleted. They are called wasting assets. The more they are extracted, the less the reserve;
6. **Inadequacy:** As a result of expansion in the productive capacity of a company, an asset may become too small an inadequate and thus require replacement for bigger ones.

3.3 Methods of Depreciation

There are various methods of depreciating fixed assets. These are:

i) Straight Line Method
ii) Diminishing or Reducing Balance Method
iii) Annuity Method
iv) Sinking Fund Method
v) Retirement and Replacement Method
vi) Sum of the Year Digit Method
vii) Depletion Unit Method
viii) Insurance Policy Method
ix) Revaluation Method.

The method to be adopted is a matter of policy on the part of management of the business. However, consistency must be applied. This means that all similar assets should be depreciated using the same method and the same method should be used every year.

Straight Line Method

The life of the asset is estimated, together with any remaining scrap or resale value at the end of that period. The scrap value is deducted from the original cost, and the remaining figure divided by the number of years 'useful life' of the asset. The figure calculated is the amount of the yearly depreciation charge.

EXAMPLE 1

A machine costs N100,000 with an estimated 'life' of 5years. The 'trade in' value or scrap value is estimated at N5000. Use the straight line method to compute the yearly depreciation charge.

Formula to be adopted is: $\dfrac{\text{cost} - \text{Scrap value}}{\text{Life (Years)}}$

$$= \frac{100{,}000 - 5000}{5}$$

Therefore, annual depreciation charge is N19,000

As mentioned earlier, the depreciation charge may be credited to the asset account (for example, machine Account) or to a separate Provision for Depreciation of machine Account. Either way, each year, the value of the asset shown in the balance sheet will reduce by an equal amount. However, the latter way of treating depreciation is more recommendable.

The straight-line method or fixed installment (as sometimes called) is generally favoured. It is a method recommended for the depreciation of assets such as freehold buildings, plant and machinery, tools and equipment, ships, transport vehicles, leases, and patents.

Reducing Balance or Fixed Interest Method

The entries passed can be identical to the straight-line method; the difference is in the method of calculating the annual depreciation charge. Instead of an equal amount being passed each year the figure is calculated as a fixed percentage of the reduced balance on the asset account brought forward from the previous year.

EXAMPLE 2

Assuming that the annual depreciation rate is 20 percent using the reducing balance method and the cost of the machine is N100,000 as in our example above.
Formulae:

Year I: Depreciation charge = cost x 20%
Year II: Depreciation = (Cost – Depreciation of year 1) x 20%
Year III: Depreciation = (cost – Depreciation of year 1 & II) x 20%

Therefore, the calculations will appear thus:

Year I: Depreciation = 100,000x20% = ₦ 20,000
Year II: Depreciation = (100,000-20,000) x 20% = ₦ 16,000
Year III: Depreciation = (100,000-20,000-16,000) x 12% = ₦ 12,800`

Sinking Fund Method

Unless the business physically sets aside cash when passing entries for depreciation, there is no certainty that sufficient liquid funds will be available when the assets need replacement. The effect of debiting the profit and loss Account with the depreciation charge is to reduce profits and thus reduce the ability of the owners to draw all their profit entitlements but 'plough back' at least some of these to help the business grow. These liquid funds are then absorbed by enabling the business to purchase extra stocks, or allowing debtors to increase. The sudden withdrawal of a large sum of money to finance the replacement of a fixed asset, even if possible, is quite likely to cause difficulties, which the business will probably prefer to avoid. Cash shortage problems at asset replacement time is one of the main purposes for using the Sinking Fund Method. In effect, this is action carried out in addition to the normal book entries for depreciation. The sinking fund method involves investing cash equal to the annual depreciation charge in a fixed interest yielding investment/stock. Interest that accrues on the investment is reinvested and together with the further annual investments over the life of the asset should produce a fund which is sufficient to replace the asset being depreciated.

EXAMPLE 3

A machine purchased today at a cost ₦ 100,000 is expected to be replaced after 5 years. The old machine is expected to realize ₦ 20000 when disposed in 5 years, time while the new machine is anticipated to cost ₦ 120000. Hence, the sum of ₦ 100,000 will be expected to make up for the cost of the machine in 5 years time.

The company adopts sinking fund method of depreciation and decides to set aside an equal annual amount which at an interest of 5% will provide ₦ 100,000 in 5 years time. According to an annuity table, ₦ 0.180975 invested annually at 5% will provide N1 in five years time. Therefore the depreciation needed on an annual basis will be:

= ₦ 0.180975x100,000
= ₦ 18,097.50

Accounting entries of the sinking fund method

Profit and loss Account – *debited with the annual depreciation charge (₦ 18, 097.50)*
Depreciation (or sinking) fund account- *Credited with the annual charge (₦ 18097.50)*
Depreciation (or sinking) fund Investment Account – *debited with the cash invested (₦ 18097.50)*

Cash Account – *credited with the cash invested (₦ 18, 097.50)*

As interest or dividends are received

Cash Account – *debited with the amount of the interest or dividend (₦ 904.88 at end of year 1)*
Depreciation (or sinking) fund account– *credited with the amount of the interest or dividend (₦ 904.88 in end of year 2)*

Subsequently

Depreciation (or sinking) fund investment Account-*Debited with the interest which is invested (probably)*

At the same time as the annual depreciation charge is invested) i.e ₦ 904.88 at the beginning of year 2.

Cash Account- *credited with the amount which is invested.*

In this way at the end of each year the balances on the Depreciation fund Account and the Depreciation fund investment Account will be equal.

Insurance Policy Method

This is similar in concept to the sinking fund method in that liquid funds will be available to replace the asset. The essential difference is that Insurance Company will undertake to repay a stated sum of money at the end of the depreciation period in return for an annual premium. In this case, the amount of the annual premium is the amount of the depreciation charge to the profit and loss Account. The accounts and entries used are –
Depreciation Policy Account – *debited with annual premium*
Cash Account – *credited with the annual premium*
Profit & Loss Account – *debited with the annual depreciation amount.*
Depreciation Policy Fund Account- *credited with the annual depreciation amount*.

Depletion Method

This method is used to depreciate a mine or quarry. The rule is that the cost of the asset is depreciated in the same proportion as the annual amount extracted bears to the total raw materials estimated at the outset.

For example, if the estimated yield of a quarry is 800,000 tons and 120,000 tons (that is, 15% of the total estimated are extracted in a year, then one tenth of the original cost) will be depreciated in the year.

Annuity Method

The principle involved is that cash invested in an asset could have been invested elsewhere to earn a profit. To compensate for this, interest is charged to the asset account and credited to profit and Loss Account, whilst the annual charge for depreciation is debited to the profit and loss account. As the balance of the account falls so is the interest (which is calculated on the outstanding balance) reduces. The effect is that the net charge to profits for depreciation increases over the life of the asset. The method is most suitable for long leases involving high initial outlays, but having an accurately determined life. The rate of interest can either be the rate expected on normal investments or the rate the business earns on its own capital.

Sum of the Year Digit (SYD) Method

This method like the diminishing balance method, also seeks to accelerate the accumulation of depreciation. Under this method, a decreasing depreciation is computed by a simple mathematical procedure relating to arithmetical progression. Each year of an asset's life should be represented by a digit. Add these digits and charge fraction of the asset cost to the years in a reverse order.

EXAMPLE 4

Assuming machine 'X' costs ₦ 10, 000 and has an estimated useful life of 5 years, what will be the depreciation for at least the first three years using SYD method.

Solution:

Step 1: SYD= 1+2+3+4+5=15

Where the number of years (n) is large SYD is given by the expression:

$$\frac{N(n+1)}{2}$$

Applying this formula to the data given we have:

$$\frac{5(5+1)}{2} = \frac{5(6)}{2} = \frac{30}{2} = 15$$

Step 2:

Year one depreciation charge

$$= \frac{\text{No of years remaining}}{\text{SYD}} \times \text{cost of asset}$$

$$= \frac{5}{15} \times 10000 = ₦\ 3{,}333.33$$

Year two depreciation charge

$$= \frac{4}{15} \times 10000 = 2{,}666.67$$

Year three depreciation charge

$$= \frac{3}{15} \times 10000 = ₦\,2,000$$

It would be observed that this method also yields reducing yearly charges, although the rate of decline is less steep than is the case with the reducing balance method. An important difference between the two methods is that the SYD does not yield any residual (scrap) value unless explicitly brought into the computation.

AMORTISATION

Amortization and depreciation are related concepts in that both attempt to allocate costs over different accounting periods. However, while depreciation is concerned with allocating cost of tangible fixed assets, amortization is concerned with intangible fixed assets, such as Goodwill, trade marks and patents whose values are gradually lost within a determined period. It is usually computed using a simple formula:

$$\frac{\text{Value of intangible asset}}{\text{No. of years}}$$

The usual accounting entry is to debit profit and loss account and credit the relevant (deferred revenue expenditure or intangible asset) account. Note that differed revenue expenditure such as long term advertising cost, preliminary or formation expenses etc are also amortized.

3.4 Accounting for Depreciation

After calculating the depreciation charge for an accounting year, it is very important that these amounts are recorded in the books of account. The process of providing for depreciation is recording for the use of fixed assets during the accounting period. This therefore, means that depreciation is a revenue expenditure and as such must be recorded in the same manner that accountants record normal business expenses.

There are two main ways of recording depreciation in the books of account of a business organization:

3.4.1 The Old Method

Here, depreciation charges are recorded in the fixed, asset account. The double entry of depreciation is as follows:

(a) Dr. Depreciation Expenses Account, Cr. The Fixed Asset Account.
(b) Dr. Profit and Loss Account, Cr. Depreciation Expense Account.

3.4.2 The Modern Method

The modern practice of recording depreciation treats depreciation as a contra to the fixed asset account. The fixed asset account is maintained at its original cost. A ledger account called "accumulated provision for depreciation account" is opened and all depreciation calculations are credited to that account, the corresponding entry being passed into the depreciation charge account as a debit. The double entry is as follows:

Dr. Depreciation Charge (Expense) Account.
Cr. Accumulated Provision for Depreciation Account.

(i) Dr. Profit and Loss Account
Cr. Depreciation Charge Account

3.5 Disposal of Fixed Assets

An organization can dispose off its fixed assets by either selling it for cash, exchanging it for a similar asset or a different one, or merely by discarding the asset. In all these three situations, you must remember to take out the disposed asset from the main fixed asset account. This is done by opening an account for the purpose of the disposal. Into this account is entered the cost of the fixed asset and its associated accumulated depreciation provision. A profit or loss may arise from the disposal of the fixed asset depending on the outcome of the fixed asset disposal account,

3.6Accounting Entries

The old and new methods of depreciation can be applied as follows:

(a) Old Method

Where the depreciation has been credited to the asset account, the following procedures must be followed:

(i) Dr. Cash book
Cr. Asset Account } with amount realized on sale of asset.

(ii) If a profit is made on sale of fixed asset:

Dr. Asset Account }

Cr. Profit and loss account.

(iii) If a loss was sustained on disposal of fixed asset:

Dr. Profit and loss account
Cr. Assets account.

(b) Modern Method

When depreciation has been carried to a provision for depreciation account, it is best dealt with by opening the disposal account to which the original cost of the asset and the accumulated depreciation are transferred.

The procedures are:

(i)	Dr.	Asset Disposal Account	with cost price of asset.
	Cr.	Asset Account	
(ii)	Dr.	Provision for depreciation account	Accumulated
	Cr.	Asset Disposal Account	depreciation
(iii)	Dr.	Cash book	with cash or cheque
	Cr.	Asset disposal account	received on sale
(iv)	Dr.	Asset disposal account	with profit on sale
	Cr.	Profit and loss account	of asset.

It means that the balance on the fixed asset disposal account is credit. That is, the amount received from the sale is more than the net book value of the fixed asset.

(v)	Dr.	Profit and loss account	with loss on sale
	Cr.	Asset disposals account	of asset.

Where the balance on the fixed asset disposal account is debit, it means that the amount received from the sale of the fixed asset is less than the net book value of the fixed asset sold.

EXAMPLE 5

A motor car was bought for ₦ 300,000. It is to be depreciated at 25% on cost for 3 years and was sold for ₦ 100,000 at the end of the 3rd year.

Prepare:

(a) Motor car account
(b) Cash account
(c) Profit and loss account.

Using the straight line method

SOLUTION TO EXAMPLE 5

(a) Old method

	₦
Motor Car	300,000.00
Year 1 Depreciation (25% x 300,000.00)	75,000.00
	225,000.00
Year 2 Depreciation (25% x 300,000.00)	75,000.00
	150,000.00
Year 3 Depreciation (25% x 300,000.00)	75,000.00
Net book	75,000.00

Motor A/C

Dr.	₦		**Cr.** ₦
Year 1 Cash	300,000	Year 1 Depreciation	75,000
		Balance c/d	225,000
	300,000		300,000
Year 2 Balance b/d	225,000	Year 2 Depreciation	75,000
		Balance c/d	150,000
	225,000		225,000
Year 3 Balance b/d	150,000	Year 3 Depreciation	75,000
	150,000	Balance c/d	75,000
Year 4 Balance b/d	75,000		150,000
Profit on sale	25,000	Year 4 Cash book	
	100,000		100,000

Dr **Cash Book** **Cr**

	₦		
Motor Car	100,000		

Profit and Loss Account

Dr			Cr
	₦		₦
Year 1 Depreciation	75,000	Profit on sales	25,000
Year 2 Depreciation	75,000		
Year 3 Depreciation	75,000		

(b) New Method

Dr			Cr
	₦		₦
Year 1 Jan 1 Cash	300,000	Year 3 Asset Disposal	300,000

Provision for Depreciation Account

Dr.			Cr.
	₦		₦
Year 1 Balance c/d	75,000	Year 1 Profit and Loss	75,000
Year 2 Balance c/d	150,000	Year 2 Jan balance b/d	75,000
	150,000		150,000
Year 3 Balance c/d	225,000	Year 3 Depreciation	75,000
	225,000	Balance c/d	75,000
			225,000
Year 4 Asset Disposal	225,000	Year 4 Balance b/d	225,000

Asset Disposal Account

Dr			Cr
	₦		₦
Year 1 Cost of assets	300,000	Year 4 Jan Cash	100,000
		Jan 1 Provision for	

Profit	25,000	Depreciation	
	325,000	225,000	
			325,000

Profit and Loss Account

Dr			Cr
	₦		₦
Year 1 Depreciation	7,500	Profit on sales	7,500
Year 2 Depreciation	7,500		
Year 3 Depreciation	7,500		7,500

SELF ASSESSMENT EXERCISE

1. A textile manufacturing has the following machines in the factory on 1st January, 2009:

Machine Model	Cost ₦	Depreciation written off to date
Machine S	360,000	144,000
Machine T	240,000	96,000
Machine U	300,000	81,000

During the year ended 31st December, 2009, the following machines were bought on the dates shown:

Machine Model	Date	Cost ₦
Machine V	1st February 2009	420,000
Machine W	31st March, 2009	480,000
Machine X	1st August, 2009	600,000
Machine Y	1st December, 2009	720,000

On 30th June, 2009, machine U was sold for N180,000. Depreciation is written at the rate of 12% per annum on cost, new machines being depreciated from the date of purchase and any machine disposed off is depreciated up to the date of sale.

Requirement:

(a) You are required to prepare a statement showing the depreciation on each machine for the year ended 31st December, 2009.

(b) Calculate:

(i) The total depreciation for the year
(ii) The profit or loss on the disposal of machine.

2. Describe the following methods of depreciation

i) Sinking Fund Method
ii) Annuity Method

4.0 CONCLUSION

Fixed assets produce revenue through use rather than through resale. They can be viewed as quantities of economic service potential to be consumed over time in the earning of revenues. Depreciation recognition transfers a portion of acquisition cost and capitalized post-acquisition cost of fixed assets to an expense account called depreciation expense. The corresponding credit is to make provision for depreciation, a control fixed asset account that reduces gross asserts to net book value. This expense is recorded as an adjusting entry at the end of each accounting period. Depreciation expense could be classified as a selling or administrative expense, depending on the assets function.

Manufacturing firms include depreciation of plant and machinery or factory building in the cost of goods produced. When the goods are sold, depreciation becomes part of cost of goods sold.

5.0 SUMMARY

This study unit has:

- defined depreciation
- discussed the causes of depreciation
- discussed the methods of charging for depreciation
- show how accumulated depreciation is treated in situation where assets are disposed.

6.0 TUTOR-MARKED ASSIGNMENT

1a) "The word depreciation has been grossly overworked; it has been and is currently used in varying senses and with different connotations". Explain the different meanings of the word depreciation when applied to different types of long-lived assets.

b) What factors should an accountant take into consideration in determining the amount to be charged as annual depreciation of fixed assets?

c) Describe the following methods of depreciation

i) Sinking Fund Method
ii) Annuity Method

2. PALLADAN ENTERPRISES bought Five Motor Vehicles on 1st January, 2005 at a cost of N350,000 each. They were estimated to have a useful life of 10 years after which they would have a salvage value of ₦ 20,000 each.

i) Using the straight-line method of depreciation calculate the amount of depreciation to be written off in each of the ten years

ii) Show the entries for the First Five years if depreciation is written off directly from the Motor Vehicles accounts. Also show the depreciation account.

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UNIT 6 MANUFACTURING ACCOUNTS

CONTENTS

1.0 INTRODUCTION

Manufacturing firms usually prepare an additional account called manufacturing account, which shows the cost of goods produced or manufactured. The cost of goods manufactured, normally called the production costs is transferred from the manufacturing account into the Trading account by crediting the manufacturing account and debiting the trading account. The production cost effectively replaced purchases found in the trading account of a retail enterprise.

2.0 OBJECTIVES

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

- define and explain a manufacturing account
- outline sub-heads of a manufacturing account
- prepare a manufacturing account
- prepare final accounts of a manufacturing company.

3.0 MAIN CONTENT

3.1 Definition of Manufacturing Account

Manufacturing of goods is the transformation of raw materials into finished goods. Some firms have to manufacture their products before they are sold to the public. Examples are Nigeria Bottling Company, Nigeria Breweries and Cadbury Plc. whereas some merely sale products which are acquired in finished form. A manufacturing organization will acquire raw materials; engage labour and other inputs necessary to change the raw materials into finished goods. Manufacturing accounts is prepared to ascertain the cost of goods manufactured during the financial year. It is in fact an extension of the trading account.

Any concern which is involved in a manufacturing or production process should prepare a manufacturing account so that the basic costs of production can be recorded and, perhaps related to the cost of purchasing goods of similar quality in a finished state from outside sources.

The manner of preparing a manufacturing account can be varied to meet particular circumstances but, usually will be prepared to show the prime cost of production and the factory or market cost of production. The difference between the two is that prime cost is the total of direct items consisting of wages, materials and expenses, whereas factory cost also includes the cost of indirect production costs.

3.2 Format for Manufacturing Accounts

Manufacturing, Trading, Profit and Loss account of ABC Enterprises:

	₦	₦		₦	₦
Opening stock of raw materials		X	Cost of Production C/d		XX
Add purchases of raw materials		X			
Add carriage inward on raw materials		X X			
Less closing stock of raw materials		X			
Cost of raw materials consumed		X			
Add direct wages		X			
Royalties		X			
Direct Expenses		X			
Prime cost		X			
Factory overhead					
Factory power	X				
Factory rent & rate	X				
Indirect wages	X				
Factory Insurance	X				
Depreciation of plant & machinery	X				
Fuel and power	X				
Lubricants	X	X			
Add opening stock of work in progress		X X			
Less closing stock of work in progress		X			
Cost of Production		XX			XX
Opening stock of finished goods	X		Sales		x
Add cost of production	X	X			
Less closing stock of finished goods		X			
Cost of Goods sold		X			
Gross profit		X			
		XX			XX
Selling and distribution Expenses:					
carriage outwards	X		Gross profit b/d		X
Commission on sales	X		Discounts received		X
Salesmen Salaries	X	X			
Administration					
Admin Salaries	X				
Office rent	X				
Office insurance	X				
Office lighting	X				
Office machine depreciation	X	X			
Net Profit		X			
		XX			XX

The sequence and grouping of items in a manufacturing account depends on the costing system of the firm and is usually designed to yield the maximum amount of information on the composition of the total cost of production.

Manufacturing account is prepared using both the T-Method as in the format above and the Vertical method as in the example below.

EXAMPLE

ABA FOOT WEAR COMPANY is manufacturer of shoes. On 31st December, 2006 the company had the following balances:

	₦
Furniture & Fittings	73,500
Bank Overdraft	4,800
Drawings	26,750
Machinery	328,400
Office Equipment	85,630
Cash in hand	2,760
Delivery Van	124,500
Salaries & Wages	98,140
Stock on 1st January 2006:	
Raw Materials	22,610
Work-in progress	17,300
Finished Shoes	156,400
Capital	727,500
Factory wages	68,130
Factory insurance	4,900
Provision for bad Debts	2,510
Administrative Expenses	16,470
Sundry Creditors	223,920
Factory repairs and Maintenance	34,690
Bad Debts	5,330
Land & Building	467,200
Sundry Debtors	89,490
Purchases of raw materials	215,820
Lighting & Cooling	8,350
Selling expenses	19,040
Sale of shoes	975,220
Stationeries	47,180
Repairs of Delivery van	21,360

The following additional information is also given:

1. A debt of N130 is considered irrecoverable and should be written off
2. Stationery of ₦ 570 is unused
3. Lighting and cooling is to be allocated to factory and office in the ratio of 5:1

4. Provision for Bad Debts is to be adjusted to 2.5 percent of the new balance of sundry debtors.
5. Factory wages of ₦ 1,870 are yet to be paid
6. Depreciation is to be written off the Machinery at 5 percent and all other fixed assets except land and Buildings at 10 percent.
7. Stocks on 31st December, 2006 were.

	₦
Raw materials	36,620
Work in progress	12,750
Finished shoes	181,340

You are required to prepare:

a) Manufacturing Account
b) Trading, Profit and loss Accounts for the year ended 31st December, 2000, and
c) A Balance Sheet as at that date.

SOLUTION

ABA FOOTWEAR COMPANY

a) MANUFACTURING ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER, 2006

	₦	₦	₦
RAW MATERIAL:			
Opening Stock		22,610	
Add Purchases		215,820	
		238,430	
Less Closing Stock		36,620	201,810
FACTORY COSTS:			
Wages	68,130		
Add Amount Accrued	1,870	70,000	
Insurance		4,900	
Repairs and Maintenance		34,690	
Lighting & Cooling (5/6 x 8,350)		6,958	
Depreciation on Plant & Machinery		16,420	132,968

(328,400 x 5%)

WORK IN PROGRESS (W.I.P)				
Opening Stock			17,300	
Less Closing Stock			12,750	4,550
Cost of Goods Produced and Transferred to Trading A/c				339,328
Sales				975,220
FINISHED GOODS:				
Opening Stock			156,400	
Cost of Goods Produced			339,328	
			495,728	
Less Closing Stock			181,340	
Gross Profit				314,388
				660,832
LESS OPERATING EXPENSES:				
Salaries & Wages			98,140	
Provision for Bad Debts				
(2,510 – (89,490 -130) x 2.5%)			276	
Administrative Expenses		16,470		
Bad Debts (5,330 + 130)		5,460		
Lighting & Cooling (1/6 x 8,350)			1,392	
Selling Expenses			19,040	
Stationery		47,180		
Less Unused Stock		570	46,610	
Repairs of Delivery Van			21,360	
Depreciation:				
Furniture & Fittings		3,675		
Office Equipment		4,282		
Delivery Van	6,225			
Land & Buildings	46,720		60,9022	69,098
Net Profit				391,734

c) BALANCE SHEET AS AT 31ST DECEMBER, 2006

	COST	DEP.	NBV
FIXED ASSETS:	₦	₦	₦
Land & Buildings	467,200	46,720	420,480
Plant & Machinery	328,400	16,420	311,980
Office Equipment	85,630	4,282	81,348
Furniture & Fittings	73,500	3,675	69,825
	954,730	71,097	883,633
CURRENT ASSETS:			
Stocks: Raw Materials		36,620	
W. I. P.		12,750	
Finished Goods	181,340		
Stationery	570	231,280	
Debtors: Balance as per A/c	89,360		

Additional B/Debt (130)			
Prov. for B/Debt	(2,234)	86,996	
Cash in Hand		2,760	
		325,634	
LESS CURRENT LIABILITIES:			
Sunday Creditors	223,920		
Bank Overdraft	4,800		
Accrued Wages	870	230,590	95,044
			1,045,952
FINANCED BY:			
Capital			727,500
Add Net Profit Carried Forward			391,734
			1,119,234
Less Drawings			73,282
			1,045,952

3.2.1 Work in Progress

This can be defined as the partly finished goods or incomplete work. The cost of production must be adjusted for work in progress at the beginning and end of the year.

3.3 Transfer Pricing

The usual practice in the preparation of manufacturing account is to transfer the production cost to the trading account at historical cost. This means that the manufacturing account will not record any profit and for that matter, one will not know whether the manufacturing process is profitable.

A technique is therefore devised with the purpose of ascertaining profit on the manufacturing account. This is done by transferring from the manufacturing account the market value of the goods produced for the period. The reason for the use of the market value as the transfer figure to the trading account is to ascertain the cost of the manufactured item, had the firm decided to acquired those products in the open market instead of producing them. In this situation, the manufacturing account will show a balance, which will reveal either a profit or loss on production.

SELF ASSESSMENT EXERCISE

1. Define transfer pricing as it relates to manufacturing accounts.

2. XYC Ltd is a manufacturing company. The following is an extract from the company's books for the year ended 31st December, 2009:

	₦
Stock of raw materials as at 1st January	30,000
Purchases of raw materials	240,000
Return outwards (raw materials)	2,000
Manufacturing wages	40,000
Office salaries	28,000
Royalties	10,000
Opening stock of finished goods	13,000
Carriage outwards	2,400
Printing and stationery	5,600
Rent and rates	16,000
General expenses	26,000
Travelling expenses	16,800
Factory expenses	10,000
Sales	480,000

You are also supplied with the following additional information:

(a) Depreciation of 10% is to be charged on pant and Machinery worth 20,000

(b) The following were on hand at 31st December 2009:
Stock of raw materials 16,000
Stock of finished goods 15,000

(c) Half of the rent and rates is chargeable to the manufacturing account.

Required:

Prepare the manufacturing, trading and profit and loss account fore the year ended 31st December, 2009.

4.0 CONCLUSION

Enterprises that manufacture products for sale require an additional account called manufacturing accounts to record the total cost incurred in producing the products. The manufacturing accounts are utilized to ascertain the cost of the goods manufactured and to also ascertain the amount of any profit on the manufacturing process.

5.0 SUMMARY

This study unit has treated exhaustively:

- The need for manufacturing accounts
- Formats for preparation of manufacturing accounts
- Cost elements of the manufacturing account
- Prepare a manufacturing account
- Explain the principle of transfer pricing.

6.0 TUTOR- MARKED ASSIGNMENT

1. Below is the data Mallam Sule, a manufacturer of Pure Water, for the year ended 31st December, 2009

	₦
Stock of Raw materials at beginning	300,000
Purchases Raw materials	1,200,000
Stock of Raw materials at end	500,000
Work in progress at end	500,000
Direct Wages	600,000
Direct Expenses	100,000
Indirect wages	300,000
Indirect material	200,000
Depreciation & plant	50,000
Factory Rent & rates	150,000
Work in progress at start	600,000

You are required to prepare a Manufacturing Account for the business concern.

2. The following balances existed in the books of NISCOCO Beauty Soap Manufacturing Company Plc as at 31st December, 2006

	₦
Selling & Administrative Expenses	3,826
Rent	16,950
Sundry Creditors	8,749
Plant & Machinery	276,510
Stock on 1st Jan. 2005:	
Raw materials	1,882
Work-in-progress	6,396
Finished goods	12,458
Capital	416,874
Sundry Debtors	5,391
Bank Balance	81,472
Drawings	7,750

Motor Vehicles	52,918
Carriage of raw materials	1,306
Sale of finished goods	198,293
Factory wages	39,627
Office Electricity	806
Purchase of raw materials	59,113
Factory Insurance	2,500
Stationery	1,758
Factory Lighting and Cooling	3,279
Furniture	34,081
Stock on 31st December 2005:	
Raw materials	2,896
Work-in-progress	4,752
Finished goods	18,519
General expenses	2,761
Office Salaries and Wages	15,957
Returns of raw materials	1,418
Returns of Finished goods	783
Discount received	2,190

You are also given the following information:

1. Motor vehicle repairs of ₦ 682 for the year were paid by cheque but this has not been recorded.
2. Office electricity of ₦ 59 is yet to be paid while selling and administrative expenses of ₦ 170 has been paid in advance
3. Rent is to be shared between the office and factory in the ratio 1:2
4. Depreciation is to be written off at the rate of 5 percent on all fixed assets.

You are required to prepare:

i. the Company's Manufacturing Account
ii. the Trading and Profit and Loss Account for the year ended 31st December, 2005, and
iii. the Balance Sheet as at that date.

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MODULE 2

UNIT 1 ACCOUNTS OF NON-TRADING ORGANIZATIONS

CONTENTS

1.0 INTRODUCTION

Commercial and Industrial organizations are usually set up principally to make and maximize profit. But Non-profit making organizations are not profit-oriented, but exist to promote activities, which interest their members or to provide services to needy people. There are many types of non-for-profit organizations. They include: Government owned hospitals, voluntary health and welfare organizations, religious organisations, private and community foundations, professional associations, research and scientific organizations, social and country clubs, trade associations, labour organizations, political parties, sports clubs, societies, charitable organizations, self-held organizations and self-projects, etc. Some of them may maintain an elaborate set of account books similar to those kept by any major commercial undertaking; others do not appreciate the need for – or cannot afford the cost of setting up proper double entry records. In place of trading and profit and loss account found in trading concerns, they prepare the following accounts to show the financial affairs to their members:

(a) Receipt and payment accounts
(b) Income and expenditure accounts
(c) Balance sheet.

2.0 OBJECTIVES

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

- differentiate between final accounts of not-for profit organizations and those of commercial enterprises
- prepare receipts and payments account
- prepare income and expenditure account
- prepare the accumulated fund of a not-for profit organizations
- prepare a balance for not profit making organizations.

3.0 MAIN CONTENT

3.1 Receipt and Payment Accounts

This is the account that shows the summary of cash actually received and paid over a particular period of time. Receipts being debited and payments credited. It is, in effect, a summary of the cashbook, and therefore, shows the opening and closing balances of cash in hand, and receipts and payments of any kind and on any account made during the period. Here, capital receipts and payments, revenue receipts and payments are included even if it did not relate to the particular accounting period. However, amount owing (accruals) or any form of arrears will not be shown in this account. A receipts and payments account would usually take the following form:

XYZ
RECEIPTS AND PAYMENTS ACCOUNT

Dr			Cr
₦			₦
Balance b/f	XX	Salaries and wages	XX
Subscriptions	XX	Stationery and postage	XX
Membership fee	XX	Rent and rates	XX
Donations	XX	Refreshments	XX
Dance Tickets	XX	Travelling	XX
Sale of drinks, etc.	XX	Purchase of an asset	XX
Sale of an asset	XX	Balance c/f	XX
	XX		XX

The receipts and payments account usually excludes any income received in a form other than cash, e.g. a donation of books, and any expenses that may not be paid in cash, e.g. depreciation.

EXAMPLE 1

Nsa social club

Receipts and Payments Account for the year ended 31 December, 2006

Dr.			Cr.
	₦		₦
Balance b/f	4, 900	Easter outing	12, 000
Monthly dues	30, 000	Christmas outing	15, 000
Proceeds from –		Donations	3, 500
Dance (Easter)	7, 700	Stationery	1, 200
Dance (Christmas)	10, 300	Transport fare	800
Bank interest	1, 000	Assistance to members	4, 500
Free will offerings	2, 100	Swimming goggles	1, 800
		Hiring of canopies	700
		Balance c/d	16, 500
	56,000		56,000
Balance b/d	16, 500		

The disadvantage of a receipts and payments account is that it cannot cater for in arrears; neither can it deal with non-cash entries such as depreciation.

3.2 Income and Expenditure Accounts

This account will be used to calculate the excess of income over expenditure (or the opposite) by taking account of cash, non-cash entries such as payments which are due but not paid, and depreciation. It is the non-trading organisation's equivalent of a profit and loss account of a business, and therefore excludes any capital items.

The rules are stated below:

(x) Expenses are debited and incomes are credited;
(xi) Capital items are excluded;
(xii) All revenue items relating to the period are credited, whether actually received or not;

(xiii) All expenditure items relating to the period are debited, whether actually paid or not;
(xiv) All items relating to previous or next periods are excluded;
(xv) The balance on the account represents the excess of income over expenditure (surplus) or excess of expenditure over income (Deficit).

3.3 Differences between Receipt and Payment Accounts and Income and Expenditure Account

Receipts and Payment Accounts	**Income and Expenditure Accounts**
Only Cash transactions are recorded	There is adjustment for accruals and prepayments
It includes capital items	It excludes capital items
Balance represents cash in hand or bank overdraft	Balance represents surplus or deficit

3.4 Format of Income and Expenditure Account

Expenditure:		**Income:**	
	₦		₦
Rent	X	Subscriptions	X
Wages	X	Donations	X
Postage	X	Rent received	X
Secretary honorarium	X	Profit on bar	X
Depreciation	X		
Lighting	X		
Surplus of income over expenditure	X		
	XX		XX

3.5 Accumulated Fund

The capital sum, which represents the difference between the assets and liabilities belongs to the members of the society or club and will be called the accumulated fund or capital fund.

3.6 Adjustments

3.6.1 Arrears of Membership Subscriptions

Although it may seem that subscriptions which are owed by members are an asset in the same way as any debtor is, in fact, unlike the situation which normally exists between debtors and creditors, it is most unlikely that the society would bother to press very hard for arrears of subscription. Membership will be allowed to lapse and no further action will be taken. It follows, therefore, that subscriptions, which are due, should not be included in the income and expenditure account until actually received. Overdue subscriptions subsequently received, should be included in the current year's income, but entered separately. There may, however, be occasions when the view is taken that subscription in arrears at a year end should be accounted for – this will depend on the attitude of the management committee.

Refreshments, Restaurant, and Bar

If the club have a restaurant or bar requiring separate accounting action, these accounting action will be summarized and shown alongside the main income and expenditure account. Any profit or loss on the activity will be transferred to the income and expenditure account.

3.6.2 Membership Subscription in Advance

There is the sum of money paid for future years by the members. It is treated as a current item.

3.6.3 Life Membership

Subscriptions are often received from life members. Life members pay a once and for all subscription, which entitles them to membership facilities for the rest of their lives. The once and for all payments from life members are not income relating to the year in which they are received, because the payment is for the life of the members, which can of course last a very long time to come. In practice, if life member's subscriptions are small, they are credited to income as received, but if they are significant in amount, then they should be credited in equal proportion over the estimated active membership of such members.

3.7 Trading Activities

Many associations take part in activities designed to improve their financial positions. They can run bars, restaurants and other commercial activities. When a club is operating a bar, it is usual to prepare a separate trading account to show the results of its activities. The profit or loss is carried to the income and expenditure account. If profit is made, it must be credited to the income and expenditure account and loss will be debited.

EXAMPLE 2

The following receipts and payment account has been prepared for the Two Acres tennis club. Taking account of the additional information given below, prepare the income and expenditure account and a balance sheet.

Receipts and Payments Account for the year ended 31 may 2007

	₦		₦
Balance b/f	40, 000	Club house repairs	2,000
Subscriptions	25, 000	Purchase of land	20,000
Entrance fees	4, 000	Ground men's wages	20,000
Annual dance receipts	5, 000	Upkeep of courts	5,000
Gyang:		Hire of dance band	1,000
Loan	10, 000	Hire of dance hall	1,200
Bar profit	2, 000	Stationery	1,000
		Cost of food etc, dance	1,800
		Secretary's expenses	400
		Purchase of mower (1/1/06)	1,000
		Heat & light	2,000
		Extension to club house	10,000
		Tournament fees	600
		Balance c/d	20,000
	86,000		86,000
Balance b/d	20, 000		

Notes:

1. ₦ 300 is owed for printing the dance tickets
2. Gyang's loan is interest free
3. Land was acquired at a total cost of ₦ 30, 000; the vendor, Neken has been paid ₦ 20, 000 and has agreed to leave the rest as a loan to the club with interest at 10 per cent per annum. The loan was created six months ago – no interest has been paid.
4. The secretary is owed ₦ 100 for her out of pocket expenses
5. Equipment to be depreciated at 10 per cent per annum on cost
6. ₦ 1, 000 is still to be paid for the changing room extension
7. Half of the tournament fees relate to the forth coming season
8. The committee has just accepted four new members and it has been agreed that their entrance fees of ₦ 800 should be taken into the past year's accounts even though they have not paid.
9. As at 1st June 2006, the club house and grounds had been valued at ₦ 100, 000; with various equipment valued at cost N5,000 less depreciation to date ₦ 2, 500.
10. ₦ 250 owed for heat & light.

The solution is shown below:

	₦
Capital fund at 1June 2006	
Clubhouse and grounds	100,000
Equipment less depreciation	2,500
Cash	40,000
	142,500
Less owing for heat & light	250
	142,250

Two Acres Tennis club
Income and Expenditure account for the year ended 31 May 2007

	₦		₦	₦
Grounds man's wages	20,000	Dance receipts		5,000
Repairs to club house	2,000	Less: Hire of band	1,000	
Stationery	1,000	Hire of hall	1,200	
Upkeep of courts	5,000	Tickets	300	
Secretary's expenses	500	Food etc.	1, 800	4,300
Depreciation	600	Profit on dance		700
Heat & light	1,750	Subscriptions		25,000
Tournament fees	300	Entrance fees		4,800
Loan interest	500	Bar Profit		2,000
Excess of income over Expenditure	850			
	32,500			**32,500**

Two Acres Tennis club
Income and Expenditure account for the year ended 31 May 2007

	₦	₦	**Fixed asset**	₦	₦
Capital fund (1/6/06)		142,250	Club house and ground		10,000
Excess of income over			Additional land		30,000
Expenditure		850	Extension to changing rooms		11,000
		143,100			141,000
Long-term Liabilities			Equipment	5,000	
Loans – Gyang	10,000		New mower	1,000	
Neken	10,000	20,000		6,000	
			Less depreciation	3,100	2,900

Current liabilities			**Current assets**		
Dance tickets	300		Cash	2,000	
Neken interest	500		Tournament fees		
Secretary	100		in advance	300	
Changing rooms	1,000	1,900	Entrance fees due	800	3,100
		165,000			**165,000**

SELFASSESSMENT EXERCISE

1. Enumerate financial reporting problems associated with Non-profit organizations.
2. The following receipts and payment account, which you are to balance, has been prepared for the Jos Tennis club. Taking account of the additional information given below, prepare the income and expenditure account and a balance sheet.

Receipts and Payments Account for the year ended 31 December, 2009

	₦		₦
Balance b/f	70,000	Club house repairs	3,000
Subscriptions	45,000	Purchase of land	35,000
Entrance fees	24,000	Ground men's wages	30,000
Annual dance receipts	15,000	Upkeep of courts	15,000
Gyang:		Hire of dance band	11,000
Loan	20,000	Hire of dance hall	10,200
Bar profit	32,000	Stationery	10,000
		Cost of food etc, dance	18,000
		Secretary's expenses	1,400
		Purchase of mower (1/1/06)	10,000
		Heat & light	12,000
		Extension to club house	15,000
		Tournament fees	1,600

Notes:

1. ₦ 600 is owed for printing the dance tickets
2. Gyang's loan is interest 10% per annum and is due
3. Land was acquired at a total cost of ₦ 25, 000; the vendor, Mr Goodness has been paid ₦ 10, 000 and has agreed to leave the rest as a loan to the club at an interest free
4. The secretary is owed ₦ 200 for her out of pocket expenses
5. Equipment to be depreciated at 15 per cent per annum on cost
6. ₦ 2, 000 is still to be paid for the changing room extension
7. The committee has just accepted four new members and it has been agreed that their entrance fees of ₦ 800 should be taken into the past year's accounts even though they have not paid.

8. As at 1st June 2006, the club house and grounds had been valued at ₦ 150, 000; with various equipment valued at cost N15,000 less depreciation to date ₦ 12, 500.
9. ₦ 250 was owing for heating & lighting.

4.0 CONCLUSION

It is not only profit making organizations that make up accounts for interested parties, also Non- Profit making Organizations need to tell their stakeholders how they have dealt with the funds they have contributed. Components of final accounts of Non-Profit organizations consist of the Receipts and Payments Account, Income and Expenditure Account and a Balance Sheet. The procedure for preparing final accounts of Non-Profit organizations which do not have double-entry records is similar to the procedure for single –entry situations.

5.0 SUMMARY

This study unit has:

- Explained the basic statements to be found in the final accounts of Non-Profit organizations.
- Prepared a receipt and payment accounts
- Prepared an income and expenditure account
- Prepared a balance of Non-profit making organization.
- Made adjusting entries in the final accounts of Non-profit making organizations.

6.0 TUTOR-MARKED ASSESSMENT

1. The Club 99 had the following balances in its books on 1st January, 2002:

	₦
Office Equipment	34,360
Cash in hand	6,120
Bank overdraft	2,960
Furniture	18,730
Stock of drinks	790
Subscriptions paid in advance	1,560
Debtors for drinks	620

Unused stationary	370

During the year 2002 the following receipts and payments were made:
Receipts: Subscriptions ₦ 28,400, sale of drinks ₦ 16,730, Gate fees ₦ 6,240.
Payments: Telephone ₦ 5,600; Miscellaneous expenses ₦ 6,280, Insurance ₦ 3,250, Purchase of drinks ₦ 13,800, Repairs of office equipment m=₦ 2,170, Disco expenses ₦ 4,730, Rent ₦ 4,200, Salaries ₦ 12,000, Stationery ₦ 240.

On 31st December 2002, the Club had a Bank overdraft of ₦ 4,510 and a stock of drinks of ₦ 1,060. Subscriptions paid in advance amounted to ₦ 1,890 while N540 was still due from other members. Office equipment and Furniture are to be depreciated at the rate of 5 percent each. Stationery of ₦ 180 remained unused on 31st December 2002, while rent of ₦ 600 was yet to be paid and members owed ₦ 830 for drinks.

You are required to prepare:

a) Receipts and payments account for the year ended 31st December 2002
b) Bar Trading Account
c) Income and Expenditure Account for the year, and
d) Balance Sheet as at 31st December 2002

2. The Nsa Social Club had the following assets and liabilities on 1st January, 2003:

	₦
Fixed Assets	580,000
Debtors for drinks	9,720
Creditors for drinks	2,900
Prepaid Electricity	800
Stationery	370
Cash at Bank	13,510
Sports Equipment	16,300
Stock of drinks	1,530

During the year, the following transactions took place:

Paid Wages, ₦ 26,800; Collected Membership Fees ₦ 471,200; Bought a Motor Van ₦ 380,000; sold Drinks ₦ 35,690; Paid Electricity ₦ 3,200; Bought Stationery ₦ 1,420; Bought Drinks ₦ 23,700 paid Rent ₦ 6,800; Profit from Dances ₦ 7,460; Profit from Tombola ₦ 12,830.

Payments to Creditors for Drinks were included in purchases, while collections from Debtors for Drinks are included in Sales.

On 31st December 2003, Debtors for Drinks summed-up to ₦ 9040; Stock of Drinks ₦ 2,940; Creditors for Drinks ₦ 2,780; Prepaid Electricity ₦ 560; Membership Fees due from Members ₦ 2,120; Membership Fees paid in advance ₦ 1,630.

Depreciation is to be written off at 10% on Fixed Assets and Sports Equipment:

You are required to prepare:

a) The Receipts and Payments Account
b) Bar Trading Account
c) The Income and Expenditure account for the year ended 31st December, 2003 and
d) The Balance Sheet as at that date.

7.0 REFERENCES/FURTHER READING

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UNIT 2 SINGLE ENTRY AND INCOMPLETE RECORDS

CONTENTS

1.0 INTRODUCTION

The unit discusses how you will prepare the trading, profit and loss account and balance sheet for an enterprise that has only opening and closing net assets and perhaps capital as the only known figures. You will also understand and learn how to ascertain the proprietor's drawings and any additional capital contribution during an accounting period from scanty information provided by a cashbook summary.

2.0 OBJECTIVES

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

- explain what is meant by incomplete records and single entry records
- calculate profit of an enterprise using the accounting equation from available information
- derive proprietor's cash drawings or additional capital as a missing figure where all other information relating to cash payments and receipts are known
- derive expenses incurred and revenue earned from incomplete records.

3.0 MAIN CONTENT

3.1 Definition of Single Entry and Incomplete Records

The term 'single entry' is applied to any system, which does not provide for the two fold aspect of transactions, while the alternative term 'incomplete records' is often applied to books of account kept on such a single entry or incomplete double entry system (ATSWA, Study Pack 2009: 240). In other words, it is the system of bookkeeping, which does not conform to the basic principles of double entry.

This system of record keeping is very common with small business enterprises where the proprietors are neither trained accountants nor rich enough to employ the services of qualified or experienced accountants. Since the records prepared by the record keeper are incomplete or inadequate, accountants have to use their mental ingenuity to prepare the accounts from the available information. Incomplete records present a large amount of unsorted information.

Pure 'single entry' recognizes only the personal aspect of transactions; consequently, the only essential books are personal ledgers for recording transactions with debtors and creditors. That is, real and nominal accounts are not kept by the business enterprises.

3.2 Disadvantages

(i) It does not conform to the principle of double entry book-keeping;
(ii) The flexibility of the double entry principle is lacking;
(iii) It is difficult to obtain accurate information since the records are not complete;
(iv) It is always very difficult to arrive at the profit for the year.

3.3 Calculating Profit from Two Balance Sheets

Under this method, the assets and liabilities are given but information relating to sales and purchases are not given. The profit or losses are ascertained under this system by a comparison of the value of the opening capital with the value of the closing capital. Because of insufficiency of information, the statement of affairs method will have to be adopted.

3.3.1 Book-keeping Rule for Single Entry

(i) The opening statement of affairs is prepared to show the opening capital. The information required are all fixed assets, total of debtors and creditors, expenses owing and payments in advance, cash in hand and bank, etc.
(ii) Adjust the capital by adding any additional capital contributed either in cash or assets and deduct drawings either cash or goods;
(iii) Another statement of affairs is constructed to show the closing capital using all the assets and liabilities at the end of the period.
(iv) The opening capital is compared with the closing capital.
(v) If the capital at close is greater, then there is a profit.
(vi) If the capital at close is lower, then there is a loss.

3.3.2 Format for Computing Statement of Affairs

The format of computation is shown under:

Step 1:

Opening Statement of Affairs

	₦			₦
Opening Capital	X	Fixed assets		X
Liabilities	X	Current assets	X	
	X			X

Note: Opening capital = Assets - Liabilities

Step 2:

Closing Statement of Affairs

	₦			₦
Closing Capital	X	Fixed assets		X
Current liabilities	X	Current assets	X	
	X			X

Having arrived at the closing and opening capital, the net profit is calculated. The best way is to prepare the statement of profit.

Step 3:
Statement of Profit or Loss for the Year

	₦	₦
Closing Capital		X
Add Drawings		X
		X
Less: opening capital		X
Additional capital	X	X
Net Profit or Loss		X

The profit can also be calculated using the accounting equation, as seen below:

Opening capital – drawing + additional capital = New capital.
Profit = New Capital + Drawings – Opening Capital – additional Capital.

EXAMPLE

Innocent Okeke started business a year ago by putting N500, 000 cash into a bank account and trading in a general way from rented accommodation. He wants to calculate how much profit he has made during the year.

The following information is gleaned from a detailed scrutiny of his bank statement.

Drawings in the year are N2, 000, 000
His brother in-law lent him N1, 500, 000 during the year, interest free.
Payments of N6, 200, 000 have been made to his suppliers during the year.

His customers have paid him ₦ 9, 000, 000 in the year.
The bank balance is ₦ 90, 000, cash in hand ₦ 10, 000
Rent of ₦ 100, 000 is owing and so is a bill for electricity of ₦ 100, 000.
Rates of ₦ 400, 000 have been paid for the whole year and three months have still to run.

A van was acquired for ₦600,000, but is now estimated to be worth ₦500, 000.
Stock held is thought to have cost ₦600,000, but would sell for ₦900, 000.
The total value of goods purchased from suppliers was ₦ 9, 000, 000.
Innocent Okeke has invoiced his customers to a total value of ₦ 13, 100, 000 during the year.
One customer who owes him ₦ 300, 000 has moved from the area without leaving a forwarding address.

Prepare a statement of assets and liabilities to show the profit or loss for the year.

SUGGESTED SOLUTION

John Innocent, statement of assets and liabilities

Assets:	₦	₦	₦
Motor van			500,000
Stock			600,000
Debtors – invoiced		13,100,000	
Less bad debt	300,000		
Cash received	900,000	9,300,000	3,800,000
Rates paid in advance			100,000
Bank			90,000

Cash			10,000
			5,100,000
Less liability:			
Loan		1,500,000	
Creditors	9,000,000		
Less cash paid	6,200,000	2,800,000	
Rent due		100,000	
Electricity		100,000	4,500,000
Closing capital			600,000
Add drawings			2,000,000
			2,600,000
Deduct capital at start			500,000
Profit for year			**N2,100,000**

Obviously a statement of assets and liabilities does not show the details of how the profit or loss was arrived at, and if this information is required, a greater depth of investigation will have to be carried out. It may not be possible for the trader to establish a full set of double entry records; but where he keeps a record of his suppliers' and customers' accounts, together with a properly narrated cash book preparation of the final accounts, makes it possible. This is greatly helped by using an Analysis Cashbook, that is, a cashbook with several columnar rulings so that income and expenditure can be entered in accordance with the various headings chosen.

SELF ASSESSMENT QUESTION

1. Enumerate the disadvantages of Single Entry System of Bookkeeping?
2. Bitrus Jat started business a year ago with ₦ 600, 000 cash which he later paid to bank and trading in a general way from rented accommodation. He wants to calculate how much profit he has made during the year.

The following information is gleaned from a detailed scrutiny of his bank statement.
Drawings in the year are ₦ 2, 500, 000

He collected a Bank Loan of ₦ 1, 800, 000 during the year, at interest of 5% per annum fre.
Payments of ₦ 7, 200, 000 have been made to his suppliers during the year.
His customers have paid him ₦ 12, 000, 000 in the year.
The bank balance is ₦ 190, 000, cash in hand ₦ 100, 000

Rent of ₦ 150, 000 is owed and so is a bill for electricity of ₦ 120, 000.
Rent and Rates of ₦ 450, 000 have been paid for the whole year and three months have still to run.
A Delivery van was acquired for ₦ 800, 000, but is now estimated to be worth ₦ 700, 000.
Stock held is thought to have cost ₦ 650, 000, but would sell for ₦ 1,000, 000.

The total value of goods purchased from suppliers was ₦ 10,500, 000.
Bitrus Jat has invoiced his customers to a total value of ₦ 15, 100, 000 during the year.

One customer who owes him ₦ 400, 000 has moved from the area without leaving a forwarding address. However, the customer left behind a grounded Van which is estimated to cost ₦ 180,000.

Prepare a statement of assets and liabilities to show the profit or loss for the year.

4.0 CONCLUSION

Single entry is a system of book keeping which does not conform with the basic principles of double entry. Despite the fact that financial records of some of these businesses are not kept in the proper double entry system, some of them succeed in making profits from year to year and others sustain losses too. From the scanty records kept by proprietors of such businesses, trained accountants have devised a way of finding out whether a profit has been made or a loss has been sustained. The method used is known as the increase or decrease in net worth approach.

5.0 SUMMARY

This study unit has:

- Defined single entry and incomplete records;
- Discussed the disadvantages of incomplete records;
- Demonstrated how profit can be calculated from incomplete records;
- Gave a hypothetical format of steps involved in the preparation of accounting statements.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the principles of ascertaining profit in a single entry system?
2. Evet started business a year ago by putting ₦ 1, 000, 000 cash into a bank account and trading in a general way from rented accommodation. She wants to calculate how much profit she has made during the year.

The following information is extracted from a detailed scrutiny of her bank statement.

Drawings in the year are ₦ 4, 000, 000
Her cousin brother lent her ₦ 3, 000, 000 during the year, interest free.
Payments of ₦ 12, 400, 000 have been made to her suppliers during the year.
Her customers have paid him ₦ 18, 000, 000 in the year.
The bank balance is ₦ 180, 000, cash in hand ₦ 20, 000
Rent of ₦ 200, 000 is owing and so is a bill for electricity of ₦ 200, 000.
Rates of ₦ 800, 000 have been paid for the whole year and three months have still to run.
A van was acquired for ₦ 1,200, 000, but is now estimated to be worth ₦ 1,000, 000.
Stock held is thought to have cost ₦ 1,200, 000, but would sell for ₦ 1,800, 000.
The total value of goods purchased from suppliers was ₦ 18, 000, 000.
Evet has invoiced her customers to a total value of ₦ 26, 200, 000 during the year.
One customer who owes her ₦ 600, 000 has moved from the area without leaving a forwarding address.

Prepare a statement of assets and liabilities to show the profit or loss for the year.

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UNIT 3 PREPARATION OF FINAL ACCOUNTS FROM A SET OF INCOMPLETE RECORDS: CONVERSION OF SINGLE ENTRY TO DOUBLE ENTRY

CONTENTS

1.0 INTRODUCTION

Business organizations whose books are being kept under the single entry system may decide to improve the system of accounting by introducing a complete double entry system. It is possible for complete records to be reconstructed by applying the principle of double entry to the information available.

2.0 OBJECTIVES

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

- convert single entry and incomplete records into double entry records
- prepare detailed trading and profit and loss account from records that were not kept on double entry system
- determine purchases and sales figures from the purchases ledger-control and the sales ledger control accounts
- derive expenses incurred and revenues earned from incomplete records.

3.0 MAIN CONTENT

3.1 Conversion of Single Entry to Double Entry

The single entry records can be converted to double entry system. When trained accountants are given certain degree of financial information, they are capable of converting the incomplete records of a business enterprise into a full set of accounts on the double entry principle. The conversion from single entry to double entry system becomes most necessary when the business whose proper books of accounts have not been kept has prospects for growth, when it requires adequate financial planning and control, and when the proprietors becomes aware of internal control problems as a result of fast rate of expansion.

In the Adjustment Account in the sales ledger, the same information would be given, but on the opposite sides. This means that the entries in the General Ledger Adjustment Account in the sales ledger would be on the opposite sides to those on which the entries had been made in the personal accounts.

In General Ledger, Purchases Ledger Adjustment Account

	₦		₦
Total cash paid to creditors	XX	Balances of all personal accounts of creditors b/f	XX
Total discount received	XX	Total purchases	XX
Total returns to suppliers	XX		
Total of bills payable accepted	XX		
Total inter-ledger transfers	XX		
Balance c/f	XX		
	XX		XX

3.1.1 Required Books for Conversion

The financial records that will be needed to prepare final accounts from incomplete records are:

(i) Sales ledger
(ii) Purchases ledger
(iii) Day books
(iv) Cash books
(v) Assets and liabilities account
(vi) Normal accounts.

The Trial balance may be extracted to show the accuracy of the postings. There are no specific sets of rules to be followed except a proper understanding of the principles of double entry.

3.2 Preparation of Final Accounts

In preparing final accounts from incomplete records, the following operations must be carried out:

(a) Preparation of a statement of affairs to calculate the capital;
(b) Analysis of the cashbook;
(c) Reconstruction of those accounts that is necessary to find figures not given in the question. Analysis of purchases and sales control account to get both purchases and sales figures required;

(d) Preparation of any other required working schedule, e.g. reconstruction of nominal accounts;
(e) Preparation of trading, profit and loss account;
(f) Preparation of the balance sheet.

3.2.1 Preparation of a Statement of Affairs

The first step is to construct a statement of affairs listing the assets and liabilities at the beginning of the year. This statement is prepared to show the financial position of the business at the year is technically called statement of affairs.

In most practical situations, the owner of the business will provide lists of values of fixed assets that he/she uses in the business together with the dates of acquisition. It should therefore, be easy for you to calculate the accumulated provision for depreciation of the fixed assets from the date of their purchase to the date of reporting. Values of such items as stocks in trade, debtors and liabilities may have to be estimated with the help of the owner.

From the above financial information, a journal should be opened and accounting entries with the aim of achieving the dual purpose of recording accounting transactions should be effected. This means that appropriate debit entries must be posted into assets account and credit entries entered into capital or liabilities accounts.

The difference between the assets and liabilities, which usually end up with the assets exceeding the liabilities may be assumed to be the initial amount that the owner used in starting the business and therefore, will be recorded as the capital of the business. It is possible that the owner may be able to mention the initial amount he used in commencing the business. Where this is the case, then any difference between such capital and the net assets estimated may be recorded as the balance on the profit and loss account retained in the business.

3.2.2 Preparation of Cash and Bank Summary

To ascertain the cash position of the business, this could be deduced by carefully examining available passbooks, pay in slips, bank statements and the cheque counterfoil. The cashbook will appear thus:

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

	Cash ₦	**Bank ₦**		**Cash ₦**	**Bank ₦**
Balance b/f	X	X	Purchases	X	X

Interest received	-	X	Rent	X	X
Receipt from customers	X	X	Bank charges	X	X
			Wages	X	X
			Insurance	X	X
			Fixed Assets	X	X
			Drawings	X	X
			Balance c/d	X	X
	XX	XX		XX	XX
Balance b/d	X	X			

3.2.3 Analysis of Unbanked Cash Sales

At this stage, it is very important to determine the amount of cash sales which have not been banked by the owners, but which might have been used by the owner to pay for business expenses, cash purchases, and personal drawings. It is possible that the owner might have made use of some of the physical stock in trade for his or her personal use. In such a situation, conducting an informal interview with the owner would confirm the existence of such occurrences and so will help the book keeper make an appropriate estimate for stock drawing, physical stock taking by head counting of items in stock at the close of business which will give you the actual closing stock figure and therefore, may not need to be estimated.

3.2.4 Posting from the Cash and Bank Summary

After analysing cash and bank transactions, the next step is to post the entries into the ledger.

From the analysis of the debit side of the cash and bank summary and information obtained from the pay-in-slips:

(a) All cash sales or takings should be credited to the debtors account in the sales ledger;
(b) Any proceeds from the sale of fixed assets should be credited to the respective asset account;
(c) Any interest or income from investment must also be credited to the appropriate revenue account;
(d) Any other item should be posted to the credit of the relevant account;

From the analysis of the credit side of the cash and bank summary and information obtained from the cheque counterfoils:

(i) All payments for goods purchased should be debited to the trade creditors' account in the purchases ledger account;
(ii) Payment for expenses should be debited to the relevant nominal account;
(iii) All purchases in connection with fixed assets should be debited to the appropriate asset accounts;
(iv) Any charges should be posted to the debit of the bank charges account;
(v) Any other item should be posted to the debit of the relevant account.

3.2.5 Preparation of Debtors and Creditors Schedule

A schedule should be compiled detailing all customers who are owing the business, as a result of goods sold to them on credit. The total of the schedule of debtors therefore, represents debts owed to the business and as such, must be carried forward to the credit of the total sales ledger control account. There is likely to be a missing figure in the debit side of the total debtors' account, which represents total sales on credit for the period and should be transferred to the credit of the trading account as sales or turnover.

Another schedule that must be prepared is a list of amounts owing by the business to its suppliers for goods purchased on credit. The total of this schedule represent total liabilities by way of trade creditors outstanding at the end of the period and should therefore, be carried forward to the debit of the purchases ledger control account. The total of purchases for the period will be derived from the credit side of the purchases ledger control account as a balancing figure and should be transferred to the debit side of the trading account.

Similarly, accruals and prepayments will be carried forward as closing balances in the appropriate expense accounts. The actual expense amount that has been incurred for the accounting period should be accounted for as a balancing figure.

3.2.6 Preparation of Any Other Required Working Schedules

All expenses that are expected to be charged to the profit and loss account must be calculated.

3.2.7 Extraction of Trial Balance

Since all transactions would have been recorded and the double entry completed, the next stage is to extract a Trial Balance, which will form the basis for the preparation of the trading, profit and loss account and balance sheet.

3.2.8 Preparation of Trading, Profit and Loss Account

The Trading, Profit and Loss account will be prepared, since the purchases and sales figure would have been arrived at, using the control accounts. The gross and net profit figures will be ascertained applying the normal rules.

3.2.9 Preparation of Balance Sheet

The Balance sheet is prepared using the closing balances of assets and liabilities and the capital calculated in the statement of affairs.

EXAMPLE

The following is the summary of cashbook of Jeka-kadima Enterprises for the year ended 31st March, 2009.

Cash Book

	₦		₦
Balance b/f	23,430	Cash paid to creditors	110,560
Cash from debtors	182,350	Salaries	10,800
Additional capital	60,000	Postages	2,400
		General expenses	12,340
		Drawings	35,000
		Rent	5,700
		Balance c/d	98,980
	265,780		265,780

Additional Information

	1/4/08	31/3/09
	₦	₦
Stock	5,600	3,400
Debtors	12,020	9,880
Creditors	9,800	10,510
Accrued Salaries	4,200	750
Prepaid Rent	440	670

You are required to prepare:

(a) Statement of Affairs as at 1st April, 2008.
(b) Debtors and credit control accounts
(c) Trading, Profit and Loss Accounts
(d) Balance Sheet as at 31st Mach, 2009.

SUGGESTED SOLUTION JEKA-KADIMA ENTERPRISES

(a) Statement of Affairs as at 1st April, 2008

	₦		₦
Capital	27,490	Debtors	12,020
Creditors	9,800	Stock	5,600
Accrued Salaries	4,200	Rent Prepaid	440
		Cash	23,430
	41,490		41,490

(b) Debtors and Creditors Control Accounts

Dr			Cr
	₦		₦
Balance b/d	12,020	Cash	182,350
Sales	180,210	Balance c/d	9,880
	192,230		192,230

Creditors Control Account

	₦		₦
Cash	110,560	Balance b/d	9,800
Balance c/d	10,510	Purchases	111,270
	121,070		121,070

(c) Trading, Profit and Loss Account for the year ended 31st March, 2009.

	₦		₦
Opening Stock	5,600	Sales	180,210
Add purchases	111,270		
	116,870		
Less closing stock	3,400		
	113,470		
Gross Profit	66,740		

	180,210		180,210
Expenses:			
Salaries (wk 1)	7,350	Gross Profit b/d	66,740
Postages	2,400		
General Expenses	12,340		
Rent (wk 2)	5,470		
Net Profit	39,180		
	66,740		66,740

Workings: ₦

1.	**Salaries**	10,800
	Add owing 2009	750
		11,550
	Less owing 2009	4,200
	Profit and Loss	7,350
2.	**Rent**	5,700
	Prepaid 2008	440
		6,140
	Less prepaid 2009	670
	Profit and Loss	5,470

(d) Balance Sheet as at 31st March, 2009

	₦		₦
		Current Assets:	
Capital	27,490	Stock	3,400
Additional Capital	60,000	Debtors	9,880
	87,490	Cash	98,980
Profit	39,180	Rent Prepaid	670
	126,670		

Less drawings		25,000		
		101,670		
Current Liabilities:				
Creditors	10,510			
Salaries	750	11,260		
		112,930		112,930

SELF ASSESSMENT ASSIGNMENT

1. The balance sheet of Kowa Enterprises as at 1st January 2010 is as follows:

	₦		₦
Capital	148,960	Motor Vehicles	69,500
Loan	25,000	Office equipment	43,700
Creditors	6,756	Furniture	28,400
Accrued Expenses	1,284	Stock	16,200
		Bank balance	19,350
		Cash in hand	472
		Prepaid expenses	760
		Debtors	3,618
	182,000		182,000

The accounts clerk employed to keep the records is not conversant with the double entry system and thus uses the single entry.

An analysis of the bank account for the year ended 31st December, 2010 shows the following:

Receipt	₦	Payments	₦
Cash sales	74,000	Expenses	32,915
Debtors	15,140	Office equipment	8,500
		Drawings	3,750
		Cash purchases	29,645
		Interest on loan	3,000

		Creditors	24,310
	89,140		102,120

The following additional information was also obtained from the books of accounts:

1. Accrued and prepaid expenses on 31st December, 2010 were ₦1,653 and ₦580
2. Stock on 31st December, 2010 amounted to ₦14,700
3. Creditors and Debtors balances on that date were ₦7,840 and ₦3,259 respectively.
4. Bad debts of ₦683 have been written off in arriving at the balance of debtors.
5. Depreciation is to be written off at the rate of 10% on the balance of fixed assets.
6. Provision for bad debts is to be made at the rate of 2% on the balance of debtors.
7. Travelling expenses of ₦120 were paid from cash in hand.

You are required to Prepare:

(a) Trading, Profit and Loss Account of Kowa Enterprises for the year.
(b) Balance sheet as at that date.

2. The Balance Sheet of TELIMA AND SONS ENTERPRISES as at 1st January, 2007 was as follows:

	₦		₦
Capital	148,960	Motor Vehicles	69,500
Loan	25,000	Office Equipment	43,700
Creditors	6,756	Furniture	28,400
Accrued Expenses	1,284	Stock	16,200
		Bank Balance	19,350

		Cash in Hand	472
		Debtors	3,618
		Prepaid Expenses	760
	182,000		182,000
	======		======

The Accounts Clerk employed to keep the accounting records is not conversant with the double entry system and thus uses the single entry. An analysis of the bank Account for the year ended 31st December, 2007 shows the following:

Receipts	**₦**	**Payments**	**₦**
Cash Sales	74,000	Expenses	32,915
Debtor	15,140	Office Equipment	8,500
		Drawings	3,750
		Cash Purchase	24,310
	89,140		102,120
	======		======

The following additional information was also obtained from the books of accounts:

1. Accrued and prepaid expenses on 31st December, 2007 were ₦ 1,653 and ₦ 580 respectively.
2. Stock on 31st December, 2007 amounted to ₦ 14,700
3. Creditors and Debtors balances on the date were ₦ 7,840 and ₦ 3,259 respectively
4. Bad debts of ₦ 683 have been written off in arriving at the balance of Debtors
5. Depreciation is to be written off at the rate of 10 percent on the balance of fixed assets.
6. Provision for Bad Debts is to be made at the rate of 2 percent on the balance of Debtors
7. Travelling expenses of ₦ 120 were paid from cash in hand.

You are required to prepare:

a) Trading and Profit and Loss Accounts of Telima and Sons for the year ended 31st December, 2007, and
b) Balance Sheet as at that date.

Note: All workings must be shown

4.0 CONCLUSION

As you can see, the single entry bookkeeping negates the fundamental principle of accounting. Besides, some of the vital records are not kept and this calls for derivation of their figures. Therefore, preparation of a complete sets of account from the single entry and incomplete records requires some good knowledge of double entry bookkeeping.

5.0 SUMMARY

This study unit has comprehensively explained:

- How to covert single entry ad incomplete records into double entry records;
- Prepared final accounts from records that were not kept on double entry system.
- Determined purchases and sales figures from the purchases ledger control and the sales ledger control accounts.

6.0 TUTOR-MARKED ASSIGNMENT

1. Mr A. Careless keeps his books by single entry. He had the following balances on 1st January, 2006:

	₦
Creditors	2,586
Stock	648
Prepaid Insurance	75
Bank overdraft	210
Furniture	3,279
Freehold Premises	10,000
Debtors	4,585
Loan	6,500

The following information is extracted from his cash book in respect of the year end 31st December 2006.

Debit Side	₦	Credit Side	₦
Sales	2,795	Bank overdraft	210
Received from Debtors	5,364	Salaries	1,500
		Paid Creditors	2,840
		Drawings	750
		Miscellaneous Exp.	438
		Electricity	265
		Insurance	45
		Purchases	873

	______	Cash in hand c/d	1,238
	N8,159		N8,159
	=====		=====
Cash in hand b/d	1,238		

He had the following balances on 31st December, 2006:

	₦
Freehold Premises	10,000
Stock	722
Furniture	3,279
Debtors	5,037
Creditor	3,366
Loan	6,500

Interest on loan is to be paid at $2^1/_2$ percent. Bad Debts of ₦ 126 are to be written off while a provision is to be made on the remaining ones (debtors) at the rate of 21/2 percent
Depreciation is to be written off the furniture at the rate of 5 percent.

You are required to prepare:

i. Trading and Profit and Loss Account for the year ended 31st December, 2006.
ii. The statement of affairs as at 1st January 2006 and
iii. Balance sheet as at 31st December, 2006.

2. Chief Emeka Njoku is an enlightened trader who refused to keep a complete set of accounting records. A summary of his two columnar cash book for the year ended 31st December, 2005 was as follows:

Receipts

	Cash	Bank
	₦	₦
Balance on 1st January	150	21,030
Cash Sales lodged directly		32,900
Credit Sales [paid in by cheques)		29,600
Rent of room sublet	520	
Proceeds of sale of old fixture		
With written down value of N300	100	
Additional capital introduced		1,750
Cash From Bank	1,2180	
	₦ 12,950	₦ 85,280

Payments

	Cash	Bank

	₦	₦
Purchases for resale	42,200	
General expenses	600	2,000
Rent and Rates		2,950
Wages	5,600	
Personal drawings	6,500	
Travelling expenses		3,000
Cost of new fixtures		1,600
Cash from Bank		12,180
Balance at 31st December	250	
	₦ 12,950	₦ 85,280

i) Inspection of the Credit Sales Invoice Book showed that customers owed ₦ 12,500 on 1st January and ₦ 15,600 on 31st December 2005, of which ₦ 580 and N680 respectively were doubtful debts.

ii) Examination of the paid invoices for purchases disclosed creditors of ₦ 9,500 at 1st January and ₦ 10,600 at 31st December 2005.

iii) Chief Emeka Njoku estimates that he had taken goods from stock for his domestic use, costing ₦ 1,200 during the year and had not paid for them.

iv) At the beginning of the year the shop fixtures on which depreciation is chargeable at 5% per annum was worth ₦ 5,700.

v) Stock was valued at ₦ 9,500 on 1st January and ₦ 9,000 on 31st December 2005.

You are required to prepare:

a) a statement of capital at 1st January 2005:
b) Trading, Profit and Loss account for the year ended 31st December 2005 and
c) a Balance Sheet as at that date

7.0 REFERENCES/FURTHER READING

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UNIT 4 SELF-BALANCING LEDGERS

CONTENTS

1.0 INTRODUCTION

In your preliminary study of accounting and bookkeeping, you must have learnt how the Ledger can be classified into separate books, each recording a particular class of transaction. This is where book keeping comes into play. The invariable result of double entry bookkeeping is that "the sum of the debits is equals to the sum of the credits" and this applies quite irrespective of the number of ledgers that may be employed. The entire debit balances in the entire ledger must necessarily equal the entire credit balances, and a trial balance of the complete set of books should give an exact agreement of the debit and credit totals, and thus prove the arithmetical accuracy of the ledger.

When the system adopted involves the balancing of the ledgers as a whole and the trial balance disagrees, it indicates that one or more errors exist in the ledgers; but it gives no indication as to the nature of the mistake, nor does it enable one to determine which ledger is affected. Our main business in this unit is study how a self-balancing principle can be used to proof the accuracy of ledger accounts.

2.0 OBJECTIVES

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

- define self-balancing ledgers
- discuss the advantages of self balancing ledgers
- explain the principles of self-balancing ledgers.

3.0 MAIN CONTENT

3.1 Definition of Self-Balancing Ledger

Originally, the accounts of debtors and creditors were only show in the General Ledger. Later, the idea of raising these accounts in separate sales ledger and purchases ledger with reversed entries were developed. The opening of the accounts both in the General Ledger and the sales and purchases ledger results to corresponding debit and credit entries and renders the accounts 'self-balancing". The accounts prepared under this principle are called adjustment accounts. For all intents and purposes, adjustment accounts are memorandum accounts that are prepared only to check the accuracy of the books and not as part of the financial records proper.

3.2 Advantages and Disadvantages of Self-Balancing Ledgers

It is desirable and convenient practice to adopt a system by means of which each ledger can be balanced independently of the other ledgers. The advantages of this separate balancing are four fold, namely:

(1) As errors are detected, delay in balancing is minimized, there by saving time, money and labour;
(2) A complete trial balance may be compiled before the individual personal ledger balances are extracted, thus facilitating the preparation of both interim and draft final accounts;
(3) It enables accounting systems that would otherwise be unwieldy; to be divided into self- contained sections;
(4) The control accounts provide a quick means of ascertaining the up to date amounts owing to and by the business. This information can be very useful to the management.

3.3 The Principles of Self-Balancing System

The basic principle of a "self- balancing" ledger is that it must contain a record of the two fold aspects of all the transactions with which it relates, that is, that the double entry has been completed within the ledger itself. The method by which this is effected is by means of a control account (sometimes termed a "Total" or "adjustment" account), which is kept at the end of the ledger and contains a summary of the totals of each class of transaction debited or credited in detail to the individual personal accounts in the ledger concerned.

3.4 Format of Self-Balancing Ledger

In the General ledger, Sales ledger adjustment account

	₦		₦
Balances of all personal accounts b/d	XX	Total cash paid by customers	XX

Total sales	XX	Total discount allowed	XX
Dishonored cheques	XX	Total returns from customers	XX
Charges made to customers for carriage, package, etc.	XX	Total of bills receivable from customers	XX
Interest on overdue accounts	XX	Total of bad debts	XX
		Inter-ledger transfers	XX
		Balance (c/d to debit side)	XX
	XX		**XX**

EXAMPLE

Goodness Neken keeps his sales ledger upon the "self- balancing" principle. From the under mentioned particulars, prepare the "Sales Ledger Adjustment Account" as it would appear in the general ledger on 31st January 2008.

		₦
1	total debtors debit balances at this date were	120,542
2	Total goods sold to customers for the mouth	210,658
2	Carriage paid on behalf of customers	10,000
31	Total goods returned by customers for the mouth	9,042
31	Total cash received from customers for the mouth	150,621
31	Discount allowed to customers who pay before the due date	2,000
31	Total acceptances (Bill of Exchange) received from customers during the month	30,471
31	Total acceptances dishonoured by customers during the month.	5,042
31	It was reliably gathered that a customer who owed ₦ 4,500 is now bankrupt and there is no way of debt recovery.	

Note:

i. Interest of 2% is charged on any outstanding balance at the end of the month.

ii. A customer who owes the business ₦ 6,000 is also owed by Neken and the two have settle for books offsetting.

SUGGESTED SOLUTION TO EXAMPLE

In the General ledger, Sales ledger adjustment account

Particulars	₦	**Particulars**	₦
Balances of all personal accounts b/d	120,542	Total cash paid by customers	150,621
Total sales	210,658	Total discount	2,000

		allowed	
Dishonored cheques	5,042	Total returns from customers	9,042
Charges made to customers for carriage, package, etc.	10,000	Total of bills receivable from customers	30,471
Interest on overdue accounts	2,872	Total of bad debts	4,500
		Inter-ledger transfers	6,000
		Balance (c/d to debit side)	146,480
	349,114		**349,114**
Balance B/d	146,480		

3.5 Modern Practice

Although at one time, it was usual to double-enter the Adjustment Account, it is becoming increasing the practice in modern business to omit the Adjustment Accounts in the personal ledgers and to retain only the control accounts in the general ledger. No advantage is sacrificed through this omission. As a separate control account is kept for each personal ledger, the total amount of the balances in each ledger is known, and a mistake can thus be traced to the ledger in which it occurs. Moreover, there is no valid reason why both adjustment accounts should be kept since neither forms part of the doubt-entry system.

SELF ASSESSMENT EXERCISE

(a) What are the main advantages of self-balancing ledgers?
(b) "It is becoming increasingly the practice I modern business to omit the adjustment accounts in the personal ledgers and to retain only the control accounts in the general ledger", discuss.

4.0 CONCLUSION

In most businesses, the largest group of accounts consists of the accounts of Debtors and Creditors. For these reasons and to facilitate posting, these accounts are usually kept in separate ledgers, namely: the Sales Ledger Adjustment Account or Purchases Ledger Adjustment Accounts. However, these Adjustments accounts do not obey the double entry rule as in-fact, they constitute third entries, made for convenient only and not included in the balance sheet. In modern accounting practice, many organizations prefer to maintain control accounts rather than self-balancing ledgers, as both are memorandum accounts.

5.0 SUMMARY

This study unit has:

- Defined self balancing ledgers
- Discussed the advantages of self balancing ledgers
- Explained the principles of self-balancing ledgers
- Prepared a hypothetical formats of sales ledger adjustment account and purchases ledger adjustment account
- Explained the modern practice with respect to preparation of self-balancing ledger.

6.0 TUTOR-MARKED ASSIGNMENT

1. Kim Mayare keeps his sales ledger upon the "self- balancing" principle. From the under mentioned particulars, prepare the necessary "Sales Ledger Control Account" as it would appear in the general ledger on 31st January 2008.

		₦
1	total debtors debit balances at this date were	120,542
2	Total goods sold to customers for the mouth	210,658
31	Total goods returned by customers for the mouth	9,042
31	Total cash received from customers for the mouth	150,621
31	Total acceptances received from customers during the month	30,471
31	Total acceptances dishonoured by customers during the month.	5,042

2. Explain the principle of self-balancing ledger in accounting.

7.0 REFERENCES/FURTHER READING

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UNIT 5 CONTROL ACCOUNTS

CONTENTS

1.0 INTRODUCTION

As a business grows in size, so does, the problem of keeping accurate accounting records, especially of transactions that occur too frequent. The ledger will be split into several parts such as the Bought, Sold, and General Ledgers. These could further be arranged alphabetically. In order to control the accounting operations and to locate errors, each ledger will be made self balancing by opening control accounts.

In the general ledger will be recorded a sales ledger control account and a bought ledger control account. The balance in each will correspond to the total balances outstanding on the individual accounts within the respective ledger, that is, the total of all the debtors' account recorded in the sales ledger will be the same as the debit balance on the sales ledger control account. In the sales ledger will be a general ledger control account, which will have a credit balance equal to the debit balance on the sales ledger control account. Each ledger is then fully self-balancing. The totals of the items, which have been individually posted to the respective personal accounts, will be posted periodically to the control accounts from the books of prime entry.

2.0 OBJECTIVES

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

- explain what control accounts are
- discuss the advantages of control accounts
- itemise the sources of information for control accounts

- prepare control accounts from given information
- describe debtors statement or statement of accounts
- prepare debtors statement or statement of accounts
- it will enable you to clear more of the grey areas.

3.0 MAIN CONTENT

3.1 Definition of Control Accounts

A control account is an account in which the balance reflects the aggregate balances of many related subsidiary accounts which are part of the double entry system.

It is a memorandum record only, it does not form part of the double entry system, but it is kept using double entry principle. Control accounts are maintained to facilitate easy detection of errors because they act as a check on the entries in the various ledgers. Where the trial balance totals are not equal, balances in each ledger can be added together and compared with the balance in the respective control accounts. Ordinarily, the two should be equal, where there is a difference, such ledger that fails to reconcile with the control account will be investigated rather than all the ledger accounts.

Control accounts are classified into two main divisions: viz:

1. Total Debtors Control Account or Sales Ledger Control Account.
2. Total Creditors Control Account or Purchases Ledger Control Account

3.2 Advantages of Control Accounts

The merits of using control accounts can be summarised as follows:

(a) Control accounts helps in locating errors.
(b) It can provide a check on the accuracy of balances of the ledgers
(c) Fraud will become very difficult to penetrate
(d) The balances of the total debtors and creditors can easily be calculated
(e) They can be used to detect missing figures
(f) They save time
(g) They allow homogenous accounts to be grouped together.

3.3 Sources of Information for Control Accounts

Information recorded in control accounts are obtained from:

- Debtors and creditors accounts
- Returns inwards and outwards accounts
- Bills payable and receivable accounts
- Dishonoured cheques
- Cash paid to creditors and cash received from debtors (obtained from the cash book)
- Discount received and discount allowed accounts
- Sales day book and purchases day book.

3.4 Sales Ledger Control Account

This is the control account for sales ledger. It can also be referred to as total debtors control account. The format of presentation is given in 3.4.1.

3.4.1 Format for Sales Ledger Control Account

Format for sales ledger control account i*n the general ledger:*

Dr	₦		Cr ₦
Opening balance goods sold (sales)	XX	Return inwards	XX
Interest charges	XX	Cash received	XX
Dishonoured cheques	XX	Discounts allowed	XX
Dishonoured bills	XX	Bills received	XX
Renewed Bills	XX	Allowances & Bad Debts	XX
Payment to debtors	XX	Others (if any)	XX
Other charges (if any)	XX	Balance c/d	XX
	XX		**XX**
Balance B/d	X X		

Sales ledger control account is the account containing the summary of all debtors or customers' accounts. What is posted to the debit side of this account is the aggregate of all the items recorded on the debit side of the debtors' accounts. The same thing applies to the credit side of the account.

3.5 Creditors or Purchases Ledger Control Account

This is the account containing the summary of all the accounts of the creditors or supplies in the purchases ledger. This is the control account for the purchases ledger. It can also be referred to as total creditors control account (See XX on Pp. 79).

3.5.1 Format for Purchases Ledger Control Account

<u>Format for purchases ledger control account</u>.
In the general ledger;

Dr____Cr

	₦		₦
Returns outwards	XX	Opening balance	XX
Cash	XX	Purchases (Goods)	XX
Discount Received	XX	Others	XX
Bills payable	XX		
Others	XX		
Balance c/d	XX		
	XX		**XX**
		Balance b/d	XX

EXAMPLE 1

Mr. Bala Gonji had the following balances in his books on 1st July, 2004

	₦
Sundry Creditors	9,724
Sundry Debtors	14,581
Debit Balances in Purchase Ledger	660
Credit Balances in sales ledger	902

The following transactions took place during the month of July:

	₦
Bad Debts Written off	627
Payment to Creditors	28,368
Discount allowed	1,593
Sales Returns & Allowances	840

Bills payable accepted	15,129
Receipts from Debtors	32,708
Discounts Received	1,838
Purchases Returns & Allowances	749
Credit Sales	37,906
Bills Receivable Accepted	8,351
Sales & Purchases Ledger Transfers	1,498
Credit Purchases	47,317

The following balances also existed in the books on 31st July, 2004
Purchases ledger debit balance ₦ 856
Sales ledger credit balances 1,279

You are required to prepare

a) The Sales ledger control account and
b) The Purchases Ledger control for the month of July, 2004

SUGGESTED SOLUTION

MR BALA GONJI

a) SALES LEDGER CONTROL FOR THE MONTH OF JULY, 2005

DR.			CR
	₦		₦
Balance brought down	14,581	Balance brought down	902
Credit Sales	37,906	Bad debts	627
Balance carried down	1,279	Discount allowed	1,593
		Sales Returns & Allowances	840
		Received from debtors	32,707
		Bills Receivable	8,351
		Purchases transfer	1,498
		Balances carried down	7,249
	N53,766		N53,766
Balance brought down	7,249	Balance brought down	1,279

b) PURCHASES LEDGER CONTROLFOR THE MONTH OF JULY, 2005

DR			CR
	₦		₦
Balance brought down	660	Balance brought down	9,724
Payment to Creditor	28,368	Credit Purchases	47,317
Bills Payable	15,129	Balance c/d	856

Discount Received	1,838		
Purchases Returns	749		
Sales Transfer	1,498		
Balance carried down	9,655		
	₦ 57,897		**₦ 57,897**
Balance brought down	856	Balance brought down	9,655

3.6 Contra Entries

Contra entries occur when a supplier is also a customer. The firm can sell on credit to a customer and buy on credit from the same person. The inter-indebtedness will be set off against each other. At the end of the period, the smaller of the two balances will be set off against the larger balance.

3.7 Debtors Statements or Statements of Account

Debtors' statements are documents sent periodically, usually once a month, by a seller to his customers, showing the position of their accounts up to a certain date. Each statement gives the particulars of the invoices, debit notes and credit notes that the seller has sent to the customer during a month, payment made and how much the customer owes the seller and when the account will be due for payments. The statement is often a copy of the customer's account in the seller's books.

The statement may be kept for reference purpose or returned to the seller with the customer's cheque. In either case, neither the customer nor the seller records the statement in his books.

EXAMPLE

The following transactions took place between Abinbola Macaulay Enterprises of No.3 Ilupepu, Lagos and her customer Angels & Co. of No.32 Area 10 Abuja in January, 2009.

2nd January 2009: Invoiced goods worth ₦23,120 on invoice number 426.
9th January 2009: Invoiced goods worth ₦16,240 on invoice number 489.
16th January 2009: Angels & Co. paid a sum of ₦25,140 with cheques.
22nd January 2009: Invoiced goods worth ₦52, 910 on invoice number 563.
25th January 2009: Credit note number 1326 for ₦6, 000 was sent.

REQUIRED:

Prepare a Debtors Statement to show these transactions.

SUGGESTED SOLUTION

Abinbola Macaulay No.3, Ilupeju, Lagos
Angels & Co
No.32, Area 10 Abuja

January, 2009

Date of Invoice	Details	Invoice/Credit	Debits ₦	Credits ₦	Balances ₦
January 2nd	Goods	Note No. 426	23,120		23,120
January 9th	Goods	489	16,240		39,360
January 16th	Payment	Cheque		25,140	14,220
January 22nd	Goods	563	52,910		67,130
January 25th	Credit note	1326		6,000	61,130

Amount due on 31st January, 2009 = 61,130.

SELF ASSESSMENT EXERCISE

1. Chris Bature had the following balances in his books on 1st January, 2009

	₦
Sundry Creditors	9,724
Sundry Debtors	14,581
Debit Balances in Purchase Ledger	660
Credit Balances in sales ledger	902

The following transactions took place during the month of January:

	₦
Bad Debts Written off	627
Payment to Creditors	28,368
Discount allowed	1,593
Sales Returns & Allowances	840
Bills payable accepted	15,129
Receipts from Debtors	32,708
Discounts Received	1,838
Purchases Returns & Allowances	749
Credit Sales	37,906
Bills Receivable Accepted	8,351
Sales & Purchases Ledger Transfers	1,498
Credit Purchases	47,317

The following balances also existed in the books on 31st January, 2009
Purchases ledger debit balance ₦ 856
Sales ledger credit balances 1,279

You are required to prepare

a) The Sales ledger control account and
b) The Purchases Ledger control for the month of January, 2009

2. Distinguish between Debtors Ledger Control Account and Creditors Ledger Control Account.

4.0 CONCLUSION

Control accounts are total accounts that assist in the detections of errors and in the management of the subsidiary accounts. The advantages of using control accounts are most appreciated if the numbers of customers are very large. If a mistake occurs and there is no indication as to which ledger contained the mistake, all the ledgers accounts would have to be checked – a labourious and costly process.

5.0 SUMMARY

This study unit has:

- Defined control accounts;
- Discussed the advantages of using control accounts;
- Outlined the sources of information for control accounts;
- Explained the sales and purchases ledger control accounts;
- Prepared sales and purchases ledger control accounts;
- Discussed control entries;
- Explained and prepared a debtor's statement.

6.0 TUTOR-MARKED ASSIGNMENT

1a) Define Control Accounts and briefly state their uses
b) On 1st January, 2003 Kabewa & Sons had the following balances in his books:

₦

Sundry Debtors	9,658
Sundry Creditors	7,420
Sales Ledger Credit Balances	725
Purchases ledger debit balances	583

During the year ended 31st December 2003 the following transactions took place:

Discount allowed	670
Credit Sales	25,186
Cash received from Debtors	18,948
Discount received	1,635
Purchases returns	872
Credit Purchases	16,296
Bills payable accepted	4,500
Sales returns	937
Cash paid to creditors	9,850
Bad Debts written off	618
Bills receivable accepted	5,200
Sales and Purchases ledger transfers	464

The sales ledger credit balances and purchases ledger debit balances on 31st December, 2003 were N1,290 and N924 respectively.

You are required to prepare:

i) The sales Ledger Control Account
ii) The purchases Ledger Control Account

2. The following balances were extracted from the books of Mr. A. D. Pam on 1st April, 2005:

	₦
Sundry Debtors	4,875
Sundry Creditors	7,209
Debit balances in purchases Ledger	193
Credit balances in sales ledger	226

The following transactions were also recorded during the second quarter ended on 30th June, 2005:

	₦
Purchases returns to creditors	1,624
Sales and Purchases ledger transfers	841
Discount received	795
Cash Sales	12,618

Bad Debts written off	693
Carriage inwards	531
Discount allowed	406
Goods returned by Debtors	727
Credit purchases	35,983
Bills receivable accepted	3,680
Carriage outwards	782
Credit Sales	28,471
Bills payable accepted	9,816
Payment to creditors	21,733
Cash received from Debtors	17,295

The following balances were also taken from the books on 30th June, 2005:

	₦
Credit balances in sales ledger	187
Debit balances in Purchases ledger	304

You are required to prepare:

a) The sale ledger control account and
b) The purchases ledger control, account for the second quarter ended 30th June, 2005.

7.0 REFERENCES/FURTHER READING

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MODULE 3

UNIT 1 JOINT VENTURE ACCOUNTS

CONTENTS

1.0 INTRODUCTION

Two or more people may decide to combine resources for the purpose of a single joint project or endeavor. It may be that one person has special contacts for the disposal of certain types of goods, whereas another person has finance available to support the venture. Their purpose in combining is to exploit the joint resources, but without the intention of establishing a full trading partnership. In these circumstances, because of the short term nature of the venture, joint books will not be established, but each party will open a personal account in his own books entitled joint venture with ----.

This account will reflect the individual party's transactions on behalf of the joint venture and on completion will send a copy of this to his co-adventures. A combined account in memorandum form will be prepared to calculate the resultant profit or loss and to show the apportionment of this amongst the parties.

2.0 OBJECTIVES

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

- define a joint venture business
- explain the working of joint venture businesses
- prepare joint venture Accounts from Information provided.

3.0 MAIN CONTENT

3.1 Joint Venture Defined

A joint venture is a business activity undertaken jointly by two or more person (or firms) that are otherwise independent. The joint venture is normally for a specific business activity so at the end of such an activity, the firm dissolves.

3.2 Joint Venture Accounts

Each party to the joint venture is expected to contribute to the initial outlay and the running expenses at the agreed ratio and at the end is expected to share in the results of the venture at the same ratio.

In every joint venture, there is the memorandum of joint venture account, which is common to all the parties in the venture. It is in this account that the revenue is matched against the costs to determine the profit or loss of the venture. This account also shows the distribution of the profit or loss of the venture among the parties involved (Okwoli, 1993:300). Each party in the joint venture then opens an account in his ledger, in which each will debit his/her colleague with all the expenses incurred and credits him/her with every revenue (including unsold stocks taken over) he/she received. If there is a debit balance in this account, the amount is due to the owner of the ledger and vice-versa. At the end of the life of the venture, the balance due from one party to the other is determined and once it is paid, the business closes up.

EXAMPLE

Wang, Wale and Willy decide to enter into a joint venture for the purpose of trading in lot of antique fire dogs available at auction in Kaduna. Wang will bid at auction, Wale will provide the immediate finance, which is required, and arrange cartage to Lagos where Willy will sell to various dealers with whom he is in contact.

The transactions arising in 2007 were as follows:

Wang

April 12-19

Expenses relating to viewing the items at various auction rooms, petrol, and agreed mileage allowance – ₦ 300

April 19-26

Cost of having the items sent to his home to await collection by Wale – ₦ 500

Wale

April 19-26

Payments to various auctioneers for goods purchased – ₦ 5000

May 2

Packing insurance and freight cost for transport from Wang's home to Willy's storage rooms – ₦ 1000

Willy

May 3

Agreed labour costs for unpackaging the items and setting up on display – ₦ 200

May 10-31

Various sales made to different parties totaling – ₦ 12, 000

May 31

Agreed expenses relating to transport of items to prospective purchasers – ₦ 300

Required:

Record the above transactions in the relevant Books of Accounts of the parties in naira.

SUGGESTED SOLUTION TO EXAMPLE

In Wang's Books

Joint Venture Account (with Wale & Willy)

2007:		₦	2007:	₦
April 12-19	Expenses	300	May31 Cash received from Willy	3,400
19.26	Cash- Transport cost	500		
May 31	Profit & loss a/c	2,600		
		3, 400		**3, 400**
		=====		====

SUGGESTED SOLUTION TO EXAMPLE

In Wang's Books

Joint Venture Account (with Wang & Willy)

2007:		₦	2007:	₦
April 12-19	Bank - Various drafts	5,000	May31 Cash received from Willy	8,600

May 2	Packing etc. Costs	1,000		
May 31	Profit & loss a/c	2,000		
		8,600		**8,600**
		=====		====

Joint Venture Account (with Wang & Wale)

2007:		₦	2007:	₦
May 3	Labour	300	May 10-31 Cash from sale proceeds	15, 000
May 31	Transport	500		
May 31	Profit & loss a/c	2,600		
	Cash-			
	Wang	3,400		
	Wale	8,600		
		15,000		**15,000**
		=====		====

Memorandum Joint Venture
(Wang, Wale and Willy)

2007:		₦	2007:	₦
April 12-19	Expenses	300	May 10-31 sale proceeds	15, 000
20-21	Transport	500		
	Auctioneers	5,000		
May 2	Packing	1,000		
	Labour	200		
31	Transport	200		**15,000**
	Profit c/d	7, 800		====
		15,000		
		=====	Profit b/d	7,800
Share of profit:				
	Wang	2,600		
	Wale	2,600		
	Willy	2,600		
		7, 800		**7, 800**
		=====		=====

SELF ASSESSMENT EXERCISE

1. What are the merits of Joint Venture compared to other types of businesses?
2. Chung and Inyang were dealers in men garments who decided to do their business on a joint venture basis. They agreed that

anyone that makes a sale (including sales through an agent) should be allowed a commission of 10% on the profit arising from the sales and the remaining profit should be shared equally. No separate books were kept for the joint venture.

On 7th May 2007 Chung bought twenty garments for ₦ 3, 200 and Inyang bought thirty garments for ₦ 2, 700. They incurred expenses of ₦ 50 and ₦ 30, respectively.

On 10th May Chung sold twelve garments for ₦ 1, 320 and on 27th May consigned 20 garments to his friend Tukur at Maiduguri at an invoice price of ₦ 180 per garment. The cost of carriage of the consignment was paid by Chung at ₦ 10 per garment.

On 2nd June Inyang sold all his garments for ₦ 3,600 and on 10th June Chung sold the remaining 8 garments with him for ₦ 960.

On 23rd June Chung received an account sale from Tukur together with a cheque for balance of money due. The account sales showed that 16 garments had been sold for ₦ 2,080, and a selling expense of ₦ 30 was incurred. Two garments were returned to Chung.

Tukur was entitled to 8% commission on any sales proceeds he realized from the consignment.

On 30th June the four garments were still unsold and it was agreed that Chung should take them over at an agreed value of N320.

You are required to prepare:

a) The necessary accounts, relating to the joint venture; transactions in Chung books and Inyang's books;
b) The "Consignment to Tukur" account in Chung" books;
c) Tukur's account in Chucks' books;
d) The (memorandum) Joint Venture account.

4.0 CONCLUSION

Joint venture businesses do not have perpetual succession. They are usually prepared for businesses entered into with specific terms. The venture usually terminates at the specific activity it was entered into is accomplished.

5.0 SUMMARY

This Unit has:

- Defined a joint venture account
- Explained the workings of joint venture accounts
- Prepare joint venture accounts.

6.0 TUTOR -MARKED ASSIGNMENT

1. Explain clearly, what you understand by Memorandum Joint Venture Account?
2. Chuks and Dele were dealers in women garments who decided to do their business on a joint venture basis. They agreed that anyone that makes a sale (including sales through an agent) should be allowed a commission of 5% on the value of his sales and the remaining profit should be shared equally. No separate books were kept for the joint venture.

On 7th May 2005, Chuks bought twenty garments for ₦ 1, 600 and Dele bought fifteen garments for ₦ 1,350. They incurred expenses of ₦ 25 and N10 respectively.

On 10th May, Chuks sold six garments for ₦ 660 and on 27th May consigned 10 garments to his friend Tobe at Sokoto at an invoice price of ₦ 90 per garment. The cost of carriage of the consignment was paid by Chuks at ₦ 5 per garment.

On 2nd June, Dele sold all his garments for ₦ 1,800 and on 10th June Chuks sold the remaining 4 garments with him for ₦ 480.

On 23rd June, Chuks received an account sale from Tobe together with a cheque for balance of money due. The account sales showed that 8 garments had been sold for ₦ 1,040, and a selling expense of ₦ 20 was incurred. Two garments were returned to Chuks.

Tobe was entitled to 5% commission on invoice price and an additional 2.5% on any amount above the invoice price.
On 30th June, the two garments were still unsold and it was agreed that Chuks should take them over at an agreed value of ₦ 160.

You are required to prepare:

a) the necessary accounts, relating to the joint venture transactions in Chuk's books and Dele's books.

b) the "Consignment to Tobe" account in Chucks" books
c) Tobe's account in Chucks' books
d) The (memorandum) Joint Venture account

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UNIT 2 CONSIGNMENT ACCOUNTS

CONTENTS

1.0 INTRODUCTION

There will be occasions when a manufacturer or supplier of goods will use an agent to sell goods on his behalf. This will occur perhaps because the agent will have special local knowledge enabling him to find buyers, which otherwise, would never be put into contact with the manufacturer or supplier. To avoid delays, the agent must have the goods in his possession even though he never obtains ownerships of the goods. The use of an agent can arise either when the market is overseas or in the same country as the seller.

In such cases, some records must have to be considered which are necessary since the one merchant, known as consignor, will send a consignment of goods to another merchant, the consignee to be sold on behalf of the consignor. In this unit, we shall consider the keeping of these records.

2.0 OBJECTIVES

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

- explain what consignment accounts are
- record transactions in the books of the consignor
- record transactions in the consignee's books.

3.0 MAIN CONTENT

3.1 Definition Consignment

A consignment is an arrangement whereby goods are sent to an agent who tries to sell them on behalf of the sender on commission basis. There is therefore, a consignment when goods are sent to an agent known as the consignee for sale by the sending party called the consignor. A paper called pro-forma invoice, which gives brief description of the goods on consignment and the minimum price at which they could be sold normally accompanies all goods on consignment s instructions from the consignor to the consignee.

3.2 Basic Terms

3.3 Operation Arrangements

(i) Goods sent to an agent are usually despatched in bulk and are termed a consignment;

(ii) The party sending the goods is the consignor and the agent is the consignee;

(iii) Both parties incur expenses in connection with the consignment;

(iv) Periodically, the consignee sends an "account sales" to the consignor. This is a document which shows the sales made by the consignee, along with his expenses and commission. A banker's draft for the net balance may accompany the account sales or make a "money transfer" in that respect;

(v) Sometimes, the consignee guarantees that all the trade debts will be collected, and should any prove to be bad, that he will bear the loss. He receives an extra commission (known as del credere) on all sales for the additional undertaking.

3.4 Accounting Arrangements

The act of consigning goods to an agent does not constitute a sale by the consignor but merely a transfer of location of the goods concerned. Ownership of such goods remains vested in the consignor although they are in possession of the consignee. Sales arises when the goods are sold by the consignee to third parties and the accounting arrangements reflect this situation and are different for each of the two parties. Hence, two people's account books are affected when goods are sent on consignment – the consignor's books and the consignee's books.

3.5 Consignor's Books

In the consignor's books, three main accounts may be opened, namely:

(i) The consignment outwards account, which shows the goods sent on consignment;

(ii) The consignment to consignee account, which shows the proceeds of sales of the consigned goods and the consequent net profit or loss on the consignment; and

(iii) The consignee account, which records the gross proceeds of the sale, his entitlements and the balance to be remitted to the consignor. In the consignor's balance sheet, unsold goods on consignment form part of his current assets under the name of goods on consignment.

3.5.1 Accounting Entries

1. Debit Consignment to agent Account, Credit Goods on Consignment account (with value of goods transferred to agent).

2. Debit Goods on consignment account or trading account (with closing balance of goods on consignment).

3. Debit Consignment to agent account, Credit Bank or cash or creditors etc as appropriate (with expenses incurred in connection with the consignment).

4. Debit consignment to agent account or sales (with consignee's expenses and commission on receipt of the account sales).

   The opposite entries are posted to a personal account opened in the name of the agent. The balance on this account is settled in cash or by bill of exchange or is carried forward to the next accounting period.

5. Debit balance carried down at start of the next accounting period, Credit consignment to agent account (with unsold stock).

EXAMPLE 1

When the goods are consigned to the consignee, the consignor cannot regard that as sales, neither can he consider the consignee as being a debtor. So two "pigeon–hole accounts" are opened. Various authorities give these accounts different names, although the purposes remain the same.

The accounts used and their purposes are shown next with hypothetical figures.

Consignment to (Agent) or Consignment a/c

	₦		₦

Goods on consignment	40,000	Gross proceeds of sale	60,000
Expenses incurred	4,000		
Commission	3,000		
Profit on consignment	13,000		
	60, 000		**60, 000**
	=====		=====

Consignment Outwards /Goods on Consignment/Goods Consigned Outwards Account

	₦		₦
Trading a/c	40,000	Goods on consignment	60,000

The consignment to (agent) account: thus becomes a miniature profit and loss account for the particular transaction. The balance is transferred to the profit and loss account.

The consignment outwards account: although credited with the cost of goods, is not a sales account. The balance when transferred, should be debited in the trading account from the purchases figures, or shown as a separate credit from sales. This is because the sales figure includes gross profit, whereas the balance of the consignment outwards account is at cost price.

Unfortunately, consignment accounts cause a lot of confusion to students because of the difficulty in remembering which account is debited, or credited with the entries so try to pay special attention to learning this aspect. If you study the example below, you will see that the consignment to (agent) account has a lot of entries, is the miniature profit and loss account and is debited initially with the cost of the goods consigned. The consignment outwards Account will only (normally) have one credit during a financial period.

Here is a simple example:

Bunny & Co. sends goods costing N20, 000 to their agent, Tani. The cost involved are freight N1, 400, insurance N800, all in March 2, 2007.

Consignment Outwards to Tani Account

	₦		₦
March 2, 2007:		Goods on consignment	60,000
Consignment outward a/c	20, 000		

Freight	1, 400		
Insurance	800		

Consignment Outwards to Tani Account

March 2, 2007:		March 2, 2007:	
	₦		₦
Consignment outward a/c	20, 000	Consignment to Tani	20, 000
Freight	1, 400		
Insurance	800		

Corresponding entries will also be made in freight, and insurance Account.

In due cause, Tani is successful in selling all the goods to one purchaser, Larry and Co. Tani will render an account sale which is a statement showing the expenses incurred in handling the goods, commission arising from the sale and setting out the net amount due to Bunny and Co. On receipt of this, the next entries can be made.

The Account sale shows that the goods were sold for ₦, 000; that storage expenses were ₦ 1, 600; haulage costs ₦ 1, 200; and his commission ₦ 1, 600. The net amount due is thus ₦ 27, 600. All transaction details were received on June 6.

The accounts are shown next:

Consignment to Tani Account

2007:		2007:	
	₦		₦
May 2 consignment outward a/c	20,000	June 6 Tani	32,000
Freight	1,400		
Insurance	800		
June 6 Tani re-Storage	1,600		
Haulage	1,200		
Commission	1,600		
Balance c/d (profit)	5,400		
	32,000		**32, 000**
	=====		=====

Tani Account

June, 2007:	₦	June, 2007:	₦
6 Consignment to Tani	32,000	6 Consignment to Tani A/c storage)	1,600
Freight	1,400	Haulage	1,200
Insurance	800	Commission	1,600
June 6 Tani re-Storage	1,600	Balance c/d	27, 600
Haulage	1,200		
Commission	1,600		

Balance c/d (profit)	5,400		
	32,000		**32, 000**
	=====		=====

In due cause, the agent, Tani, will remit the monies due, unless already sent. At the end of the financial period, the consignment accounts can be closed.

Assuming Tani remitted the cash of N27,600 on August 1, 2007.

Tani Account

		₦			₦
June 6	Balance b/d	**27,000**	August 1	Bank	**27,000**
		=====			======

Consignment to Tani Account

	₦			₦
December 31 to profit & loss a/c	**5,400**	June 6	Balance b/d	**5,400**
	====			=====

Consignment Outwards

		₦		₦
December 1	Trading a/**c**	**20,000**	March 2 Consignment to Tani	**20,000**
		=====		=====

Showing goods on consignment in the Balance sheet

If the end of the financial year intervenes between consigning the goods and their sale, the value of these goods must obviously appear in the balance sheet. The actions to be carried out are: -

(1) Close the consignment outwards account by transfer to the trading account
(2) Balance the consignment to (agent) account and carry this forward.
(3) This balance will appear (totaled with others) in the balance sheet as part of the stock items: -

	₦	₦
Stock on hand	N10,000	
Stock on consignment	N8,000	18,000

If only a portion of the stock has been sold, then the expenses incurred when the stock was consigned will have to be apportioned. Assume that Tani had sold only half when the balance sheet at 30 June was prepared, then the expenses with half the cost of the stock would be carried forward: -

Consignment to Tani Account

2007:		₦	2007:		₦
Mar 2	Consignment outward	20,000	June 6	Tani	16,000
	Freight	1,400	June 30	Balance c/d	10,000
	Insurance	800			
June 30	Profit & loss a/c	200			
		26,000			**26,000**
June 30	Balance b/d	10,000			

This balance of ₦ 10, 000 would appear in the balance sheet as part of stock on consignment.

3.5.2 Valuation of Stock on Consignment

In arriving at the closing stock valuation, only amounts relating to unsold stock are included; thus, the agent's expenses incurred on the incoming consignment are included but certain items of a marketing nature are excluded from the calculation on the grounds that they relate to the goods, which have been sold and not to those remaining unsold.

Closing stock value thus comprises the aggregate of the initial cost of the goods plus the attributable cost of both the consignor and consignee, but a further refinement is required when stock losses occur.

3.5.3 Stock Losses

When goods on consignment are lost or stolen or damaged in transit, further accounting problems arise:

(i) Debit suitable account, credit consignment to agent account (with the cost of the loss).
(ii) Stock in agents hands is calculated as follows:

(a) <u>Stock Quantity</u>

Total consignment quantity x Consignor's attributable costs
(to point of loss)

(b) A further calculation is then made of:

<u>Stock quantity</u>

Total consignment quantity x Consignee's attributable cost - quantity loss

3.6 Consignee's Books

In the consignee's books, only one account – the consignor's account is of particular interest. The consignor's account shows the gross proceeds on sale of the consignment, all expenses incurred by him in respect of the consigned goods, his entitlements and the final balance due to the consignor. If the consignee had entered the cash proceeds of sale in his private cash book on sale of the consignment, when the consignor is paid, the cash book should be credited. Cash book should be credited. He does not concern himself with any cost not borne by him. Unlike the consignee, the consignor takes all costs into account to determine his profit or loss on consignment.

3.6.1 Accounting Entries

1. On receipt of the consignment, the consignee makes a memorandum record of quantities etc, but does not record their value in his ledger.

2. Debit account in the name of the consignee (with expenses, commission on sales), credit account in the name of the consignee (with sales).
   Opposite entries for all of these transactions are made in the consignee's bank, commissions received, debtors, etc accounts as appropriate.

3. Consignee does not bring the closing stock balance into account because the value of the consignment was not originally recorded in the accounts.

4. The balance on the consignor's account at the end of the period represents the net sum due from the consignee to the consignor and may be settled by payment or carried forward to the next accounting period, depending on the agreement between the parties. It should agree in amount with the balance on the agent's account in the consignor's ledger.

EXAMPLE 2

Baraka Da Sallah of Zamfara consigned goods to Obi in Enugu on 1st April 19 x 9. The following data relate to the transitions for the month of April, 19 x 9:

April Baraka Da Sallah consigned 500 crates of goods costing ₦ 15 per crate.

₦

April Baraka Da Sallah paid: Transport expenses 1,000

Handling charges 500

Sundry expenses 1,500

April 15 Obi paid: Carriage Expenses 1,000

Delivery expenses 1,000

Fire Insurance 550

April 25 Obi sold 450 of the crates of goods at ₦ 30 each
April 26 Obi submitted an account of sale to Bakara Da Sallah and remitted the net balance in bank draft to him (Baraka Da Sallah) after deducting his agreed commission t 5% of the sales.

April 30 – 10 of the crates were discovered to have been damaged in trnsit and had to be discarded, Bareaka Da Sallah agreed to write them off his books.

REQUIRED:
Show these transactions in the:

(i) Consignor's books including the balance on 30th April, 19 x 9; and
(ii) Consignee's books.

SUGGESTED SOLUTION

In the consignor's books journal proper (Baraka Da Sallah, Zamfara)

Date 19 x 9	**Particulars**	**Debit ₦**	**Credit ₦**
April 1	Consignment to Obi Account	7.500	
	Consignment outward. Being the cost of goods sent on consignment to Obi (N15 x 500)		7,500

April 1	Consignment to Obi Account	3,000	
	Transport expenses Account		1,000
	Handling charges Account		500
	Sundry expenses account. Being sundry expenses paid the consignor in respect of his consignment.		1,500
April 5	Consignment to Obi account	2,550	
	Obi: Carriage expenses account		1,000
	Delivery expenses account		1,000
	Fire Insurance account. Being sundry expenses paid by the consignee)		550
April 26	Obi	13,500	
	Consignment to Obi Account. Being proceeds of sale of part of the goods on consignment by Obi.		13,500
April 26	Consignment to Obi Account	675	
	Obi (5% Commission). Being Commission due to Obi on the consignment)		675
April 26	Bank account	10,275	
	Obi Being remittance of net proceeds by Obi to the consignor		10,275
April 30	Consignment outwards account	150	
	Consignment to Obi account. Being goods on consignment which were damaged and held to be written off.		150

CONSIGNMENT OUTWARDS ACCOUNT

Particulars	₦	Particulars	₦
April 30 Consignment to Obi	150.00	April consignment to Obi	7,500.00
April 30 Stock of unsold goods	600.00		
April 30 Transfer of Trading Account	6,750.00		

	7,500		7,500.00
		May 1 Stock balance b/d	600.00

CONSIGNMENT TO OBI ACCOUNT

Particulars	₦	Particulars	Credit ₦
April 1 Consignment outwards	7.500.00	April 26 Consignee (proceeds of sales)	13,500
Consignor's expenses:			
Handling charges	500.00	April 30 Consignment outwards	150.00
Transport expenses	1,000.00	April 30 Stock of unsold goods	600.00
Sundry expenses	1,500.00		
April 15 Consignee:			
Carriage expenses	1,000.00		
Delivery expenses	1,000.00		
Fire insurance	550.00		
April 26 Commission	675.00		
April 30 Profit on Consignment	525.00		
	14,250.00		14,250.00

OBI, ENUGU

Particulars	₦	Particulars	Credit ₦
April 26 Consignment to Obi (proceeds of sales)	13,500.00	April 15 Carriage expenses	1,000.00
		April 15 Delivery expenses	1,000.00
		April 15 Fire insurance	550.00
		April 26 Commission	675.00
		April 26 Bank	10,275.00
	13,500.00		13,500.00

Baraka Da Sallah Balance Sheet as at 30th April 19 x 9

		₦
	Current Assets:	
	Goods on Consignment	600.00

IN THE CONSIGNEE'S BOOKS
JOURNAL PROPER (OBI, ENUGU)

Date 19 x 9	**Particulars**	**Debit ₦**	**Credit ₦**
April 15	Baraka Da Sallah Cash Account	2,550.00	
	Carriage expenses		1,000.00
	Delivery Expenses		1,000.00
	Fire Insurance (Being Sundry Expenses paid by the consignee)		550.00
April 26	Cash Account	13,500.00	
	Baraka Da Sallah Being cash proceeds of sale of a consignment		13,500.00
April 26	Baraka Da Sallah	675.00	
	Commission Receivable, (Being Commission receivable by Obi and deducted from the consignor's account)		675.00
April 26	Baraka Da Sallah	10,275.00	
	Bank Account (Being payment of net proceeds of sale to the consignor)		10,275.00

BARAKA DA SALLAH, ZAMFARA

Particulars	₦	**Particulars**	**Credit ₦**
April 15 Cash Carriage expenses	1,000.00	April 26 Cash (Sales)	13,500.00
Delivery expenses	1,000.00		
Fire Insurance	500.00.00		
April 26 Commission	675.00		
April 26 Bank	10,275.00		
	13,500.00		13,500.00

SELF ASSESSMENT EXERCISE

1(a) What is a consignment account?

(b) What are the parties involved in a consignment transaction and how do they settle their accounts?

2. Sofiya of Lokoja consigned goods to Saratu in Yola on 1st June 2009. The following data relate to the transitions for the month of June, 2009:

June Sofiya consigned 500 cartons of goods costing N15 per crate.

		₦
June Sofiya paid:	Transport expenses	3,000
	Handling charges	1,500
	Sundry expenses	3,500
June 15 Saratu paid:	Carriage Expenses	3,000
	Delivery expenses	3,000
	Fire Insurance	1,550

June 25 Saratu sold 500 of the crates of goods at N90 each
June 26 Saratu submitted an account of sale to Bakara Da Sallah and remitted the net balance in bank draft to him (Sofiya) after deducting his agreed commission of 5% of the sales.

June 30 – 15 of the crates were discovered to have been damaged in transit and had to be discarded, Sofiya agreed to write them off his books.

REQUIRED:
Show these transactions in the:
(i) Consignor's books including the balance on 30th June, 2009; and
(ii) Consignee's books.

4.0 CONCLUSION

Consignment accounts are usually necessary where a business is separated from its customers or client either as a result of geographical separation or some other factors. These goods are usually dispatched to the consignee. The goods never become the property of the consignee. Therefore, he incurs no liability as a result of the transaction until the goods are sold, when he becomes liable for payment of the proceeds. He is paid by a commission. The consignor and consignee will both keep their separate records.

5.0 SUMMARY

This study unit has:

- Explained the arrangement involved in consignment accounts;
- Discussed the basic terms in consignment accounting;
- Outlined the accounting entries needed to be made in the books of the consignor and consignee.
- Discussed how stocks are valued;
- Discussed how losses are treated.
- Prepared consignment account both in the books of the consignor and the consignee.

6.0 TUTOR-MARKED ASSIGNMENT

1. Enumerate the procedure in consignment businesses
2. Zen of Jos consigned goods to Olu in Lagos on 1st September 2009. The following data relate to the transitions for the month of September, 2009:

September Zen consigned 500 crates of goods costing N30 per crate.
September Zen paid: Transport expenses ₦ 2,000; Handling charges 1,000; Sundry expenses ₦ 3,000
September 15 Olu paid: Carriage Expenses ₦ 2,000; Delivery expenses ₦ 2,000; Fire Insurance N1,100
September 25 Olu sold 450 of the crates of goods at ₦ 60 each
September 26 Olu submitted an account of sale to Zen and remitted the net balance in bank draft to him (Zen) after deducting his agreed commission of 5% of the sales.
September 30 – 10 of the crates were discovered to have been damaged in transit and had to be discarded, Zen agreed to write them off his books.

You are required to show the above transactions in the:

(i) Consignor's books including the balance on 30th September, 2009; and
(ii) Consignee's books.

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UNIT 3 CONTAINER ACCOUNTS

CONTENTS

1.0 INTRODUCTION

For many products, some form of packaging is very essential. Items of food are usually put into bags or wrappers or tins, as appropriate. Cigarettes are put into packets; paint and motor oil are sold in metal or plastic cans. Certain other products require much stronger containers. Acid is stored and transported in a non-corrosive (usually glass) carboy, radio – active materials in special casks. Beer is put inside cartons; soft drinks are put inside crates, shirts into waterproof bags, granulated sugar, salt into bags, etc.

Containers of the type mentioned above may or may not be re-usable. The consumer throws packages of items that cannot be re-used away when the product, which it is protecting, is used up. For some other types that are re-usable, they are returnable to the manufacturers or suppliers, when empty.

2.0 OBJECTIVES

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

- define a container
- discuss the accounting arrangement for the different types of containers
- prepare container accounts.

3.0 MAIN CONTENT

3.1 Definition of Container

A container is any item that contains goods for the purpose of either preservation or conveyance to an agreed destination. In marketing, the container is called the package, which may be divided into three main levels of materials – the primary, secondary and the labelling levels. The primary package is the product's immediate container, the secondary package is the additional level of layer of material designed to protect the primary package and the labelling is any printed information which appears on the package to describe the product in it.

3.2 Accounting for Containers

In accounting literature, a container is looked at from two main standpoints – either it is non-returnable or returnable.

3.2.1 Non-Returnable Container

Non-returnable containers create no problems to the accountant after sale because in costing the goods, the cost of packaging would have been taken into consideration. A container of that nature is treated as a manufacturing expense and no record is taken of it after sales. Customers are not chargeable for non-returnable containers outside the selling price which may, however cover all expenses including the package. These are primary packaging, which is in effect, an integral part of the product and which is discarded when the product is used up, constitutes part of the manufacturing cost of that product and forms part of the cost of sales figure of the manufacturer.

3.2.2 Returnable Containers

The cost of returnable containers is not taken into consideration in costing the goods that are sold. It has its own distinct cost which is returnable. Re-usable secondary packaging, for example crates and primary packaging are treated as a distribution cost if not returned to the manufacturer or supplier.

In those instances where the manufacturer or supplier is eager for the container to be returned, a deposit is invariably imposed on the customer. This is refundable in full or in part, according to the condition of the container, if returned. It is apparent here that the manufacturer or supplier must keep records showing container bought, lost, damaged, scrapped and in stock and records showing deposits receivable, refunded and refundable. Just like there are opening and closing balances of stock of goods for sale, there can also be opening and closing balances of stocks of containers.

3.3 Accounting Entries

Method 1: Two accounts should be opened as follows, each with separate columns for quantities, unit values and total amounts.

(a) Container Stock Account

Containers stock account records containers bought, scraped, retained by customers and in stock. Containers in customers' hands but capable of being returned are regarded as stock but distinguished from stock available for despatch to customers. Sums written off the value of containers are also passed through this account. The container stock account usually shows the profit or loss arising on containers. When a period ends, accounts are prepared, the derived figure of profit or loss on containers is transferred to profit and loss account, whilst the closing balance, representing refundable deposits appears partly or wholly, as appropriate, as a deduction from debtors or as creditors. The losing balance on containers stock is included in stock.

Four main prices may be associated with container accounts – the book value which represents the price of which stock of containers is valued for balance sheet purposes. Cost price which is paid for purchases of new containers, charge-out price which represents the price at which containers are charged (hired) out to customers and the credit back price which represents the amount which customers are credited with on return of the containers.

3.3.1 Non-Returnable Containers

1. **Debit container stock account with:**

- Opening stock;
- Purchases during the period

2. **Credit container stock account with:**

- Unit and value of unused containers as carried down.

3. **Difference between** both sides of this account represents container consumed during the period and would be passed on to manufacturing account or profit and loss account as distribution cost.

3.3.2 Returnable Containers

There are several problems associated with returnable containers and some may include:

(i) Closing stock may be held partly in the warehouse and partly in the hands of customers;

(i) Each container will presumably have a limited life, and a reasonable allowance for depreciation must be made;

(iii) Some of the damaged containers may be repaired from time to time and eventually scrapped when they are no longer in use;

(iv) Profit may arise if price charged to customer is above cost.

(v) Further profit may yet arise if the allowance made on return is less than price charged;

(vi) A time limit may be set for return after which container in the hand of customers will be written off;

(vii) Each container should have an identification number and the columns should be provided in the sales daybook or journal and in the customers' accounts for these numbers periodically.

These numbers need to be cancelled after the in and out entries movement of container. Generally, there are three methods that could be used in keeping accounts of returnable containers having regards to the associated problems.

Method II

Under this method, two accounts are prepared. These are:

(a) Container stock Accounts; and
(b) Container Trading Account.

The container stock account here records stock of containers at their book value and keeps accounts of only stock items, while Container Trading Account is used for measuring profit or loss on container and monitoring the movement of container in the hands of customers. It records the refundable deposit, deposit receivable and forfeited (through non-return), sum written off in form of depreciation and repairs and maintenance.

Container Stock Account Format

	Units	Rate	Amount		Units	Rate	Amount
Balance b/f:				Depreciation			XX
In warehouse	X	X	X	Destroyed	X	X	X
With customers	X	X	X	Scrap	X	X	X
Purchases	X	X	X	Retained:	X	X	X
				Balance c/d			
				Warehouse			
				Customers	X	X	X

Container Trading Account Format

	Units	Rate	Amount		Units	Rate	Amount
Returned	X	X	X				
Depreciation	X	X	X				

Loss on destroyed	X	X	X	Balance b/d	X	X	X
Loss on scrap	X	X	X	Sent to customer	X	X	X
P & L							
Retained	X	X	X				
Balance c/d	X	X	X				

Method III

This method combines the attribute of both method I and II. It involves recording transactions in the following account:

1. Container Stock Account, which keeps records of stocks of containers alone. Stocks are recorded at cost or book value except purchases, which is recorded at cost of purchases, and depreciation, which is credited against the cost of purchase.

2. Container suspense account: This is basically used to monitor the movement of containers in the hand of customers and recorded at refundable amount/price.

3. Container sent to customers account: This is a total account used in monitoring debtors' balance. It records transactions at charge out price.

4. Container profit and loss account: This is used to ascertain profit or loss on all the transactions.

Container Stock Account Format

	Quantity No	**Rate**	**Amount**		**Units**	**Rate**	**Amount**
Balance b/f:		BU		Depreciation			XX
In warehouse	X	XBV	X	Container:			
With customers	X	XBV	X	Destroyed	XX	BV	XX
In transit	X	XBV	X	Scrapped	XX	BV	XX
Purchases	XX	XCP	XX	Retained	XX	BV	XX
Balance c/d:							
In warehouse	XX	BV	XX				

With customers	XX	BV	XX				
In transit	XX	BV	XX				
	XX	XX	XX		XX	XX	XX

NB:
CP = Cost price/purchase price
BV = Balance sheet value price

Container Stock Account Format

	Qty	Rate	Amount		Units	Rate	Amount
				Opening Bal	-	-	XX
Container returned	XX	RA	XX	Container sent	XX	RA	XX
Container retained:							
From stock a/c	XX	BV	XX				
For P&L a/c (Profit on retained	-	(RA-BV	X				
Balance c/d	XX	RA	X				
	XX	-	XX		XX	-	XX

N.B: RA = Refundable Amount.

Container Sent to Customer Account Format

	Qty	Rate	Amount		Units	Rate	Amount
Balance b/f				Container retained:	-	-	XX
With customers	XX	COP	XX	From suspense a/c	XX	RA	XX
Container sent:							
From suspense a/c	XX	RA	XX	Bank a/c	XX	(COP-RA)	XX
For P&L a/c	-	-	-	Container retained (COP-RA)	XX		
(Hire charge)	XXX	-	XXX	Bal c/d	XX	COP	XXX
					XXX	-	XXX

COP - Charge Out Price

Container Profit and Loss Account Format

	₦		₦
Depreciation	XX	Hire charges	XX
Loss on container destroyed	XX	Profit on container retained	XX
Loss on container scrapped	XX		
Cost of repairs	XX		
Gen. P&L a/c (Diff)	XX		
	XX		
	XX		

EXAMPLE

R^2 Ltd. despatched its products to customers in bulk in wooden rates. The crates are bought from the manufacturers at ₦1.5 each, but are valued for stock purposes at ₦10 each Customers are charged a deposit of ₦25 per crate, N20 of which is refunded when the crate is returned.

At the beginning of 2009, R^2 Ltd. was holding 1,750 crates on its premises, whilst customers held 1,460. The corresponding figures at the end of the year were 3,021 and 1,983 crates respectively. During the year 2009, the company bought 2,000 crates charged out 5,663 crates to customers and made refunds on 5,104. Of the remainder, 170 crates were scrapped and customers retained 36. The company incurred ₦ 857 in making damaged crates re-usable.

REQUIRED

Prepare the crates stock and crates suspense accounts for the year 2009.

SUGGESTED SOLUTION

In the Books of R^2 Ltd

CRATES STOCK

	Quantity No	Rate	Amount		Quantity No	Rate
2009 Balance b/d:				Crates suspense		
On premises	1,750	10	17,500	Scrapped	170	10
With Customers	1,460	10	14,600	Retained	36	10

				Depreciated – (2,000x(N15-N10) Balances c/d:		
Purchases	2,000	15	30,000	On premises	3,021	10
				With customers	1,983	10
	5,210	62,100			5,210	

CRATES SUSPENSE

	Quantity No	Rate	Amount		Quantity No	Rate
2009 Debtors (refunds)	104	20	102,080	2009 Balance b/d	1,460	20
Crates Suspense:				Debtors (charges	5,663	25
Scrapped			1,700			
Retained	36	10	360			
Depreciation			10,000			
Repairs			257			
Balance c/d	1,980	20	39,660			
Profit and loss			16,718			
(Profit) (derived)	7,123		170,775		7,123	

The profit can be reconciled as follows:

Profit on hire (5,663 x (N25 – N20)		28,315
Profit on retained crates (36 x (20 – 10)	360	
Expenses (1,700 + 257 + 10,000)	(11,957)	
Profit as above		**16,718**

Amount
N
1,700
360
10,000

30,210
19,830
62,100

29,200
141,575
170,775

SELF ASSESSMENT EXERCISE

1. Garuba Limited sells a new mineral water in barrels. The barrels are purchased at N20 each, and these are then charged to customers at N40 per barrel. The customer is credited with N30 a barrel if it is returned within one month from the de of receipt.

The following information relates to the year to 30 September 19 x 0:

(a) There were 1,000 barrels in stock at 1st October, 19 x 9

(b) 2,000 barrels were with customers at 1st October, 19 x 9 and 3,000 at 30th September, 19 x 0. As at these dates, the time limit for the return of the barrels had not expired.

(c) 14,000 barrels were purchased during the year

(d) 500 barrels were scrapped, the sales proceeds being ₦ 2,000

(e) 90,000 barrels were sent to customers

(f) 80,000 barrels were returned by customers within the time limit.

The company keeps details of the barrels stock account and a barrels suspense account. Both these accounts have memorandum columns for the number of barrels and the price per barrel as well as double entry columns in which details concerning barrel transaction are entered.

REQUIRED

(a) Write up the following ledger accounts for the year to 30th September 19 x 0:

(i) Barrels stock account; and
(ii) Barrels suspense account. And

(b) Show how the respective balances in the above accounts would be disclosed in Garuba Ltd's balance sheet as at 30th September 19 x 0.

2. Oduduwa Company delivers goods to customers in plastic crates which are invoice to them at ₦ 10 each, and credited in full if returned within three months of delivery. The crates are

purchased by the company from another plastics limited, at the sum of ₦ 10 per crate.

On 1st January 200 x 8, there were 5,000 crates in the warehouse, 17,000 with customers and 500 in transit. During the year, the following transactions took place:

- 10,000 crates were purchased during the year;
- 20,000 crates were invoiced to customers;
- 30,000 crates were returned by customers and credited in full;
- 200 crates were retained by customers;
- Repairs to the tune of ₦ 1,000 were made to the crates;
- 500 crates were damaged beyond repair and therefore, discarded; and the closing stock take shows:

(i) 24,000 crates in the warehouse
(ii) 6,800 crates in the hands of customers; and
(iii) 1,200 crates in transit.

REQUIRED

Prepare appropriate accounting records for all crate transactions for the year ended 31st December 200 x 8 in the Books of the company.

4.0 CONCLUSION

Most manufacturers or producers of goods/products package their products in one form or the other, using different forms of material enclosure. The packages used in dispatching goods to customers are referred to as containers. For example, drum for chemicals or liquid products, case or wooden/plastic crate for eggs and other breakable products, packets for cigarettes, bottles, cartons, and cans. Containers make it very convenient to move goods from one location to another and also form the basis for monitoring the movement of such containers, both in the warehouse and in the customers' hands. In accounting literature, a container is looked at from two main standpoints – either as non-returnable or returnable.

5.0 SUMMARY

This study unit has:

- Defined a container
- Discussed how containers are accounted for in accounting
- Showed accounting entries to be made in financial records

- Prepared container accounts.

6.0 TUTOR -MARKED ASSIGNMENT

1. What the problems associated with returnable containers? Enumerate eight of such problems.
2. Kuru Ltd. despatched its products to customers in bulk in wooden rates. The crates are bought from the manufacturers at ₦3 each, but are valued for stock purposes at ₦20 each Customers are charged a deposit of ₦50 per crate, ₦ 40 of which is refunded when the crate is returned.

At the beginning of 2009, Kuru Ltd. was holding 1,750 crates on its premises, whilst customers held 1,460. The corresponding figures at the end of the year were 3,021 and 1,983 crates respectively. During the year 2009, the company bought 2,000 crates charged out 5,663 crates to customers and made refunds on 5,104. Of the remainder, 170 crates were scrapped and customers retained 36. The company incurred ₦ 1,714 in making damaged crates re-usable.

REQUIRED

Prepare the crates stock and crates suspense accounts for the year 2009.

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UNIT 4 BILLS OF EXCHANGE

CONTENTS

1.0 INTRODUCTION

Under normal trading arrangements, the period of time which elapses between goods and services being supplied and being paid for can vary from two weeks to six months or even longer. The supplier may not wish to wait so long for payment because he may need the cash to finance his current operations. One way in which the supplier can obtain payment at an early stage whilst at the same time allowing the purchaser the benefit of the full credit period, is for the parties to agree to the use of a bill of exchange to finance the transaction.

2.0 OBJECTIVES

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

- define a bill of exchange
- explain the types of bills of exchange available
- enumerate the main parties to a bill of exchange
- state how the accounting entries are made in the books
- prepare bills of exchange accounts.

3.0 MAIN CONTENT

3.1 Definition of Bill of Exchange

Here is the definition of a bill of exchange taken from the bills of exchange Act, 1882. It is 'An unconditional order in writing addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money, or to the order of a specified person, or to bearer'.

A cheque is a specialised form of bill of exchange, drawn on a banker and payable on demand.

3.2 Types of Bills of Exchange

(i) **Inland Bill:** This is a bill of exchange drawn and payable in Nigeria.

(ii) **Foreign Bill:** This is a bill drawn in Nigeria and payable in another country.

(iii) **Accommodation Bill:** An accommodation bill is a bill of exchange, which has been accepted, drawn or endorsed by a person, known as accommodation party, not for valuable consideration but for the sole purpose of lending his name/reputation to another person, known as accommodation party, so that the accommodated party can enjoy some benefits which he could not have enjoyed otherwise. Such benefits, of course, depend on the exact nature of the accommodation bill. They include, but are not limited to the following:

- The accommodated party can enjoy credit facility from his supplier because the latter would be reassured by the reputation of the accommodated party;
- The accommodated party can raise funds by discounting the accommodation bill, with a financial institution because, with the reputation of the accommodation party, the financial institution is reasonably assured that it can recover the debt.

3.3 Advantages of Bills of Exchange

(a) It is a means of settling foreign debts and financing of exports;

(b) A bill of exchange enables the debtor to postpone payment to a later date;

(c) It is an evidence of indebtedness of the debtor to the creditor;

(d) It enables the holder to sue in his/her own name and free from equities;

(e) It fulfils, to a certain extent, the function of money;

(f) It enables the creditor to receive money immediately despite the fact that the debtor is yet to pay his debt. The creditor does this by discounting the bill with a bank or discount house;

(g) By means of an accommodation bill, a person can lend his name and reputation to another person, thus, enabling that other person to enjoy some benefits which he could not have enjoyed otherwise.

3.4 Options Available to the Holder of a Bill of Exchange

The beneficiary of a bill of exchange has four options:

(i) Wait until the maturity date to collect the value from the acceptor;

(ii) Negotiate the bill (by endorsement, etc.) to another person in settlement of his own indebtedness;

(iii) Discount the bill with a bank or discount house;

(iv) Obtain an advance on the bill from a bank.

3.5 Accounting for Bills of Exchange

A bill becomes an accounting issue only when it has been accepted by the drawee, who now becomes an acceptor. It is only then that the following accounting entries are made.

3.5.1 In the Books of Drawer (Supplier)

1. Debit Drawer A/C, Credit Sales A/C – (with the value of credit sales).

2. Where the drawer discounts the bill:

(i) Debit Bills Receivable, Credit Drawee (Debtor) – (with the value of the accepted bill on the date of acceptance);

(ii) Credit Bills Receivable – (with the full value of the discounted bill on the date of discounting);

(iii) Debit Discount on Bills, Credit Bank – (with the discount charge on the bill on the date of discounting);

(iv) Debit profit and loss a/c, Credit Discount on bill – (with the discount charged on the bill at the end of the accounting period).

3. When the bill receivable is transferred to a creditor of the drawer:

a(i) Debit Bills Receivable, Credit Drawee – (with the value of the accepted bill on the date of transfer);

(ii) Debit Creditor, Credit Bills Receivable – (with the full value of the accepted bill on the date of transfer);

b. No accounting entries are required, if payment is made by the acceptor on the due date;

c. If the bill is dishonoured by acceptor on the due date:

Debit Debtor (Bills' acceptor), Credit Creditor – (with the full value of the bill transferred on the due date).

4. When the bill is held till maturity:

(a) Debit Bank, Credit Bills Receivable – (with the value of the accepted bill on the due date).

(b) No accounting entry is required, if payment is made by the acceptor on the due date.

(c) If the bill is dishonoured by the acceptor on the due date:
Debit Debtor, Credit Bank.

3.5.2 In the Books of Drawee (Debtor)

(1) Debit Purchases, Credit Drawer – (with the value of credit purchases).

(2) Debit Drawer's account, Credit Bills Payable account – (with the value of the accepted bill on the date of acceptance)

(3) No accounting entry is required when the drawer discounts the bill on the discounting date.

(4) If the bill is paid by the acceptor on its due date:

Debit Bill Payable account, Credit Bank account – (with the full value of the accepted bill on the due date).

(5) If the bill is dishonoured by the acceptor on its due date:

(i) Debit Bills payable account, Credit Drawer account – (with the value of dishonoured bill on the due date.

(ii) Debit Expenses account, Credit Drawer account – (with the value of noting charges incurred on the dishonoured bill). Furthermore, the defaulting acceptor will be charged interest for his/her default. In the drawer's book: Debit Drawee account; Credit Interest Receivable account – (with the interest charge) and Credit Drawer account – (with the interest charged).

3.6 Noting Charge

This is the fee paid to a notary public, preferably lawyer to represent dishonoured bill to the acceptor. This fee was incurred primarily due to the failure of the acceptor to honour the bill of exchange on the due date. Hence, the expenses incidental to the representation of the dishonoured bill will be charged on the debtor's account as follows:

Debit Drawee and Credit Bank or Transferee – (with the value of the noting charge).

EXAMPLE

The balance sheet of Omoya Salisu show the following balances as at December 31st, 2007:

Debtors Balance:

Fatima	₦ 54,600
Femi	₦ 45,000

The following transactions took place during the period ending March 31st, 2008:

2008

Jan 1 Received duly accepted bills from Fatima and Femi.

Jan 5 Discounted bills with his bank, paying a discounting charge of ₦ 3,750 on Fatima's bill and ₦ 2,250 on Femi's bill.

March 15 Fatima's bill matured and it was honoured by him. Femi's bill was marked returned bill and was duly noted on march 7, the charge being ₦ 100.00

REQUIRED:
Record the above transactions in the books of Omoya.

SUGGESTED SOLUTION

In the Books of Omoya

Fatima's Account

2008	₦	2008	₦
1 Jan Balance b/f	54,600	1 Jan Bills receivable	54,600

Femi's Account

2008	₦	2008	₦
1 Jan Balance b/f	45,000	1 Jan Bills receivable	45,000
15 March Bank	45,000	31 March Balance c/d	45,900
15 March Noting charge	900		90,900
	90,900		
Balance b/d	45,900		

Bill Receivable Account

2008	₦	2008	₦
1 Jan Fatima	54,600	1 Jan Bank - Fatima	54,600
1 Jan Bank	45,000	31 March Bank - Femi	45,000
	99,600		99,600

Bank Account

2008	₦	2008	₦
Bills Receivable		1 Jan Fatima - Discount charge	3,750
5 Jan Fatima	54,600	31March Femi - Discount charge	2,250
5 Jan Femi	45,000	31 March Femi - Noting charge	100
		31 March, Femi returned bill	45,000
		Balance c/d	48,500

	99,600		99,600

Discount Charge Account

2008	₦	2008	₦
5 Jan Bank Fatima	3,750	31 March Profit & Loss	6,000
1 Jan Bank – Femi	2,250		
	6,000		6,000

SELF ASSESSMENT EXERCISE

RATAWU commenced trade on 1st of July 19 x 8. The following records were extracted from his book:

1/7/x8	Bought goods from Oluwa ₦ 25,000
2/7/x8	Sent cheque for ₦ 12,000 to Oluwa and accepted a bill drawn on him payable on 1/8/x8 for ₦ 10,000
8/8/x8	Sold goods to Oni for ₦ 12,000
9/7/x8	Drew two bills on Oni for ₦ 10,000 and ₦ 2,000 payable on 8/8/x8 and 8/9/x8 respectively.
14/7/x8	Bought goods from Afosa for ₦ 7,000 and paid ₦ 4,000 on account.
23/7/x8	Sold goods to Akimade for ₦ 5,000 and received cheque for ₦ 2,000 and a bill for the balance payable on 22/8/x8.
26/7/x8	Endorsed Akimade's bill to Oluwa in settlement of the balance due to the latter.
4/8/x8	Oluwa agreed that the bill of ₦ 10,000 be withdrawn after which RATAWU paid cheque for ₦ 6,000 and accepted another bill payable on 3/9/x8.
11/8/x8	Oni's bill for ₦ 10,000 was returned dishonoured.
20/8/x8	Agreed with Oni that he should return goods invoiced to him for N5,000 against a credit to him of N4,000.
22/8/x8	Akimade's bill was duly honoured.

You are required to prepare:

(i) The ledger accounts (excluding bank account) to record these transitions in the books of RATAWU up to 31st August 19 x8, and

(ii) The Trading and Profit and Loss account (extract) for two months ended 31st August 19 x8 and balance sheet (extract) at the same date.

4.0 CONCLUSION

When goods are supplied to or services rendered on credit to a person, the supplier of the goods or services would normally wait for a considerable period of time before final payment is made. The supplier of these goods or services may be unwilling to wait till such a period when final payment is made as he/she may be in need of money to finance his/her current operations. He may, therefore, engage in any of the following:

(a) Sell the debt to a third party who now pays the sum due after deducting a certain amount as discount. This is known as debt factoring.

(b) Use the debt as a security to obtain a bank draft from a bank.

(c) Draw up bill of exchange on the debtor, who after accepting it becomes a legal proof of the debt.

The drawer usually draws up the bill and sends it to the drawee, who signs it to signify that he/she accepts the liability by writing the word "ACCEPTED" on the face of the bill. He then returns the accepted bill to the drawer. The accepted bill becomes "Bill Receivable" to the drawer and the "Bills payable" to the drawee.

5.0 SUMMARY

This study unit has:

- Defined a Bill of Exchange;
- Discussed the types of bills of exchange;
- Outlined the advantages of bills of exchange;
- Explained options available to the holder of a bill of exchange
- Explained the accounting entries in the books of both the drawer and drawee.

6.0 TUTOR-MARKED ASSIGNMENT

1. Ade bought goods on credit from Osuji for ₦ 12,500 on the 1st February, 2007. Two weeks later, Asuji drew a bill for ₦ 12,420 payable after two months. Ade accepted the bill which was discounted by Asuji at 95% with Hope Discount House (HDH) on the 15/2/2007. The full amount of the bill was paid at maturity.

Required: Show the entries to record these transactions in the books of Ade, Asuji and HDH.

2. The Balance Sheet of Busa Buji show the following balances as at December 31st, 2008:

Debtors Balance:

Fatima	₦ 27,300
Femi	₦ 22,500

The following transactions took place during the period ending March 31st, 2009:

Jan 1 Received duly accepted bills from Zainab and Tutu.

Jan 5 Discounted bills with his bank, paying a discounting charge of ₦ 1,875 on Zainab's bill and ₦ 1,125 on Tutu's bill.

March 15 Zainab's bill matured and it was honoured by him. Tutu's bill was marked returned bill and was duly noted on March 7, the charge being ₦ 50.00

REQUIRED:

Record the above transactions in the books of Busa Buji.

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UNIT 5 APPLICATION OF COMPUTER IN AN ACCOUNTING ENVIRONMENT

CONTENTS

1.0 INTRODUCTION

Computers can be used for commercial, mathematical, scientific and engineering processes. In modern business environment, computers have taken over most of the financial accounting and reporting tasks that were being carried out manually in the past. Any accountant or prospective accountant must therefore, be knowledgeable in the use of computer software and hardware. It should be noted that the underlying principles in manual financial accounting and reporting remain unchanged by the advent of computerised accounting. Computers only make it possible to process large volume of accounting information quickly, accurately and reliably.

2.0 OBJECTIVES

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

- explain the accounting tasks that the computer can be used to perform
- discuss the advantages and disadvantages of computerised accounting over manual accounting
- discuss the software used in accounting.

3.0 MAIN CONTENT

3.1 Computerisable Accounting Tasks

The computer can be used to perform the following tasks in a computerised environment:

1. Purchase Ledger System

The purchase requisition order, receipts and invoice are prepared without any problem. The computer is also used for purchase ledger and to produce a purchase analysis sheet. Fields in each record will include account number, name, address, credit details, bank details, cash discount details, details of transactions, balance outstanding, etc.

2. Sales Ledger System

The sales invoice will be posted to the customer's ledger card, a statement for the customer and a summary sheet or sales analysis is prepared. The fields in each record will include customer account number, customer name, address credit limit, sales analysis, account type, transaction date, transaction description, transaction code, debits, credits and balance, etc.

3. Payroll System

The computer will prepare the payroll to know the wages, tax and pension contributions and insurance, using inputs like time sheets, details of overtime worked, clock cards, amount of bonus or appropriate details if the computer calculates the bonus. Outputs will include payslips, payroll, payroll analysis, including analysis of deductions and details for costing purposes, etc.

4. Nominal Ledger System

In the nominal ledger, a trial balance will be prepared from journal entries.

5. Stock Control System

The computer will process data quickly and make available information on stock level and rate of stock turnover. Inputs will include data on goods received note, issues to production, production to finished goods store, despatch notes, adjustments and record fields may include stock number, description, standard cost, quantity in stock, etc.

6. Reconciliation

The computer will speed the preparation of bank reconciliation statements by running a cashbook file against the file containing details from the bank statements.

7. Fixed Assets System

There will be a complete register of all fixed assets of the company and depreciation will be easily calculated. Inputs will include data about capitalisation policy, depreciation policy, purchase invoices, cash payments and adjustments. Fields in each record will include asset class, asset name/description, asset identification code, cost and date of acquisition, estimated useful life, depreciation rate, disposal value and date, current depreciation, accumulated depreciation and book value of asset.

8. Financial Application

The computer can be used by banks to handle cheque clearing and payments.

3.2 Advantages and Disadvantages of Computerised Account System

3.2.1 Advantages of Computerised Accounting System Over Manual Accounting System

(i) Accounting packages can be used by non-experts;

(ii) Computerised system can process large amount of data quickly and accurately;

(iii) Computers can handle repetitive tasks without getting bored like humans do;

(iv) Computers improve the flow of information;

(v) It provides effective and efficient services to the users;

(vi) Staff of organisations are relieved of tedious work;

(vii) Computer can be used for management decision-making. It can be used for forecasting and projecting;

(viii) Computers make banking operations easier and faster; and

(ix) Computer creates more jobs, e.g. system analyst, programmer.

3.2.2 Disadvantages of Computerised Accounting Over Manual Accounting

(i) The initial acquisition and set-up costs of a computerised system as well as cost of training the personnel to handle the system may be too high, particularly for a small company;

(ii) There is a need for series of security checks and controls to preserve the integrity of the system and the accounting information contained therein;

(iii) Due to the fact that accounting information is now held in invisible machine sensible form, there is usually a lack of audit trail – the ability to trace a transaction through the recording process from inception to conclusion. This lack of audit trail may make it difficult to trace fraud and errors;

(iv) The use of computers tends to induce over-reliance on the system and, where there are no adequate back-ups for information stored in the system, operations might be seriously disrupted if the system breaks down; and

(v) Employees might resist the introduction of computers because of fears that it might be accompanied by loss of their jobs.

3.3 Accounting Packages

An accounting package comprises different accounting modules such as cashbook, sales ledger, purchases ledger, general ledger and payroll. An accounting module consists of a programme for executing an accounting function. For example, there would be separate modules for invoicing, inventory, payroll, cashbook, report generator and so on. A programme is a set of instructions which tell the computer how to process data. The term used to describe computer programme is software while the term hardware describes the physical components – keyboard, monitor, a box known as central processing unit (CPU) - containing the disk drives and electronic devices and printer.

Accounting software which carry out specific accounting tasks such as payroll, fixed assets register, and inventory control are known as Application Software. There are other application software such as databases and spreadsheets, which have applications beyond accounting.

3.4 Coding

To obtain maximum utility from computers, it is important that a system of coding be established so that there would be unique codes for each item. A code may be numeric (i.e. entirely made up of numerals) or alphanumeric (i.e. made up of a combination of alphabets and numerals). Numeric systems of coding tend to be more flexible and are thus more popular. Described below is the format of a simple numeric coding system.

Ledger and Cash Book	**Code**
Nominal ledger	01
Purchase ledger	02
Sales ledger	03
Cashbook	04

Each of the accounts or items within a ledger may be given a three-digit code. For example, the accounts of customers A, B, C, D and E may be given codes 001, 002, 003, 004 and 005 respectively. Also, the following accounts in the nominal ledger may be allotted the following codes:

Purchases account	100
Salaries account	101
Printing and Stationery account	102
Rates account	103
Repairs account	104
Sales account	200
Discount received	202
Interest Income account	203
Rent Income account	204

With the above coding structure, sales account in the nominal ledger has code 01 – 200 (or 01/200), while the account of customer C in the sales ledger has code 03 – 003 (or 03/003). If a credit sale is made to customer C, the command to the system would be to debit code 03-003 and credit code 01-200.

3.5 Integrated Software Versus Stand-Alone Module

Integrated software is an application package in which the accounting modules are integrated so that if data is entered in one module, all other modules affected would be updated either automatically or by the user's command. For example, if goods are purchased from a supplier, the supplier's account in purchases ledger would need to be credited, the stock quantity in the inventory records would need to be increased, purchases account in the nominal ledger would need to be debited and analysis of purchases in report generator would need to be updated. In an integrated application package, only one data entry is needed to update all relevant records.

A strand-alone module is an application package consisting of one module, where a transaction occurs that is required by more than one module, the user has to manually load and unload disks and enter the data in all the relevant modules.

3.6 Database

A database is a 'collection' or 'pool' of related data, which is available for use by any number of application packages, including accounting packages. The software that runs the data base is known as Database Management System (DBMS). The chartered Institute of Management Accounting (CIMA)'s computing terminology defines a Database as:

> … a file of data structured in such a way that it may serve a number of applications without its structure being dictated by any one of those applications, the concept being that programmes are written around the database rather than files being structured to meet the needs of specific programme. The term is also rather loosely applied to simple file management software.

CIMA's Computing Terminology also defines DBMS as:

> … any system which enables the definition, storage and retrieval of information from discrete files within a system. Thus, many file-handling systems are frequently referred to as 'Database Systems'.

3.6.1 Advantages of Database

The advantages of database are:

(i) Database reduces storage requirements by reducing redundancy;

(ii) Time required for file up-date and maintenance is reduced to the barest minimum;

(iii) Database saves programming time because of efficient handling of construction and processing of files;

(iv) It makes information supply for use of managers to be consistent and valuable because it is based on comprehensive collection of data;

(v) Access to data is made faster and easier by the use of DBMS in a database; and

(vi) It minimises the amount of input preparation needed by the single input principle of database.

3.6.2 Disadvantages of Database

(i) The implementation of database requires special analysis and design skills;

(ii) One error made in the database can create a chain of errors throughout the database;

(iii) Privacy is always a problem in a multi-user environment where data are common to users.

3.7 Database Management System (DBMS)

When organisations first started to use computers, they began by computerising one application at a time. For example, they started with the salaries and wages accounts department, and then computerised stock and so on. They produced what were essentially file management systems. The systems were all separate and data was often transferred from one department to another on paper and the same data was typed in again. Connecting the systems was not as easy as they were all separately designed.

However, database systems changed things; they made it possible to integrate the data from several departments in the database. The data can be accessed by anyone (with the right access password) and data from different files and different departments can be shared. Therefore, a database is a collection of data files, which is integrated and organised so as to provide single comprehensive file system.

The data is governed by rules, which define its structure and determine how it can be accessed. The purpose of a database is to provide convenient access to the common data for a wide variety of users and use needs.

3.7.1 Advantages of Database Management System

(a) Avoidance of unnecessary duplication of data. It recognises that data can be used for many purposes but only needs to be input and stored once;

(b) Multiple use of data from (a), if follows that data is input one, but it can be used for several purposes;

(c) A database provides data for the organisation as a whole, not just for individual departments. The database concept encourages management to regard data as a resource that must be properly managed just as any other resources;

(d) Developing new application programmes with a DBMS is easier, because, the programmer is not responsible for the file organisation, which is already taken care of by the DBMS software;

(e) The organisation of data into database, rather than into separate files, encourages the integration of data, and makes data more widely available;

(f) Because data is only held once, it is easier to ensure that it is up-to-date, so that no department in an organisation uses outdated, or data that differs from the data used by other departments.

3.7.2 Types of Database

There are three categories as follows:

Relational Database: In relational database, records are represented using table that is made up of rows and columns. The columns represent the various fields, while the rows represent record. For example, there could be customer records, product records, order records and so on. These systems are relatively simple and are suitable for manipulation by non-data processing personnel.

Network Database: These are further developments of linkage systems with many more record types and linkages. Linkage system requires the user to know what linkages have been established in order to know on what basis data can be retrieved. The linkage systems are technically more efficient but do require greater data processing knowledge so their use tends to be restricted to information specialists.

Hierarchical Database: This is a system having in-built linkages whereby there are other records which own numerous ‘member’ records. Data items have parent-child relationship. Each parent may have many children but each child can only have only one parent.

It is easy to implement, modify and search. It is however difficult to establish, use up a lot of storage space and not easily transferable from one computer to another.

3.8 Spreadsheet

A spreadsheet is powerful software used for processing data. It can perform all kinds of calculations, from basic ones like addition and subtraction to very complex ones. A spreadsheet appears on the computer monitor like a flat sheet of paper with columns and rows resembling an analysis sheet. The intersection of a column and a row is known as a cell. Only a tiny portion of the spreadsheet is visible on the screen of the monitor. An example of a spreadsheet is “Microsoft Excel”.

A cell can contain text, number or formula. Where a cell contains a formula, it would display the result of the calculation of the variables in the formula. The variables may be the values in other cells. If the values in those other cells change, the formula recalculates the variables and displays the new result in the formula cell.

A spreadsheet can therefore, be used to create a variety of financial models such as budgets.

SELF ASSESSMENT EXERCISE

(a) What is integrated accounting software?
(b) Define a database.
(c) Define an accounting code and give concise examples to elucidate your answer.

4.0 CONCLUSION

Virtually every area of business can be computerised, particularly financial accounting and reporting. The obvious advantages of computerised accounting over manual accountings have been well explained in this study unit. No serious-minded business organisation, except the small ones, can afford to continue with manual systems. Most organisations now appreciate how information technology applications can help them achieve their objectives better and faster.

5.0 SUMMARY

This study unit has:

- Explained areas in business where computers can be utilised;

- Discussed the advantages and disadvantages of computerised accounting systems;
- Explained what accounting packages and accounting codes are;
- Defined a database with its advantages and disadvantages;
- Explained database Management Systems and the advantages of database management systems;
- Discussed the spreadsheet and benefits of usage in accounting.

6.0TUTOR-MARKED ASSESSMENT

1. Illustrate the workings of a database management information system in a hypothetical organisation.
2. Outline the types of database that you may like to come in contact with in the performance of your duties as an accountant.

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