Discounts

Discounts

- Discount (Reduction)
  - Trade Discount (To increase the trade)
    - Trade Discount Received (When buying) No double entry
    - Trade Discount Given / Allowed (When selling) No double entry
  - Cash Discount (To get the cash quickly)
    - Cash Discount Received (When paying cash to payable) Income
    - Cash Discount Given / Allowed (When receiving cash from receivable) Expense

Trade Discount

Trade discount is a discount which is given at the point of sale as a reduction from normal selling price (list price / catalogue price). Objective of giving trade discount is increase trade (increase the sales).

1. Trade discount received
2. Trade discount given

Question 1

XYZ Ltd purchased goods. List price $40,000. Received trade discount of 20%.

Record the journal entries

Question 2

XYZ Ltd purchased goods on credit. List price $50,000. Received trade discount of 10%.

Record the journal entries

Question 3

XYZ Ltd purchased a machine. List price $100,000. Received trade discount of 10%.

Record the journal entries

Question 4

XYZ Ltd purchased a machine on credit. List price $200,000. Received trade discount of 20%.

Record the journal entries

Question 5

In the month of June XYZ Ltd sold 20 tables and gave a trade discount of 5%.

Each table list price is $100.

Record the journal entries

Cash Discount / Settlement Discount

Cash discount is a discount which is given at the point of settlement of the debts. Cash discount is given in order to motivate to settle the debt earlier than due date.

1. Discount allowed (given)
2. Discount received

Question 6

XYZ Ltd purchased goods for $50,000 on credit. When settling the amount, received a cash discount of 10%.

Record the journal entries

Question 7

XYZ Ltd sold goods on credit for $60,000 and allowed (gave) a cash discount of 10% at the time of settlement.

Record the journal entries

Question 8

A company purchased goods for $10,000 less trade discount of 10%. These goods were bought on credit. Company received another discount of 5% when paying the cash to the credito$

Record the journal entries

Question 9

A company sold goods for $25,000 less trade discount of 20%. These goods were sold on credit. Company gave another discount of 10% when receiving the cash from debto$

Record the journal entries

PROFIT MARKUP
&
PROFIT MARGIN

PROFIT MARKUP

Question 1

Selling Price - $ 1,000
Cost - $ 800

Calculate the PROFIT MARKUP

PROFIT MARGIN

<u>Question 2</u>

Selling Price - $ 1,000
Cost - $ 800

Calculate the PROFIT MARGIN

PROFIT MARKUP

<u>Question 3</u>

Cost	**-**	**$ 800**
Profit Markup	**-**	**25%**

Calculate the selling price

PROFIT MARGIN

Question 4

Cost	**-**	**\$ 800**
Profit Margin	**-**	**20%**

Calculate the selling price

Question 5

Cost - $ 1600

Calculate the selling price if,

a) **Profit Markup - 20%**
b) **Profit Margin - 20%**

Question 6

Selling Price - $ 2000

Calculate the cost if,

a) **Profit Markup - 25%**
b) **Profit Margin - 25%**

VAT
Value Added Tax

	We are VAT Registered Business	We are VAT Not Registered Business
VAT on Sales	If we are registered for VAT, we have collect VAT from customer and send to the government. Until we send, we are liable to the government. This will create VAT Liability	If we are not registered for VAT, we CANNOT collect VAT from custome$
VAT on Purchase / Payment	If we are registered for VAT, whatever VAT on purchase / payment, we can recover back from government. This will create a VAT Asset.	If we are not registered for VAT, we CANNOT recover the VAT on purchase / payment back from the government. In this situation, VAT will be a part of the cost / expense.

Accounting for Sales Tax (VAT) based on

VAT not registered business
    Part of an expense or non current asset
VAT registered business (mostly examiner silent)
    Current Asset or Current Liability

VAT not registered business
Rule 01 – Non registered businesses cannot charge sales tax (VAT) from its customers when selling goods and services. (no sales tax when selling goods)

Rule 02 – Non registered businesses might pay VAT when purchasing goods, non current assets, services or paying expenses. These VATs are considered as part of cost of the transactions and they are never recorded separately in VAT (sales tax) account.

Non registered businesses will never prepare a VAT account under any situation.

Vat registered business always prepare sales tax / vat account. This account either asset or liability account.

For registered business vat is never recorded as expense or income. Therefore, vat is not recorded in the statement of profit or loss.

Including – gross
Excluding – net

IAS 02 Inventories

Definition of inventory

Asset held in the form of finished goods, work in progress or raw materials for the purpose of selling is called inventory.

Measurement of Inventories

Inventories are measured or recorded at lower of cost and net realizable value (NRV)

Journal Entry to record closing inventory

Dr. Inventory / stock account
Cr. Trading account / SOPL / COS

Cost of closing stock

Cost of Raw Materials		
Purchase Cost	xx	
Directly attributable cost *(Carriage inwards, loading cost, shipping cost, import duties)*	<u>xx</u>	xx
Cost of Conversion - Cost incurred to covert the raw material into finished goods		
Direct labour	xx	
Direct other expenses *(Royalty payment)*	xx	
Production overhead *(Factory rent, factory electricity, factory depreciation)*	<u>xx</u>	xx

Inventory Cost Formula / Inventory Valuation Methods

1. First In First Out (FIFO) method

2. Weighted Average Cost (WAC) method

3. Last In First Out (LIFO) method

According to IAS 02, this method is not allowed use in financial reporting

Continuous and Periodic Inventory Systems

✅ Continuous Inventory Records (Perpetual System):

In this system, inventory records are updated after every purchase or sale. This helps the business know the exact quantity and value of goods available at any time.

Example:
A supermarket records every sale through its barcode system. When a customer buys 2 packets of milk, the system automatically reduces the inventory balance by 2 packets.
👉 *This allows the supermarket to know the real-time stock level and reorder when needed.*

✅ Period-End Inventory Records (Periodic System):

In this system, inventory is not updated during the period. Instead, a physical stock count is done at the end of the accounting period to find the closing inventory.

Example:
A small clothing shop counts all its clothes at the end of the month to find the closing stock.
👉 *The shop then calculates Cost of Goods Sold as: Opening Stock + Purchases – Closing Stock.*

✨ In summary:
Continuous system = updated daily, gives real-time info.
Period-end system = updated only at period end, simpler but less accurate during the period.

Question 01

01/01	Opening inventory	1000 units at $9 each
10/01	Bought / purchased / receipt	2000 units at $14 each
22/01	Bought / purchased / receipt	1000 units at $15 each
23/01	Sold / issued	2500 units at $22 each
25/01	Bought / purchased / receipt	1500 units at $16 each
31/01	Sold / issued	2000 units at $23 each

a) Calculate the value of closing inventory using the FIFO method
b) Calculate the cost of sales
c) Calculate the gross profits

Question 02

01/01	Opening inventory	1000 units at $9 each
10/01	Bought / purchased / receipt	2000 units at $14 each
22/01	Bought / purchased / receipt	1000 units at $15 each
23/01	Sold / issued	2500 units at $22 each
25/01	Bought / purchased / receipt	1500 units at $16 each
31/01	Sold / issued	2000 units at $23 each

a) Calculate the value of closing inventory using the WAC method (continuous)
b) Calculate the cost of sales
c) Calculate the gross profits

Question 02

01/01	Opening inventory	1000 units at $9 each
10/01	Bought / purchased / receipt	2000 units at $14 each
22/01	Bought / purchased / receipt	1000 units at $15 each
23/01	Sold / issued	2500 units at $22 each
25/01	Bought / purchased / receipt	1500 units at $16 each
31/01	Sold / issued	2000 units at $23 each

a) Calculate the value of closing inventory using the WAC method (Periodic)

Question 03

01/01	Opening inventory	1000 units at $9 each
10/01	Bought / purchased / receipt	2000 units at $14 each
22/01	Bought / purchased / receipt	1000 units at $15 each
23/01	Sold / issued	2500 units at $22 each
25/01	Bought / purchased / receipt	1500 units at $16 each
31/01	Sold / issued	2000 units at $23 each

a) Calculate the value of closing inventory using the LIFO method
b) Calculate the cost of sales
c) Calculate the gross profits

Capital & Revenue Expenditure

Capital Expenditure and Rev Expenditure

Capital Expenditure

- These are expenditures which provide economic benefits more than one financial year (Expenditures which provide long term economic benefits)
- Purchase and improvements of non current assets
- Capital expenditures are recorded / capitalized as non current asset in SOFP

Revenue Expenditure

- These are expenditures which provides economics benefits for less than one financial year (Expenditures which provide sort term economic benefits)
- All factory expenditures
- Selling and distribution expenses
- Admin expenses
- Finance expenses
- Repair cost maintenance cost servicing cost are considered as revenue expenditures
- Staff training cost of related to non current assets
- Purchase of any assets for reselling purpose are considered as revenue expenditure

IAS 16
PPE
(Property Plant & Equipment)

IAS 16 – Property Plant and Equipment

- Definition of PPE
- Examples of PPE
- Recognition criteria of PPE
- Depreciation of PPE
- Revaluation of PPE
- Disposal of PPE

Definition of PPE

These are tangible assets held for use in business for more than one accounting period. And these are used for production, distribution, administration or rental purpose.

Examples of PPE

Land, Building, Machinery, Motor Vehicles, Office Equipment, Furniture, Fixtures and fittings

Recognition criteria of PPE

A company must satisfy the following two conditions (criteria) in order to record PPE in financial statements.

- ✓ It is probable that PPE will generate future economic benefits
- ✓ The cost of PPE can be measured reliably

Definition of Depreciation

Depreciation is a systemic allocation of depreciable value of a tangible asset over its useful life.

Depreciable value = Cost or Fair Value – Estimated Residual Value (Scrap Value / Salvage Value)

Methods of depreciation

1. Straight-line method
2. Reducing balance method
3. Usage method (machine hrs method / output method)

Straight-line method

Question 01

A company bought a machine for $80,000 on 01/04/2018.
The estimated residual value is $20,000.
The estimated useful life of the machine is 6 yea$
The accounting period is from 01/04 to 31/03.

a) Calculate the annual depreciation

b) Calculate the NCV as at 31/03/2021

Question 02

A company bought a machine for $12,000 on 01/04/2015.
This machine is depreciated 20% on cost.
The accounting period is from 01/04 to 31/03.

a) Calculate the annual depreciation

b) Calculate the NCV as at 31/03/2017

Question 03

A company bought a building for $100,000 on 01/04/2010. The estimated useful life was 20 years zero scrap value. The company has made a major improvement for the building by incurring an additional cost of $65,000 on 01/04/2015 (after 5 years). The total life of the building has increased from 20 to 30 years (life increased by 10 years). The accounting period is from 01/04 to 31/03.

a) Original annual depreciation for the year ended 31/03/2011
b) NCV of the building as at 31/03/2015
c) Depreciation for the year ended 31/03/2016
d) NCV of the building as at 31/03/2018

Revaluation of PPE

Question 04

A company bought for $28,000 on 01/04/2016. The estimated useful life of this vehicle is 10 years with zero scrap value. This vehicle is revalued to $36,000 01/04/2018 (after 2 years). The accounting period is from 01/04 to 31/03.

a) Depreciation for the year ended 31/03/2017
b) NCV of the asset as at 01/04/2018
c) Revaluation surplus on 01/04/2018
d) Depreciation for the year ended 31/03/2019
e) NCV of the asset as at 31/03/2020

Reducing balance method

Annual depreciation =NBV x Depreciation %

Question 05

A company bought machinery for $100,000 on 1/4/2015.
This machinery is depreciated at 10% using the reducing balance method.
The accounting period is from 01/04 to 31/03.

a) Calculate the annual depreciation for the first 4 years
b) Calculate the Net Book Value end of year 4
c) Calculate NBV (NCV) using the short cut method

Question 06

A company bought equipment for $300,000 on 01/4/2004.
This equipment is depreciated at 20% using the reducing balance method.
The accounting period is from 01/04 to 31/03.

a) Calculate the annual depreciation for the first 3 years
b) Calculate the Net Book Value end of year 5
c) Calculate NBV (NCV) using the short cut method

Accounting for depreciation

Question 07

A company bought a machine for $200,000 on 01/04/2018. This machine is depreciated at 25% using the reducing balance method. The accounting period is from 01/04 to 31/03.

Prepare the following accounts for the first 3 yea$

a) Machine account
b) Depreciation account
c) Accumulated depreciation account
d) Extract of SOPL
e) Extract of SOFP

Disposal of PPE

Question 08

A company bought a machine for $30,000 on 01/04/2018. The estimated useful life of the machine is 5 years with zero residual value. This machine was sold (disposed) for $10,000 on 31/03/2021. The accounting period is from 01/04 to 31/03.

Prepare the following accounts up to the date of disposal.

a) Machine account

b) Depreciation account

c) Accumulated depreciation account

d) Extract of SOPL

e) Extract of SOFP

f) Disposal account

Question 09

A company bought a machine for $150,000 on 01/04/2018. The machine is depreciated at 20% using the reducing balance method. The machine was disposed of (sold) for $100,000 on 31/09/2019. The accounting period is from 01/04 to 31/03.

Prepare the following accounts up to the date of disposal.

a) Machine account

b) Depreciation account

c) Accumulated depreciation account

d) Extract of SOPL

e) Extract of SOFP

f) Disposal account

Depreciation policy

1. Full-year depreciation policy
2. Proportionate depreciation policy

Question 10

A company bought a machine for $200,000 on 01/10/2018. The machine is depreciated at 20% using the straight-line method. The machine was disposed of (sold) for $170,000 on 31/09/2020. The accounting period is from 01/04 to 31/03.

Calculate the depreciation amount relevant for each accounting period until the disposal.

Question 11

A company bought a machine for $500,000 on 01/06/2018. The estimated useful life of the asset is 5 yea$ Scrap value is estimated at $50,000. According to the company policy, full-year depreciation should be made for the year purchase and no depreciation for the year of disposal. The machine was disposed of (sold) for $170,000 on 31/08/2021. The accounting period is from 01/04 to 31/03.

Calculate the depreciation amount relevant for each accounting period until the disposal.

Question 12

A company bought a machine for $120,000 and after 4 years they are expecting to sell it for $20,000. Using the asset they are expecting to produce the following number of units

Y1 – 10,000 units
Y2 – 20,000 units
Y3 – 20,000 units
Y4 – 50,000 units

Calculate the depreciation for each year.

Exchange of PPE

Question 13

The company exchanged a car with a cost of $10,000 for a new car costing $12,000 on 31.03.2015.

As a result of the exchange, the company paid an additional $7,000.

Motor vehicles are depreciated at 10% per annum.

The company purchased the old car on 01.04.2011.

Required:
Prepare the journal entries for the exchange.

Question 14

The company exchanged a car with a cost of $10,000 for a new car costing $12,000 on 31.03.2015.

As a result of the exchange, the company paid an additional $4,500.

Motor vehicles are depreciated at 10% per annum.

The company purchased the old car on 01.04.2011.

Required:
Prepare the journal entries for the exchange.

Fixed Asset Register

Fixed Asset (NCA) register

Non current asset register includes details of each and every individual non-current asset in the company. This is primarily maintained for internal control purposes. This may include details such as

- asset code number
- supplier details
- date of purchase
- cost of the asset
- estimated useful life of the asset
- estimated residual value
- colour of the asset
- department of the asset
- responsible person
- depreciation detail (method of depreciation, policy, %)
- NCV / NBV
- all other details

Difference between NCA register and Nominal Ledger (General Ledger)

NCA Register

- Not part of double-entry bookkeeping system
- This records financial and non-financial information
- This includes details of individual assets

Nominal ledger

- Part of double-entry bookkeeping system
- This records only financial information
- This has only summarized information

NCA register values and nominal ledger values should be the same. If it is not the same, there is an error

Accruals
&
Prepayments

Question 01

A company has paid a rent of $12,000 during the year ended 31st March 2021. This payment included prepaid rent of $4,000 as at 31st March 2021.

Prepare the rent account and identify rent expense for the year.

Question 02

A company has paid an insurance of $650 for the year ended 31st March 2021. There is an accrued insurance of $150 as at 31st March 2021.

Prepare an insurance account and identify the insurance expense for the year.

Question 03

Rent paid for next one year period on 01/04/2019 was $1,200

Rent paid for next one year period on 01/04/2020 was $1,800

Calculate the rent expense for the year ended 31/12/2020 and prepare the rent account.

Question 04

Accounting year ended 30/09/2020

Business took a loan of $100,000 with 10% interest per annum on 01/01/2020. Interest is paid once in three months in arrea$

Calculate the interest expense for the year ended 30/09/2020 and prepare the interest expense account.

Irrecoverable Debt
and
Allowance for Receivable

Irrecoverable Debt and Allowance for Receivable

(Bad Debt)

(Provision for Doubtful Debt)

Irrecoverable debt (bad debt)

- This is a receivable (debtor) that cannot be recovered from receivables (debtors).
- When there is an irrecoverable debt, we should recognize it as an expense (admin expense) and deduct it from receivables in the receivables account.

Journal entry for irrecoverable debt:

Allowance for receivable (provision for doubtful debt)

- This is a receivable (debtor) where the recovery is doubtful.
- When there is a doubtful debt we should recognize it as an expense in accordance with the prudence concept.
- Doubtful debt cannot be recorded in the receivable account. Instead, we should record in an account called allowance for the receivable account (provision for doubtful debt).

Journal entry for an increase in the allowance for receivable:

Journal entry for the decrease in allowance for receivable:

Question 01

Credit Sales $10,000
During the year $500 worth of credit customer became an irrecoverable debt

a) Prepare the relevant accounts
b) Prepare an extract of SOPL & SOFP

Question 02

Credit Sales $20,000
Allowance for doubtful debt is $2,000

a) Prepare the relevant accounts
b) Prepare an extract of SOPL & SOFP

Question 03

Credit Sales $50,000
Beginning of the year allowance for doubtful debt balance is $3,000
End of the year allowance for the doubtful debt should be $5,000

a) Prepare the relevant accounts
b) Prepare an extract of SOPL & SOFP

Question 04

Credit Sales \$10,000
Beginning of the year allowance for doubtful debt balance is \$2,000
End of the year allowance for the doubtful debt should be \$1,500

a) Prepare the relevant accounts
b) Prepare an extract of SOPL & SOFP

Question 05

As at 31/12/2015

Receivable	$10,000
Allowance for doubtful debt	$500

During the year 2016

Credit Sales	$200,000 (During the year 80% of the customers made the payment)

- ❖ From the receivable balance, 3% of the credit customers became irrecoverable debt
- ❖ Company policy is to maintain a 5% allowance for doubtful debt

a) Prepare the relevant accounts for the year 2016

b) Prepare an extract of SOPL & SOFP (2016)

Question 06

$1000 cash recovered from a doubtful debt customer

a) Write the journal entries

Question 07

$8,000 cash recovered from an irrecoverable debt customer

a) Write the journal entries

Question 08

$2,000 doubtful debt customer became an irrecoverable debt

a) Write the journal entries

Salaries & Wages

Question 01

Salary details of a company for the year ended 31/03/2021 are given below.

1. Annual gross wage $10,000
2. Employee's Nation Insurance Contribution (NIC) / Social Security Contribution is 10% of gross wages
3. Pay as you earn tax (PAYE) is 8% of gross wages
4. Saving scheme contribution is 5% of gross wages
5. Charity contribution is 2% of gross wages
6. Employer's Nation Insurance Contribution (NIC) / Social Security Contribution is 15% of gross wages

Requirement

a. Calculate the salary paid to the employee

b. Calculate the amount to be charged for SOPL for the year ended 31/03/2021 (salary expense)

c. Accounting for salaries and wages

IAS 38

Intangible Assets

Tangible vs Intangible Assets

Basis	Tangible Assets	Intangible Assets
Meaning	Assets that have **physical substance** and can be touched or seen.	Assets that have **no physical substance**, but have value to the business.
Examples	Buildings, machinery, vehicles, equipment	Patents, trademarks, software, copyrights
Depreciation / Amortization	Depreciated over useful life	Amortized (if finite life) or tested for impairment (if indefinite life)
Accounting Standard	IAS 16 – Property, Plant & Equipment	IAS 38 – Intangible Assets

💡 Definition of Intangible Asset

According to IAS 38, an **intangible asset** is an *identifiable non-monetary asset without physical substance*, controlled by the entity, and expected to bring future economic benefits.

👉 Example: A company’s accounting software, patent for a new design, or registered trademark.

Recognition Criteria

An intangible asset is recognized only if:

It is **identifiable** (separable or arising from legal/contractual rights).

1. The entity **controls** it.
2. It is **probable** that future economic benefits will flow to the entity.
3. The **cost can be measured reliably**.

💰 Initial Measurement

At **cost** when first recognized.

Cost includes:

- Purchase price
- Taxes
- Directly attributable costs to make it ready for use

👉 *Example:* Purchased software = cost of software + installation charge.

🔁 Subsequent Measurement

Two models can be used:

Cost Model:
Cost – Accumulated Amortization – Impairment losses

Revaluation Model:
Fair value – Accumulated Amortization – Impairment losses *(only if there's an active market)*

🕓 Amortization

If **finite life**, amortize over useful life.
If **indefinite life**, do **not amortize**, but check for **impairment** annually.

👉 Example:
Software (5 years life) costing $ 100,000 → Amortization = $ 20,000 per year.

🚫 Internally Generated Intangibles

Stage	Treatment
Research Phase	Expense immediately
Development Phase	Capitalize if specific conditions are met (technical feasibility, future benefits, reliable measurement, etc.)

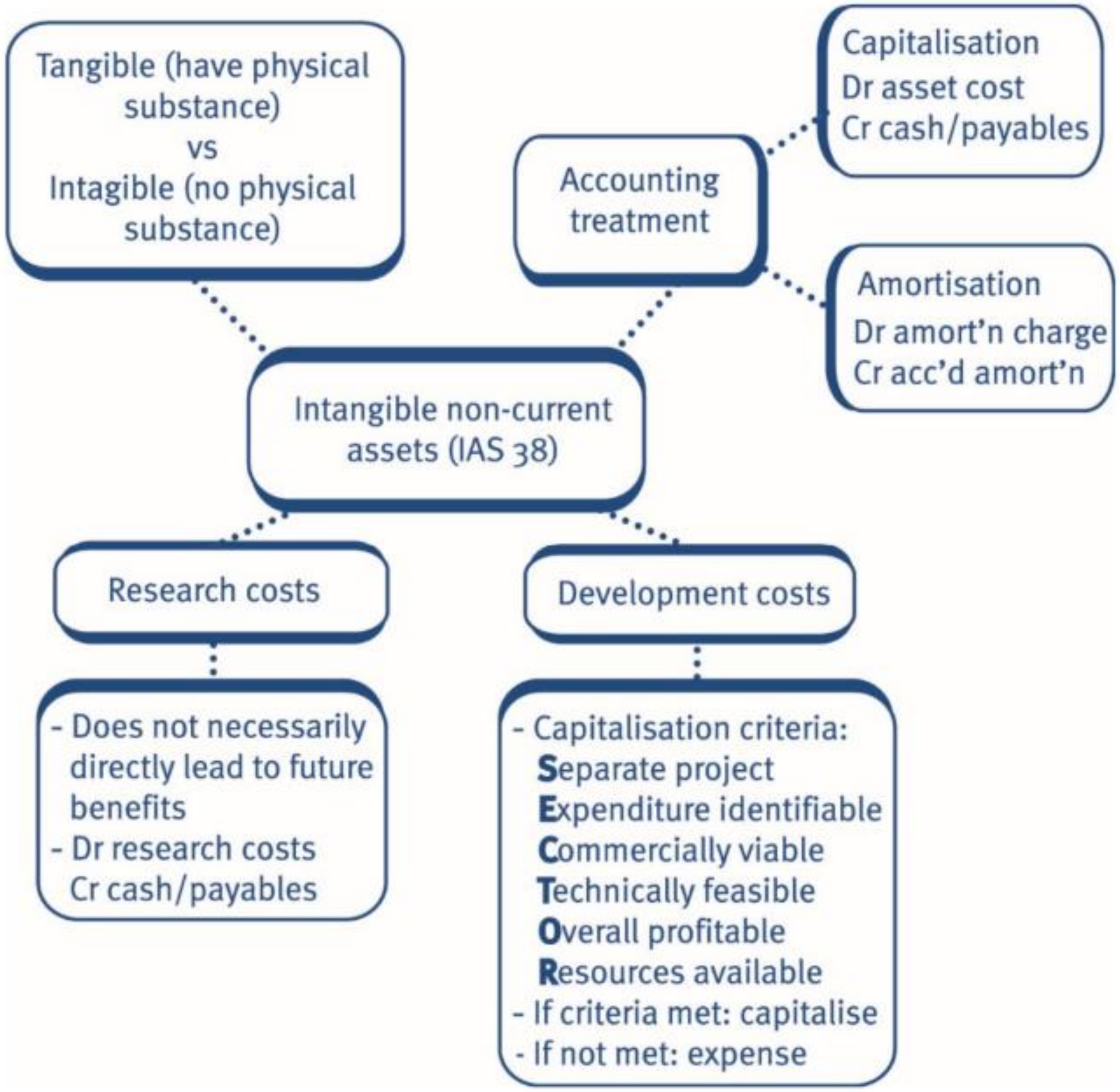
📊 Disclosures in Financial Statements

- Useful lives (finite or indefinite)
- Amortization method and period
- Carrying amount at beginning and end of year
- Reconciliation of carrying amount

💡 Treatment of Intangible Assets under IAS 38

Useful Life	Accounting Treatment
Finite (known period)	✅ **Amortize** over its useful life (e.g., 5 or 10 years) ✅ **Test for impairment** only if there are signs the value might have fallen.
Indefinite (unknown period)	❌ **Do not amortize** ✅ **Test for impairment** every year (even if there are no signs of loss).

Chapter summary



IAS 37

Provisions, Contingent Liabilities & Contingent Assets

📜 Definition of Liability

A **liability** is a **present obligation** of an entity arising from **past events**, the settlement of which is expected to result in an **outflow of resources** (money, goods, or services).

Types of Obligations

Type	Meaning	Example
Legal Obligation	Arises from a **law, contract, or regulation**.	Paying taxes, warranty as per contract, pending court case.
Constructive Obligation	Arises from the **company's actions or promises**, even if not legally required.	A company that always gives refunds may create an expectation among custome$

💡 Why We Keep a Provision

We create a **provision** to recognize **expected future expenses or losses** that arise from **present obligations**.

⚖️ Difference Between Provision and Normal Liability

Basis	Normal Liability	Provision
Certainty	Amount and timing are certain	Amount or timing is uncertain
Example	Trade payables, loan payable	Warranty, legal case, environmental cost
Recording	Recorded at the exact amount	Recorded at an estimated amount

◆ Definition of Provision

A **provision** is a **liability of uncertain timing or amount**.

It is recognized when:

- There is a **present obligation** (legal or constructive).
- An **outflow of resources** is **probable**.
- The **amount can be estimated reliably**.

If any of these three conditions are not met → **Do not recognize** as a provision.

📘 Journal Entries

Provision for Warranty

Example: Expected warranty cost $ 10,000

Journal Entry:

Dr. Warranty Expense A/c $ 10,000

Cr. Provision for Warranty A/c $ 10,000

Provision for Legal Claim

Example: Possible legal payment $ 50,000

Journal Entry:

Dr. Legal Expense A/c $ 50,000

Cr. Provision for Legal Claim A/c $ 50,000

Provision for Restructuring

Example: Company plans staff layoff costs $ 100,000

Journal Entry:

Dr. Restructuring Expense A/c $ 100,000

Cr. Provision for Restructuring A/c $ 100,000

🚫 Not IAS 37 Provisions

IAS 37 only applies to **liabilities of uncertain timing or amount** that result from **past events** and where there is a **present obligation** (legal or constructive).

But the below “provisions” are actually **adjustments or estimates —** not true liabilities:

- **Provision for doubtful debts** → adjustment of *asset value* (receivables), not a liability.
- **Provision for depreciation** → represents *allocation of asset cost*, not a liability.
- **Provision for employee training / advertising / stock loss** etc → future expenses without a present obligation yet.

Question

Sales $1,000,000

Keep a warranty provision of 5%

Question

Opening warranty provision $50,000

Closing warranty provision 5% of sales

Sales for the year $1,200,000

During the year warranty paid $100,000

Calculate the warranty expense for the year?

Question

Opening warranty provision $80,000

Closing warranty provision 5% of sales

Sales for the year $500,000

During the year warranty paid $30,000

Calculate the warranty expense for the year?

Disclosures for Provisions

- Opening and closing balance of the provision
- Additional provisions made during the year
- Amounts used during the year
- Unused amounts reversed
- Description of the obligation and expected timing of outflows

⚠️ Contingent Liability

A **contingent liability** is:

1. A **possible obligation** from past events, confirmed only by future uncertain events, **or**
2. A **present obligation**, but the **outflow is not probable** or **cannot be measured reliably**.

👉 It is **not recorded**, only **disclosed** in notes to the financial statements.

Example:
A company is being sued for $. 1 million. The lawyer says it's unlikely the company will lose.
→ **Contingent Liability**, not a provision.

Disclosure Example:
"The company is involved in a legal case. The potential loss is estimated at $ 1 million, but the outcome is uncertain.

Example for better understanding

Situation	Certainty of Loss	Certainty of Amount	Accounting Treatment	Explanation
1 We will lose amount **sure** – $500,000	More than 50%	Certain	**Liability (Provision)**	There is a present obligation and amount is known. Recognize provision.
2 **Don't know whether we will lose**, if we lose amount $500,000	Less than 50% (possible)	Certain	**Contingent Liability**	Possible obligation — only disclose in notes, not recorded.
3 We will lose, **amount not sure**	More than 50%	Uncertain	**Contingent Liability**	Amount cannot be measured reliably
4 **Don't know whether we will lose** and **amount also not sure**	Less than 50% (possible)	Uncertain	**Contingent Liability**	Disclose only in notes — not recognized.
5 We will **not lose**	No obligation (Remote)	—	**No entry**	Nothing to record or disclose.

📘 According to **IAS 37**, when the chance of an outflow is **remote (**very unlikely),
👉 **no provision** is recognized, and
👉 **no contingent liability disclosure** is required.

💰 Contingent Asset

A **contingent asset** is a **possible asset** that may arise from past events but will be confirmed only by future events not under the company’s control.

👉 **Not recorded** in financial statements, only **disclosed** when the inflow of benefits is *probable*.
If inflow becomes *virtually certain*, it is **recognized as an asset**.

Example:
A company has filed a case to claim compensation of $ 500,000.
→ Contingent asset until the case is almost certainly won.

Disclosure Example:
"The company has filed a legal claim of $ 500,000. The outcome is uncertain, but management expects a favourable result."

Note

Note that the reporting standard gives no guidance regarding the assessment of the probability of an event occurring, it is a matter of estimate and/or judgement.

One possible interpretation is as follows:

Virtually certain > 95%
Probable 51% – 95%
Possible 5% – 50%
Remote < 5%

Question

Madras Co – Year ended 31 Dec 20X6
The draft financial statements of Madras Co are under review. The following points are noted:

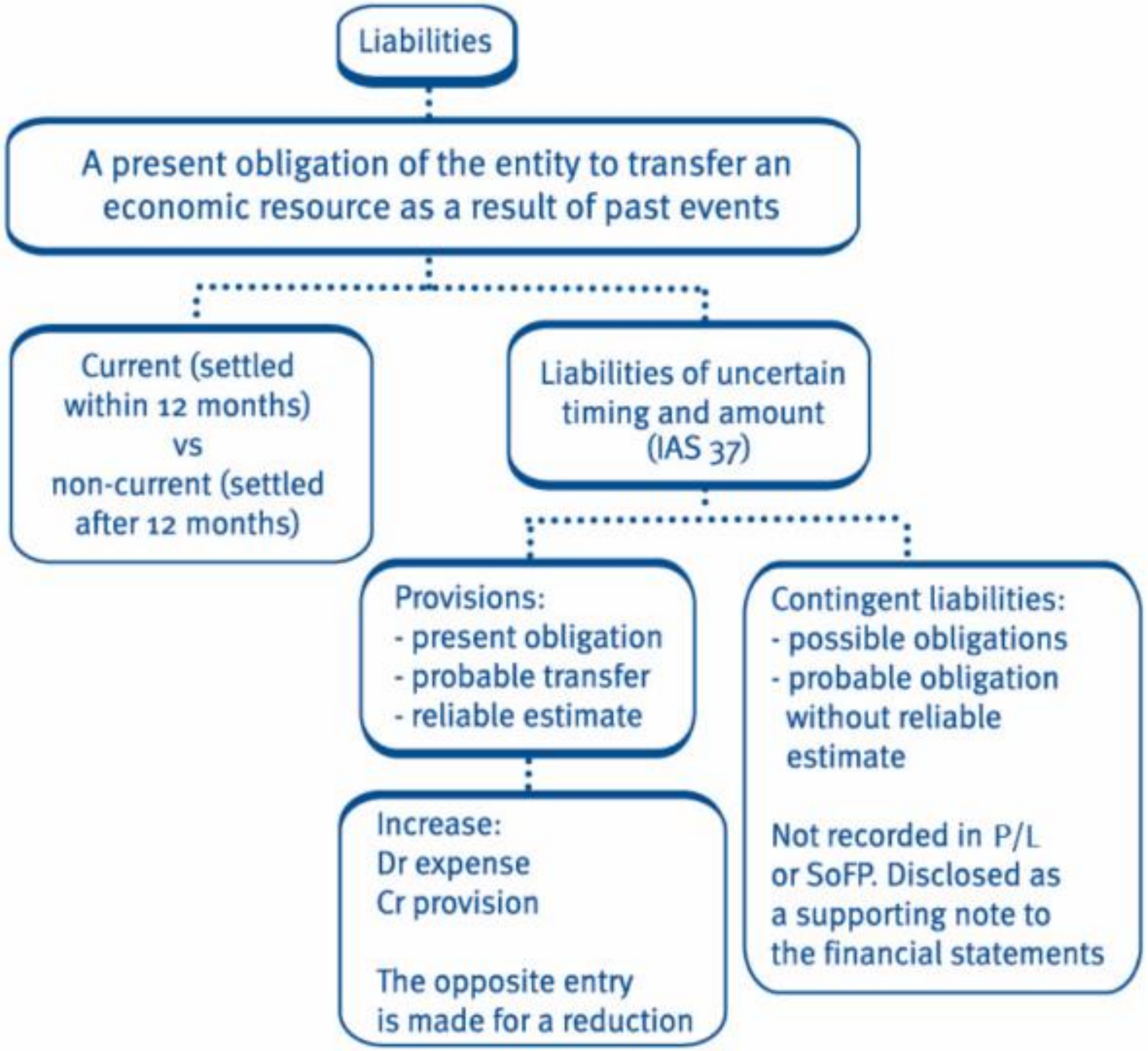
1. An ex-employee has filed a legal case for wrongful dismissal. Lawyers say the claim is unlikely to succeed.
   Legal costs (incurred whether successful or not) $5,000
   Settlement if successful $15,000

2. Madras Co refunds goods returned by dissatisfied custome$Estimated returns after year-end $4,800.

3. A customer claims injury from a defective product. Probable compensation $100,000. Madras Co has a counter-claim against the supplier for $100,000.

Required: State what adjustments, if any, should be made in the financial statements.

Summary


Liabilities
A present obligation of the entity to transfer an economic resource as a result of past events
Current (settled within 12 months) vs non-current (settled after 12 months)
Liabilities of uncertain timing and amount (IAS 37)
Provisions:
- present obligation
- probable transfer
- reliable estimate
Contingent liabilities:
- possible obligations
- probable obligation without reliable estimate
Not recorded in P/L or SoFP. Disclosed as a supporting note to the financial statements
Increase:
Dr expense
Cr provision
The opposite entry is made for a reduction

Contras between receivables and payables

Contras between receivables and payables means **offsetting** the amount a business should receive from a party **against** the amount that business payable to same party.

👉 In simple words:
If a person is both your **debtor (receivable)** and **creditor (payable)**, you can “contra” the two balances.

🧾 **Example:**
- You owe **Mr. A** = $3,000 (he’s your supplier)
- **Mr. A** owes you = $2,000 (he’s also your customer)

✅ **Contra entry:**
You set off $2,000.
Now you only owe him **$1,000**.

Supplier Statement

Supplier Statement

A **supplier statement** (also called a **statement of account**) is a document sent by a supplier to a business (customer) showing:

- Invoices issued,
- Credit notes,
- Payments received, and
- The **balance owed** by the customer.

It's usually sent **monthly** to help both parties confirm what is owed.

Reconcile a Supplier Statement

To **reconcile** means to **compare** the supplier's statement with your own **creditor's ledger** (accounts payable record).

If there are differences, you identify and correct them — e.g., missing invoices, unrecorded payments, or timing errors.

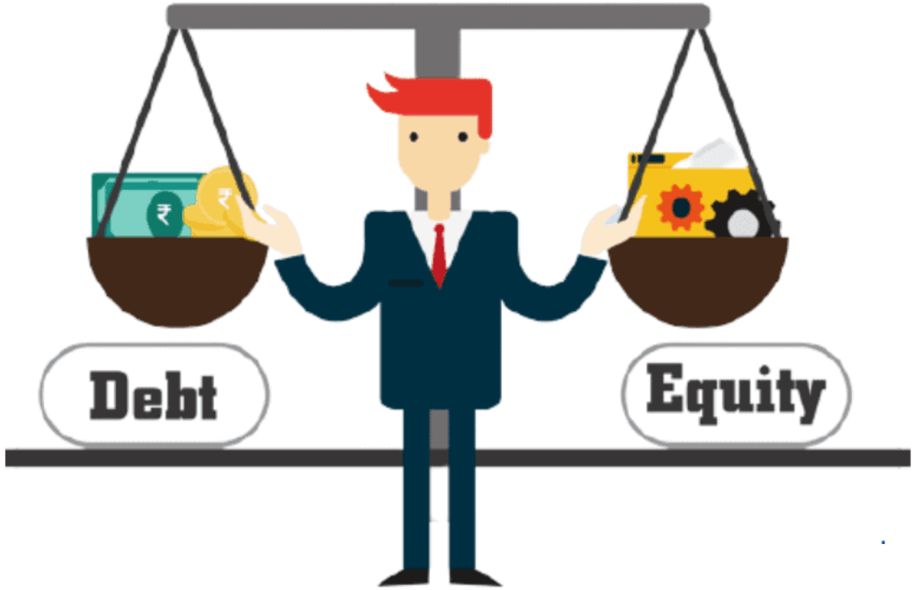
Question

Opening balance	$15,000
01.01 – Inv no 135	Purchased goods from Mr. Supplier on credit for $100,000
02.01 – Debit Note 05	Returned goods costing $10,000 to Mr. Supplier
10.01 – VN 45	Paid $50,000 for Mr. Supplier and received a discount of $5,000
25.01 – Inv no 140	Purchased goods from Mr. Supplier on credit for $20,000
25.01 – VN 49	Paid $2,000 for Mr. Supplier
26.01 – Debit Note 06	Returned goods costing $5,000 to Mr. Supplier

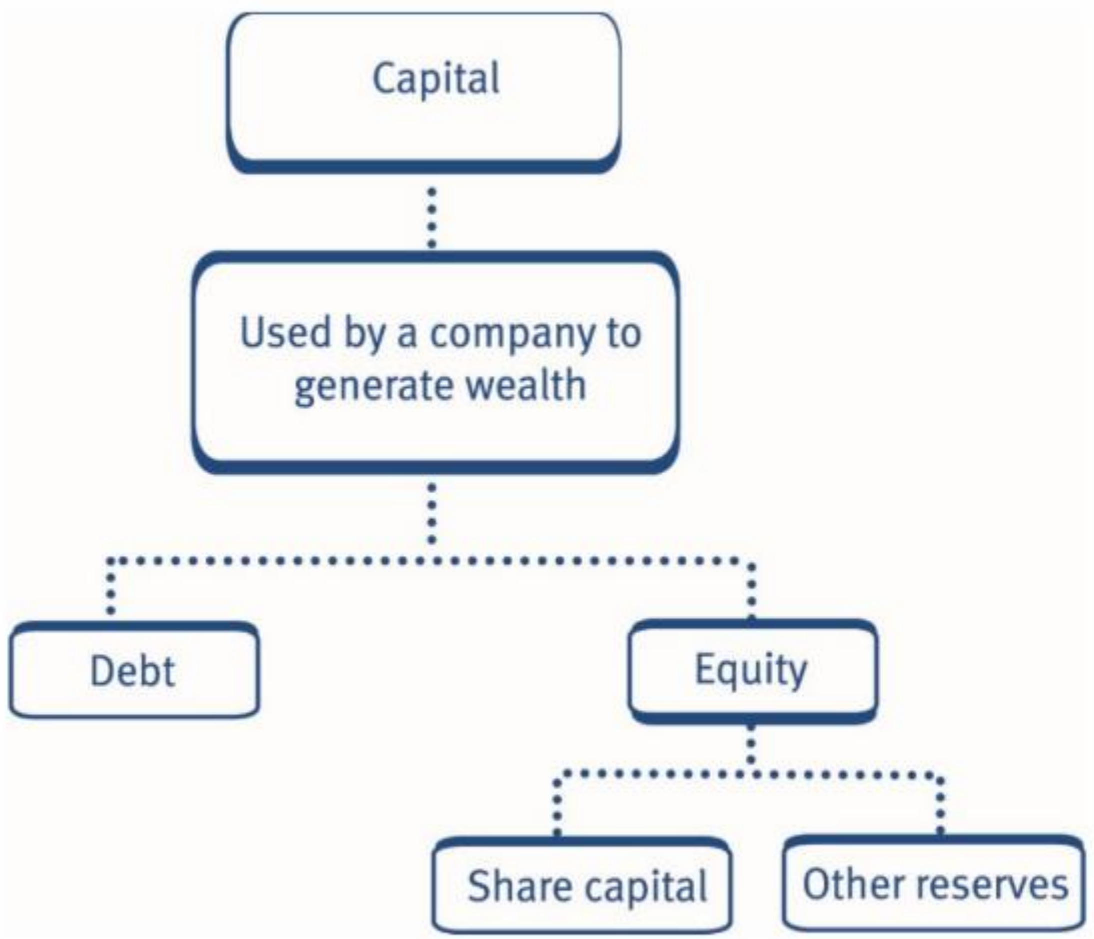
Record the above transaction in the relevant prime entry books and ledger accounts

01.01	Balance		15,000
01.01	Inv No 135	100,000	115,000
02.01	DN5->CN 15	10,000	105,000
10.01	Cash	50,000	55,000
10.01	Discount	5,000	50,000
25.01	Inv No 140	20,000	70,000
26.01	DN6->CN 17	5,000	65,000

Above Supplier Statement was received from Mr. Supplier.
Reconcile it



Capital Structure and Finance Cost


Capital
Used by a company to generate wealth
Debt
Equity
Share capital
Other reserves

Capital Structure of a Limited Liability Company

The **capital structure** refers to the mix of funds a company uses to finance its operations and growth. It generally includes **equity capital** and **borrowed capital**.

Component	Description
i) Ordinary (Equity) Shares	These are the main type of shares issued to the owners of the company. Holders of ordinary shares are the real owners and have **voting rights** in company decisions. They receive **dividends** depending on the profit earned, and they are **paid last** after all other claims. Example: 100,000 ordinary shares of Rs.10 each.
ii) Preference Shares	These shareholders receive a **fixed rate of dividend** before ordinary shareholders. They usually **don't have voting rights**. Preference shares can be of two types: • **Redeemable preference shares** – The company will repay the capital to shareholders after a specific period. • **Irredeemable preference shares** – The capital is not repaid during the company's lifetime (only repaid at liquidation).
iii) Borrowings	Funds obtained from external parties such as **banks, debenture holders, or financial institutions**. Borrowings must be **repaid with interest** within a fixed period. Examples include **bank loans** and **debentures**. These form the **debt capital** of the business.

Ordinary Shares

Ordinary share capital is treated as equity and the associated dividend payments are recorded in the statement of changes in equity.

Question

B Co issued 200,000 share at price of $5
Show this transaction using ledger accounts.

Same company issued another 50,000 shares at price of $7
Show this transaction using ledger accounts.

Right Issue Shares

A rights issue is:
the offer of new shares to current shareholders in proportion to their existing shareholding at a stated price (normally below market value).

The advantages are:

- A rights issue is the cheapest way for a company to raise finance through the issue of further shares.
- A rights issue to current shareholders has a greater chance of success compared with a share issue to the public as shares are offered at a slightly lower price as an incentive to take up the share issue.

The disadvantages are:

- A rights issue is more expensive than issuing debt.
- It may not be successful in raising the finance required.

Question

Upon incorporation in 20X4, JBU Co, a limited liability company, issued 1,000 50c shares at nominal value. Needing further funds, in 20X5 it made a rights issue of 1 for 5 at $0.75. This offer was fully taken up.

What accounting entries are required in 20X4 and 20X5?
Illustrate the relevant section of the statement of financial position at year end 20X5.

Bonus Issue

A bonus issue is:

the issue of new shares to current shareholders in proportion to their current shareholding. No cash is received by the company as a result of making a bonus issue.

The advantages are:

- Issued share capital is divided into a larger number of shares, thus reducing the market value per share, and so more marketable.
- Issued share capital is brought more into line with assets employed in the company by reducing stated reserves and increasing share capital.

The disadvantage:

- Administration costs are incurred when making the bonus issue.

As no cash is received from a bonus issue, the issue must be funded from reserves. Any reserve can be used, though a non-distributable reserve such as the share premium account would be used in preference to reserves which can be distributed:

Dr Share premium (or other reserve)	$X Nominal value
Cr Share capital	$X Nominal value

Question

GKL Co currently has 20,000 50c shares in issue (each issued for $1.25) and made a 1 for 4 bonus issue, capitalising the share premium account.

What are the balances on the share capital and share premium accounts of GKL Co after this transaction?

	SC	SP
	$	$
A	15,000	10,000
B	12,500	12,500
C	25,000	Nil
D	22,500	2,500

Question

RIT Co has 200,000 25c shares in issue. At 1 January 20X6 the balance on the share premium account was $75,000. The following transactions occur during the year ended 31 December 20X6:

31 January – A ‘2-for-5’ rights issue was made which was fully taken-up by all shareholders. The issue price was $1.80.

12 August – A 1-for-10’ bonus issue was made using the share premium account.

What are the balances on the share capital and share premium accounts of RIT Co at 31 December 20X6?

	S Cap	S Prem
	$000	$000
A	308	111
B	77	84
C	154	93
D	77	192

Dividends

Dividends are distributions of profits to shareholders, usually shown **per share** (e.g. 10c per share or 10% of nominal value).

Preference shares receive a **fixed dividend**, such as 5% of nominal value.

Ordinary shares may get:

- **Interim dividend** (paid mid-year):
  Dr Retained earnings / **Cr Cash at bank** – shown in the *statement of changes in equity*.
- **Final dividend** (declared at year-end): proposed after the year but must be **approved at the AGM** before payment.

Until approval, **proposed dividends are not liabilities** and **should not appear** in the statement of financial position.

Loan Notes (Loan Stock)

A **loan note** is a **fixed-term loan** used by companies to raise funds. It's a **certificate** showing the company's debt.

Each loan note has a **nominal value** (e.g. $100) and may be issued at any price. The company must **repay** the loan note holder at the **end of the term** and pay **annual interest** (e.g. 5% of nominal value).

Interest is recorded under **finance costs** in the *statement of profit or loss*.

Accounting entries:

- When cash is received:
  Dr Cash at bank
  Cr Non-current liability
- When interest is due/paid:
  Dr Finance charges (P/L)
  Cr Cash at bank / Current liabilities (depending on payment status).

Question

Custard Creameries Co needs to raise funds to purchase plant and machinery. On 1 March 20X5 it issued $150,000 10% loan notes, redeemable in 10 years' time. Interest is payable half yearly at the end of August and February.

What accounting entries are required in the year ended
31 December 20X5? Show relevant extracts from the statement of financial position.

Preference Shares

- **Redeemable preference shares** are treated like **loan notes**

— shown as a **liability** in the *statement of financial position*, and their **dividends** are recorded as **finance charges**.

- **Irredeemable preference shares** are treated like **ordinary shares**

— both the **share capital** and **dividends** are shown as **equity** items.

Question

Cracker Co, a limited liability entity, had issued share capital throughout 20X7 as follows:

Ordinary share capital (50c shares) $200,000

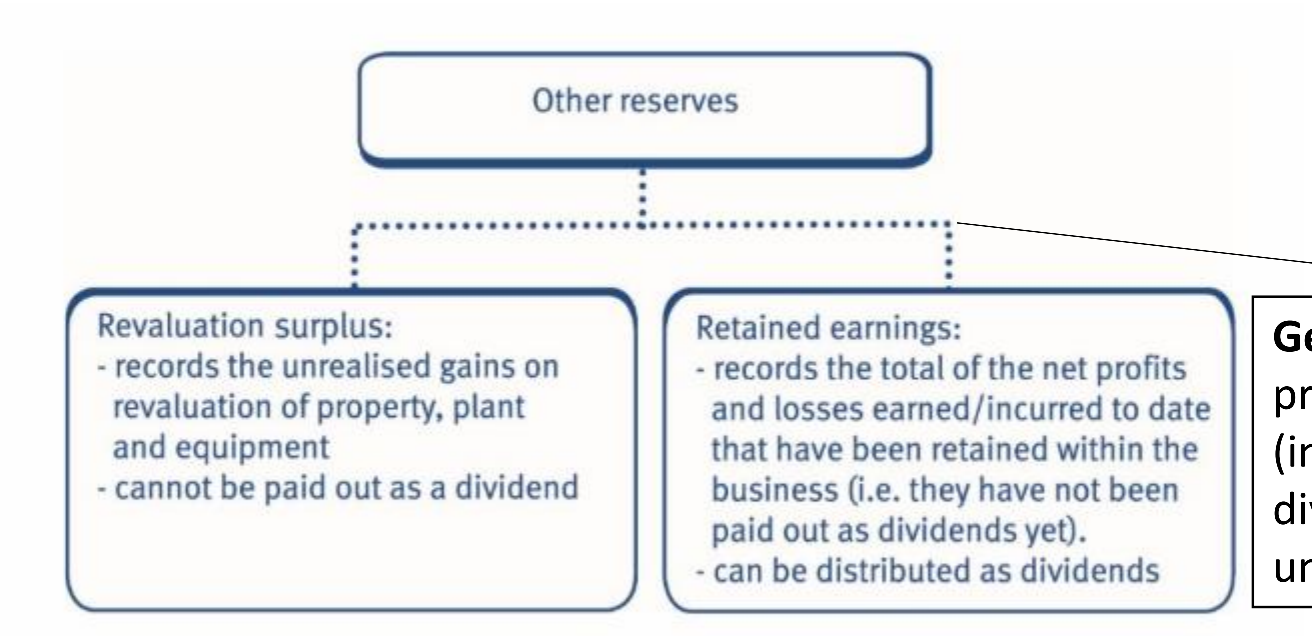
8% Irredeemable preference share capital $50,000

Cracker Co paid an interim dividend (i.e. a dividend declared part way through the financial year) of 12.5c per share to its ordinary shareholders and paid the dividend due on the preference shares, although this is not mandatory. Prior to the year-end Cracker Co proposed a final dividend of 36.5c per share to its ordinary shareholders.

Calculate the amounts shown in the statement of changes in equity (SOCIE) and statement of financial position (SFP) in relation to dividends for the year ended 31 December 20X7.

	SOCIE	SFP
	$000	$000
A	200	150
B	54	nil
C	200	146
D	101	72

Other Reserves



General Reserve — It's a part of profits that a company keeps aside (instead of distributing as dividends) for future needs or uncertainties.

Statement of Changes in Equity

A specimen statement summarising changes in equity during the year is presented below:

Statement of changes in equity for the year ended 30 June 20X7

	Equity share capital	Share premium	Revaluation surplus	Retained earnings	Total
	$	$	$	$	$
Balance at 1 July 20X6	34,000	1,100	3,000	25,200	63,300
Profit after tax for the year				19,950	19,950
Dividend paid in the year				(1,500)	(1,500)
Revaluation in the year			2,000		2,000
Issue of share capital	6,000	900			6,900
Balance at 30 June 20X7	40,000	2,000	5,000	43,650	90,650

Income Tax

- **Sole traders & partnerships:** Tax is on the individual, not the business. If business funds pay personal tax, it's treated as **drawings**.
- **Limited liability companies:** Tax is on the company as a **separate legal entity**. The **income tax charge** is an **expense in the P&L**, and any unpaid tax is shown as a **current liability** in the SFP.
- Tax is estimated at year-end (since company and tax year-ends rarely match) and later adjusted when the actual tax is known.

Accounting steps:

1 **Estimate tax liability:**
Dr Income tax charge (P&L)
Cr Income tax liability (SFP)

2 **When tax is paid:**
Dr Income tax liability
Cr Cash at bank

3 **Adjust for over/under provision:**
- **Overprovision:** Dr Income tax liability / Cr Income tax charge
- **Underprovision:** Dr Income tax charge / Cr Income tax liability

✅ Ensures correct total tax expense is recorded over the years.

Question

GB Co commenced trade on 1 January 20X4 and estimated that the tax payable for the year ended 31 December 20X4 was $150,000.

In September 20X5, the accountant of GB Co received and paid a tax demand for $163,000 for the year ended 31 December 20X4. At 31 December 20X5 it was estimated that GB Co owed $165,000 for income tax in relation to the year ended 31 December 20X5.

Prepare the tax charge and income tax payable accounts for the years ended 31 December 20X4 and 20X5 and detail the amounts shown in the statement of financial position and statement of profit or loss in both years.

Question

Choc Co estimated the tax charge for the year ended 30 June 20X4 to be $230,000. Choc Co settled the amount due with the tax authorities at $222,000. The difference arose because Choc Co's financial statements were submitted before the tax computation was finalised. Therefore the directors had to make a prudent estimate of the potential income tax liability to include in the financial statements.

For the year ended 30 June 20X5, Choc Co estimated its tax bill to be $265,000, but it is a little confused as to how this should be reflected in the financial statements.

Which of the following is correct relating to taxation in Choc Co’s financial statements for the year ended 30 June 20X5?

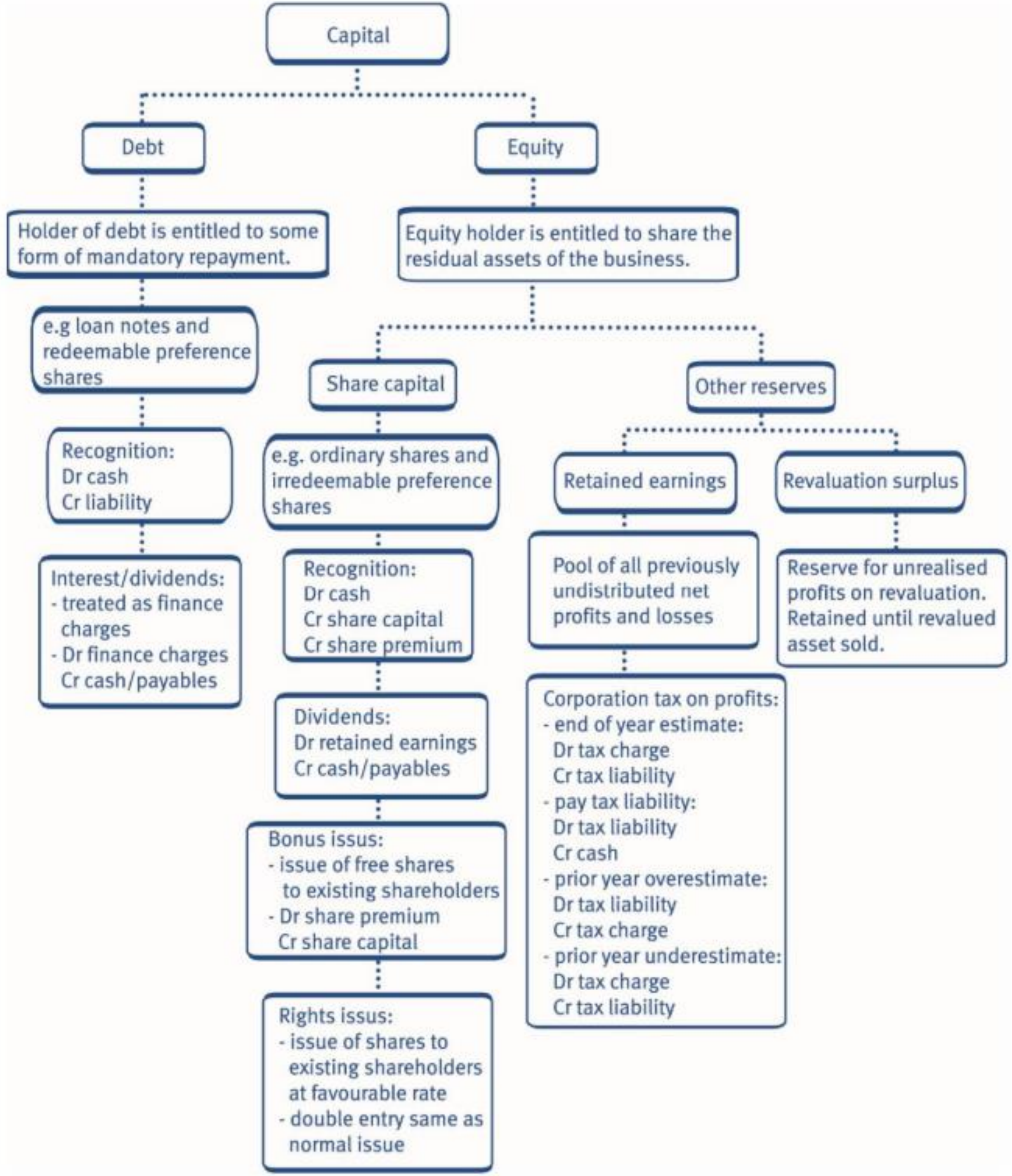
	Statement of financial position liability ($)	Tax expense ($)
A	257,000	265,000
B	273,000	265,000
C	265,000	257,000
D	265,000	273,000

SOFP Extract

Equity

Ordinary Share Capital
Preference Share Capital (if irredeemable)
Share Premium
Revaluation Reserve
General Reserve
Retained Earnings

Summary


Capital
Debt
Equity
Holder of debt is entitled to some form of mandatory repayment.
Equity holder is entitled to share the residual assets of the business.
e.g loan notes and redeemable preference shares
Share capital
Other reserves
Recognition: Dr cash Cr liability
e.g. ordinary shares and irredeemable preference shares
Retained earnings
Revaluation surplus
Interest/dividends: - treated as finance charges - Dr finance charges Cr cash/payables
Recognition: Dr cash Cr share capital Cr share premium
Pool of all previously undistributed net profits and losses
Reserve for unrealised profits on revaluation. Retained until revalued asset sold.
Dividends: Dr retained earnings Cr cash/payables
Corporation tax on profits: - end of year estimate: Dr tax charge Cr tax liability - pay tax liability: Dr tax liability Cr cash - prior year overestimate: Dr tax liability Cr tax charge - prior year underestimate: Dr tax charge Cr tax liability
Bonus issus: - issue of free shares to existing shareholders - Dr share premium Cr share capital
Rights issus: - issue of shares to existing shareholders at favourable rate - double entry same as normal issue