# Financial Accounting

## BCS-4

**2nd Jan 2021**

m.asif@fuuast.edu.pk

# Financial Accounting

Adjustments For Financial Statements

- **Adjustments For Financial Statements**
- Capital expenditure and revenue expenditure
  - Depreciation of fixed assets: nature and calculations
  - Double entry records for depreciation
- Bad debts, provisions for doubtful debts, and provisions for discounts on debtors
- Accruals and prepayments and other adjustments for
- financial statements
- Bank reconciliation statements
- Control accounts
- Errors not affecting trial balance agreement
- Suspense accounts and errors

# Financial Accounting

Adjustments For Financial Statements

- Capital expenditure and revenue expenditure

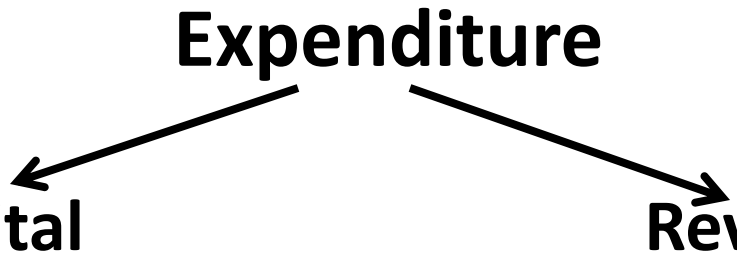
  Depreciation of fixed assets: nature and calculations

  Double entry records for depreciation

# Financial Accounting

Adjustments For Financial Statements

- Capital expenditure and revenue expenditure




Included in such amounts should be spending on

- acquiring fixed assets
- bringing them into the business
- legal costs of buying buildings
- carriage inwards on machinery bought
- BMR (balancing modernization replacement)
- any other cost needed to get a **fixed asset ready for use**

Expenditure which is not spent on increasing the value of fixed assets, but on running the business on a day-to-day basis, is known as **revenue expenditure.**

# Financial Accounting

Adjustments For Financial Statements

- **Differences between capital and revenue expenditure**

**Exhibit 24.1**

| Expenditure | Type of Expenditure |
|---|---|
| 1 Buying van | Capital |
| 2 Petrol costs for van | Revenue |
| 3 Repairs to van | Revenue |
| 4 Putting extra headlights on van | Capital |
| 5 Buying machinery | Capital |
| 6 Electricity costs of using machinery | Revenue |
| 7 We spent £1,500 on machinery: £1,000 was for an item (improvement) added to the machine; and £500 was for repairs | Capital £1,000<br>Revenue £500 |
| 8 Painting outside of new building | Capital |
| 9 Three years later – repainting outside of building in (8) | Revenue |

# Financial Accounting

Adjustments For Financial Statements

**Machine Cost Calculation**

| | | |
|---|---|---|
| List Price | | 100,000.00 |
| Less Trade Discount | | (2,000.00) |
| Invoice Price | | 98,000.00 |
| less Cash Discount | | (5,000.00) |
| Machine Purchase price | | 93,000.00 |
| **Add : Other Expenditures** | | |
| Transportation | 15,000.00 | |
| Insurance In transit | 2,000.00 | |
| Import Duties | 2,000.00 | |
| Transportation | 1,500.00 | |
| Foundation | 20,000.00 | |
| Installation | 5,500.00 | |
| Trial run | 2,000.00 | |
| **Total Expenditure** | | 48,000.00 |
| **Total Machine Cost** | | 141,000.00 |

# Financial Accounting
# Adjustments For Financial Statements

| | Dr | Cr |
|---|---|---|
| Machine | 93,000 | |
| Bank | | 93,000 |
| Machine | 48,000 | |
| Bank | | 48,000 |

**Machine**

| | |
|---|---|
| 93,000 | |
| 48,000 | |
| 141,000 | |

# Financial Accounting

Adjustments For Financial Statements

## Review questions

## 24.1- 24.3

# Financial Accounting

**Depreciation Of Fixed Assets**
**Nature And Calculations**

## Depreciation Of Fixed Assets

## Nature And Calculations

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

- **Definition**

1. Reduction in the value of an asset over time, due in particular to wear and tear.

2. Depreciation is an accounting method of allocating the cost of a tangible or physical asset over its useful life or life expectancy. Depreciation represents how much of an asset's value has been used up.

# Financial Accounting

**Depreciation Of Fixed Assets**
**Nature And Calculations**

- **Causes of depreciation**

1. Physical deterioration
    1. Wear and tear
    2. Erosion, rust, rot and decay
2. Economic factors
    1. Obsolescence.
    2. Inadequacy**.**
3. Time
4. Depletion

Natural resources such as mines, quarries and oil wells come under this heading. To provide for the consumption of an asset of a wasting character is called provision for **depletion.**

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

- **Methods Of Calculating Depreciation Charges**

1. Straight line method
2. Reducing balance method.

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

- **Straight line method**
- if a lorry was bought for £22,000 and we thought we would keep it for four years and then *sell it for £2,000 the depreciation to be charged each year would be:

$$\frac{\text{Cost (£22,000)} - \text{Estimated disposal value (£2,000)}}{\text{Number of expected years of use (4)}} = \frac{\text{£20,000}}{4}$$

= £5,000 depreciation each year for four years.

- If, on the other hand, we thought that after four years the lorry would have no disposal value, the charge for depreciation would be:

$$\frac{\text{Cost (£22,000)}}{\text{Number of expected years of use (4)}} = \frac{\text{£22,000}}{4}$$

$$= \text{£5,500 depreciation each year for four years.}$$

*Note: Scrape value , Residual value , salvage value, disposal value

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

- **Reducing balance method.**

In this method, a fixed percentage for depreciation is deducted from the cost in the first year. In the second or later years the same percentage is taken of the reduced balance (i.e. cost *less* depreciation already charged). This method is also known as the *diminishing balance method or* the *diminishing debit balance method.*

If a machine is bought for £10,000 and depreciation is to be charged at 20 per cent, the calculations for the first three years would be as follows:

| | £ |
|---|---|
| Cost | 10,000 |
| First year: depreciation (20%) | ( 2,000) |
| | 8,000 |
| Second year: depreciation (20% of £8,000) | ( 1,600) |
| | 6,400 |
| Third year: depreciation (20% of £6,400) | ( 1,280) |
| end of Year 3 | 5,120 |

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

- The basic formula used to find the percentage to apply with this method is:

$$r = 1 - \sqrt[n]{\frac{s}{c}}$$

where *n = the number of years*

*s = the net residual value (this must be a significant amount or the answers will be* absurd, since the depreciation rate would amount to nearly one)

*c = the cost of the asset*

*r = the rate of depreciation to be applied.*

Using as an example the figures

*n = 4 years*

*s = residual value £256*

*c = cost £10,000*

$$r = 1 - \sqrt[4]{\frac{256}{£10{,}000}} = 1 - \frac{4}{10} = 0.6 \text{ or } 60 \text{ per cent}$$

# Financial Accounting

Depreciation Of Fixed Assets
Nature And Calculations

## Review questions

## 26.1-26.3

## Assignment

## 26.11A

# Financial Accounting

Depreciation Accounting

- **Depreciation Accounting**

Operating Exp

Depreciation Exp Debited

Accumulated for depreciation Credited

Contra Assets Account B/S

# Financial Accounting

Depreciation Accounting

- **Exhibit 27.1**

**Computer**

| | | | £ | | | |
|---|---|---|---|---|---|---|
| 20X5 | | | | | | |
| Jan | 1 | Cash | 2,000 | | | |

**Accumulated Provision for Depreciation – Computer**

| | | | £ | | | | £ |
|---|---|---|---|---|---|---|---|
| 20X5 | | | | 20X5 | | | |
| Dec | 31 | Balance c/d | 400 | Dec | 31 | Profit and loss | 400 |
| 20X6 | | | | 20X6 | | | |
| Dec | 31 | Balance c/d | 720 | Jan | 1 | Balance b/d | 400 |
| | | | | Dec | 31 | Profit and loss | 320 |
| | | | 720 | | | | 720 |
| 20X7 | | | | 20X7 | | | |
| Dec | 31 | Balance c/d | 976 | Jan | 1 | Balance b/d | 720 |
| | | | | Dec | 31 | Profit and loss | 256 |
| | | | 976 | | | | 976 |
| | | | | 20X8 | | | |
| | | | | Jan | 1 | Balance b/d | 976 |

**Profit and Loss Account (extracts) for the year ended 31 December**

| | | £ |
|---|---|---|
| 20X5 | Depreciation | 400 |
| 20X6 | Depreciation | 320 |
| 20X7 | Depreciation | 256 |

# Financial Accounting

Depreciation Accounting

| | Depreciation Exp | | |
|---|---|---|---|
| Acc.Dep 2005 | 400 | P&l | 400 |
| Acc.Dep 2006 | 320 | P&l | 320 |
| Acc.Dep 2007 | 256 | P&l | 256 |

# Review questions
# 27.2

**27.2** A company starts in business on 1 January 20X3, the financial year end being 31 December. You are to show:

(a) The machinery account.
(b) The provision for depreciation account.
(c) The balance sheet extracts for each of the years 20X3, 20X4, 20X5, 20X6.

The machinery bought was:

| | | |
|---|---|---|
| 20X3 | 1 January | 1 machine costing £1,400 |
| 20X4 | 1 July | 2 machines costing £600 each |
| | 1 October | 1 machine costing £1,000 |
| 20X6 | 1 April | 1 machine costing £400 |

Depreciation is over ten years, using the straight line method, machines being depreciated for the proportion of the year that they are owned.