CHAPTER ONE
NATURE AND GENERAL FRAMEWORK OF ACCOUNTING

Contents of Chapter One

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Learning Objectives on the Nature and General Framework of Accounting

After studying this chapter, readers should be able to:

a) Explain and State the Nature and Significance of Accounting

- *Explain the historical development of accounting;*
- *Define and State the Objectives of Accounting;*
- *State the Purpose of Accounting;*
- *State the Qualitative Features of Accounting;*
- *State Principles of Coding;*
- *Identify Types of Accounts;*
- *Identify Users of Financial Statements and their Information Needs;*
- *Explain the Range of Accountant’s Services to an Organisation;*
- *State the Role of Accounting in the Economy; and*
- *Explain Ethical Issues in Accounting.*

b) State and Explain the Regulatory Environment of Accounting

- *Explain the roles of the International Accounting Standards Board(IASB); and*
- *State the Functions of the relevant Financial Reporting Bodies.*

Nature and Significant of Accounting

Financial Accounting is majorly concerned with a method or a procedure of reporting financial performance and financial position or position statement of an entity. It is a stewardship function of primary interest to the management to satisfy basic information needs of parties not involved in the day to day running of an entity. It is the art of collecting, recording, analyzing and summarising items of revenue, costs, assets and liabilities to measure performance (i.e. profits) and the position (net worth) of an entity in a period a year. A set of financial statement usually consists of the Income Statements (i.e. Statement of Profit or Loss and Other Comprehensive Income for the year ended, Income and Expenses), Statement of Financial Position as at the end of the year (Assets, Liabilities and Capital), Cash Flow Statements and Notes or workings to the Financial Statements. There is a starting part of Financial Accounting, which is referred to as Book-Keeping. The term Book-Keeping is the art of recording raw basic data in the source documents such as receipts, invoices, payment vouchers and subsidiary or books of original entries, for example, Sales Day Book, Purchases Day Book, Cash Book, Petty Cash Book etcetera. The primary aim of Book Keeping is to clearly how the transactions emanate and how they are recorded in the subsidiary records or books of original entry.

A Chartered Accountant relies on the work of a book-keeper to classify, analyse and summarise the data into a meaning form for management to take major economic decisions. No matter how big or small a business entity is, the recording of transactions into various source documents (cheque books, cheque book counterfoil, electronic transfer request) is vital either manually or electronically at regular time interval.

The underlying purpose of accounting is to provide financial information aboutan economic entity to assist the direct users (shareholders/owners, management, employees, short-term and long-term lenders to the company etc.) and indirect users (financial analysts, investors, government and Tax Agencies etc.) in making major economic decisions.The information is usually provided periodically toshareholders and others connected with the organization to enable them decide the extent to which they want to continue to commit financial resources (equity, capital, loans, loan notes, preference shares, supply of credits etcetera) totheentity. The need for presentation of accounting information cannot be overemphasized where a lot offinances and management efforts are required to ascertain the performance and measure the risk of an entity. Financial information is essentially needed in an entity to plan, coordinate, control the finance and operation ofabusiness to guarantee efficiency and productivity in the use of financial and physical resources of an entity.

Every other person such as the owner, supplier of goods and short-term outstanding credits (Payables), long term government credits, employee and other partiesneed financialinformation of a business for one purpose or the other; details of whichwouldbediscussed laterin this chapter.

Brief Historical Development of Accounting

Financial Accounting is as old as man because there was no time business men and women did not use one crude methods or the others to measure performance, profits or gain from business operations. However, Financial Accounting was developed in Italy in the 14th Century when Italian Merchants started using double entries in terms of plus(+) and minus (-) to record transactions on a daily basis. The first theory double entry was found in the accounts of the stewards of Commune of Genoa in the year 1340. This was further developed from its rudimentary plus (+) and minus (-) to the level of book-keeping by Fr. *Lucia Pacioli*, an Italianmonk in 1494.In his book titled"*Summade Arithmetical,Geometrica,proportioniet proportionalita*," published in 1494 on Arithmetic, Geometry and Proportion, he devoted achapter to put forward the principles of the double entry system. Consequently, it became necessary formanagers to report to the owners on the performance, position (net worth) and liquidity of businesses during the period under review. Such report s wouldincludemainlythefollowing:

- How the financial resources of the business have been obtained and how they have been invested duringthe'period
- The profit earned orloss incurred during the 'period'an
- The assets, liabilities and the owners' equity at the end of the period under review.

After this initial development, a lot of changes have been witnessed in accounting.These changes were informed by the so phistication and complexity of businesse industrial and political environments which placed more responsibilities on management of business to disclose more information to owners and other interested parties.

For instance, a lot of local Generally Accepted Accounting Principles (GAAPs), which have h i t h e r t o been developed are now internationalized and converged in 2010 under International Financial Reporting Standards (IFRS). Thus, after the adoption of IRRS by the former President Good Luck Ebele Jonathan in 2010, businesses in Nigeria are now to follow and deploy IFRS as the minimum standards in the preparation of Financial Statements. Also, accounts of limited liabilities companies in accordance to the Companies and Allied Matters Act (CAMA) as amended to must be“audited” and reported on as presenting a “true and fair” position by the Chartered Accountants to shareholders in the Annual General Meeting (AGM).

Accounting has also gone beyondmere reporting for managerial decisions,to include tax management,government accounting, sustainability, environmental and social responsibility accounting. The IFRS is a minimum standard applicable in the preparation of Financial Statements. The regulations in the Companies and Allied Matter Act, Bank and other Financial Matter Act, Insurance Act, Security and Exchange Act, Financial Reporting Council regulations and other extant laws developed from time to time are to be followed in the preparation of a General Purpose Financial Statements to keep pace with changes in the economic and political environments.

The Meaning and Objectives of Accounting

Accounting is the art of recording, classifying, summarizing, analyzing financial transactions of a business, presenting and communicating the information to take major decisions on day-to-day operations. It follows, therefore, that accounting is a process, theproduct of which is the provision of financial information that is useful to a widerangeofusers to make major economic decisions.

Bookkeepingisthe basicrecordingphaseof financial accounting.Itistheclassificationandrecording of business transactions in the source documents and books of account such as sales day book, purchases day bock, returns inward and outward day books, petty cash book and cash book among other subsidiary records the recording of thetransactionsis aroutinetask, there for eittends to be repetitive. It provides financial data in basic raw forms for use of the accountants to prepare financial statements on a yearly basis.

The processes or steps involved in book keepingare as follows:

(a) Classification of business transactions using source documents;

(b) Recording of transactions inappropriate subsidiary books or books of prime entry;

(c) Posting of entries from subsidiarybooks to the ledger and

(d) Extraction of theTrial Balance.

Accounting, however, includes not only the keeping of accounting records, but also the design of efficient accounting, systems, preparation and presentation of Financial Statements, analysis and interpretation of the Financial Statements as well as the development of forecast for decision-making. The accounts of companies contained in their Annual Reports and Accounts are examples of the product of accounting and they are called *financial statements.*

1.3 EXPLAIN PURPOSE OF ACCOUNTING

a) It measures the performance of a business entity, at the end of a financial year, the owner of a business will obtain profit information from the financial accounting;

b) The report gives the revenue and item of expenses for the year ended;

c) Financial accounting indicates the net worth or the position of a business entity as at a given date;

d) Accounting shows liquidity, that is , how much cash and cash equivalents an entity has as at the end of year;

e) It indicates the wealth of an entity;

f) Accountings reveals the assets, noncurrent and current assets of an entity as at the end of a year;

g) It reports the capital, equity, the non-current and current liabilities as at the end of a financial year; and

h) It provides information in the notes or workings about are figures in income statements and statement of financial position are derived.

Scope of and purpose of Accounting

Accounting generally covers Financial Accounting; Cost Accounting, Performance Management, Auditing, Government Accounting, Taxation, Financial Management,Forensic Accounting, Social and environmental Accounting etc.

The following are the Objectives of financial accounting:

a) It assists owners to ascertain profit of a business entity;

b) Accounting aids to have effective control to be exercised on resources invested on a business entity;

c) It helps uses to take major economic decisions on a daily basis;

d) It facilitates accountability, transparency and probity of daily transactions;

e) It aids in assessing future prospects of a business entity;

f) It provides a yardstick to assess performance of an entity;

g) Accounting offers a window to evaluate the worth and position of a business entity;

h) It assists the employee to evaluate job security and the ability to pay salaries as and when due;

i) Short and long term lenders can use accounting information to assess credit worthiness of an entity;

j) Accounting information is useful in the computation of tax payable in a year of assessments; and

k) It can be used to determine the extent to which an entity is indebted to external parties, that is the proportion of the leverage or gearing of a business.

Other Specialised Purposes of Accounting

i. Cost Accounting

Cost accounting is the procedure for accumulating cost data or initial cost of an item to provide information for managerial action or decision daily. Cost accumulation is the collection of cost data in some organised way by means of accounting systems. The cost accumulated will be related to specific products and departments for planning, control and decision making by management.

ii. Performance Management

Performance Management is a continuousprocess where managers and employees combine effort in planning, monitoring and reviewing the effectiveness of the workforce towards the achievement of the overall objectives of the entity.

iii. Auditing

Only complete and reliable financial statements can be of any use to interested parties. To guarantee this, the Financial Statements must be examined by an independent person called *an Auditor*.Auditing is the independent examination of the books of accounts and records of an entity by a professional accountant who will gather various forms of audit evidence before the forms an opinionon the financial statements. At theend of the audit exercise, he will write a report on the fairness of the financial statements and the scope of work he Carrie doutbe fore arriving at his opinion.

iv. GovernmentAccounting

Government accounting is the process of recognising and reflecting in the appropriatebooks of accounts and records of the generated revenue and disbursed expenditure ofGovernment in such a way as to easily provide relevant financial information vital forappropriate decision making from time to time, and in compliance with the laws regulating government finances.

It is a class of Accounting in the Public Sector where government has some executive responsibility. Public sector consists of the ministries and Departments and their agencies (MDAs). Government accounting is concerned with planning, control and appraisal of governmentactivitiesand in effect, accountability.

v. Taxation

The accounting profits generated in the financial statements provide the basis fordetermining the taxable profits of an entity. The taxable profits are different from the accounting profits be causecertainexpensesandincomeareallowableforaccountingpurpose but disallowed for tax purpose. A good understanding of the knowledge of these taxable and non-taxable incomes and expenses would help an entity in its taxmanagement.

vi. FinancialManagement

Finance is meant to be the cash and cash equivalents and other financial resources of anentity.Financial Management is the process employed by management of an entity toensure the resources are efficiently and effectively procured, utilized and accounted for bytheowners ofthebusiness in such awayto maximisethewealth oftheowners.

The primary task of financialmanagement is best divided into three,namely

(a) Financing decisions;

(b) Investment decisions;and

(c) Dividend decisions

The financial manager ensures he obtains adequate and cost effective funds for the entity'suse at the right time.The various investments on which the funds are employed arecarefully and professionally selected.Finally, he also ensures the efficient distribution ofprofitsearned to Owners and otherstakeholders. Othersecondaryroles of thefinancial managerinclude:

a) Treasury and liquidity management;

b) Replacement of non-currentassets;

c) Taking appropriate insurance policies on the entity'sassets generally;

d) Tax management;and

e) Management of the entity's working capital

vii. Forensicaccounting

Forensic accounting refers to the application of accounting skills to investigate and probefrauds, deliberate misrepresentations (Falsifications, misappropriations) or embezzlements of an entity's resources with a view to recovering such funds, usually through legal proceedings.

viii. Social and environmental Accounting

Social and environmental Accounting is the branch of accounts that deal with the accountingfor and reporting of the social and environmental impact of an entity's activities upon thes take holders (investors, management, employees, customers,suppliers, local community where the entity operates, etc).

ix. Sustainability Accounting

Sustainability Accounting is a new branch of accounting, which focuses on the disclosure of non-financial or qualitative information about an entity's performance to the external users/stakeholders. The information guides the supplier of funds (short-term and long-term suppliers of funds), owners and equity holders to know other non-financial and non-quantitative information about an entity in a financial year.

x. Project Accounting

a big entity, a project accountant is dedicated to manage a specific large project worth billions of naira. The project accountant presents, analyse cost and prepares reports at intervals to track and monitor financial progress of the project. The project accountant provides historical financial data to assist management in forecasting or estimating future costs to be incurred and determine the likely completion time of the project.

xi. Fiduciary Accounting

A Fiduciary Accountant handles the accounts entrusted to a person who is responsible or in custody to manage a property. The Fiduciary Accountant prepares records of income and expenditure of a property to guide in allocation of funds efficiently. The Fiduciary Accountant serves as trust manager, receivership or estate manager.

xii. Fund Accounting

A Fund Accountant works in not for profit organisation or Non-Governmental Organisation (NGO) to prepare receipts and payments, income and expenditures, statement of financial position to ensure efficient and accurate funds allocation. An organization such as Churches, Educational Institutions, Hospitals, Clubs, Government Agencies and Charities.

1.4 Fundamental Qualitative Characteristics of FinancialAccounting

One of the foremost objectives Financial Accounting reports is the supply or provision financial information to assist the users of the report in making effective decisions about how the economic resources of entities are deployed. The information provided in the Financial Accounting will assist the users of the information to make timely economic and other financial decisions. Financial Accounting is principally concerned with providing accounting information to both internal and externalusers. In accordance with IAS 1 on presentation of Financial Statements, the components of Financial Statements are:

- Statement of Financial Position;
- Statement of Profit or Loss and Other Comprehensive Income (OCI, in this syllabus as Statement of Profit or Loss);
- Statementofcashflows, (this is outside the present syllabus, it will be addressed as candidates progress in the ICAN examinations);
- Statement of changes in equity(also, this is also not in this syllabus); and
- No test other financial statements (not in this syllabus).

Qualitative Characteristics of Useful Financial Information

The qualitative characteristics of Financial Statements are the main features or attributes or basic elements that are inherent in the reports to make it useful and address the purposes why they are prepared. The International Accounting Standards Board, which is referred to as the IASB's conceptual framework; it states that accounting information is use fulifit possesses both the fundamental and enhancing qualitative characteristics.

FundamentalQualitativeCharacteristics

The fundamental Qualitative Characteristics are relevance and faithful representation. These are explained in the order of presentation.

a. Relevance

A financial information is relevant if it can make a difference in the decision made by users.A financial information makes difference in users' decision when the users areaware capable of making differencein decisions when it:

- has the capacity to directly influence the outcomes of how users used the reports to allocate economic resources among various alternative courses of actions, that is such report should have capacity to influence major economic decisions of users on resource allocations;
- is supplied in time to directly influence the economic decisions;
- has Predictive Value, Confirmative value or both information has predictive value if it helps the users to predict what happen in the future. Where the information helpsusers confirm their earlier assessments and predictions made in the past, it is said topossess confirmatoryvalue

b. FaithfulRepresentation

Financial reports are depictions or representations of economic phenomena in words and numbers. An information is faithfully presented if it indicates faithfully the transactions they contained, other events it purports to present and these are reported and accounted for in accordance to the substance and economic realities but not merely their legal form of ownerships. In other words, for a financial information to beuseful,theinformation reportedmustnotonlyrepresentrelevant the phenomena,butitmust also faithfully represent the phenomena that it purports to represent.For an information to be perfectly and faithfully reported, it must have three characteristics. The information must be:

- **Complete**

A complete depiction includes all information and explanations necessary for a user to understand thephenomenonbeingdepicted.

Aneutraldepictioniswithoutbiasintheselectionorpresentationoffinancialinformation.

Freefromerrormeansthereare noerrorsoromissionsinthedescriptionofthephenomenon, and the process used to produce the reported information has been selectedandapplied with no errors in the process.

- Neutral, free from biasness;and
- Free from error, free from material errors that can distort the uses of the information, such an information must mislead users of the information. An error free financial statements do not mean the information is accurate in all ramifications, but the errors must be minimal and must distort judgements of the users of the information.

Enhancing Qualitative Characteristics

These are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully presented. Theyinclude:

i. Comparability
ii. Verifiability
iii. Timeliness
iv. Understandability.

i. Comparability

Comparability is that qualitative characteristic of financial information that allows a choice between. Where an entity is privileged to have information about the financial performance of other entities of similar sizes in the same industry, a comparison of the entity's performance with those of others enablessoundeconomicdecisionstobemade.For example, decisions as to whether to dispose or hold a particular investment, whether toinvestin oneindustryinpreferenceto anotheraremadebythis process. For financial information to be neutral, it must be:

- Consistent; and
- Fully disclosed all necessary explanations and information useful to the users

ii. Verifiability

Verifiability is the quality that enables users to have the assurance that the information depicts exactly what it purports to state. As such different knowledgeable people considering the information will be able to arrive at similar decisions on the same issue.

iii. Timeliness

Timeliness implies that users are given the relevant information needed to take economicdecisions in Generally, the longer the information had been obtained the less useful itbecomes for making today's decisions.However, where a user is required to make sometrendanalysis, seeminglyold information mayhavesomecontinuingusefulness. The older an information the less it is not useful to the users of the information.

iv. Understandability

Information should be presented in a way that the user can comprehend it. This can be achieved if the information is appropriately classified so that the user easily grasps theinformation. Financial reports should therefore be presented in a form that any average knowledgeable reader can understand for it to beuseful tohim.

1.5 Principles of Coding in Financial Accounting

Coding in Financial Accounting means processes through which data is recorded in the books of accounting. Each book of accounts or account heads are assigned unique code used in identifying the correct account for posting in a computerized or manual accounting systems. In a computerized or manual accounting environments, codes/symbols (alpha-numeric, numeric and combination) are engaged to represent revenue, purchases, inventories, expenses, assets and liabilities are assigned numeric or alpha-numeric acronyms, which are used to describe the transactions and posting in the accounts.

The Financial Accounting coding consists of fields and codes to classify, record and analyse transactions and financial data in a computerized accounting environments. Coding is a symbolic representation (alpha-numeric, SW, numeric, 1010, or combination, QQ12) of transactions in the process of preparing financial accounting. The coding can be designed in such a way to capture location (i.e. place), services, activities, journals, ledgers, account codes and other books of accounts.

Objectives of Coding in Financial Accounting

a) Uniformity

Coding is designed in such a way to ascertain sameness for preparation of financial accounting, budgeting and data collation in an entity.

b) Consistency

It is consistently applied to represent items of revenue, expenses, assets, capital and liabilities. For example, cash sales may be represented with 1001, credit sales 1002, sales return 1003, cash purchases 1004, credit purchases 1005, purchases returns 1006, carriage inwards 1007, inventories 1008, salaries and wages 1009, electricity bills 1010, stationery 1011, property, plant and equipment 1012, depreciation, trade payables 1013, trade receivables 1014, loan 1015 and capital 1016 among other transactions

c) Brevity

The acronym used in coding is not too lengthy. It is short and easily comprehensible.

d) Conformity with Generally Accepted Accounting Principles (i.e. International Financial Reporting Standards (IFRS).

The code is designed in such a way that the principles in the IFRS is not violated. The code conforms with the International Accounting Standards (IAS) and the IFRS to assist in the preparation of a general purpose financial statements.

e) Regulatory Compliance

The coding demonstrates compliance with all extant regulations imposed by government and regulatory agencies in Nigeria.

f) Data Integration

The coding (field and codes) integrates with an entity's chart of accounts and it yield must be consistent with external reporting needs such as the Integrated Post-secondary Education Data System (IPEDS). It must be duly accredited by bond rating organization in compliance with external reporting.

g) Conciseness and Unambiguity

It must be und--erstandable and less ambiguous to the users in the preparation of financial accounting in an entity.

Advantages of Coding in Financial Accounting

a) It compresses large volume accounting and financial data in a fast growing entity;

b) It provides tools analyses for chartered accountants to measure trends of performance and position statements to predict into the future;

c) It assists in programming and production of accounting software;

d) It assists in fast processing of real time transactions and other transactions;

e) It is unambiguous in processing of financial transactions;

f) It is efficient and reliable in processing huge volumes of financial transactions of an entity.

g) It reduces amount to be incurred on labour to capture data in an entity; and ₵It aids the use of batch and real time processing of financial data.

1.6 Types of Accounts

An account is a record, which is used to post financial transactions of an entity's over a stated period of time. The account has two sides, the debit and the credit sides. The account records twice every transaction in a period of time. A ledger is a form of account with the debit and credit sides. The principles of duality or double entry principles are usually engaged to record transactions into ledgers.

Debit Sides Kofi Business Enterprise Accounts Credit Sides

Date	**Descriptions**	**Amount**	**Date**	**Descriptions**	**Amount**
		₵			₵
	Left Hand Side=			Right Hand Side=	
	Debit entries			Credit entries	

(a) Kofi started business with ₵100,000 Cedis

Capital Account and Cash Account

a) Purchased goods worth ₵20,000 cash

Purchases Account and Cash Account

b) Cashsales worth ₵30,000

Cash Account and Sales Account

c) Bought goods worth ₵60,000 from Mr. Gbeki

Purchases Account and Mr. Gbeki's Account

d) Goods worth ₵90,000 sold to Mr. Essien

Sales Account and Mr. Essien's Account

In financial accounting, every transaction has two accounts. These are indicated in transactions a –e above. In Financial Accounting, a ledger is a form of account. It has a T-format. In an entity, ledgers record accounts of individuals, partnerships, suppliers (payables), customers (receivables), physical assets and liabilities.

In Financial Accounting, there are two (2) main classifications of ledger. These are:

a) General Ledgers; and

b) Subsidiary Ledgers

General Ledger (GL)

A General Ledger is a set of account, which records the day-to-day transactions of business entity using the concept of double entries. This is known as duality concept. The General Ledger reveals the summary of all subsidiary ledgers in which every transaction is recorded. Each transaction has two parts, these are the debit and the credit parts. GL contains information which is needed to prepare the financial statements.

The transactions recorded in the GL reveals the summary/balance of assets, liabilities, capital/equity, revenues and expenses. The GL encompasses all transactions to prepare the Income Statements, Statement of Financial Position and other reports. The GL is very useful in extracting the Trial Balance, list of balances in all books of accounts of an entity. This assist in locating errors in the books of accounts.

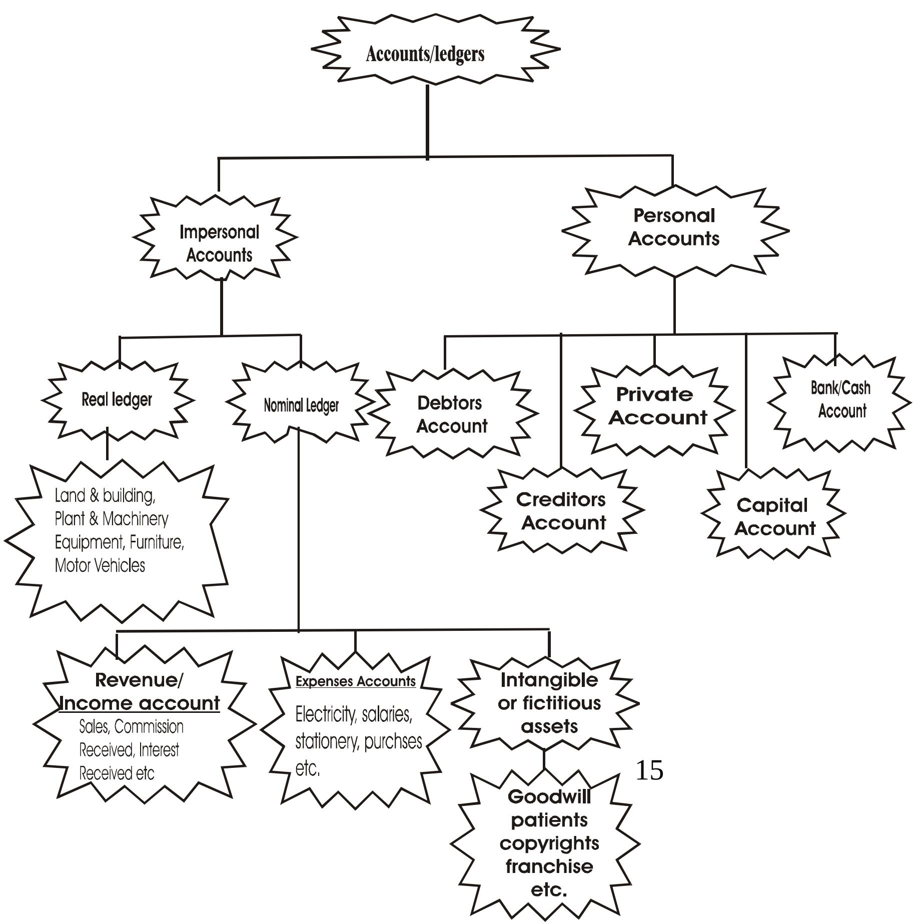
Subsidiary Ledger

A subsidiary ledger is called books of original entry or books of prime entry. The subsidiary accounts consist accounts such as Sales Day Book, Purchases Day Book, Returns Inward Day Book, Return Outward Day Book, Cash Book and Petty Cash Book, which will be discussed later in the study pack.

Classification of Ledger/Accounts

Accounts/Ledgers:

Accounts/ledgers can be subdivided into the following types as depicted in the diagram below.



a) Impersonal Accounts

An impersonal ledger account *does not* involve individuals, firms, sole traders, partnership or company.Impersonal account does not affect these groups of people. An Impersonal Ledger Account can be classified into two main categories; these are real account and nominal account

(i) Real Accounts

A real account records transactions relating to tangible property or possession of individuals, firms, and companies, etc. ***A real account can never be a liability account. Real accounts are assets accounts.*** Examples of real account transactions include plant and machinery, furniture, equipment, machinery, building, etc. They physically exist in reality.

(ii) Nominal Accounts

Nominal Accounts consists of accounts of incomes and expenditures or expenses and intangible assets. Income relates to gain, that is, excess of revenue over costs; while expenditures are expenses/costs expended on anything. Also, intangible assets are assets that do not have physical existence e.g. Franchise, Patents, Goodwill and Copyright. Examples of expenditures are rent, salaries and wages, stationery, rates, petrol, lubricants and postages etc. Examples of incomes are discount received, commission received, sales, interest received, commission received, and interest received among others. ***It should be stressed that all entries in the nominal accounts end in the Statement of profit or loss.*** That is, the balances in the nominal accounts are normally used to prepare the Statement of Profit Or Loss for the year ended 31 December, 20X2. In smaller entities, every account may be kept in just one ledger but bigger organizations keep their accounts in many ledgers.

b) Personal Accounts

On the opposite, personal ledger records the accounts of various individuals, firms, sole traders, partnerships, companies etc. Examples include Yinka's, ABC's account, Olukunle's Account. It can be further categorized as: **Receivables' Ledger,** which records customers who bought business goods on credit, it is called **sales ledger**. It may also be **Supplier's Ledger** – records of suppliers who sold goods on credit to the business. Also, there is a **private ledger**. A private ledger records private information such as capital account, drawings account, loans account, personal advances, bank/cash account and Statement of Profit or Loss for the ended--- Capital Account monitors the resources use in starting business and Bank/Cash account, is used to keep all monies of the business.

1.7 Users of Financial Statements

Accounting information is of interest to various groups of people. The users of Financial Statements may be classified under two main headings:

a) Direct Users; and

b) Indirect Users

Direct users are mainly the stakeholders in the business. The direct users bear the consequences of losses made in the course of a business. They are owners of business, management, employees, long and short-term supplier of funds. The indirect users of financial statements do not have financial stake in the running of a business entities. Examples of indirect users of financial statements are the Federal Inland Revenue Services, State Inland Revenue Services, customers, financial analysts, government at various levels, community and associations among others. The following people are likely to be interested in accounting information.

(a) **Owners of the business/investors**: These are Sole traders, partners and shareholders.They need accounting information to asses show efficiently the management is performing –they want to know how profit able the business is and how much of this profit they can withdraw for their own use. It will also allow shareholders tomake appropriate investment decisions such as buying and selling of shares, deciding on whether to dispose some or all the shares,or to acquire more of the entity’s shares.

(b) **Management**: These are the people who manage the affairs of the business for the owners.Ina limited liability company, they are the member so the board of directors and other management.They need accounting information to ascertain the efficiency of the policy they formulate and to plan and control there sources of the business.

(c) **Trade Payables**: These are the people who supply goods to the business on credit.The trade pay ables want to know the ability of the business to pay or the good ssupplied to the business promptly.They will be interested in the liquidity of the business.

(d) **Customers:** These are the people who purchase the goods or services provided by the business. The customers want to know whether the business will continue to be areliable source of supply; though they will also be interested in the quality of theproductsofthebusiness.

(e) **Tax authority**: Accounting Profits determine the basis of computingtax. The taxa uthority wants to determine the taxpayable by the entity and its employees.

(f) **Employees of the entity:** Existing employees need accounting information to enable them decide how secure their job is and the ability of the business to pay good salaries and provide good welfare facilities.

(g) **Lenders**: These include the banks and other loan payables. Financial statementsenable them to decide whether more credit facility can be granted and whether thecompany will be able to pay interest and principal when they fall due. They areinterested in the liquidity and of the entity's profitability as well asreliability of itsunderlyingassets.

(h) **Government:** Government needs accounting information to enable it formulate fiscal policies.

(i) **Financial Analysts:** They analyze financial statements for their clients in order to help them make informed decisions. Financial analysts include stock brokers, credit agencies and financial reporters.

(j) **The Public**: Member sof the general public (individuals, trade unions and associations, political parties, African unions, International Monetary Funds (IMF) etc need accounting information for various purposes. They use the available financial information to take decisions on whether or not to deal with an entity determine their level of involvement in its activities.

1.8 Range of Accountant's Services to an Entity

a) The Work of an Accountant

A professional accountant performs various types of work for an entit yeither as an employee or as a consultant. For instance, member so the Institute of Chartered Accountants of Nigeria (ICAN) are classified into two broad categories; members in public practice and members not in public practice.

b) Members in Public Practice

These are accountants working in accounting firms which offer a variety of accountingservicesto theirclients.Theirprincipal functions are:

i. **Auditing**: They examine the books and records of the entities, obtain reliable,relevant and sufficient audit evidence and then issue a report on the true and fair view of the financial statements. The report issued by the auditor enables users torelyon the financial statements;

ii. **TaxServices**: They engage in tax planning for entities or in dividuals with a view to minimizing their tax payable. Their services are also engaged by government in the investigation of the adequacy of tax paid by entities and individuals**;**

iii. **Management advisory services**: Firms rely on the extensive knowledge of accountants to provide arrange of management consulting services. They could render advice in the area of mergers and acquisition as well as give advice on whether an entity should enter a new line of business or divest.They could also offer advice on assetre place mentpolicy, the best Computer based accounting system to adopt, setting up and operating the accounting system, etc;

iv. **Insolvency Services**: They could act as receiver manager in the process of winding up of entities**;**

v. **Investigation and Forensic Services:** They investigatefraud oranyother matter for which investigation services are required, including the use of forensic accounting. As a forensic accountant, he can investigate specific cases of frauds in an entity and provide evidences at the appropriate government related agencies and court of appropriate jurisdictions.

c) Membersnotin PublicPractice

These are accountants in the employment of government ministries and parastatals or in private entities. Their main functions include the following:

i. They prepare the financial statements and the annual reports of the entity on behalf of management;

ii. They provide relevant management accounting information for decision making;

iii. They set up and run efficient systems of accounting and internal control;

iv. They act as treasury managers; and

v. Theyfunctionastreasuryandfinancialmanagers.

1.9 Role of Accounting in the Economy

A business if efficiently runs, why should it have to go through the stress of accounting procedures in other to provide accounting information? Does it necessary? The following are some of the reasons why accounting information are highly invaluable and inevitable in an economy:

a) It communicates economic measurement and details information on how management uses resources;

b) It indicates where the resources are obtained for the use of business;

c) To measure the performance of the business yearly in terms of profit earned;

d) It is also used to indicate assets and liabilities of the business;

e) It shows the true value (price) or net worth of the business;

f) It facilitates the process of calculating the business tax payable;

g) It keeps the inventory records, and receivable records and registers of items of noncurrent assets; and

h) It indicates how liquid a business is i.e. ability to meet short-term credit obligations.

In an economy, other important roles of Financial Accounting

a) It offers useful information that is necessary for the efficient, economic and effective running of the business. This is to ensure that scares resources, in term of Capital, Land, Labour and Materials are well managed and optimally used;

b) It guarantees that resources placed in trust with the management are well utilized to attain the basic missions, goals and objectives of a business in a transparent and accountable manner;

c) It provides transactions recorded in the Financial Accounting are reasonable, fair and can be relied upon;

d) It gives the basic rules, regulations, conventions, principles ideology and postulates are followed religiously in the preparation of accounts;

e) It supplies necessary information to the tax authorities;

f) It offers information that aids forecasting and planning;

g) It gives information for take-overbids, merger and acquisition;

h) It is useful in providing information in order to measure the performance of management;

i) It offers a guide to proper investment and acquisition decision;

j) Financial Accounting provides information that will facilitate preparation of budget and allocation of resources among the competing alternatives;

k) It enables financial resources to be divide into short and long term; and

l) It measures wear and tear of noncurrent assets and amortization of intangible assets

1.10 Explain the Ethical Issues in Accounting

It may be difficult to explain ethics at this beginning stage of Financial Accounting. However, suffice to mention that the Institute of Chartered Accountants of Nigeria (ICAN) has a Professional Code of Conduct for every member of the Institute. A professional accountants owe certain duties to the public at large and those who employ him/her to carry out external auditing and other accountancy services. The professional assignments may sometimes be contrary with the personal interest of the

Chartered Accountants, at all times, the Professional Codes of ICAN must guide the professional and observe it for continuous membership of the Institute. The members and students of the Institute must comply with Professional Codes of ICAN. The Professional Codes of ICAN are:

a) Integrity;

b) Objectivity;

c) Professional Competence and Due Care;

d) Confidentiality; and

e) Professional Behaviour

Integrity

This implies that all students and members of the Institute must be honest, fair, transparent and straightforward in all professional dealings with the public and clients. A Chartered Accountant or a would-be Chartered Accountant must not attest to false or misleading statements or recklessly omit or suppress information to mislead members of the public at large.

Objectivity

It means that all students and members of the Institute must not be bias or act where there is conflict of interest or allow undue influence of others to override his or professional judgments.

Professional Competence or Due Care

All members of the Institute have a duty to maintain adequate professional knowledge, skills and competence in the discharge of his or her duties to members of the public. The members of the Institute must render his or service to the clients based on competent services, current developments in the field, techniques, legislations and other extant standards.

Confidentiality

The members of the Institute must ascertain confidentiality and secrecy in the use of information provided by the clients in course of his or her professional services. The members of the Institute must not disclose information provided by clients to third parties without authority to do so. The members of the Institute can only disclose information supplied by the clients if he or she has authority under the or has a duty to disclose such information provided by the clients.

Professional Behaviour

Every member of the Institute must strictly comply with all relevant laws and must avoid any behaviour, which discredits the profession in general. He or she must at all times avoid acts unbecoming of a Chartered Accountant to embarrass the Institute. A Chartered Accountant must be courteous, careful and diligent in his or her duty to the clients. He must avoid acts inimical to the overall interest of ICAN.

1.11 Explain the Roles of International Accounting Standards Board (IASB)

The constitution of the IFRS Foundation states that the IASB:

i. Has complete responsibility for alltechnical matters of the Board including the preparation and issuing of International Financial Reporting Standards (IFRSs) (other than Interpretations) and exposure drafts, each of which shall include any

ii. Publishes exposure drafts on all projects and normally publishes a discussion document for public comments on major projects in accordance with procedures approved by the Trustees.

iii. in exceptional circumstances, and only after formally requesting and receiving prior subject to thefollowing:

  a) Consulting the Trustees and the Advisory Council; and

  b) Carrying out a public consultation every three years.

iv. has full discretion over project as signment son technical matters: In organizing the conduct of its work, the IASB may outsource detailed research or other work to national standard-set tersor other organisations.

v. establishes procedures for reviewing comments made within a reasonable period on documents published for comment.

vi.normally forms working groups or other types of specialist advisory groups to give advice on major projects;

vii.consults the Advisory Council on major projects,agend a decisions and work priorities; normally publishes a basis for conclusions with an IFRS or an exposure draft;

viii.considers holding public hearings to discuss proposed standards, although there is no requirement to hold publich earings for every project;

ix.considers undertaking field tests (both in developed countries and in emerging markets) to ensure that proposed standards are practical and workable in all environments, although there is no requirement to under take field tests for every project; and

reasons if it does not follow any of the non-mandatory procedures set out in

(b),(g),(i), (j)and (k).

1.12 The Functions of Relevant Financial Reporting Bodies

1. The IFRS Interpretations Committee (IFRIC)

The constitution of the IFRS foundation states that the IFRIC Interpretation Committee's duties are:

a) Interpreting the application of IFRS and providing timely guidance on financial reporting issues not specifically addressed in IFRSs, in the context of the IASB's Frame work and under taking other tasks at the request of the IASB.

b) In carrying out its work under (a) above, have regard to the IASB's objective of working actively with national standard-setters to bring about convergence of national accounting standards and IFRSs to high quality solution.

c) Publishing after clearance by the IASB draft Interpretations for public comment and consider comments made with in are as on able period before finalisingan Interpretation

d) Reporting to the IASB and obtaining the approval of nine of its members for final Interpretations if there are fewer than sixteen members, or by ten of its members if there are sixteen members.

2. The Financial Reporting Council of Nigeria (FRCN)

The Financial Reporting Council of Nigeria Act gives the FRCN responsibility to:

i. Develop and publish accounting and financial reporting standards to be observed in the preparation of financial statements of public interest entities.

ii. review, promote and enforce compliance with the accounting and financial reporting standards adopted by the Council.

iii. receive notices of non-compliance with approved standards from preparers, users, other third parties or auditors offinancial statements.

iv. receive copies of annual reports and financial statements of public interest entities from preparers within 60 days of the approval of the Board.

v. advise the Federal Government on matters relating to accounting and financial reporting standards.

vi. maintain a register of professional accountants and other professionals engaged in the financial reporting process.

vii. monitor compliance with the reporting requirements specified in the adopted code of corporate governance.

viii.promote compliance with the adopted standards issued by the International Federation of Accountants and International Accounting Standards Board.

ix.monitor and promote education, research and training in the fields of accounting, auditing, financial reporting and corporate governance.

x.Conduct practice reviews of registered professionals.

xi.review financial statement and reports of public interest entities.

xii.enforce compliance with the Ac and the rules of the Council on registered professionals and the affected public interest entities.

xiii.establish such systems, schemes or engage in any relevant activity, either alone or inconjunction with any other organization or agency, whether local or international, for the discharge of its functions.

xiv.receive copies of all qualified reports together with detailed explanations for such qualifications from auditors of the financial statements within a period of 30 days from the date of such qualification and such reports shall not be announced to the public until all accounting issues relating to the reports are resolved by the Council.

xv.adopt and keepup-to-date accounting and financial reporting standards, and ensure consistency between standards issued and the International Financial Reporting Standards.

xvi.specify, in the accounting and financial reporting standards, the minimum requirements for recognition, measurement, presentation and disclosure in annual financial statements, group annual financial statements or other financial reports which every public interest entity shall comply with, in the preparation offinancial statementsand reports.

xvii.develop or adopt and keep up-to-date auditing standards issued by relevant professional bodies and ensure consistency between the standards issued and the auditing standardsand pronouncements of the International Auditing and Assurance Standards Board.

xviii.perform such other functions which in the opinion of the Board are necessary or expedient to ensure the efficient performance of the functions of the Council.

Chapter Summary

In this chapter we have discussed:

- Nature and significance of accounting and book-keeping;
- History of Accounting;
- Objectives of Financial Accounting;
- Purposes of Accounting;
- Qualitative Characteristics of Financial Accounting;
- Coding Principles;
- Accounts and its types;
- Users of Financial Statements and their information needs;
- Range of Accountant's Services to an entity;
- Role of Accounting to the economy;
- Ethical Issues of ICAN;
- Roles of the International Accounting Standard Boards (IASB); and
- Functions of Relevant Financial Reporting Bodies.

Revision Questions

Multiple Choice and Short-Answer Questions

(1) The last phase of book keepingis

a) Extraction of the Trial Balance

b) preparationoffinancialstatements

c) issuingannualreports

d) preparationofsourcedocument

e) Interpretations of accounts

(2) Who reports on the“ true and fair view” of the financial statements?

a) Government agencies

b) Owners of the entity

c) The entity's accountant

d) The Auditor

e) Financial Director

(3) What is the use fullness of the Annual Reports and Accounts?

a) To boost entity's profit

b) For periodic review of entity's performance

c) For daily operations of the entity by management

d) To be able to minimize tax payable by the entity

e) Personnel Management

(4) One of the following is **NOT** an example of business entity

a) Soletrader

b) Partnership

c) Limited liability Company

d) Club or Association

e) Religious Association

(5) One of the following is **NOT** an importance of accounting and book keeping.

a) Book keeping provides permanent records for all financial transactions

b) The records are used by the Inland Revenue for tax assessment.

c) The records can be used to determine the promoters of the organization

d) The assets and liabilities of a business are shown

e) Fraud discovery

6) Which of the following is recorded in the statement of profit or loss?

(a) Revenue

(b) Bad debt

(c) Return inward

(d) Return outward

(e) Depreciation reserve

(7) Which of the following is an indirect user of financial accounting?

(a) Tax Authority

(b) Management

(c) Employee

(d) Lenders

(e) Trade Union

(8) A procedure for accumulating cost is called______

(a) Performance Management

(b) Cost Accounting

(c) Financial Management

(d) Taxation

(e) Financial Accounting

(9) A new branch of accounting which deals with non-governmental accounting is called__

(a) Fiduciary Accounting

(b) Sustainability Accounting

(c) Environmental Accounting

(d) Fund Accounting

(e) Project Accounting

10. A financial statement that is capable of making a difference in the decision made by the users is said to be _____

(a) faithfully represented

(b) relevance

(c) comparable

(d) verifiable

(e) complete

Short Answer Questions (SAQ)

(1) The two main financial statements drawn up by a sole trader are................. and.......................

(2) Which form of accounting provide information needed for the day to day running of a business?

(3) The body responsible for developing International Financial Reporting Standards is the...........................

(4) Financial Accounting is majorly concerned with reporting on ______

(5) An accountant primarily relies on the work of _____ to prepare and analyse financial information.

(6) The first theory of double entry was found in the account of _______

(7) The book titled the Summa De Arithemetical Geometry and Proportion was published in the year______

(8) Financial Accounting was developed in which country?

(9) An acronym GAAP means.

(10) State two (2) main processes involved in double entries.

Practice Questions

1. Define the following

    a) Accounting

    b) Book-keeping

    c) Social and environmental accounting

    d) Forensic accounting

    e) Performance Management

2. Briefly trace the historical development of accounting to the present day.

3. A professional accountant performs many roles for anentity.

4. State and explain the roles of professional accountants to an entity.

5. (a) Explain the qualitative characteristics of Useful Financial Information.

    (b) Explain the functions of each of:

    (i) The IASB

    (ii) The IFRIC

    (iii) The FRCN

Solutionto Multiple Choice Questions (MCQ)

(1)	A	(6)	E
(2)	D	(7)	A
(3)	B	(8)	B
(4)	D	(9)	D
(5)	C	(10)	B

Solutions to Short Answer Questions (SAQ)

1. The statement of profit or loss and statement of financial position
2. Performance Management
3. International Accounting Standards Board (IASB)

4. Performance and Position of an entity
5. Book-Keeper
6. Commune of Genoa
7. 1494
8. Italy
9. Generally Accepted Accounting Principles
10. - Recording of transactions in the source documents
    - Posting into subsidiary records
    - Ledger posting
    - Trial balance extraction

CHAPTER TWO
FORMS AND STRUCTURES OF BUSINESS ENTITIES

Chapter Two Contents

- Types and features of business entities
- Regisration process and documentation of business entities
- Advantages and disadvantages of various business entities
- Public sector entities

2.0 Learning Objectives

After studying this chapter,readers should be able to:

- Define the characteristics of business entities.
- State the registration process and documentation of business entities.
- State the characteristics of sole proprietorship, partnership and Limited Liability Company.
- Compare sole proprietorship, partnership and Limited Liability Company.
- State the characteristics, advantages and disadvantages of public sector entities.

Forms of Entities

There are two major types of entities, these are:

a) Business entities

b) Not-for-profit entities

Business

Business is defined as the activity of buying and selling commodities, products, or services; the amount or volume of this activity; and the variety of this activity in which a person is engaged.Business, however, is defined in ICAN Financial Accounting Study text is used in different contexts: It is used to describe:

- An economic system where goods and services are exchanged for one another or for money;
- A commercial entity that aims to make a profit from its operations; and
- An integrated set of activities and an asset that is capable of being conducted and managed for the purpose of providing are turn to investors or other owners.

Characteristics of Business

The following are some of the characteristics of business:

c) It exists to make profits;
d) It makes profit by supplying goods or services toothers(customers);
e) It supplies goods that it either makes or buys from other parties; and
f) Its reward for accepting risk is profit
g) The profit earned by it belongs to its owners (sole proprietor, partners or shareholders).

Types of Business entities

There are three sub-types of Business Entities. They are:

h) Sole Proprietorship
i) Partnership
j) Limited Liability Companies

Sole-proprietorship

It is a business owned by an individual. This individual bears there sponsibility for running the business and heal one takes the profits or loss.The sole-proprietorship is not regulated by special rules of law.

Advantages of Sole-proprietorship

(a) The individual provides the capital and employs ahandful of people, if and when necessary.
(b) He takes decisions quickly without consulting any body.
(c) He is highly committed because the profit is entirely his own incase of success and he depends on the business for his livelihood.
(d) There is privacy
(e) It is not regulated by special rules of law.

Disadvantages of Sole-proprietorship

(a) The finance available for expansionis limited to that which the sole trader can raise.
(b) The ownerhasun limited liability because all his assets might be seizedifth business goes bankrupt.
(c) It lacks continuity because the death of the owner automatically leads to the collapse of the business.

Sole-proprietorship is common in retailing, farming, personal services such as hair dressing, fashion designing etc.

Partnership

(f) PartnershipFormation

Partnership is the relationship which exists between two or more persons, commonly referred to as partners, carrying on a business in common with a view to making profit. The business may also result in a loss although the purpose is that of profit. Their coming together is voluntary and the exit of a partner may also bevoluntary.

The Partnership Act 1890 and the Limited Partnership Act 1907 contain the provisions which govern the relationship between persons carrying on a business with the intention of making profit.

The maximum number of partners in a firm is twenty.There is no maximum limit for professional firms such as accountants and solicitors who have received the approval of the law for this purpose A firm with more than twenty members would normally be incorporated as a Limited Liability Company.

Most partnerships are form edundera for malagreement. In the absence of anagreement, the Partnership Act 1890 provides amongo ther things, that:

A. All profits and losses are to be shared equally between the partners

B. No interest is allowed on capital and current accounts.

C. Noremuneration will be paid to a partner.

D. Any advance or loan made by a partner in excess of his agreed share of capital will attract interestat 5% per annum.

An agreement is most important, if it is intended that partners should be rewarded according to their differing contributions made to the firm inform of capital, expertise, experience or effort. Resulting from this, an agreement would necessarily contain provisions regarding the following, to ensure as far as possible, that there is an equitable distribution of profits or losses.

(a) The amount of capital to be provided and maintained by each Partner.

(b) The rate of interest (if any) to be paid on capital.

(c) The extent to which drawings are allowed and the rate of interest (ifany) to be charged on drawings.

(d) The remuneration ifany) to be paid to partners for their services.

(e) The interest to be paid on any advance or loan made to the firm by apartner over and above his agreed capital.

(f) The proportions in which profits or losses are to be share dafter taking account of any adjustments as a result of the above.

Decisions regarding the distribution of profits can be quite interesting in practice due to the search for an equitable relationship among partners. If all partners provide equally in all respects, an equal distribution of profits might adequately represente a chpartner's interest. But in case of differ in gamounts of capital,while all other contributions to the firm are equal, the varied amounts of capital would usually be compensated for by allowing interest on capital at an agreed partners'rate'.In this way, each partner would be given a return on his capital before distribution of the remaining profit. Differences in partners' contributions in the formof expertise, experience or effort could be compensated with salaries and/or differential distribution of profits.

The problems in herentin determining a just and equitable distribution of profits are not usually a concern of examination candidates. A question will normally indicate:

(a) Whether salaries are to be paid.

(b) Whether interest is to be allowed on capital

(c) Whether interest is to be charged on drawings, and

(d) How the remaining profit should be distributed.

Candidates'problems are usually technical, arithmetical and presentational.

Fixed or flexible capital accounts

A partnership will of tenmainta in affixed **amount of capital.** Under these circumstances, it is preferable that only an agreed capital ratio should be credited to as separate capital account for each partner. All of her transactions involving partners such as share of profits, interest, salary, drawings, should be dealt within their current accounts rather than through the capital accounts.It is simple in this way to keep a constant check on the current accounts; provided a partner's Current Account is not over drawn, the agreed capital at least must remain with the firm. Of course, profits (or losses) are accruing over the whole of they ear, and not just when the final accounts are prepared. It follow there fore that an over drawn current account is not necessarily an indication that a partner is not maintaining his agreed capital.It is up to the partners to agree on the extent to which drawings areallowedandwhetherthedrawingsmay exceed the current account balance at the beginning of the year.

(b) PartnershipAgreements

Since the essence of partnership is mutual agreement, it is desirable for the partners to come to some understanding before entering into partnership as to the conditions upon which the businessis to be carried on and the irrespective rights and powers.

The Partnership Act 1890 provides certain rules to be observed in the absence of any agreement. How ever, the circumstances must determine whether these rules are applicable in the particul arcaseands in e many matters should be decided which are not included in these rules, it is important that a formal agreement been tered in to with a view to preventing disputes in the future.The advantages of written agreements need no emphasis and it is preferable that it should be under seal, since the character of a deed precludes contradiction by any party of the terms which have been agreed.

Even where a formal agreement is made, it doesnotpreclude subsequent variation where changing circumstances demand it; such variation an always be

Effected with the consent of all the partners, which may be evidenced by an amended agreement.

New amendments and current development in the partnership business can be referenced in the Finance Act 2021.

Contents of Partnership Agreements

The provisions affecting partnership accounts are as follow:

(a) **Capital Contribution:** The agreement states whether each partner should contribute a fixed or a flexible amount.

(b) **Division of Profits or Losses:**The basis as to how profits and losses shall be shared among the partners.

(c) **Fixed or Flexible Capital:** Whether the Capital Accounts are to be Fixed Account, or a wings and profits are to be adjusted in the current accounts, or in the capital accounts.

(d) **Intereston Capital and/orDrawings:** Whether interest on capital and/or Drawings are to be allowed or charged before arriving at the profits divisible in the agreed proportions, and if so, at what rate.

(e) **CurrentAccounts:** Whether current accounts (if any) are to be a rinterest, and if so, at what rate.

(f) **Partners'Drawings:** Whether partners' drawings are to be limited in amount in order to prevent an egative balance against the capital account,and/or whether rinterests are to be charged on drawings and at what rate.

(g) **Partners' Remuneration:** Whether partners are to be allowed remuneration for their services before arriving at divisible profits, and if so, the amount of there muneration.

(h) **Accounting Records:** Proper accounts shall be prepared at least once a year and that these shall be audited by a professional accountant and signed by all the partners.

(i) **SignedAccounts:** The accounts, when prepared and duly signed, shall be binding on the partners, bu shall be capable of being reopened within a specified period on an error being discovered.

(j) **Valuation of Good will:** The method by which the value of Good will shall be determined in the event of admission, retirement or death of any of the partners.

(k) **Compensation to the Estate of Deceased Partner:** The method of determining the amount due to the estate of a deceased partner and the manner in which the liability is to be paid with in a specified period , by instalments of certain proportions and therate of interest to be allowed on outstanding balances.

(l) **Insurance Premiums:** Where there are partnership insurance policies, the division of the policy among partners and the method of treating the premiums the re on must be stated.

2.4.5 Comparing Partnership with sole proprietorship

The main advantages of partnership oversole-proprietorshipare:

(a) Greater finance is to partnership than to sole proprietorship

(b) Higher performance may be achieved by the partnerships than the sole proprietorships’ since two heads are better than one.

(c) Decision-making is also swifts in copartners are friends and they are not many, though may not be as fast as in sole proprietorships’

(d) Decision made in partnerships are more efficient and effective than decisions made in sole proprietorships

The disadvantages are:

(a) The major disadvantage is tha the liability of members of the partnership is unlimited.

(b) The amount of capital the partner’s canraise may still not been ough to enable them carryout large investments.

(c) The death and bankruptcy of apartner may lead to the dissolution of the entity. There is no perpetual succession.

(d) Disagreement may occur between the partners.They may find out that they are not compatible which may lead to the dissolution of the partnership.

2.4.6 LimitedLiabilityCompany

Nature, for mationand statutorybooksof Limited LiabilityCompanies

What is a company?
A company is a productive unit formed by a number of people usually refers to as shareholderswith the ultimate objective of exploiting a given economic activity to the maximum.

A limited liability company is a form of business entity that has a personality distinct from those of its owners. The attraction of this form of business enterprise is its access to capital larger than what its promoters can provide.Because of its distinct legal personality, it can sue and be sued in its name and enterin to contracts for which it is solely liable.

ClassificationofCompanies

Generally, a company may be either a **private** company or a **public** company.it maybe:

- A company limited by shares
- A company limited by guarantee
- Anunl limited company

Private Company

A private company is one that is stated to be so by its Memorandum of Association and has the following features:

(g) Its Articles of Association must restrict the transfer of its shares

(h) The total number of members must not be more than 50, excluding persons who are employees of the company, existing or retired. However, where two or more persons hold one or more shares jointly, they shall be treated as a single member.

(i) It cannot invite the public to deposit money for fixed periods or payable atc all whether or not they bear interest.

Public Company

Any Company other than a private company is apublic company and its Memorandum of Association must so state that it is a public company.

Companies derive their existence under the provisions of the Companies and Allied Matters Act, Cap.C20LFN2004. The rules and procedures guiding the incorporation or formation of limited liability or unlimited liability companies are

contained in Sections 18 – 49 of the Companies and Allied Matters Act, Cap. C 20LFN2004.

Advantages and disadvantages of Limited Liability Company

Advantages

(a) The liability of the shareholders is limited to the amount they have subscribed to the company's capital if it goes bankrupt.

(b) It can raises substantial amount of capital from the numerous shareholders or from financial institutions.

(c) The chance of survival is high be cause the company is controlled and managed by highly skilled professional management team appointed by the Board of Directors who are elected by and answerable to the shareholders.

(d) The limited company is a separate legal entity distinct from its members.It cansueand besued in its name.

(e) Unless it is wound up, a limited company has perpetual succession so that it is not affected by the death,bankruptcy ,mental disorder or retirement of its members.

(f) Floating charges can be created by a limited company.

(g) Shares in a public company can be transferred without the consent of other members.

Disadvantages

- Formation of limited liability company requires costly legal expenses
- Decision making may be delayed due to bureaucratic bottle necks.
- The members of the company have no power to manage its affairs.
- Much legal and publicity form a lities are observede.e.g. Filing of annual returns, annual general meeting, etc.
- Much of its activities are open to public scrutiny.'

Formation Procedure

(a) The name proposed by the promoter of accompany has to be'searched for' and approved by the Corporate Affairs Commission ,which must be utilized within 60 Days, other wise the name has to be revalidated.

This is to ensure that the entity's proposed name does not be arresemblance of already existing names and does not cause confusion.'

(b) A limited liability company,privateorpublic,may be brought into existence when the documents enumerated below and appropriate feesare paid to the Registrar, Corporate Affairs Commission:

(i) A Memorandum of Association signed by at leas ttwo subscribers, dated and witnessed by a Chartered Accountant, Chartered Secretary'or'a Lawyer facilitating the registration of the Company.Each subscriber must agree to subscribe for at least one share.

(ii) A minimum of 25% of the authorized share capital must be taken up at incorporation.

(iii) Articles of Association will be similarly signed, dated and witnessed bytheProfessionalsinvolvedintheregistrationoftheCompanyasmentioneda bove.

(iv) A statement of nominal capital (unless the company is to have no share capital) must be stated. Stamp duty varying with the amount of authorized share capita lis payable.

(v) There is no upper limit to the amount of the authorized share capital, although the minimumis currently ₦10,000 for a private company while that of a public limited liability company is N500,000 (except in cases of special companies such as ,banks and insurance companies).

(vi) A statutory declaration by a solicitor engaged in the formation of the company or by one of the persons named as directors or secretary that there quirements of the Companies and Allied Matters Act 2004 in respect of registration have been complied with.

(vii) A statement (in the prescribed form) of the particulars of the first directors and secretary and the first address of the company's

Registered office.The persons named as directors and secretary must sign the form to record their consent to act in the relevant capacity and when the company is incorporated; these persons are automatically appointed.

(c) When the Registrar General, Corporate Affairs Commission is satisfied that all the documents are in order and that the objects specified in the memorandum are lawful, he issues a certificate of incorporation.

(d) The purpose of the memorandum and articles of association is to define the constitution of the company.The memorandum sets out basic elements of the constitution while the articles are mainly internal rules, but of interest to outsiders since they define the powers of the directors to enter into contracts on behalf of the company. The memorandum prevails if there is any in consistency between it and the articles.

(e) A private company may do business and exercise its borrowing powers from the date of its incorporation but a public company (incorporated as such) may not do business or borrow until it has obtained a trading certificate (not a statutory expression) from the Registrar General.

(f) The memorandum of every company limited by shares must include:

(i) The company's name, which if the companyis limited by shares or by guarantee, should end with the word 'limited'. A limited company may in some circumstances omit the word "limited"from its name Anunal limited company does not endits name with the word"Limited".

(ii) The country (not the address) in which the company's registered office is to be situated. This determines sthe nationality and the place of domicile of the company which can not be changed.

(iii) The objects of the company contained in an "objects clause" which, because of the developments of company law overtime, specifying

both alternative business activities and express powers to engage in every kind of business which the company might wish to undertake.The objects stated in the opening paragraphs are treated as"main objects'' while the others are ancillary to them, unless the contrary isstated.

(iv) The liability of members: If the company is one limited by guarantee, this is followed by as econdclause, which states the maximum amount that each member undertakes to contribute in winding-up to enable the company pay sits debts. The authorized share capital (of a company limited by shares) must disclose the amount of the share capital with which the company proposes to be registered and specify shares of stated value into which that amount is divided.For example,the share capital of the company of ₦100,000 may be divided into 200,000 shares of 50k each. The amount of the authorized share capital may be increased (or reduced) in the manner provided by the articles, usually by passing an ordinary resolution. The authorized share capital is the maximum amount in shares which the company may issue.

(g) The articles of association deal mainly with the internal conduct of the company's affairs, e.g. the issue and transfer of its shares, alterations of its capital structure, conduct of general meetings, members voting rights, powers of directors and board meetings, dividends, accounts and notices.

(h) The articles of ssociation usually delegate the power to allot and issue shares to the directors as one of the irmanagement functions. The formal procedure is that the subscribe rapplies for shares (of tenin response to an invitation by the company) and the directors accept is offer by deciding at a board meeting to allot shares to him. His name is entered in the register of members, as hare certificate is issued and within one month of allotment, a return is submitted to the Registrar General.

Statutory Books

Statutory books are the official records kept by the company relating to all legal and statutory matters. The statutory books of the company must be maintained and kept at the company’s registered office (or alternative location notified to the Corporate Affairs Commission) where they can be inspected. The list of the registers and documents which every company is required under the CAMA to keep include:

k) The register of the company’s members,
l) The Index of members where they are more than 50,
m) The register of charges registered against the company;
n) Minutes Book (of all General meetings, Directors’ meetings and Manager’s meetings (ifany) including copies of shareholders’ resolutions passed,
o) Register of Directors’shares’ and Debentures
p) The register of directors and secretaries,
q) The register of interestin shares
r) The Accounting Records
s) Director’s service contracts

The essence of maintaining these statutory books is to offer members of the company or any other person an opportunity to inspect the records of the company and be aware of its state of affairs.

(a) Redeemable Preference Shares

Under section 122 and 158 of the Companies and Allied Matters Act CapC20LFN2004, accompany so authorized by its articles may issuere deemable preference shares, provided that:

(i) Thereareinissueothershareswhicharenotredeemable.

(ii) The redeemable shares may not be redeemed unless they are fully paid.

(iii) The terms of redemption provide for the company to make payment at the time shares are redeemed. The redemption may be affected on such terms and in such manner as may be provided by the articles as long as the provisions of the Act are complied with.

(iv) Redemption is made out of the:

- Distributable profits of the company
- Proceeds of a fresh issue of shares made for the purposes of the redemption.

(v) Any premium payable on redemption is payable out of the company's distributable profits, except: the premium payable on the redemption of redeemable preference shares which were issued before the appointed day may be paid out of the share premium account or partly out of the distributable profits (section 158(4) of the Companies and Allied Matters Act, Cap. C20,LFN2004).

(vi) Where the redemption is made out of the proceeds of a fresh issue of shares made for the purpose of the redemptionand the shares to beredeemed were originally issued at a premium, any premium payable on the irredemption shall be paid out of the share premium account up to anamount equal to the lower of:

- the aggregate of the premium received by the company on the issue of the shares redeemed, or
- the current amount of the company's share premium account (including any sum transferred to that account in respect of premiumon the new shares).

(b) Participating Preference Shares

Where specific provisionis made in the articles, preference shares may be participating preference shares.This type of shares entitles the holders to share in any remaining profits after the preference shares and ordinary shares have received specified dividends.

(c) Ordinary shares

The ordinary share capital of a company is often termed the ''equity capital''. Ordinary shares may be divided into preferred and deferred ordinary shares, in which case the balance of the profit is shared between the two types of ordinary shares in some prescribed

Proportions.

Not for Profit Entities

Not-for-profit entities are entitiesthat do not have profit maximisation as their main objectives. Decision making in Not-for-profit entities is not based on cost-benefit analysis. A goal can still be pursued even where the cost out-weighed the benefits provided such goal will add value to the intended beneficiaries. Their performances are usually not measured in terms of return on investment. Not-for-profit entities can be sub-divided into two groups as follows:

a) Governmental entities

b) Non-governmental entities

Governmental Entities

Governmental entities are also called Public Sector Entities.They are the Local, State and Federal Governments as well as their Ministries, Departments and Agencies generally called (MDAs).

Among the agencies of government are Public Corporations. These are special government entities that are runon similar basis as Private Sector Businesses.The government provides the capital for the entity.The Minister/Commissioner acting on behalf of the Federal/State government appoints the members of the Board who in turn formulate policies with in the enabling Act establishing the Corporation and the framework. Examples of public corporations are Ghana Airways, the Nigerian Railway Corporation, the Nigerian Ports Authority and the Nigerian National Petroleum Corporation (NNPC).

Characteristics of Public Sector Entities

The following are the key characteristics of Public Sectorentities:

i) The requirement for public accountability by the operators

ii) They have multiple objectives

iii) The rights, powers and responsibilities of the entities are derived from the constitution or the law setting them up

iv) There is no equity ownership

v) Their operating and financial frame works are set by legislation

vi) Budget is very important

vii) By their nature, profit maximization is not a major objective

Non-Governmental Entities (NGOs)

These are usually described as (NGOs). They include religious, charitable, social entities, etc. Since the source of their funding is mainly from the public, the characteristics of NGOs are akin to that of public sector entities.

Advantages of Governmental Entities

(a) Some activities such as the generation of electricity, provision of port facilities and rail transport services involve huge financial out lays which the private entrepreneurs can not provide. These facilities must be provided to quicken the pace of economic evelopment and industrial growth.

(b) It enables some natural resources, especially minerals to be efficiently exploited and effectively managed.

(c) Some essential goods or services if left in the hands of private businesses may not be provided insufficient quantities or may be provided at exorbitant prices.Thus, the common people will not be able to afford them and this may worsen their standard of living.

(d) The public company can borrow money externally by issuing bonds or Loan Notes. This is not possible for the private sector entities.

Disadvantages of Governmental Entities

- The major disadvantage of public sector enterprises is that members of the Board are political appointees who control and manage the corporation.Often times, they do not possess the relevant skills to manage such organisations efficiently. Some members of staf are appointed on political grounds and quota basis, resulting in low productivity.

- The performance of public sector entities is poor when compared with the private sector entities. Most of the public sector entities are being run at a loss as the motive for establishing them is not for profit.

- They receive subventions from the government with out commensurate service to the people.

Chapter Summary

In this Chapter, we have discussed:

- The forms of entities and their conceptual definitions.
- The characteristic of the entities.
- Formation, advantages and disadvantages of the entities.

Multiple Choice Questions (MCQ)

1. The maximum number of partners in a professional firm such a solicitors an accountants is
   A. Five
   B. Unlimited
   C. Between Ten and Twenty
   D. Between Twenty and Thirty
   E. Fifty
2. In the absence of apartnership deed
   A. Partners'remunerationis 5% of profit
   B. Noremuneration will be paid to apartner
   C. Remuneration will be paid equally to all the partners
   D. Remuneration will be paid net of tax
   E. Partners'remunerationis 10% of profit.
3. The minimum authorized capital of a public limited liability companyis
   A. ₦10,000
   B. ₦25,000
   C. ₦500,000

D. ₦1,000,000

E ₦50, 000

4. The body charged with the responsibility of incorporation of limited liability companies in Nigeriais

   A. The Central Bank of Nigeria

   B. The Federal Ministry of Finance

   C. The Ministry of Foreign Affairs

   D. Corporate Affairs Commission

   E. Security and Exchange Commission

5. The underlisted are forms of Loan Notes **EXCEPT**

   A. Secured

   B. Bearer

   C. Preference

   D. Redeemable

   E. Naked

6. One of the following is NOT a form of business entity.

   A. Sole Proprietorship

   B. Partnership

   C. Limited Liability Companies

   D. Private Companies

   E. Quasi-Companies

7. ONE of the following is not among the Partnership Act 1890 provision when there is no agreement in a partnership business:

   A. All profits and losses are to be shared equally between the partners

   B. No interest is allowed on capital and current accounts.

   C. No remuneration will be paid to apartner.

   D. Any advance or loan made by a partner in excess of his agreed share ofcapitalwillattract interestat 5%perannum.

E. Profit should be retained in the books.

2.10 Short Answer Questions (SAQ)

1. Identify two sources of capital available to a public limited company.
2. A company that has no share capital is describedas…………….
3. Undistributed profits accumulated ove they ears by a limited liability company are referred to as……………
4. The major advantage of limited liability company over partnership is……….
5. The major disadvantage of public enterpriseis……………

2.11 Solution to Multiple Choice Questions

1. B
2. B
3. C
4. D
5. C
6. E
7. E

2.12 Solution to Short Answer Questions (SAQ)

1. Issue of shares and loan notes
2. Limited by guarantee
3. Reserves
4. The liability of members of the company is limited to the amount unpaid on their shares.
5. Political influence.

2.13 Examination like questions with solutions

1. a) Explain any three characteristics of a business.

   b) Describe two key features each of sole proprietorship, partnership and Limited Company.

2. Enumerate the advantages and disadvantages of Limited Liability Companies.

2.14 Solutions to examination like questions

1. Characteristics of Business

a) The following are some of the characteristics of business:

i. It exists to make profits

ii. It makes profit by supplying goods or services to others (customers)

iii. It supplies goods that it either makes or buys from other parties

iv. Its reward for accepting risk is profit

v. The profit earned by it belongs to its owners (sole proprietor, partners or shareholders).

b. Two key features of **Sole-proprietorship**

- It is a business owned by an individual.
- He bears the responsibility for running the business and he alone takes the profits or loss.
- The sole-proprietorship is not regulated by special rules of law

Partnership Formation

- Partnership is the relationship which exists between two or more persons, commonly referred to as partners, carrying on a business in common with a view to making profit.
- Most partnerships are formed under a formal agreement. In the absence of an agreement, the Partnership Act 1890 provides among other things, that:
- All profits and losses are to be shared equally between the partners
- No interest is allowed on capital and current accounts.
- No remuneration will be paid to a partner.

- Any advance or loan made by a partner in excess of his agreed share of capital will attract interest at 5% per annum agreement is most important, if it is intended that partners should be rewarded according to their differing contributions made to the firm in form of capital, expertise, experience or effort. Resulting from this, an agreement would necessarily contain provisions regarding the following, to ensure as far as possible, that there is an equitable distribution of profits or losses. The amount of capital to be provided and maintained by each Partner.
- The rate of interest (if any) to be paid on capital.
- The extent to which drawings are allowed and the rate of interest (if any) to be charged on drawings.
- The remuneration (if any) to be paid to partners for their services.
- The interest to be paid on any advance or loan made to the firm by a partner over and above his agreed capital.
- The proportions in which profits or losses are to be shared after taking account of any adjustments as a result of the above.

2. Advantages and disadvantages of Limited LiabilityCompany

Advantages

The liability of the shareholders is limited other amount they have subscribed to the company's capital if it goes bankrupt.

- It can raise substantial amount of capital from the numerous shareholders or from financial institutions.
- The chance of survivalis high because the company is controlled and managed by highly skilled professional management team appointed by the Board of Directors who are elected by and answerable to the shareholders.
- The limited company is a separate legal entity distinct from its members.It cansueand be sued in its name.
- Unless it is wound up, a limited company has perpetual succession so that it is not affected by the death, bank ruptcy, mental disorderorretirement of its members.
- Floating charges can be created by a limited company.
- Shares in a public company can be transferred without the consent of other members.

Disadvantages

- Formation of limitedliability company requires costly legal expenses
- Decision making may be delayed due to bureaucratic bot tlenecks.
- The members of the company have no power to manage its affairs.
- Much legal and publicity formalities are observed e.g. Filing of fannual returns, annual general meeting, etc.
- Much of its activities are open to public scrutiny.’

2.15. Examination like questions without solutions

1. What are the divergences between a sole proprietorship and a partnership?

2. Explain in detail the procedure of Company formation.

CHAPTER THREE
ACCOUNTING CONCEPTS AND CONVENTIONS

Chapter Three Contents

- Accounting concepts
- Accounting convention

Learning Objectives

At the end of this chapter candidates should be able to:

- *Identify and explain the relevance of accounting concepts;*
- *Explain various accounting concepts underlying preparation of financial statements;*
- *Explain off setting; and*
- *Explain relevance and faithful representation*

3.1 Accounting Concepts

In preparing a Generabl Purpose Financial Statement, the IASB's conceptual framework prescribes that an entity is required to apply accounting concepts and conventions in IAS 1. A General Purpose Financial Statement is one in which it is intended to meet the expectations of users who are not opportune to ask for .reports tailored in the order of their needs, General purpose financial statements are prepared under certain assumptions generally regarded as concepts and conventions.

Concepts and Conventions Compared

Concepts, principles, conventions, laws, rules and regulations combined are known as Generally Accepted Accounting Principles (GAAP).GAAP varies from country to country but with the adoption of International Financial Reporting Standards (IFRSs) by many countries, the variations are greatly reduced to the extents of accommodating local extant rules affecting the preparation of financial statements. These local rules include but not limited to the Companies and Allied Matter Act as amended to date, Securities and Exchange and Stock Exchange Acts etcetera.Nigeria is one of the countries that have adopted (IFRSs).The concepts and conventions as described inconceptual framework and international Accounting Standard number(I) (IAS1)are discussed below:

3.2 GoingConcernConcept

Unless otherwise stated, it is always assumed that busines sentity will continue in operation for the fore seeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or curtailing significantly the scale of its operation. In order words, the life of a business entity is indefinite and it operates in perpetuity.

The going concern concept will help investors, payables, employees, customers and other stakeholders to determine the extent to which they want to continueto patronize the business. Not only that, it assists long and short-term suppliers of credits to have assurances that their credits would be repaid as well as guaranteeing job security and salaries and wages of employees. The going concern concept may be more justified in a limited liability companywhere the death or withdrawal of any member (shareholder) may not affect its scale of operation.

Assets and liabilities of a going concern entity are generally valued on historical cost basis, or fair value basis.

3.3 Money Measurement Concept

Money serves as the commonde nomin at or for measuring the various assets and liabilities of an entity, therefore, accounting transactions are expressed in monetary values. The Naira and the Cedi represents a unit of value which has the ability to common and goods and services in Nigeria and Ghana respectively. Apart from the fact that money serves as a common unit, accountants also believe that it is stable in value.

There are some limitations in the use of money as measure of value in accounting. These include:

(a) The value of money does not always remain table particularly in an inflationary economy.

(b) Apart from inflation, the time value of money today is greater than the time value of money in any future time. This affects the cost of funds.

There are some activities of an entity that are not recorded because monetary value can not be attached to them. Examples are good management, employees'morale, an entity's comparative advantages, etc.

(c) However, accounting does not provide all the information about a firm, it provides only economic information that can be expressed in monetary terms. We may then understand why limited liability companies are now being required to disclose a lot of non-accounting information in their annual reports and accounts.

3.4 Consistency

Usually there is more than one way of treating an item in the accounts without going against any accounting principle Consistency concept requires that when a method has been adopted in treating an item in the financial statements, the method should not be changed but used consistently from period to period. For instance, there are many methods of depreciating non-current asset such as straight line, reducing balance, sum of the digits methods. If a straight line metho is chosen to depreciate buildings in year one,the company should continue to depreciate buildings on straight line basis from year to year. This method should not be changed unless there are compelling reasons. In other words, if First-in-First-out (FIFO) is chosen value inventory under IAS 2 in a year instead of Weighted Average Cost, it is suggestive that FIFO should be consistently engaged over year before an entity can consider a change to a new method.

The essence of this principle is to make it easy for users of financial statements to compare the results of one period to another. Constant change in method will distort profits and make comparison difficult. However, occasionally there may be justification to change from one method to another. If the change is made, adequate disclosure must be made about the nature of the change and the effect of the change on profits.

3.5 Prudence Concept

The prudence concept requires that an accountant should not recognize income until the for all known losses. The essence of the principle is that profits and assets are not over stated, expenses and liabilities are not understated in the financial statements in any accounting period. In a nut shell, prudence means the preparer of financial statements should exercise caution in making decisions under conditions of uncertainty.

The prudence concept is most useful when matters of judgement or estimates are involved. For instance, if the credit policy of a business requires a customer to pay for the goods sold to him within 60 days and he has not paid after 120 days, it may be reasonable to make allowance for the entire amount as irrecoverable and doubt fuldebt. Another example is when inventories becom obsolete and its netrealizable value falls below cost, the difference between the cost and the net realizable value should be written off to the statement of profit or loss.

Failure to write fore see able losses off or the recognition of unrealized income will producea misleading result which may lead to payment of taxes or distributions that should not have been made.

3.6 Materiality and Aggregation

Any accounting information that affects users' decision about are porting entity's performance when such information is omitted or misstated is regarded as material. The principle of materiality holds that financial statements should separately disclose items which are significant enough to affecte valuation or decisions. It refers to the relative importance of an item in the financial statements. Therefore some level of judgement may be required to determine an item that is material to an entity in the financial statement. In other words, what is material to a sole trader may be immaterial to a large company.

The nature, amount (value) and size of a business (in terms of capital employed) will generally be considered in determining the materiality of an item of cost. For instance, stapler, perforator, waste basket are expected to be used for more than one period, so that their costs should be measured over the period of use. How ever, because of the insignificant amounts involved, the concept of materiality permits the immediate write off of these costs as expenses.

3.7 Accrual/Matching Concept

This can be called either accrual or matching concept. The accrual concept states that in come should be recognized when they are earned and not when they are received in cash. Expenses should also be recorded when they are incurred and not when paid. The application of this concept gives rise to prepayments and accrued expenses (accrual).An accrued expense occurs when it has been incurred but has not been paid for in the accounting period. Prepaid expenses occur when payment has been made for services but benefits have not been derived from the payments made during the accounting year. They give rise to liabilities and assets respectively. Prepaid expenses and outstanding receivables are current assets (payable within a financial year) while income received in advance and outstanding payables are current liabilities of the business payable within a financial year.

All expenses due but not yet paid should be added (debited) to the expenses paid inorder todetermine the total expenses for the period and this will be treated as a credit entry, which is an item of current liability in the Statement of Financial Position. All expenses prepaid should be excluded ordeducted (i.e. credited to expense) in the statement of profit or loss. This is debited as an expense receivable, which is an item of current asset in the Statement of Financial Position. All income due and receivable should form part of the income for the period. While all income received in advance should be excluded, which means it is debited to revenue account and credited as an item of current liability in the Statement of Financial Position.

The concept also holds that for any accounting period, the earned revenue should be matched with the cost that earned them. If revenue is deferred from one period to another, all elements of cost relating to them should also be carried forward accordingly. The concept is important in measuring the cost of goods sold or services rendered in a period. It is also useful in determining when the cost of an item becomes expenses (that is expired cost).This conceptis applied to products where the costs can be related directly to them. It is applied in relation to time period where the cost incurred can not be related to the product. For instance, if a trader bought 50 pairs of shoes for ₦50,000 and sold 35 pairs for ₦70,000 at the end of a period. The cost of goods sold would be measured on the 35 pairs sold. That is 35/50x₦50,000 =₦35,000.₦15,000 would be deferred to the nex period Some costs that can not be related to specific transactions are depreciation,electricity bill, insurance cost etc. When this concept is not properly applied profits are either over stated or understated.

3.8 Objectivity/FairnessConcept

Objectivity concept holds that financial statements should not be influenced by personal bias of the management. The use of historical cost for asset valuation is an attempt to beobjective, because it can be backed up by vouchers, invoices, cheques, bills etc. A change in the value of an asset should therefore be recognized when it can be measured in objective terms and such valuation is premised on the report of an independent professional valuer.

Objectivity,is useful in accounting in the following ways:

(a) Auditing is made possible

(b) Accounting data are standardized.

(c) Fraud and falsification of accounts are minimized.

(d) Data is available for an independent party to cross-check.

In spite of the goals of objectivity concept some personal opinions and judgement are brought into accounting information in a few instances. For instance, estimates are required to determine the useful life of a non-current asset and the net realizable value of inventories or the allowance to be made for irrecoverable and doubtfuldebts. However, figures used infinancial statements should rely as little as possible on estimates or subjectivity.

3.9 Historical Cost Convention

Historical cost is the amount of cash or cash equivalent paid or the fair value of the considerations given to acquire an item Property, Plant and Equipment (PPE) collectively called noncurrent assets. It may also include the amount of cash or cash equivalents given to acquire inventory of goods meant for resale.In this vein, liabilities are recorded at the amount of proceeds received in exchange for an obligation. The justification for the historical cost principle is its objectivity; that is, the cost can be traced to the source documents (receipts, invoices, payment vouchers etc.) Whereas,other measures of value, for examples, fair value or valuation of noncurrent assets, basis of selecting straight line method of depreciation, reducing balance method, output method or sinking fund method would be based on the subjective judgement or factors not measurable by management. Themain criticism against the historical cost concept is that, with the passage of time, costwould no more represent the fair value of an item of Property, Plant and Equipment (PPE). For instance, the value of a building constructed ten years ago might have appreciated considerably over the period. In periods of inflation, the use of historical cost instead off airvalues, normally lead to de-recognition of “holding gain” or “revaluation surplus” because cost would significantly understate the value of there sources being consumed. Hence, the IASB has prescribed the use of fair value as an alternative. However, if not effectively managed; recognizing holding gain or revaluation surplus may lead to the distribution of the unearned profits that would have been retained in the business for further expansion.

3.10 Fair Value Basis

Fair value is the price that would be received from knowledgeable parties at arm’s length transaction to sell an item of Property, Plant and Equipment (PPE) or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Thebasis for determining fair value is arm’s length transaction, that is, transaction thatinvolvesdealingwith unrelated orunknown knowledgeable parties in a market where buyers are fully aware of all necessary information.

3.11 Periodicity concept

The assumed life span of a business is usually subdivided into smaller periods of twelve months (one year). This enables an entity’s operations to be subjected to periodic reviewto determine the financial performance and position of the entity.It also empowers the management to make periodic distributions to the owners. The periodic review would also help to assess management efficiency and the planning and control of future operations.

3.12 Off setting

In accounting, offsetting refers to accounting entries necessary to reduce or negate the balance of another account that it is paired with. It is otherwise referred to as a contra- entry. For an example, an opening debit balance of ₵100,000 in the trade receivable account could be offset with an opening balance of ₵100,000 in the trade payable account. In other words, an asset account could be used to offset a liability account.

3.13 Relevance and Faithful Representations

a) Relevance

An accounting information is relevant if its contents have ability to influence the economic decisions of users of the information. The information is relevant if it is supplied at a time it would influence major economic decisions of the users of such information. An accounting information is relevant if it has two (2) elements, these are:

- Predictive Value; and
- Confirmatory Value,

Predictive value means the information would enable users to assess, evaluate, judge or appraise past, present and future transactions to make major economic decisions.

Confirmatory value assists users of accounting information to verify, substantiate or validate current values reported in the financial statements.

(b) Faithfull Representations

An accounting information is faithfully presented if it purports to represent the value reported in the financial statements. In other words, such information must be accounted for and presented in accordance with their economic reality or substance and not merely their legal reality.

An accounting information that is faithfully presented has three (3) features, these are:

- **Completeness**, it must contain detailed and necessary information, explanation, and description to assist users of the information to make major economic decisions;
- **Neutrality,** information must be neutral, and free from bias. An accounting information is not neutral if by selecting or presenting information, it influences the making of a

decision

in order to achieve a predetermined outcome; and

- **Free from error,** an accounting information must be free from material error that will distort or mislead users of the information. A false information could mislead users of accounting information in taking major economic decisions.

Other Concepts

Substance Over Form

Although business transactions are usually governed by legal principles; nevertheless they are accounted for and presented in accordance with their financial substance and reality and not merely by their legal form. In order to be useful information contained in financial statements must be relevant and reliable. This can only be achieved if the substance of transactions is recorded. If this did not happen the financial statements would not represent faithfully the transactions and other events that had occurred. Examples are found in sales and re-purchase agreements, lease contracts and consignment of goods.

Realisation Concept

Under accrual concept, revenue should be recorded when it is earned. The realization concept is concerned with determining when revenue is earned.

The realisation concept holds that revenue should be recognised at the time goods are sold and services are rendered; that is the point at which the customer has incurredliability.

Before revenue can be realized and recorded, it must have met the following two conditions

(a) The revenue is capable of objective measurement

(b) The value of asset received or receivable is reasonably certain.

The realization concept may however be difficult to applyin hire purchase transactions, lease transactions, contract jobs, and advertisement agencies etc.

You will learn the rules that are applied in recognizing revenue as you progress in your studies.

Entity Concept

In the strict legal sense, only limited liability companies are regarded as legal entities separate from their owners.They can acquire assets and incur liabilities. They can enter in to contracts on their own and can owe debts. They can sue and be sued.

In accounting, however, all forms of entities are regarded as being separate from their owners. The resources contributed by the owner to the business is regarded as the liability of the business to the owner, which is called capital or owners'equity.

The essence of the entity concept is to distinguish the income and costs of the business from the private income and costs of the proprietor or his drawings from the business. For instance, if the owner of a business draws cash from the business bank account to repair delivery vans for business use, it would be regarded as business expenses. But if he pays his child's school fees with the business cash, the amount will be treated as drawings of the owner at her than expenses. The entity concept is key to the proper understanding of the double entry principle and so must be properly grasped at this stage. We shall next consider the other concepts and conventions.

Chapter Summary

In this chapter we have discussed the fundamental accounting concepts including entity, going-concern, historical cost, periodicity, monetary measurement, realisation, matching, consistency, prudence, materiality, accrual, substance over formand fairness concepts. We discussed the usefulness of these concepts in accounting information and their limitations.

Revision Questions

(1) Which of the following are the effects of matching concept?

i. Determination of periodic profits

ii. Unexpired costs are deferred

iii. Cost of goods sold maybe different from purchases

(a) I, II, and III

(b) I and III

(c) II and III (d) I and II

(d) None of the above

(2) The accrual concept requires a business to treat as income those which are due and receivable and to treat as expenses those which are in arrears respectively.

(a)	Yes	Yes
(b)	Yes	No
(c)	No	Yes
(d)	No	No
(e)	None	Of the above

(3) The implication of the entity concept to a sole trader is that the

(a) Business can sue and be sue dseparately

(b) Liability of the owner is limited

(c) Owner can not own private assets

(d) Private use of business assets reduces owner's capital.

(e) Owner can is sue shares to the public

(4) An accounting concept, which justifies the charging to an expense to cost of small waste basket even though it has many useful life is called ____ concept

(a) Material

(b) Prudence

(c) Going Concern

(d) Fair Value

(e) Entity

(5) Which of the following accounting concept mainly supports depreciation of non-current assets?

(a) Entity Concept

(b) Fair Value Concept

(c) Materiality

(d) Matching/Accrual

(e) Money Measurement

(6) The accounting concept with presumes that an entity continue to operate into a foreseeable future is called _____ concept.

(a) Fair Value

(b) Money Measurement

(c) Going Concern

(d) Entity

(e) Objectivity

(7) Which of the following method is used to value inventory in the financial statement?

(a) Reducing balancing method

(b) Straight line method

(c) Output method

(d) Weighted average method

(e) Sinking fund method

(8) An accounting concept which prescribes that financial statements should not be prepared to influence users of the statement is called ____ concept

(a) Fair value

(b) Fairness

(c) Historical cost

(d) Entity

(e) Materiality

(9) A financial statement which is prepared to meet the expectations of users not opportune to demand for the reports in a particular order of their needs is called _____

(a) General purpose financial statements

(b) Audited financial statements

(c) Management report

(d) Cash flow report

(e) Financial statements

(10) Which of the following is an example of local extent laws used in the preparation of financial statements?

(a) International Financial Reporting Standards (IFRS)

(b) International Accounting Standards (IAS)

(c) International Accounting Standard Board (IASB) law

(d) Stock Exchange Act

(e) IASB Interpretative law

Short Answer Questions

1. State which accounting concept justifies the depreciation of non-current assets.
2. Mensa and Co., a sole trader, discovered that the business liability is in excess of the assets, he thus included his private assets in the Statement of financial position. Which concept is violated?
3. State the meaning of IFRS
4. An accounting concepts, which assumed that an entity will continue to operate in perpetuity is called _____
5. An accounting concept which recognizes a common denominator to measure assets and liabilities is called _____
6. An accounting concept, which requires that an accountant should not recognized income until the income has been earned and adequate allowances made for all known losses is known as ____
7. A financial account is said to be ____ where a particular method is used regularly to treat transaction in accounting.
8. An accounting concept, which discloses item significant value is called _____
9. A kind of accounting concept, which recognizes income when it is earned and not when it is received in cash in known as _______
10. The price that would be received from two knowledgeable parties as an arm's length transaction

to sell an item of property, plant and equipment at a measurement date is called_____

Solution to Revision Questions

(1) C

(2) A

(3) A

(4) B

(5) D

(6) C

(7) D

(8) B

(9) A

(10) D

Solutions to Short Answer Questions (SAQ)

1. Matching and Accrual
2. Use of historical cost would understate cost of assets consumed thereby causing the business to report holding gainor to over state profits.

   Materiality

   Matching concept

   Entity concept
3. International Financial Reporting Standard (IFRS)
4. Going Concern
5. Money Measurement
6. Prudence
7. Consistent
8. Materiality
9. Accrual/Matching
10. Fair Value

CHAPTER FOUR

ACCOUNTING SOURCE DOCUMENTS AND BOOKS OF ORIGINALENTRY

Chapter Four Contents

- Accounting source documents
- Accounting books
- Cash transations
- Discounts
- Double entry principle
- Balancing of ledgers

4.0 Learning Objectives

At the end of this chapter candidates should be able to:

- identify the main source documents
- Know the importance of source documents
- Know the nature and functions of books of original entry
- Prepare day books and Journals
- Transfer from the books of original entry to the relevant ledgers
- Know the effect of trade and cash discounts on a transaction.
- Prepare relevant ledgers and extract a trial balance.

Introduction

Source documents are documents from which accounting information are gather together and classified before being recorded in the subsidiary books or books of original entry. The book of originalentry is the accounting record in which transactions are first recorded from source documents. The source documents are usually attached to vouchers or kept in some secured files as supporting documentary evidence or a paper trail to sub stantiate all the financial transactions of the business.

Importance of Source Documents

Source documents are the source of all origina information on the financial transactions of a business.

They perform the following functions:

- they serve as evidence of financial transactions there by guarding against fraud and making audit possible
- They are usually signed by the parties to the transaction therefore they are difficult to deny and also it is almost impossible to alter them in order to defraud the entity.
- Insome cases, there could be more than one source document for a transaction but they would complement one another.
- To give effect to efficient bank reconciliations.

4.2.1 Main Source Documents

The main source documents that areused for recording in the books of original entry are:

- Quotations
- Sales invoices and Bills
- Pro-formainvoices
- Credit notes
- Debit notes
- Payment vouchers
- Petty cash vouchers
- Bank Pay-in-slips
- Cheque counter foils
- Receipts
- Pay slips
- Bank statements
- Remittance advices

Others which may not contain full information to make recording possible in the books of original entry are

- Purchase orders
- Delivery notes
- Goods Received Notes
- Bin Cards

4.2.1.1 Quotation

A quotation is a formal statement of intention made by a potential supplier to supply the goods or services required by a purchaser at specified prices and within a specified period. It sometimes also contain terms of sale, payment and warranties.Acceptance of quotation by the buyer leads to issue of sales invoice by the supplier to the buyer which binds both parties

4.2.1.2 Pro-Forma Invoice

Pro-forma invoice is an estimated invoice sent by a vendor to a purchaser. It is usually sent ahead of shipment or delivery of goods. The pro-forma invoice states the kind, quantity of goods, their prices and other essential information such as weight and transport fares. It is used as a preliminary invoice to support a quotation for custom purpose in importation. However, the pro-forma invoice can be distinguished from the normal invoice in that while an invoice is a formal request for payment by a supplier, the pro-forma invoice serves as advance informationonly.

4.2.1.3 Sales Invoices and Bills

A sales invoice serves as the source document to record in the sales day book. This is adocument sent by the seller to the buyer (usually for credit sales) requesting the buyer to pay for the amount stated on the invoice for goods or services rendered to him. Usually bills are sent for service rendered while invoices are sent for goods sold.

A Sales invoice would contain the following particulars

- Name and address of the seller and purchaser
- Date of the sales
- Description and quantity of goods sold
- Unit price and total amount of invoice
- Amount charged for value added tax(VAT)
- Conditions and terms of sales such a trade discount, cash discount and the date payment falls due.
- Signature of the parties to the transaction.

Sales Invoices are pre-numbered and prepared in duplicate. The originalis sent to the buyer while the duplicateis used to updatethe sales day book.

SPECIMEN SALES INVOICE

Green
EnterprisesIl
udun
StreetOke-

Invoice No.:7491

Date:June
1,2022YourOrderNoS/K

To:Ajaka
Ventures11
Ajala Street
Idimu

	₦	
xxxpairsofshoesat₦xxx perpair		xxxx
xxxsilkshirtsat₦xxxeach	xxxx	
	xxxx	
Lessxx% trade discount	xxxx	
Salesamountdue	**xxxxx**	

Please arrange for the payment immediately. A cheque drawn on the firm's name is acceptable.

------------------------------ ------------------------------

Customer SalesManager

NOTE: Trade Discount does not form part of the double entry. It is deducted from the gross sales to arrive at the net amount of sales that would be recorded in the ledger.

4.2.1.4 Purchase Invoices

A purchase invoice serves as the source document to record in the purchases day book. As explained in the last paragraph, the purchases invoice is the original of the sales invoice sent by the supplier to the customer. Therefore, the sales invoice and the purchases invoice contain the same details. The only difference is that purchases invoices are in the books of buyer and are received from various customers and there fore will not be pre-numbered because goods are purchased from different sources. The invoice numbers are usually not sequential for the same reason.

4.2.1.5 Creditnote

A credit note is a document relating to goods returned by the buyer or refunds to him when the buyer has been over charged.

Goods may be returned by acustomer for any of the following reasons:

- Damage to the goods before delivery
- Wrong specification from the one ordered by the customer.

The purpose of credit note is to inform the buyer that his in debt edness has been reduced by the amount stated on the credit note.

Credit note issued represents returns on sales while credit note received represents returns on purchases. Acredit note is made out in red to distinguish it from an invoice.

4.2.1.6 Debitnote

The buyer normally issues a debit note to a supplier to request for a credit note. The buyer may not debit the account of the supplier until his request is approved by him as evidenced by the issue of the credit note to the buyer.

A debit note is also prepared whenever it becomes necessary, for one reason or the other, to increase the amount due from a debtor. An example is where the seller has under-charged a customer on an invoice.

Generally, any expenses that should have been charged to the customer but were erroneously omitted when the invoice was made out would be charged subsequently by means of a debit note prepared by the supplier.

4.2.1.7 Payment Vouchers

Payment voucher is an authorizing document for payment for a particular expense or service. In an entity every payment must be supported by a payment voucher. Examples are payment vouchers for salary and wages, and pettycash vouchers etc.

The voucher must be checked and authorized by are sponsible or authorizing officer before cash can be paid. Payment vouchers for little expenses recorded in the petty cash book is referred to as pettycash vouchers

4.2.1.8 Bank Pay-in-slips

Bank pay-in-slip serves as evidence of cheque and cash paid into the bank by an entity and individuals. It is the major source document for recording in the bank column of a cash book (debit side). The bank pay-in-slips are usually supplied by the banks to their customers and have the name of the particular bank on them.

Pay-in-slip contains the following information:

- Name of branch where the account number is operated
- Name of the business and the account number
- Phone number of the depositor.
- Name of the person paying in the cheques or cash
- I fit is cash, the total amount of each cash denomination is specified.
- I fit is cheque, cheque number, name of bank, amount one a cheque and branch for each of the cheques being lodged
- Column for signature of the person paying in (depositor)

- Column for signature of the bank official receiving the cheques with the bank's official stamp
- Date of lodgment

4.2.1.8 ChequeCounterfoils

Most cheque books have a small portion of the cheque where the details on the original cheque are summarised. This is called a counter foil or cheque stub. This part is left after the main cheque has been detached along the perforated line. Cheque counter foils serve as evidence of payment to payables through the bank and withdrawals made for office or personal use.

In most entities all cash received must be paid to the bank and all cash payments must be made through the bank, (except petty cash that is operated through the imprest system). Therefore for many businesses, cheque counter foils have become major source documents for recording in the bank column of the cash book (Credit side).

4.2.1.9 Receipts

Receipts are issued to acknowledge cash and cheques received from a customer for goods soldor service rendered to him. The original is issued to the buyer; it represents the document for recording cash paid in his cash book. The seller retains the duplicate, which is the document for recording cash received in the cash book of the seller. Receipts are usuallypre-numbered.

Receipts contain the following information:

-Name of customer making the payment

-Date of receiving cash/cheque

-A mount of cash/cheque received (in words and figures)

-Signature of the Receiver

4.2.1.10 PurchaseOrder

A purchase order is issued by a customer requesting the seller to supply certain quantities of goods of specified description. The purchase order will also state the agreed price and the delivery point and date.

Invoices are compared with the purchase order when invoices are received.Agoods received note isissued after it has been ascertained that the goods supplied meet the specifications in the purchase order. An example of a purchase order is the Local Purchase Order(LPO).

4.2.1.11 Delivery Note

Delivery note is a document that accompanies the goods dispatched to the customer. Delivery note protects the dispatch driver from harassment on how he comes about the goods and serves as evidence of goods received by the purchaser when it is signed by him.

4.2.1.12 RemittanceAdvice

When a customer is making payment on invoices to the supplier,he will usually accompany his remittance with a letter stating details of invoices that ate settled by theattached instrument.This letter or document is referred to as Remittance Advice.Theletter may also be sent after the remittance had been made,if it was through banktransfer.

4.2.1.13 PaySlip

This is a source document issued by employer to the employees showing details of his gross emoluments and payroll deductions. The payroll deductions consist of statutory deductions such as (personal Income Tax, employees' pension contributions, National Housing funds, National Health Insurance and non statutory deductions such as contribution to cooperative societies, uniondues, and association fees, etc

The gross emolument consists of basic salary, housing allowance, transport allowance, responsibility allowance and utility allowance etc. The difference between gross emoluments and statutory and non statutory deductions is described as net pay. The document serves as a legal evidence of employees pay records and evidence of tax payment for obtaining tax clearance certificate at the relevant tax authority.

4.2.1.14 Goods Received Note(GRN)

The good received note shows the evidence that the goods dispatched to an organisation are received in good condition and meet the specifications. The accounts department will request for the relevant GRN before paying a supplier's invoice. The GRN is also used to update the Bin Card.

4.2.1.15 Bin Card

Bin card records movements of inventories. When inventories are received into thestore the warehouse bin card is debited and when inventories are issued to production, the bin cardis credited.

Books of Original Entry

These books are also referred to as books of prime entry or subsidiary books or day books or journals. They are the books in which transactions are first recorded before being posted to the ledger. Transactions can be recorded directly to the ledger but the books of original entry are in use because they have the following advantages which the ledger does not have.

(i) They record the total of transactions rather than the individual amounts.

(ii) They provide an explanation of the transactions recorded. For instance the journal showsthe complete story of a transaction. You will not need to look at the debit and credit for a transaction in different accounts/folios.

(iii) They provide records of transactions in chronological order.

(iv) They help to prevent error. The total in the bookof original entry can be reconciled with the total in the individual accounts.

Main books of original entries are:

(i) Sales daybook

(ii) Purchases day book

(iii) Sales returns book/Returns inward book

(iv) Purchases returns book/Returns outward book

(v) Journal proper

(vi) Cashbook

(vii) Pettycash book

In a computerised accounting system the books may not be in printed form but stored in a computer memory.

4.3.1 Sales DayBook

Sales day book is the book of original entry that records credit sales. The relevant source document is the duplicate of the invoice issued to the customer. The volume of daily sales transactions normally demands that they are firstly collated for the period before being transferred to sales ledger accounts.

The sales day book shows the following information:

(i) A list of the sales invoices in the order in which they are issued

(ii) The date of issue

(iii) The name of the customer

(iv) The number of the invoice

(v) The sales ledger number to which the individual accounts are posted

(vi) The net amount of the invoice after deducting trade discount and VAT

The sales day book does not show the description of the goods. These are contained in the invoice.

Illustration4.3.1.1

Baba Olu Enterprises made the following credit sales within voice numbers 072–079 respectively. Baba Olu trades in textile materials

			₦
2022, March	1:	Addo Enterprises	1,500,000
,,	2:	Moslad&Sons	800,000
,,	3:	KanfoLtd.	2,500,000
,,	4:	Aburi&Sons	900,000
,,	5:	Akapo Enterprises	1,500,000
,,	6:	NwosuVentures	400,000
,,	7:	BamiroEnterprises	600,000
,,	7:	AdeoluVentures	700,000

Record the above sales in the sales day book.

SolutiontoIllustration4.3.1.1

Baba Olu Enterprises

SALES DAY BOOK

Date	Custome	InvoiceNo	Folio	Amount
2006 March1	AddoEnterprises	072	SL 18	₦ 1,500,000
,, 2	Moslad&Sons	073	SL 11	800,000
,, 3	KanfoLtd.	074	SL 15	2,500,000
,, 4	Aburi&Sons	075	SL 7	900,000
,, 5	Akapo Enterprises	076	SL 16	1,500,000
,, 6	Nwosu Ventures	077	SL 10	400,000
,, 7	Bamiro Enterprises	078	SL 8	600,000
,, 7	AdeoluVentures	079	SL 5	700,000
" 7	Transfer to sales A/c	CR	GL 5	8,900,000

The Folio states the sales ledger reference to which the sales to each customer are posted.At the end of the period the total of ₦8,900,000 is posted to the credit of the sales account, while transactions relating to each customer arealso posted to the debit side of the respectiveledger accounts.A business entity may trade in more than one type of products. The periodic sales areusually analyzed according to each product in the sales day book.

Illustration4.3.1.2

In the first week of September 2022 Victor Enterprises issued the following invoices to its customers.The invoice numbers were 1182 to 1187. The entity trades in wooden chairs and wall clocks.

Date	Description of goods	₦
02/09/22	Jacobs &Sons (invoice no 1182)	
	12 wooden chairs at ₦500 each	6,000
	4 wall clocks at ₦650 each	2,600
		8,600
03/09/22	Moruf Enterprises (invoice no 1183)	
	25 wooden chairs a t₦500 each	12,500
04/09/22	SagoVentures (invoice no1184)	
	40 wooden chairs a t₦500 each	20,000
	50 wall clocks at ₦650 each	32,500
		52,500
	Trade discount at 5%	2,625
		49,875
04/09/22	Koku Emmanuel (invoice no 1185)	
	2 wall clocks at ₦650 each	1,300
05/09/22	Solola and Co.(invoice no1186)	
	10 wallclocks at ₦650 each	6,500
07/09/22	Annan Enterprises (invoice no1187)	
	100 wooden chairs at ₦500 each	50,000
	80 wallclocks at ₦650 each	52,000
		102,000
	Trade discount at 8%	8,160
		93,840

Prepare the analytical sales daybook of Victor Enterprises for the week ending September 7,2022.

Solution to Illustration 4.3.1.2

VICTOR ENTERPRISESSALES DAY BOOK

					Analysis	
Date	Particulars	Invoice Number	Folio	Amount	Wooden Chairs	Wall Clock
				₦	₦	₦
2/9/16	Jacobs &Sons	1182	SL114	8,600	6,000	2,600
3/9/16	MorufEnterprise	1183	SL83	12,500	12,500	-
4/9/16	SagoVentures	1184	SL68	49,875	19,000	30,875
4/9/16	Koku Emmanuel	1185	SL101	1,300	-	1,300
5/9/16	Solola&Co	1186	SL94	6,500	-	6,500
7/9/16	Annan Enterprises	1187	SL71	93,840	46,000	47840
Transfer to Sales A/c			GL12	172,615	83,500	89,115

Notes: SL reference is the reference to the Sales Ledger GL" "GeneralL edger
The analysis would help managers to assess the rate at which each class of inventories is sold for decision making and efficient management of the business.

(i) Where trade discounts were given, the effects were distributed on a pro-rata basis between the twoclassesof goods sold.For instance in the sales to Sago Venture the amount on wooden chairs and wallclocks were calculated as follows:

Wooden chairs ₦20, 000 – (20,000 x 5%) = ₦19, 000

Wallclocks₦32, 500 –(32,500 x5%)=₦30,875

4.3.2 PurchasesDayBook

The purchases day bookis the book of original entry used to record all credit purchases. The total there in is transferred to the debit of the purchases ledger at regular intervals. An amount relating to each supplier is credited in their respective subsidiary ledgers.The period covered may be daily, weekly or monthly depending on the volume of purchases transactions. The details on purchases day book are extracted from in coming invoices. Each supplier‘s account is correspondingly credited in the subsidiary ledger.

Illustration4.3.2.1

Mambo Enterprises made the following purchases on credit

1/8/2022	MrsB.Kent	¢150,000with invoiceN0.1062
	I.AkoladeLtd.	¢108,000 withinvoiceNo.083
4/8/2022	Saidi Ojo	¢60,000 with invoiceNo. 003
	Wasiu Stars	¢82,800 withinvoice No 288
	Akala &Co	¢98,250 with invoiceNo. 1124
7/8/2022	OnuoPaul &Sons	¢120,000with invoiceNo.002
	J.Mfon Ltd.	¢67,500 withinvoice No.116
	Festac Enterprises	¢337,500with invoiceNo.644

Enter the transactions in the purchases day book of Mambo Enterprises.

Solution to Illustration 4.3.2.1

Mambo Enterprises

Purchase day book

Date	Particulars (Suppliers)	Invoice No	Folio	Detail ¢	Amount ¢
1/8/2022	Mrs.B.Kent	1062	PL22	150,000	
	I.AkoladeLtd	083	PL132	108,000	
					258,000
4/8/2022	Saidi Ojo	003	PL08	60,000	
	WasiuStars	288	PL042	82,800	
	Akala &Co	1124	PL015	98,250	
					241,050
7/8/2022	Onuo Paul &sons	002	PL06	120,000	
	J.MfonLtd	116	PL04	67,500	
	Festac Enterprises	644	PL105	337,500	525,000
7/8/2022	Transfer to purchases ledger			DR	1,024,050

Note

(vii) PL reference is the reference to the Purchases Ledger

(viii) The purchases daybook records invoices coming from different suppliers with the pre-printed numbers

4.3.2.1 AnalysedPurchases DayBook

Like the sales day book, the purchases day book can be analysed, but unlike the case of sales day book, it may contain columns for goods meant for resale, goods not meant forresale and bills received forservices.

Illustration4.3.2.1

Joy bringer, a sole trader, made the following transactions which relate to the month of July,2022.

2022			¢
July	1	Bought goods in credit from J. Leye Ltd.	1,500,000
,,	2	Bought goods on credit from Bala &Sons	850,000
,,	6	Bought stationery on credit from Suzie Ltd.	750,000
,,	9	Bought goods on credit from Sasa&Sons	640,000
,,	12	Received invoices for carriage on goods from Samcol	940,000
,,	14	Bought goods on credit from Bala &Sons	1,050,000
,,	15	Received invoice for electricity from EDCN	750,000
,,	18	Bought goods on credit from Mike Essien&Co	645,000
,,	25	Bought stationery oncred it from Suzie Ltd.	874,000
,,	26	Received invoice from Babs Motors for vehicle repair	682,000
,,	28	Bought goods on credit from Bala &Sons	1,200,000
,,	30	Bought goods on credit from Nana&Co	450,000
,,	31	Received invoices for gas consumed from Owusu Ltd.	894,500

Prepare the analysed purchases daybook for the month of July,2022 in the books of Joy bringer.

Solution to Illustration 4.3.2.1

Analysed Purchases DayBook

Date	Particulars Namesof Supplier	Folio	Total	Purchases	Stationery	Carriage Inwards	Motor Expenses	Electricity &Gas
2022			¢	¢	¢	¢	¢	
¢July1	J.Leye	PL40	1,500,000	1,500,000				
,,2	Bala&Sons	PL36	850,000	850,000				
,,6	SuzieLtd.	PL48	750,000		750,000			
,,9	Sasa&Sons	PL16	640,000	640,000				
,,12	Samcol	PL12	940,000			940,000		
,,14	Bala&Sons	PL36	1,050,000	1,050,000				
,,15	EDNC	PL18	750,000					
,,18	MikeEssien &Co	PL06	645,000	645,000				
,,25	SuzieLtd.	PL48	874,000		874,000			
,,26	BabsMotors	PL64	682,000					
,,28	Bala&Sons	PL36	1,200,000	1,200,000				
,,30	Nana &Co	PL72	450,000	450,000				
								750,000
							682,000	
,,31	Owusu Ltd.	PL04	<u>894,500</u>					<u>894,500</u>
	Total		<u>11,225,500</u>	<u>6,335,000</u>	<u>1,624,000</u>	<u>940,000</u>	<u>682,000</u>	<u>1,644,500</u>
	Transfer		(DR)	GL28	GL30	GL43	GL68	GL46

Notes

(ix) The goods bought for resale are called purchases

(x) The analysis shows all invoices for transactions that will not be paid for immediately.

(xi) The sum of the row totals should be equal to the sum of the column totals. This is useful for control purposes.

(xii) The total in each column will be debited to the purchases account, stationery account, carriage inwards account, motor expenses account and electricity and gas account respectively in the general ledger. The individual amounts are also to be credited to the accounts of the respective suppliers accordingly.

4.3.3 Sales Returns Book

The sales returns book or returns inward book is the book of original entry that records returns on goodssold to customers. The sales returns book analyses the goods were returned.

Illustration 4.3.3.1

Refer to Illustration 4.2.1

Victor Enterprises

Sept.10, 2022 Jacobs and Sons returned 3 wooden chairs

Sept.12 2022 Annan Enterprises returned 2 wallclocks

Sept.14 2022 Moruf Enterprises returned 1 wooden chair

Prepare the Sales returns book for Victor Enterprises.

SolutiontoIllustration4.3.3.1

Victor Enterprises

Sales Returns Day Book

Date	Particulars	Salesledgerref	Amount
2022 Sept.10	Jacobs &Sons		₦
	3woodenchairs	SL114	1,500
Sept.12	AnnanEnterprises		
	2wallclocks	SL71	1,196

Sept14	Moruf Enterprises		
	1wooden chair	SL83	500
	Transfer to sales return DR	GL12	3,196

Refer to illustration 4.4

Joy bringer Returns OutwardsBook

Date	Supplier	Folio	
		Purchases ledger ref	Amount
2022			¢
Aug3	J.LeyeLtd.	PL40	200,000
Aug5	Bala&Sons	PL36	150,000
Aug10	MikeEssien &Co	PL06	40,000
Aug10	Nana &Co	PL72	45,000
Transfer to returns outward account GL180			435,000

The relevant purchases ledger references would be the same as those in the purchases daybook.

4.3.4 The Journal (General Journal)

The journal isused as the book to record transactions that do not it in to other subsidiary books. The information recorded in the journal about each transaction includes:

- The date of the transaction
- The debit and credit charges in specific ledger accounts
- A brief explanation of the transaction, referred to as“narration”

The narration is required to indicate the purpose and authority of the transaction. For efficient use of the journal, candidates must be able to analyse the effect of atransaction on assets, liabilities, and owner’s equity.The subsidiary books already considered are also referred to as journals. For example, the Sales Day Book or sales Journal, Purchases Day Book or purchases Journal, etc. To distinguish this book fro mother day books, this journal is sometimes referred to as “General Journal” or “JournalProper”

4.3.4.1 UsesoftheJournal

The journal is used for the following:-

- Opening and closing entries
- Transfer from one account to the other
- Purchases and sales of non-current assets on credit.
- End of period adjustments
- Correction of errors.
- To record purchase of business transaction

4.3.4.2 The format of the Journal

The Journal has similar rulings to the purchases Day Book and other day books already considered but with slight modifications to show the accounts to be debited and credited in the ledger. A typical Journal is ruled thus:

Date	Particulars	Folio	Dr	Cr
	The name of account to debit		XX	
	The name of account to credit			XX
	The Narration			

The name of the account to be debited is always shown first.The name of the account to credit is inset to theright hand side.

The narration is not indented.After each set of journal entries, there should be a gap before the next set of entries are made.This is to make each set of journal entries stand out clearly.

4.3.4.3 OpeningEntries

When the journal is used for opening entries the aim is to determine the value of the opening capital.

Illustration 4.3.4.3.1

N.Gyanbusinessaffairs onJanuary 1,2022stoodasfollows:

	¢
Cash in hand	66,000
Cash at bank	366,000
Inventories	375,000
Furniture and fittings	180,000
Trade Payables	150,000

Prepare the opening Journal of the business.Record thesetransactionsinaJournal.

Solution to Illustration 4.3.4.3.1

N. Gyan
Journal

Date	Particulars		Dr ¢	Cr ¢
2022				
Jan 1	Cash in hand	CB1	66,000	
	Cash at bank	CB1	366,000	
	Inventories	GL1	375,000	
	Furniture and fittings	GL2	180,000	
	Trade Payables	PL3		150,000
	Capital(difference)	PL1		837,000
Being assets and liabilities of N.Gyanat January 1,2022			987,000	<u>987,000</u>

4.3.5 Transferfromoneaccountto theotherthrough thejournal

Only the journal can readily explain the transfer from one account to the other.The reason for the transfer will be explained as narration, thus removing any doubt about the authenticityof the adjustment,

Illustration 4.3.5.1

Record through the journal entry the transfer of ₦600, 000 from Waconia&Co's account in the bought ledger to their account in the sales Ledger,to set off purchase against sales. The transaction took place on 31 January, 2023.

Waconia & CoJournal

Date	Particulars	**Fol.**	Dr	Cr
31/01/23	Bought ledger control account Sales ledger control account Being balance on bought ledger Transferred to sales ledger on contract basis.	PL.20 SL.12	600,000 600,000	

4.3.6 Other uses of the Journal

The use of journal for other purposes is shown in the following illustration:**Illustration4.3.6.1**

The following transactions took place in the books of GoodluckLtd.in June, 2022.

(i) A machine is bought on credit from Jerry Enterprises for ₦186,000on June1

(ii) A motorvehicleis sold to Jebeleje on credit for₦360,000 on June8

(iii) Bobo T,adetoro wed ₦160,000.He offers a motor car in full settlement of the debt on June16 and the offer was accepted.

(iv) Ilemo bayo is a creditor. On June 25, his business is taken over by Prospect Ventures to which the debt of ₦45,000 is now to be paid.
Show thejournal entries to record the transactions

Solution to Illustration 4.3.6.1

Goodluck Ltd.Journal

Date 2022	Particulars		Fol	Dr ₦	Cr ₦
June1	Machinery	DR		186,000	
	Jerry Enterprises				
	Purchase of machinery on credit				186,000
June8	Jebeleje	DR		360,000	
	Motorvehicle				360,000
June16	Motorvehicle	DR		160,000	
	BoboT.				160,000
	Recording acceptance of motor car in full Settlement of debt.				
June25	Ilemobayo	DR		45,000	

	Prospect Ventures Debt owed to Ilemo bayo to be paid to prospect ventures			45,000

4.4 Discounts

Discounts are reductions made from the gross amount or value of goods and services.

There are two types of discounts, they are trade discounts and cash discounts

4.4 .1 Trade Discount

a. Trade discount is an allowance given to a trader buying in large quantity.

The invoice price would be the same for all customers but the net selling price may be different for customers depending on the quantity purchased by them.

b. Trade discount is not recorded in the books of accounts.It is only a means of Calculating the net selling price of goods.Only the net amount of goods sold is transferred to thebooks.

4.4.2 Cash Discounts

Cash discounts are discount granted in consideration of immediate payment or payment within a prescribed time. There are two types of Cash discounts. They are discount allowed and discount received. Discount allowed are allowances granted to customers while discount received are allowances from suppliers.

4.5 Principle of Double Entry

Double entry principle states that for every debit entry,there must be a corresponding creditentry and vice versa.If the principle is properly followed,the total of the debit entries in the accounts must be equal to the total of the creditentries.

There are three pairs of concepts that aid the understanding of the double entity principles and they are:

	Debit	Credit
1	Incoming	Outgoings
2	Receiving(Receiver)	Giving(giver)
3	Losses/Expenses	Profit/gains

Anything considered being an incoming,or being received by an entity is debited e.g. cash is an incoming to an entity hence cash received is debited.On the other hand, anything that is outgoing ,or given out is credited e.g.goods sold are out going hence sales is credited.

In general, the above principles are the underlying basis for debiting assets and expensesas well as crediting liabilities and revenue. The nature, types and functions of ledger accounts can now be discuss before we go into the application of the double entry principle.

4.5.1 LedgerAccounts

A ledger is the book containing a group of accounts. It contains the permanent records of the assets, liabilities, Income, expenses and equity of a business entity.The accounts in a ledger are those to which entries are posted from the subsidiary books.

4.5.2 Importance of the ledger accounts

(i) They serve as the means of keeping permanent records of assets, liabilities, income, expenses and owner's equity.

(ii) They provide relevant information that is required to prepare the statement of profit or loss and the statement of financial position.

(iii) They give the origin of every transaction and the parties involved.

(iv) They show the details of the movement in each account. For instance, a bank account will show what amount had been deposited or how much had been withdrawn and for what purpose.

(v) The Trial Balance is extracted from the ledger accounts at the end of the accounting period.

4.5.3 Types of Accounts:

Accounts can be grouped under three main classifications

- Real Accounts
- Personal Accounts

- Nominal Accounts

Real Accounts:These are accounts relating to tangible things that can be seen, felt, touched and moved in most cases e.g.cash, cars, good setc.The rule of double entry to these types of accounts is *Debit*,when the rear additions, that is, when more of these items are acquired. *Credit,* when these items are disposed off,either by selling them off, when damaged beyond use or when given out as gift.

Personal Accounts: These are accounts dealing with persons, corporate bodies or even partnerships. Before these accounts can exist,there must be credit transactions unlike the real accounts where both cash and credit transactions areinvolved.

In personal accounts, these accounts are opened only if the persons concerned purchase goods or services on credit or if they sell goods or services on credit.There is no need of writing or recording the names of persons who have purchased on cash basis. This amounts to a waste of time and efforts since the company has nothing to do with the persons again. However,cash paid or received for debt owed or receivable can be recorded in the personal accounts.

The case willbe different if payment is deferred till a future date,it will be necessary to know those who owe and those who are owed as the case maybe.

Nominal Accounts: These are the accounts opened for income and expenses'. They are not realor personal but are for gains and losses items.We only talk of benefits arising from these accounts as a result of the services rendered.Examples are rent,salaries, electricity, discounts, drawings, net profits or losses on trading or disposal of non-current assets etc.

4.5.4 Typesof Ledgers

Ledgers can also be classified into the following fourgroups:-

(a) **Sales Ledger or Trade Receivables Ledger**

This contains all the personal accounts of customers otherwise referred to as trade receivables.

(b) **Purchases Ledger or Payables Ledger**

This contains the personal accounts of suppliers of goods and services, other wise referred to as trade payables.

(c) **PrivateLedger**

The Private ledger contains details of capital accounts, drawings account, loan account and investment account. Usually only the senior managers have access to these accounts in order to prevent details of the items contained there in from being publicized.

(d) **General Ledger**

The general ledger,also referred to as the nominal ledger,contains the remaining accounts such as:-

- **Nominal accounts;** relating to expenses, wages, rent, sales, purchases, bad debts accounts; and
- **Real accounts;** relating to assets such as land and buildings,motor vehicles, inventories, plant and machinery.

4.5.5 Application of the doublentryprinciple

To record a transaction using the double entry principle the following steps mustbetaken.

(i) Ensure that a transaction has actually takenplace.That is at least twoparties are involved and the transaction can be measured in monetary terms.

(ii) Identify the two main accounts involved.That is, under which two main subject matters the transaction can be divided.

For example:Adeolu Enterprises purchased a motor car for ₦750, 000 cash. The transaction can be measured monetarily and it involve atleast two parties(Adeolu Enterprises and the motor dealer)

- Two main subject matters can be identified

  (a) Motor car was purchased

  (b) Cash was paid

(iii) Identify the one that receives value. In the above example motor car has increased, therefore it has received value.

(iv) Identify the one that has given value–cash has been reduced, in this case it has given value

(v) Debit the account that has received value with ₦750,000 (i.e.debit motorcar) and credit the account that has given value(i.e.creditcash)

4.5.6 Debit and Credit Entries

(a)	An account consists of two sides;the debit side to the left hand
	And the credit side to the right hand side.By the time it is ruled at –
Debit side	Title of the account Creditside

Date	Particulars	folio	Amount	Date	Particulars	folio	Amount

(b) On both sides of the accounts we have columns for date, particulars (details of the transaction),the folio and the amount.

(c) An amount recorded on the debit side is called debit entry while an amount recorded on the credit side is called a creditentry.

(d) The corresponding entry of the debit entry is found on the credit side of another account and the corresponding entry for the credit entry is found on the debit side of another account.

(e) The folio is the ledger page on which the correspondin debit or credit entry could be found.

What is explained above can be summarized as follows

Asset Account

(Debit) ₦	(Credit) ₦
Increase (through acquisition or introduction by owner)	(Decrease through disposal For cash or other considerations)

Liability Account

(Debit) ₦	(Credit) ₦
Decrease(through settlement in cash or other consideration	Increase(obtaining goods or services on credit

Capital Account

(Debit) ₦	(Credit) ₦
Decrease(as a result of losses incurred)	Increase(through cash/asset introduced and profit made)

Revenue Account

(Debit)	(Credit)
Decreas	Increase(Sales)

Expenses Account

Debit	Credit
(Increase)	Decreas

4.5.7 The general rules for recording in the ledger areas follows:

A. An account that receives is debited

(i) An increase in an asset or in an expense is debited.That is there is addition to assets and expenses.

E.g. Office rent is paid. The rent is an expense and has increased by the transaction; therefore the rent account should be debited.

(ii) Ade crease in revenue or a decrease in liability is debited.

Examples

(a) Returns on sales is a decrease of sales revenue,therefore there turn on sales/returns in wards account should be debited.

(b) When payables are paid,the liability due to the Suppliers will reduce, therefore the payables account is debited with the amount paid.

B. An account that give sis credited:

(i) Any decrease in an asset or in an expense account is credited. E.g.when a machine is sold, the amount in the account will decrease, therefore machine account is credited.

(ii) Any increase in liabilities or income is a credit.E.g.when goods are sold the revenue of the company increases, therefore sales account is credited.

4.6 Cash Transactions

The simplest way to look at the application of the double entry is through casht ransactions.

a. When cash is received,debit cash and credit the corresponding accounts

b. When cash is paid,credit cash account and debit the corresponding account.

Illustration 4.6

The following transactions took placein the books of Olu Aina Enterprises in 2022

(i) January 4,2022 Cash sales of ₦900,000

(ii) January 10, 2022 Payment of office rent ₦250,000 in cash

(iii) January 18, 2022 Purchased ₦200,000 goods for cash

(iv) January 25, 2022 Purchased stationery for N40,000 cash.

Prepare the necessary ledger Accounts for each of the transactions.

Solution to Illustration 4.6

i. Cash is received for goods sold Debit cash with ₦900,000 Credit sales with ₦900.000

CashAccount

DR		CR	
	₦		₦
2022			
January4 Salesa/c	900,000		

DR		**Sales Account**	**CR**
	₦	2016	₦
		Jan.4 Cash	900,000

Note the narration/particulars:In the cash account the particulars is“Sales Account” because the corresponding credit entry is found in the Sales Account. Following the same logic, the particulars in the Sales Account is stated as “Cash” because the corresponding debit entry is in the Cash Account.

ii Cash is paid for office rent

Credit cash account and debit rent

DR		Cash Account	**CR**
	₦	2022	₦2
		Jan 10 Office rent	50,000

DR		Office Rent Account	**CR**
2022	₦		
Jan 10 Cash account	250,000		

iii Purchased goods for cash ₦200,000

Cash is given,therefore credit cash account and debit purchases account.

DR CashAccount **CR**

	2022		₦200,000
	Jan	18 Purchases	

DR Purchases Account **CR**

2016	₦	
Jan 18Cash	200,000	

iv. Purchased stationery for cash – cash is given, therefore credit cash and debitStationeryaccount

DR CashAccount

₦	

DR StationeryAccount CR

2022		₦	₦
Jan.25	Cash	40,000	

Note

Note that for each of the four transactions of Olu Aina Enterprises cash account is affected. The four cash Accounts can be combined as shown below

Olu Aina Enterprises

Cash Account

DR CR

2022		₦	2022		₦
Jan4	Sales	900,000	Jan10	Officerent	250,000
			Jan18	Purchases	200,000
			Jan25	Stationery	40,000

This is not different from how a firm's purchases and sales of different dates will be Combined in one purchases account and sales account respectively.

4.6.1 Transactions made on credit

(i) When cash is not received immediately for goods sold then it is sold on credit. Therefore the receivables/customers'account receives instead of cash, therefore the receivables account is debited and sales account is still credited.

(ii) When cash is not paid immediately for goods, then it is purchased on credit, therefore, the creditor gives. Payables account will be credited and purchases account debited.

Illustration 4.6.1

R.Okonkwo is also a trader. The following transactions took place in his books.

₦

	Bought goods on credit from Jaja Ltd.	85,000
	Sold goods on credit to Sule I&Co	176,000
	Purchased some office machines on credit from Apala Engineering Ltd.	150,000

Show the double entries for each of the transactions.

Solution to Illustration 4.6.1

(i)

R.Okonkwo
PurchasesAccount

	₦		₦
JajaLtd.	85,000		

Payabless Account (JajaLtd.)

	₦		₦
		Purchase	85,000

(ii)

Receivables Account(SuleI&Co)

	₦		₦
Sales	176,000		

SalesAccount

	₦		₦
		Receivables(SuleI&Co)	176,000

(iii)

OfficeMachine

	₦		₦
ApalaEngineeringLtd.	150,00		

ApalaEngineeringAccount

	₦		₦
		Officemachine	150,00

Note the following

The above transactions were posted to the ledger accounts for demonstration only.In real life situation, the amount recorded in the sales ledger, purchases ledger andoffice machines would have been accumulated in the relevant books of original entry,onlythetotals would betransferred to thedifferentLedgeraccounts.

4.7 BalancingaledgerAccount

At theendofevery period ,all ledger accounts must be balanced off.Balancing means to find the difference between the debit side and credit side of one account.

(i) Balance carried down(balc/d):This is the figure that is used to force the lesser side to agree with the higherside,because the total of the two sides of an account must be equal.

(ii) Balance brought down (bal b/d): This is the closing balance (bal c/d) of the period that becomes the opening balance at the beginning of the next period.

4.8 Interpretation of the balances

(i) In a trade receivables account, the debit side is expected to be greater than thecredit side, therefore the balance c/d would be on the credit side of the trade receivables account but when it is brought down(balb/d)in the next period, it is debit balance. Therefore a debit balance in trade receivables account and other assets account represents an asset.

(ii) Ina trade payables account, the credit side is usually greater than the debit side. Balance c/d is on the debit side and balance b/d on the creditside.This is a liability.

(iii) The cash account will always be a debit balance, except where it is a bank account when it can either be a credit balance (bank overdraft) or debit balance(an asset).

(iv) The capital account will always be a credit balance.

4.9 Comprehensive Illustration

Illustration 4.9

Mensa Joe Enterprises started are tail business, selling cement on retail basis. On March1, 2022, he introduced the following in to the business:

(i) Motor van valued at ₦480,000

(ii) Cash from his salary account ₦330,000

(iii) Money borrowed from a friend ₦66,000

The following transactions also took place in March

		₦
March 3	Purchased cement on credit from Fola Ltd.	189,000
,, 3	Paid carriage on cement to ware house	16 ,456
,, 6	Sold goods on credit to Aburi &Co	190,000
,, 8	Sold cement for cash	26,280
,, 11	Paid sundry expenses	16,278
,, 15	Purchased cement on credit from Fola Ltd.	60,000
,, 17	Bought some Dunlop tyres from Okechuku Enterprises on credit	10,852
,, 20	Paid cash to Fola Ltd.on account	167,500
,, 22	Aburi&Co paid cash on account	125,000
,, 25	Paid Salaries and wages	77,958
,, 25	Paid electricity bill	6,000
,, 27	Sold cement on credit to K.Opobo	68,000

Required:

(i) An opening Journal.

(ii) Open the ledger accounts and post the opening journal and transactions during the month.

(iii) Balance the ledger accounts.

(iv) Drawu partial balance as at March 31, 2022

Solution to illustration 4.9

Mensah Joe Enterprises

(i) Opening Journal

Date	Particulars		DR ₦	CR ₦
2022	Motor Van		480,000	
March1	Cash		396,000	
	Loan(friend)			66,000
	Capital			810,000
			876,000	876,000

(ii)

Capital account

2022	₦	2022	₦
March31 Balc/d	810,000	March1Cash	330,000
		March1Motor vehicle	480,000
	810,000		810,000
		April1Balb/d	810,000

Loan account

2022	₦	2022	
March31 Balc/d	66,000	March1CashAccount	66,000
		April1 Balb/d	66,000

Cash account

2022		₦	2022			₦
Bal.b/d		Opening balance				
March1	Capital	330,000	March3		Carriage inward	16,456
,, 1	Loan	66,000	,,	11	Sundry expenses	16,278
,, 8	Sales	26,280	,,	20	FolaLtd.	167,500
			"	25	Salaries &Wages	77,958
,, 22	Aburi& Co	125,000	,,	25	Electricity bill	6,000
			"	31	Balc/d	263,088
		547,280				547,280
April	Balb/d	263,088				

Motor vehicle Account

2022	₦	2022	₦
March1Capital(Openingbal)	480,000	March31 Balc/d	480,000
April1 Bal b/d	480,000		

arriage Inwards

2022	₦	2022	₦
March3Cash	16,456	March31 Balc/d	16,456
April1Balb/d	16,456		

Aburi&Co-Receivables

2022	₦	2022	₦
March6Sales	190,000	March 22 Cash	125,000
		March 31 Balc/d	65,000
	190,000		190,000
April1Balb/d	65,000		

FolaLtd-Payable

2022	₦	2022	₦
March20Cash	167,500	March3Purchases	189,000
March31 Balc/d	81,500	March15Purchase	60,000
	249,000		249,000
		Apri l1Balb/d	81,500

SundryExpensesAccount

2016	₦	2016	₦
March11Cash	16,278	March 31 Balc/d	16,278
March31c/d	16,278		

Motor Van expenses

2022	₦	2022	₦
March17Okechukwu-	10,852	March31 Balc/d	10,852
TyresApril1 Bal c/d	10,852		

Salaries & Wages account

2022	₦	2022	₦
March25Cash	77,958	March31 Balc/d	77,958
April1Balb/d	77,958		

ElectricityBillAccount

2022	₦	2022	₦
March25Cash	6,000	March31 Balc/d	6,000
April1Balb/d	6,000		

Purchases Account

2022	₦	2022	₦
March3 Fola Ltd.	189,000		
March15 Fola Ltd.	60,000	March31Balc/d	249,000
	249,000		249,000
April1B alb/d	249,000		

Sales Account

2022	₦	2022	₦
March31 Balc/d	284,280	March6 Aburi &	190,000
		“ 8 CoCash	26,280
		,, 2 K.Opobo	68,000
	284,280		284,280
		April1	284,280

Okechuku Enterprises–Accountspayable

2022	₦	2022	₦
March31 Balc/d	10,852	March 17 M/V expenses-Tyres	10 852
		April1Balb/d	10,852

K.Opobo Account–Receivables

2022	₦	2022	₦
March27Sales	68,000	March31 Balc/d	68,000
	68,000		68,000
April1Balb/d	68,000		

Notes

(a) Balances carried down on 31 March 2022, the end of March, became the balances brought down on1April, the beginning of the next period.

(b)(i) All assets accounts, i.e. cash account, motor vehicle account and trade receivables account, have debit balances.

(ii) All liabilities accounts, i.e. loan account and Trade payables account have credit balances.

(iii) Capital accounts have credit balances

(iv) Sales account has credit balance

(v) In our illustrations in this chapter, the transactions are posted directly to the ledger accounts. In real practice the transactions would first pass through the books of original entry or Day Books.

(iv) Trial Balance

	DR	CR
	₦	₦
Capital		810,000
Loan		66,000
Cash	263,088	
MotorVehicle	480,000	
CarriageInwards	16,456	
Trade Receivables–Aburi&Co	65,000	
- K.Opobo	68,000	

Trade Payables–Fola Ltd		81,500
-Okechuku Enterprises		10,852
Sundry Expenses	16,278	
MotorVan Expenses	10,852	
Salaries and Wages	77,958	
Electricity bill	6,000	
Purchases	249,000	
Sales		284,280
	1,252,632	1,252,632

4.10 TrialBalance

A Trial Balance is a list of balances extracted from the ledger accounts at a given date, arranged according to whether they are debit balances or credit balances. The total of the debit and credit balances should agree if the double entry rules have been properly followed. Though a Trial Balance can be drawn at any time, it isusual practice to prepare it at the end of an accounting period before preparing the entity's final accounts.

Illustration4.10

The Trial Balance to our illustration 4.9 can be drawn up thus:

Mensah Joe Enterprises Trial Balance

At March 31, 2022

	Dr ₦	Cr ₦
Capital		810,000
Loan		66,000
Cash	263,088	
Motorvehicle	480,000	
Carriageinwards	16,456	
Trade Receivables– Aburi&	65,000	
Trade payables		81,500
Sundry expenses	16.278	
Motorv an expenses	10,852	
Salaries and wages	77,958	
Electricity bill	6,000	
Purchases	249,000	
Sales		284,280
Account payable		10,852
Receivables–Opobo	68,000	
	1,252,632	1,252,632

NOTE

(i) The two receivables (i.e. Aburi & Co and Opobo) accounts could have been summed up in the GeneralLedger but they are shown separately here for convenience.

(ii) The balances brought down represent the position of the items in the Trial Balance. For instance, the balances brought down for capital, loan, payables, sales and accounts payable are on the credit side, this is also their position in the Trial Balance.

4.11 Accounting equation

This signifies the relationships existing be tween thee lements of the basic financial statements (statement of financial position and statement of profit or loss)

4.11.1 Basic Accounting Equation

The basic accounting equation expresses the equality of Assets to Equity.In practice, the owner of a business out fit starts by bringing in equity and this is recorded by the business as incoming asset that is equivalent to thee quity supplied.

Mathematically, this is expressed as: Asset (A) =Equity (E)

Symbolically, this can be stated as:

A = E

Where Aisasset

Eis equity

Illustration 4.11.1

Odoguwa started his business by paying ₦250, 000 in to the Business Bank Account.

Solution

Payment by Odoguwa is equity(E)

Money received into the Business Account is asset (A)ThereforeA=E

Sub stituting values for the equation above ₦250, 000=₦250, 000

Illustration 4.11.1

If Odoguwa decides to buy inventory of ₦50,000 on credit, the structure of the quation will change.

We now have a liability, the giver of the inventory and also an asset, the inventory received. The equation has now expanded to include, Assets, Liability and equity .Symbolically, Liability is represented by L. The new accounting equation will now be:

A			=	L	+	E
₦				₦		₦
Cash at Bank	250,000					250,000
Inventory	50,000	(owingtosuppliers)		50,000		
	300,000	=		50,000		250,000

Assets and Liabilities have both increased.

The expanded equation is now

A = L + E

Changing the subject to the formula

The subject of the formula can be changed to derive any of the two other items as follows:

To make L the subject of the formula

A = L + E

A - E = L

This can be rearranged to read:L = A - E

If on the other hand Eisto be made the subject of the formula, the formula will be derived as follows:

A = L + E

A - L = L

Re arranged,it will be

E = A - L

Example 3

Use the accounting equation to fill the gaps in the table below

	Assets	Liabilities	Equity
	₦	₦	₦
(i)	-	34,561	22,416
(ii)	246,122	-	134,769
(iii)	144,903	65,711	-

Start by stating the accounting equation to derive the solutionto (i) to (iii) above

Answer

Accountinge quations

(i)	A	=	L	+	E
(ii)	L	=	A	-	E
(iii)	E	=	A	-	L

(i)	A	=	₦34,561+₦22,416		
		=	₦56,977Ans		
(ii)	L	=	₦246,122	-	₦134,769
			₦111,353	Ans	
(iii)	E	=	₦144,903	-	₦65,711
		=	₦79,192	Ans	

Revenue Based Accounting Equation

The goal of the statement of profit or loss is to derive the profit or loss made during the period. An accounting equation can also be derived from the statement of profit or loss thus:

Profit = Revenue-Expenses

Symbolically, this can be stated as:

$$P = R - E$$

Where P = Profit

R = Revenue

E = Expenses

Change of the subject of the formula

Like in the case of the accounting equation derived from the statement of financial position, the subject of the formula in the accounting equation can be changed thus:

(i) Where Revenue is not known

$$P = R - E$$
$$P + E = R$$
$$R = P + E$$

(ii) Where Expenses figure is not known

$$P = R - E$$
$$P - R = -E$$

Multiply the above equation with minusall through

$$- P -(-R) = -(-E)$$
$$- P+R = +E$$

By Re-arrangement

$$R-P=E$$
$$E=R -P$$

Example 4

(i) Inventory bought for ₦25,000; sold for ₦40,000

(ii) Inventory bought for ₦15,000; Losson sale ₦3,000

(iii) Goods sold for ₦23,500 and profit on sale is ₦4,500Required:usingtheaccountingequations:

(i) Determinetheprofit

(ii) Determine there venue

(ii) Determine the Expenses

Solution

(i) Accountingequation

P = R - E

Wherep = profit

R = Revenue

E = Expenses

 P = ₦40,500-₦25,000P

= ₦15,000 Ans

(ii) Accounting equation

R = P+E

R = ₦(3,000)+₦15,000(Loss is negative profit)

R = ₦12,000

(iii) Accounting equation

E = R-P

E = ₦23,500-₦4,500

= ₦19,000 Ans

Example5

The following information are given:

		₦
Equity	1/4/2014 – 31/3/2015	124,600
Equity	1/4/2015 – 31/3/2016	214,250
Drawings	1/4/2015 – 31/3/2016	22,390

Required:

(a) Determine the profit for the year ended 31/3/2016

(b) Assuming Equity as at year ended 31/3/2016 was ₦82,620, compute the profit or loss for the year.

Solution

			₦	
Equity	1/4/2014 – 31/3/2015	(E)	124,600	(Openingequity)
Add Profit	1/4/2015 – 31/3/2016	(P)	?	
			?	
Less:Drawings		(D)	(22,390)	
		(E_2)	214,250	

Symbolically:

Represent Equity 1/4/2014 – 31/3/20145 by E_1

Represent profit by P

Represent Drawing sat1/4/2015–31/3/2016 D

Represent Equity1/4/2015 – 31/3/2016 by E_2

(a)There fore the accounting Equation=E_1+P – D=E_2

P=E_2– E_1+D

P = ₦214,250 – ₦124,600 + ₦22,390P=₦112,040

Profit=₦112,040Ans

Proof:			₦
Equity	(E_1)	1/4/2014 – 31/3/2015	124,600
Add:Profit	(P)		112,040
			236,640
Less:Drawings	(D)		22,390
Closing Equity	(E_2)		214,250

(b). P=E_2– E_1+D

P=₦82,620-₦124,600+₦22,390P=-₦19,590

Loss

Loss= -₦19,590 Ans

Proof:	₦
Equity at beginning	124,600
Less Loss	19,590
	105,010
Less Drawings	22,390
Equity at the end	82,620

Comprehensive Example

The following are extracted from the records of Odoguwa, aproprietor.

i) The proprietor deposited ₦250,000 cash in the business Account as a start-up fund

ii) He acquired inventory of ₦50,000 on credit

iii) He paid the supplier of the inventory the sum of ₦27,000 from the business account

iv) He allowed his building worth ₦250.000to be used for the business

v) Half of the inventory acquired in (ii) above was sold for cash ₦40,000

vi) He paid ₦10,000 to the supplier of the inventory from his personal resources

Required:

a) State with the aid of a table, the effects of each transaction on Assets, Liabilities and Equity (that is,by stating 'Increase, 'Decrease' and 'No Effect')

b) Provide figures to support your sub missionin(a)above.

Solution

a.

	Assets	**Liabilities**	**Equity**
(i)	Increase	Noeffect	Increase
(ii)	Increase	Increase	Noeffect

(iii)	Decrease	Decrease	Noeffect
(iv)	Increase	Noeffect	Increase
(v)	Increase	Noeffect	Increase
(vi)	Noeffect	Decrease	Increase

Solution

b.

(i)

	A	=		E
	₦			₦
Cash at Bank	250,000	=	Equity	250,000
Thus:	Assets	=	Equity	

(ii)

	A		**L**	E
	₦		₦	₦
CashatBank	250,000	Equity		250,000
Inventory	50,000	Suppliers	50,000	
	300,000		50,000	250,000

Thus:

Assets= Liability+ Equity

(iii)

	A		L	E
	₦		₦	₦
CashatBank	223,000	Equity		250,000
Inventory	50,000	Suppliers	23,000	
	273,000		23,000	250,000

Thus:

Assets= Liability+ Equity,i.e ₦273,000=₦(23,000+250,000)

(iv)

	A		L	E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory	50,000	Equity		250,000
CashatBank	223,000	Suppliers	23,000	______
	523,000		23,000	500,000

Thus:

Assets=Liabilities+Equities i.e.₦523,000=₦(23,000+500,000)

(v)

	A	=	L	+ E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory(₦50,000 – ₦25,000)	25,000	Equity		250,000
Cashat Bank		Equity(Profit)		15,000
(₦223,000– N40,000)	263,000	Suppliers	23,000	______
	538,000		23,000	515,000

Thus:

Assets=Liabilities+EquitiesN

ote: Profit=Sales -Cost

Profit=₦40,000-₦25,000

Profit=₦15,000

(vi)

	A	=	L	+ E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory	25,000	Equity		250,000
CashatBank	263,000	Equity		10,000
		Equity(Profit)		15,000
		Suppliers	13,000	_______
	538,000		13,000	525,000

Thus:Assets= Liabilities+Equities,i.e₦538,000=₦(13,000+525,000)

4.12 Chapter Summary

In this chapter, source documents have been discussed as well as their uses and relationship to the books of original entry. Importance of the books of original entry have also been examined and illustrated how they are to be transferred to the ledger accounts. The Journal, as a means of recording un usual transactions, was also examined.

4.13 Multiple choice questions (MCQ)

(1) Which of the following statements about a journal are correct?

I. The double entry for a transaction is completed in a journal.

II. Journal issued to record withdrawal of cash to the office

III. A set-off between customers and suppliers is resolved through journal entries

IV. Journal records adjusting events.

A. I,IIIand IV

B. I,IIandIII

C. IIandIV

D. IIIandIV

E. II,IIIand IV

(2) Which of the following journal entries may be accepted

as being correct according to their narration?

		Dr	Cr
		₦	₦
(A)	Plant and machinery	250,000	
	ErnestOpare&Co		250,000
	Purchasesofinventoriesoncredit		
(B)	Baoku Ltd.	160,000	
	Cash account		160,000
	Cash received from Baok Ltd.		
(C)	Sangisha&Sons	840,000	
	MotorVehicles		840,000
	Sales of motor vehicle on credit		
(D)	Capital account	1,500,000	
	Powergeneration		1,500,000
	Introduction of generator in to the business.		
(E)	CashAccount	20,000	
	MotorVehicles		20,000
	Sales of motor vehicles on credit		

(3) The invoiced price of acommodity is ₦50, 000 with a trade discount of 10%.

C.Eghan issued the invoice to Wiki Promo. How much is recorded in the books of original entry of Wiki Promo and in what book is it recorded?

(A) ₦50,000 and purchases daybook

(B) ₦45,000 and purchases daybook

(C) ₦50,000andsalesdaybook

(D) ₦45,000andsalesdaybook

(E) ₦50,000and salesjournal

(4) Which of the following roles does a debit note serve?

(A) A document issued by the seller informing the buyer that his account has been credited for over charge on the invoice.

(B) A document issued by the seller informing the buyer that his invoice was undercharged.

(C) Adocument that generates a credit note from the seller to the buyer

(D) A document by which goods are issued from store to production.

(E) A document by which goods already issued are returned to store

(5) (I) Order and Goods Received Note (GRN)?

(II) The GRN confirms that goods are supplied according to the specificationin the purchase order.

(III) The purchase order is issued after goods have been received stating hat the goods are in order.

(IV) The amount on the purchase order is compared with the amount on the GRN before payment is made to the buyer.

(V) There is no relationship between GRN and Purchase order.

(VI) Goods Received Note is issued before arrival of the goods

a. I andIII

b. I,II andIII

c. IIandIV

d. IVandV

e. I,IIand IV

(6) The sales returns day book is used to record ______

A. Credit notes issues to customers

B Money received from account receivable

C Names and contact details of account receivables

D Debit notes issued to suppliers

E Money received from account payable

(7) Which of the following is not a subsidiary book?

A. Sales day book

B. Cash day book

C. Returns inward day book

D. Cash book

E. Purchases return day book.

4.14 Short-answer questions (SAQ)

1. What is the main source document for recording cash paid in to the bank?
2. The total in a sales daybook is transferred to account.
3. The duplicate copy of credit note will serve as the source document to recordin the book.
4. State the importance of narrationin a journal.
5. What is the source document for cash sales?

4.15 Examination type questions with solutions

1. Enter the following transactions in the double column cash book of Joe Limited for the month of January, 2022.

Jan 1	Balance of cash in hand ₦500, at bank ₦1,400
Jan 2	Paid S. Aina by cheque ₦900
Jan 3	Bought goods for cash ₦800 and with cheque ₦380
Jan 6	Drew cash from bank for office use ₦800
Jan 6	Paid Moji ₦250 by cheque
Jan 8	Sold goods for cash ₦800
Jan 8	Received cheque from Ade ₦1,350 in full settlement of his account
Jan 10	Paid ₦1,330 cash into bank
Jan 11	Received cheque from A. Williams ₦3,000
Jan 12	Paid John ₦5,000 in full settlement of his account
Jan 13	Paid ₦500 cash into bank
Jan 17	Received cash ₦500 for personal use

2. Journalise the following transactions.

2nd January, 2022	Anuoluwapo deposited N100,000 cash into First Bank of Nigeria to begin her stationery business under the name “Dasliva Enterprises”
3rd January, 2022	Purchased 120,000 of stationeries on open account from Paper products Ltd
4th January, 2022	Purchased store supplies costing N8,000 for cash from Surety company.
9th January, 2022	Sold stationery on account to Unity Ltd for ₦25,000 on credit
12th January, 2022	Bought stationeries costing ₦50,000 for cash from Paper converters Ltd
16th January, 2022	Paid wages of ₦200 to John through cheque
16th January, 2022	Paid rent to Adaza ₦1,700 cheque
20th January, 2022	Sold stationeries on credit to Tayo Ltd for ₦15,000
22nd January, 2022	Received payment cash ₦25,000 from Unity Ltd
25th January, 2022	Cash sales ₦220,000
27th January, 2022	₦40,000 was borrowed from First Bank of Nigeria

28th January, 2022	Withdrew ₦6,000 cash for personal use
30th January, 2022	Goods worth ₦5, 000 was sold on credit to Ade but it was wrongly debited to Tade's account.

4.16 Solutionto multiple choice question (MCQ)

(1) A

(2) C

(3) B

(4) B

(5) A

(6) A

(7) B

4.17 Solutions to short answered questions (SAQ)

1. BankPay-in-Slips.
2. Salesledger.
3. Returnsinwards/Returnsonsales.
4. To indicate the purpose and authority of the transaction.
5. Duplicate of the cash receipt issued by the seller.

4.18. Solution to examination type question 1:

Joe Limited

Double Column Cash Book

For the month of January, 2022

Date	Particulars	F	Cash ₦	Bank ₦	Date	Particulars	F	Cash ₦	Bank ₦
1/1/2022	Balance b/d		500	1400	2/1/2022	S. Aina			900
6/1/2022	Bank	C	800		3/1/2022	Purchases		800	380
8/1/2022	Sales		800		6/1/2022	Cash	C		800
8/1/2022	Ade			1,350	6/1/2022	Moji			250
10/1/2022	Cash	C		1,330	10/1/2022	Bank	C	1,330	
11/1/2022	A. Williams			3,000	12/1/2022	John		5,000	
13/1/2022	Cash	C		500	13/1/2022	Bank	C	500	
31/1/2022	Bal c/d		6,030		17/1/2022	Drawing		500	
					31/1/2022	Bal c/d			5,250
			8,130	7,580				8,130	7,580
1/2/2022	Bal b/d			5,250	1/2/2022	Bal b/d			6,030

Solution to examination type question 2

Dasliva Enterprise

Journal

For January, 2022

Date	Particulars	Dr ₦	Cr ₦
2/1/2022	First Bank of Nigeria Capital	100,000	 100,000
	Being capital deposited at commencement of business		
3/1/2022	Purchases Paper product ltd	120,000	 120,000
	Being Stationeries bought on credit from Paper Store Ltd		
4/1/2022	Store supplies Cash	8,000	 8,000
	Being cash purchases of store supplies		
9/1/2022	Unity Ltd Sales	25,000	 25,000
	Being sales on credit to Unity Ltd		
12/1/2022	Purchases Cash	50,000	 50,000
	Being purchases of stationery paid with cash		
16/1/2022	Wages Bank	200	 200
	Being wages of ₦200 paid with cheque to John		
16/1/2022	Rent Bank	1,700	 1,700
	Being payment of rent ₦1,700		
20/1/2022	Tayo Ltd Sales	1,500	 1,500
	Being sales on credit to Tayo Ltd		
22/1/2022	Cash Unity Ltd	25,000	 25,000
	Being payment received from Unity Ltd		
25/1/2022	Cash Sales	220,000	 220,000
	Being cash received from sales		
27/1/2022	Bank Loan	40,000	 40,000
	Being money collected from First Bank of Nigeria		
28/1/2022	Drawing Cash	6,000	 6,000
	Being cash withdrawn/used for personal use		
30/1/2022	Ade’s A/c Tade’s A/c	5,000	 5,000

	Being credit sales to Ade wrongly posted into Tade's account now corrected.	200,000	200,000

4.19 Examination type questions without solutions

1. A source document provides basic information that is used in posting entries into the books oforiginal entries. You are required to:

   (a) Explain the following types of source documents
   - (i) Receipt
   - (ii) Sales Invoice
   - (iii) DebitNote
   - (iv) CreditNote
   - (v) PaySlip
   - (vi) Cheque Counter foils

   (b) Enumerate four importances of source documents in recording in books ofaccounts.

   (c) Describe the following types of source documents:
   - i. Quotations
   - ii. ProFormaInvoice
   - iii. DeliveryNote
   - iv. PurchaseOrder
   - v. PaymentVouchers

2. On January 2,2023,Accra Enterprises issued the following invoices to its customers .The invoice numbers were serially numbered as: 2119 – 2124.Theentitytrades in gift items,designer's birthdaycards and bags.

Date	Description of Goods	
3/1/23	Joseph Ventures	
	24Cards	@N600
	8Cards	@N900
	Tradediscount@2%	
4/1/23	MichaelEnterprises	
	40BirthdayCards@	₦600each

	Tradediscount@2%	
10/1/23	SundayVentures	
	80BirthdayCards@	₦600each
	90Bags@	₦900each
	TradeDiscount @7 $^{1}/_{2}$%	
12/1/23	KatePaulina	
	5Bags@	₦900each
	12Birthdaycards @	₦600each
15/1/23	JudeDeku	
	15Birthdaycards @	₦600each
	18Bags@	₦900each
	Tradediscount @2 $^{1}/_{2}$%	
31/1/23	AdamEnterprises	
	150BirthdayCards@	₦600each
	105Bags@	₦900each
	TradeDiscount@9%	

Prepare the analytica sales day book of Accra Ventures for the month of January,2023.

CHAPTER FIVE
TRIAL BALANCE

Chapter Five Contents

- Trial balance
- Extended trial balance
- Accounting errors
- Effects of acconting errors
- Uses of Journal

Learning Objectives on Trial Balance
After studying this chapter, readers should beable to:

t) **Explain and State the Nature and Significance of Accounting**

- *Define and State Purposes of a Trial Balance;*
- *Explain Extended Trial Balance;*
- *State theUsefulness and Limitations of a Trial Balance;*
- *Identify and Explain Errors not affecting the agreement of a Trial Balance;*
- *Identify and Explain Errors that affect the agreement of a Trial Balance;*
- *Explain how journals can be used to correct errors;*
- *Identify Users of Financial Statements and their Information Needs;*
- *Explain the use of Suspense account; and*
- *Explain the effect of errors on Profit or Loss account.*

5.1 Purposes of Extracting Trial Balance

A Trial Balance is usually not an account but is a list of balances extracted from the ledger accounts at a givendate, arranged according to whether they are debit balances or credit balances. It records summary of debit and credit balances obtained from the General Ledger (GL). Thetotal of the debit and credit balances should agree if the double entry rules havebeen properly followed. Though a Trial Balance can be drawn at any time, it isusual practice to prepare it at the end of an accounting period before preparing the entity's final accounts.

Illustration 5.1

The Trial Balancetoour illustration 5.1 can bedrawn up thus:

Mensah Joe Enterprises

Trial Balance at 31March 2016

	Dr	Cr
	₦	₦
Capital		810,000
Loan		66,000
Cash	263,088	
Motorvehicle	480,000	
Carriage in wards	16,456	
Trade Receivables– Aburi&	65,000	
Trade payables		81,500
Sundry expenses	16.278	
Motor van expenses	10,852	
Salaries and wages	77,958	
Electricitybill	6,000	
Purchases	249,000	
Sales		284,280
Accountpayable		10,852
Receivables–Opobo	68,000	
	1,252,632	1,252,632

NOTE

(iii) The two receivables (i.e. Aburi & Co and Opobo) accounts could have been summed up in the General Ledger but they are shown separately here for convenience.

(iv) The balances brought down represent the position of the items in the TrialBalance. For instance, the balances brought down for capital, loan, payables, sales and accounts payable are on the credit side, this is also their position in the Trial Balance.

5.2 Extended Trial Balance

An extended trial balance is an adjusted trial balance after all identifying errors have been located, corrected and updated in a newly prepared trial balance. In this situation the initial Trial balance will not agree, it will be made to agree with a temporary suspense account debit or credit balances. To prepare an extended trial balance, all the errors will be identified, corrected with necessary accounting entries and an updated trial balance will be prepared.

5.3 Usefulness and Limitation oftheTrialBalance

ThemainusesoftheTrialBalance are:

(i) Tocheckthe arithmetical accuracyof entriesintheledger;

(ii) Todetectsucherrorsof posting thatcaneasily beidentifiedby theTrialBalance;

(iii) At a glance, it indicates balances in various ledgers and General Ledger accounts;

(iv) It is used by the external auditor to trace items with significant balances to schedule and source documents; and

(v) To facilitate preparation of the final accounts.

5.4 Accounting Errors

The following are limitations of trial balance:

(i) It is a mere list of balance and not an account;

(ii) A balanced trial balance does not signifies correctness of a trial balance; and

(iii) It does not indicate errors such as omission, principles and reversal of entries among other errors not affecting trial balance.

Errors not affecting Trial Balance Agreement

The preparation o a Trial Balance does not prove that transactions have been completely and correctly recorded in the proper accounts. These categories of errors are corrected through debit and credit entries. Thus, they do not appear in the suspense account. They are errors that do not affect the agreement of the Trial Balance and they include the following:

(i) **Error of omission**: This is a complete omission of a transaction from the ledger. Both the debit entry and the credit entry were not recorded. For example Cash Sales of ₦100,000 omitted from the record, to correct this error, DR Cash and CR Sales ₦100,000.

(ii) **Error of principle :**When a transaction is posted othe wrong class of account an error of principle has been committed. An example is where atrader purchases an additional motor vehicle for ₦950,000 in cash and treatedthe transaction as a motor running expense by crediting his cash/bank accountand debiting Motor Running Expenses Account (Nominal class of account).The motor vehicles Account (asset-Real Account) ought to have been debited and cash/bank credited. Or Purchase of Equipment ₦800,000 on Credit from Gyan debited into Purchases Account and Credited to Gyan Account. This can be corrected by Crediting Purchases Account and Debiting Equipment Account. Purchases Account only records items that are meant for resale.

(iii) **Error of commission:** This is an error within the same class of account butaffecting different persons. It is the posting of entry to the account of a personother than the one intended. For example, a payment of ₦120,000 received from B. Abbeythatis credited to B. Abu’s account. This can be corrected by debiting by debiting B. Abu’s Account and crediting B. Abbey’s Account ₦120,000.

(iv) **Compensating errors:** An error made in the ledger which, is exactly by she ercoincidence, balanced by another error else where in the ledger is referred to as a compensating error, More than one error may at times be made and yet the sum totals exactly equalan other single error some where else in the ledger. The effect is usually that there is over statement of an item in one account and an equivalent amount understated in an other account

(v) **Complete reversal of entries:** This involves error in which, for a transaction, the account that ought to be debited is credited and the one to be credited is debited. For instance, cash paid to trade receivables is debited in cash account and credited in trade payable account instead of vicevers a. For example, Cash Sales of ₦100,000, Cash Account was debited as ₦100,500 and Sales Account credited with ₦100,000. Also, purchases of goods worth ₦150,000 from Essien was debited into Purchases Account ₦150,000 and credited to Essien's Account ₦150,500. Notice that there was over debit of ₦500 and over credit of ₦500. The errors cancel out each other. To correct the errors, credit Cash Account and debit Essien's Account N500.

(vi) **Errors of original entry**: This error is committed where a transaction is incorrectly recorded in a source document or book of original entry and the incorrect amount is eventually posted to the relevant account in the ledger.This type of error will not have any effect on the agreement of the trial balance. For example if goods invoiced at ₦52,500 to J. K. Salmon is record as ₦55,200 inthe sales day book, the trial balance will in no way show the error if the incorrect amount of ₦55,200 is also debited to J. K. Salmon's account with other sales. It is a situation in which the original amount was recorded incorrectly. The double entries are observed with completely different figures. For example, a credit sales of ₦600,000 was debited to Trade Receivables Account and Sales Account as ₦1,000,000. There was over debitand over credit of ₦400,000. To correct the errors, debit Sales account and credit Trade Receivables account ₦400,000. There can also an instance of under debit and credits. Salaries and Wages Paid in Cash ₦190,000, this was debited into Salaries and Wages Account and Credited to Cash Account as ₦110,000. To correct the errors, debit Salaries and Wages Account and credit Cash Account ₦80,000.

(vii) **Transposition Errors:** The errors occur when the position of closely related figures is interchanged and debit and credit entries are passed with the interchanged figures. For example, credit purchases from Asamoah of ₦107,000 debited into Purchases Account and credited into Asamoah's Account as ₦170,000. The position of 7 in the figure was inadvertently interchanged leading to over credit and over debit of ₦63,000. This can be corrected by crediting Purchases Account and debiting Asamoah's Account ₦63,000.

5.5 Errors that affect theTrial Balance

The total of the debit side and credit side of the Trial Balance may not agree which means that one or more errors have been committed. Some of these errors are:

(i) Arithmetic/casting errors in balancing ledger accounts

(ii) Using one figure for the debit entry and an other figure for the credit entry inrespect of one transaction;

(iii) Errors of extracting the wrong figure from the ledger to the Trial Balance;

(iv) Listing a debit balance to the credit side of the Trial Balance;

(v) Listingacredit balanceto thedebitsideoftheTrial Balance;

(vii) Thepostingofdebitascreditorviceversawhiletheotherentryiscorrectlymade;

(viii) Incorrect lifting of opening balances into the trial balance; and

(ix) Making an entry on only one side of the accounts, omitting the second entry. This is called single entry posting.

5.6 Correction of Errors

There are two approaches to the corrections of errors. This is dependent on the effect of the error on the Trial Balance. For errors which do not affect the agreement of Trial Balance totals, there will always be two affected accounts in between which the error will be corrected, while errors which affect the agreement of the Trial Balance will affect only one ledger account and Suspense Account. The corrections of the errors will be by passing double entries between the Ledger Account and the Suspense Account.

SuspenseAccount

The suspense account is an account in which the net difference in Trial Balance totals is recorded temporarily until enough information is available to locate the errors and make necessary adjustments/entries to correct such errors causing the difference. It is a non-permanent account, which is used to record net difference between the debit and credit sides of an unbalanced trial balance. It ware houses interim differences in the trial balance until the errors are discovered and corrected.

Location of Errors

Errors which affect the agreement of theTrial Balance totals are more easily discovered than those which do not affect Trial Balance totals.In most cases errors not affecting the Trial Balance will only come to light through complaints from affected third parties such as customers or suppliers

.

An error of either type can belocated by taking the following steps:

(i) Re-cast/recheck the addition of ledger balances on the Trial Balance;

(ii) Check for any omission on the Trial Balance;

(iii) Make sure that the ledger balances appear on the correct side of the Trial Balance i.e. Income, Liabilities, capital and sales to be on the credit side while Expenses, Assets, Drawings and Purchases should be on the debit side;

(iv) Check for correct transfer of ledger balances to the Trial Balance;

(v) Take a general look at the entries in the ledger to see if a figure close to the difference sought is in the trial balance;.

(vi) Check the double entries in the ledger;

(vii) Check whether the opening balances from the ledger accounts are correctly lifted;

(viii) Check the arithmetic in the ledger. Recast each side of ledger accounts and reconfirm the balances c/d and b/d

(ix) If the trial balance difference is exactly divisible by two, check for one half of the difference on the trial balance, the figure might be on the wrong side of the trial balance;

(x) Take the difference between the debit and credit sides to ascertain whether there balance in the trial balance with the same value, if so correct the differences;

(xi) Examine whether Discount Allowed and Discount Received are correctly posted;

(xii) Determine whether the final figure from the Sales and Purchases journals have been posted Sales and Purchases Accounts;

(xiii) Verify to know whether balances on the Ledgers Account confirm whether they are been posted; and

(xiv) Check obvious wrong items on either the debit or credit sides of a trial balance;

(xv) If the trial balance difference is exactly divisible by 9, there could be error of transposition of figures, for example,₦98 written as ₦89.The difference is 9.

Steps involved in correcting Errors

In correcting errors which are not revealed by theTrial Balance the following steps should be taken:

(i) Read the question well and try to understand the transaction involved;

(ii) When the transaction is understood, determine the accounts involved and the entry which ought to be passed;

(iii) Compare the entries which ought to be passed with whath as been done, as reported in the question; and

(iv) On the basis of the observed difference, effect the correction of errors using double entries with either ledger accounting or journal entries.

5.7 Uses of Suspense Account

(a) It is useful in correcting errors affecting a trial balance;

(b) Incorrect balances in a trial balance is posted to suspense account; and

(c) It is useful in balancing all temporary balances.

Illustration 5.2

After extracting the Trial Balance of Giring ori Enterpriseson 31March, 2022, It was discovered that the debit side was higher than the credit side by ₦6 ,180. A review of the ledger revealed the following errors:

1. A sum of ₦720 on a Receivables’ account was omitted from the balance of Trade Receivables.
2. An item of furniture purchased for ₦5, 760 had been debited for repairs.
3. The payments side of the cash account had been under cast by ₦3,900
4. The total of one page of the sales day book had been carried forward as ₦12,924, where as the correct amount was ₦15,084.
5. A debit note of ₦1,260 received from a customer had been posted to the wrong side of his account.
6. Mr Laku whose debts of ₦3,120 to the business had been written off, paid during the year. His personal account was credited but no corresponding entry was made.

You are required to:

(i) PreparenJournalnentriesn to correct the errors.

(ii) Write up the Suspense account.

Solution to Illustration 5.2

GIRINGORI ENTERPRISES

(i) Journal Entries on 31March, 2022

			DR ₦	CR ₦
(a)	SuspenseAccount	Dr	720	
	ToPayables Account			720
	(Being entry in respect of omitted receivable balance)			
(b)	FurnitureAccount	Dr	5,760	
	ToRepairsAccount			5,760
	(Being correction of the purchase of FurnitureearlierdebitedtoRepairsaccount)			
(c)	SuspenseAccount	Dr	3,900	
	To CashAccount			3,900
	(Being correction of the undercast of cash book payment)			
(d)	Suspense Account	Dr	2,160	
	ToSalesAccount			2,160
	(Being correction of wrong amountc/f On one page of the sales day book)			
(e)	SuspenseAccount	Dr	2,520	
	ToReceivablesAccount			2,520
	(Being correction of posting a debit note to the page of the Sales daybook)			
(f)	Cash Account	Dr	3,120	
	ToSuspenseAccount			3,120
	(Being entry of recovered debt omitted from cash account)			

(ii)

SuspenseAccount

	₦		₦
Payables	720	Cash	3,120
Cash	3,900	TrialBaldiff	6,180
Sales	2,160		
Receivables	2,520		

Illustration5.3

The information relates to Kumasi Ventures, which operates eatery selling Donkunnu on wholesale to Customers in Lagos Island.

Below is the Statement of Financial Position as at 30 April, 2022:

Noncurrent Assets	**₦ '000**
Assets:	
Equipment	14,000
Trucks	12,000
Furniture	4,000
	30,000
Current Asset:	
Inventory	7,000
Trade Receivables	3,000
Bank	4,000
Suspense	2,000
	16,000
Total Assets	**46,000**
Capital	32,000
Profit or Loss	12,000
	44,000
Less: Drawings	-5,000
	39,000
Trade Payables	7,000
Total Capital and Liabilities	**46,000**

The Trial balance did not agree and the balance in the suspense account of ₦2,000,000 was posted to suspense account as indicated in the Statement of Financial Position as 30 April, 2022 above.

The following errors were discovered.

i. The closing inventory has severely impaired and it is under valued by ₦3,250,000.

ii. The Purchases Daybook was under cast ₦1,400,000

iii. Outstanding Stationery expenses of ₦1, 115,000 was omitted and not provided for.

iv. The interest received duly in the Cashbook totaling ₦1, 200,000 was not entered in the ledger.

v. A Cheque duly received from a customer, Koffi John amounting to ₦4,155,000 was credited to his account as ₦4,105,000.

vi. A payment of₦ 615,000 for Equipment was credited into the Cashbook but debited into equipment account.

vii. Discount allowed of ₦ 925,000 was posted into discount received account.

viii. Purchase of Small Delivery Van of ₦3,000,000 was recorded in the Purchases Account. This was part of the inventory above.

You are required to Prepare the:

a) Necessary Journals to correct the errors.

b) Suspense Account

c) Statement of Profit or Loss Account for the year ended 30 April, 2022 and a revised Statement of Financial Position as at this date.

KUMASI VENTURES

a) Journal Entries to Correct Errors

Particulars	**₦ '000**	**₦ '000**
Profit or Loss	3,250	
Inventory		3,250
Being amount of overvalued/impaired inventory written off		
Purchases (under cast)	1,400	
Suspense		1,400
Being amount of under cast written off to suspense account		
Profit or Loss: Stationery	1,115	
Outstanding/Accrued Stationery Account (SOFP)		1,115
Being amount of outstanding expensesomitted (SOFP)		

Suspense Account	1,200	
Interest Received (Profit or Loss)		1,200
Being interest received(single entry) written to suspense account		
Suspense Account (₦4,155 – ₦4,105)	50	
Trade Receivable (Koffi John)		50
Being correction wrong credit overstated in Koffi John's account		
Equipment Repairs (Profit or Loss)	615	
Equipment account		615
Being correction of error of principle		
Discount Allowed (Profit or Loss)	925	
Discount Allowed (Profit or Loss)	925	
Suspense Account		1,850
Being Correction of error of complete reversal of entries		
Delivery Van Account	3,000	
Inventory Account		3,000
Being correction of error of principle		

b) Suspense Account

	N '000		₦ '000
Bal b/d	2,000	Purchases (P or L)	1,400
Interest Received	1,200	Discount Allowed	925
Trade Receivables (Koffi John)	50	Discount Allowed	925
	3,250		3,250

c) Statement of Adjusted Profit or Loss for the Year Ended 30 April, 2022

		₦ '000
Net Profit (SOPF)		12,000
Add: Interest Received		1,200
		13,200
Less:		
Closing Inventory impaired/overstated	3,250	
Purchases undercast	1,400	
Equipment Repairs	615	
Stationery outstanding (Omission)	1,115	

Discount Allowed	925	
Discount Allowed	925	
		8,230
		4,970

Adjusted Statement of Financial Position as at 30 April, 2022

Noncurrent Assets	**₦ '000**	**₦ '000**
Assets:		
Equipment(14,000-615)		13,385
Trucks		12,000
Delivery Van		3,000
Furniture		4,000
		32,385
Current Asset:		
Inventory (7,000-3,000-3,250)		750
Trade Receivables (3,000-50)		2,950
Bank		4,000
		7,700
Total Assets		**40,085**
Capital		32,000
Profit or Loss		4,970
		36,970
Less: Drawings		-5,000
		31,970
Trade Payables	7,000	
Accrued Stationery	1,115	8,115
Total Capital and Liabilities		**40,085**

Chapter Summary

In this chapterwe have discussed trial balance, extended trial balance, uses of trial balance, errors that do not affect a trial balance, errors that affect a trial balance and their corrections. Also, adjustments were made to indicate how errors affect profit or loss and statement of financial position**.**

Review Questions

Multiple choice and short-answer questions

(1) Which of the following willing crease the value of the account?

I. Debitan asset account

II. Debit a liability account

III. Debit an expense account

IV Debitanincomeaccount

(A) I and II

(B) I and III

(C) II and III

(D) II and IV

(E) I and II & IV

(2) When A photo copy machine is purchased on credit for N500,000, state the account to bedebited and credited

	Debit	Credit
(A)	Officeequipment	Purchases
(B)	Purchases	Officeequipment
(C)	Seller	Officeequipment
(D)	Officeequipment	Seller
(E)	OfficeEquipment	Sales

(3) An entry on the right-hand side of a ledger accountis

(A) Creditentry

(B) Debitentry

(C) Contraentry

(D) Balancec/d

(E) Balanceb/d

Use the following information to answer questions 4 and5

The following two accounts show the application nof the double entry for a transaction on aparticular date.

Motor Vehicle

	~~N~~		~~N~~
OluVentures	75,000	Cash	15,000
		Balc/d	60,000
	75,000		75,000

OluVentures

			~~N~~
balc/d	75,000	Motor Car	75,000
			75,000

(4) What does the entryon the debit side of Motor vehicle account represent?

(A) OluVentures purchased ₦75,000motor vehicle in cash

(B) A motor vehicle of ₦75,000 is purchased from OluVentures

(C) Motor vehicle is sold to OluVentures for₦75,000

(D) OluVentures sold a motor vehicle for ₦75,000

(E) Olu Venture brought down ₦ 75,000in motor vehicle account

(5) What does the balancec/din OluVentures account stand for?

(A) Trade Payables

(B) Trade Receivable

(C) Accounts payable for motor car

(D) Accounts receivable for motor car amount transferred to statement of profit or loss'

(6) An error in which the position of figures is inter-changed is called________

(A) Errors of Principles

(B) Transposition Error

(C) Error of Commission

(D) Error of Omission

(E) Error of Complete Reversal

(7) An error which reverse errors in another book of account is known as ______

(A) Error of Omission

(B) Error of Principles

(C) Compensating Error

(D) Transposition Error

(E) Error of Commission

(8) Which of the following errors affect agreement of a trial balance?

(A) Arithmetic error

(B) Error of Commission

(C) Error of Principles

(D) Error of Original Entry

(E) Compensating Error

(9) Which of the following errors do NOT affect agreement of a trial balance?

(A) Single entry posting
(B) Error of Commission
(C) Error of Principle
(D) Error of Complete Reversal
(E) Compensating Errors

(10) A trial balance is the balance extracted from _____ ledger

(A) Real
(B) Nominal
(C) Impersonal
(D) General
(E) Personal

Short Answer Questions (SAQ)

1. Information stored in a computer-based accounting system which can be arranged in to any desired format is called.......................

2. The relationship between the ledger and the Trial Balance is that a debit balance in the ledger will be on the................side of the Trial Balance and a credit balance on the side.

3. How does the Trial Balance complement the usefulness of the double entry principle?

4. State any four types of errors that do not affect the Trial Balance

5. While the Trial Balance proves the equality of the debit and credit entries in the ledger it does not guarantee absence of......................

6. It is common to divide the ledger for a large organization into four separate ledgers known as the private,.........................and...................................

7. A non-current asset, which was bought on January 2022 was debited into purchases account and credited into cash account. What is the name of the error corrected by the book keeper?

8. A list of balances from various books of account is called _____

9. A trial balance re-prepared after all errors have been located and corrected is called _____

10. An error in within the same class of account but affecting different person is called _____

Theory and calculation Questions Review Questions

(1) (a) Identify and explain Three(3)Types of accounts

(b) Outline Four (4 uses of aledger account

(2) An entity start edatrading business in Mokolaon 1 Decembe r2016 with ₦200,000 deposited in a bank at Mokola Other transactions for the month of December 2016 were:

2/12/2016:	The propriet or gave his old car to the business for ₦180,000
3/12/2016	Bought of fice Furniture ₦40,000 from John Ventureon credit
3/12/2016	Bought goods worth ₦92,000 withch eque from Paul
4/12/2016	Cash sales worth ₦65,000 and money deposited in to the business Account by the customer direct.
10/12/2016	PaidJohnVenture₦22,500 withch equein respect of th epurchase of Furniture
12/12/2016	Purchase goods worth₦72,500 on credit from JuliusVentures
15/12/2016	Goods sold on credit to talling ₦48,900 to Azikwe Enterprise
20/12/2016	Paid Julius Venture total outstanding amount as at 12 December 2016
24/12/2016	Paid stationery expenses ₦12,500 with cheque
31/12/2016	Paid Telephone expenses for business calls ₦4,500 cheque
31/12/2016	Settled staff salaries with ₦20,000 cheque

You are required to:

(a) Prepare and balance all relevant ledger accounts as at 31 December, 2016

(b) Prepare the entity'strial balance on 31December, 2016

3. Give and explain Five (5) types of errors that do not affect balancing of atrial balance
4. Itemise and explain any SIX (6) errors that will affect balancing of atrial balance
5. Highlight any FIVE (5) errors that affect trial balance.

Solution to Review Questions

(1)	B	(6)	B
(2)	D	(7)	C
(3)	A	(8)	A
(4)	B	(9)	B
(5)	C	(10)	D

Answer to Short Answer Questions

1. Database
2. Debit, credit
3. The Trial Balance tests whether the principle of double entry is properly **followed in recording in ledger accounts.**
4. Error of principle
- Error of commission
- Error of completeomission
- Errors of compensation
5. Errors
6. Private, Sales ledger and Purchases ledger and General Ledger.
7. Error of Princi*ple
8. Trial Balance
9. Extended Trial Balance
10. Error of Commission

CHAPTER SIX
ACCOUNTING FOR NON-CURR ENT ASSETS
Chapter Six Contents

- Features and classifications of Non-current assets
- Computation and accounting for depreciation
- Disposal of non-current assets
- Non current assets register
- Non current assets coding

6.0 Learning objectives

After you have studied this chapter, you should be able to:

- State the types and characteristics of non-currentassets
- Differentiate between capital and revenue expenditure
- Define depreciation and explain the need to provide for depreciation in final accounts
- Calculate depreciation using the straight line (equal installments) and there ducing balance methods
- Calculateany profit or loss made on the sale of non-current assets
- Explain the significance of maintaining non-current assets register
- Explain asset coding

6.1 Introduction

IAS 16- Property , Plant and Equipment is the accounting standard that specify how to account for items of non-current asset classified as property, plant and equipment. **Assets:**

An asset has been defined as 'a resource controlled by an entity as result of past events, and from which future economic benefits are expected to flow to the entity'.

A careful examination of the above definition will bring out the following salientcharacteristicsof items thatwillqualifytobereferredtoas an asset.

i. It must beare source. In other words for an item to be called an asset, it must be valuable.

ii. It must be owned or controlled by the entity. By control, it means that the entity can prevent others from obtaining the same economic benefits that it is entitled to derive from there source.

iii. It must have resulted from past events. This means that an asset will ordinarily not be from a future transaction that is yet to happen. If an entity propose to buy a motor vehicle next financial year, such intention to buy the vehicle does not in any way create an asset.

iv. Economic benefits are expected to be derived by the entity from the asset infuture. An item that has no future economic benefit can not be referred to asanasset.

6.2 ClassificationofAssets

There are two forms of assets held by business organisations.

These are: Non-currentassetsandcurrentassets.

a. CurrentAssets

According to IAS I-Presentation of financial statements, current assets include cash, receivables, prepaid expenses and inventory.They are assets that are likely to bere a lised, sold or consumed in an entity’s normal opening cycle; or within twelve months after the reporting date. They are held for the purpose of trading.All other assets are classified as non-current.

b. Non-CurrentAssets

Non-current assets are those assets that were not bought purposely to be sold but to be used in the business for along time. Non-current assets are categorized in to two:

i. Tangible non-current assets

Tangible non-current assets are assets that have material and physical existence such as property (Land and buildings, plant and equipment, motor vehicles, furniture and fittings, machinery, etc). Such assets are usually held for use in the production or supply of goods andservices for rental to others or for administrative purposes.

ii. **Intangible non-currentassets**

Intangible non-current assets have no physical or material existence and can not be touched but they provide expected future benefits. Such intangible non assets aregood will, patents and trademarks.No further reference is made to intangible assets because the detail treatment is out side this syllabus.

Some times, it is not possible to state whether an asset is current or non-current until its function is known. The classification of anasset as current non-current requires a little caution.This is because an asset may indeed change with changing circumstances. Forinstance, an entity that manufactures and sells cars will classify cars as inventory, a currentasset.If however, the entity were to use one of its manufactured cars for its operations,then the classification changes from ‘current’ to ‘non-current’. It must therefore, be known that the classification of assets as property, plant and equipment is usually guided by their functions, physical attributes or expected use fullifes.

6.3 The determination of the cost of non-current assets

Almosteverybusinessentityofanysizeoractivityusesassetsofadurable natureinits

operations. Such assets are not acquired for resale but rather they are used in the business to increase the earning capacity or productivity of the organisation.

6.3.1 Initial Measurement

At the date of acquisition, items of property, plant and equipment are recorded at their initial historical cost. Cost in this case refers to the amount of cash or cashe quivalent that was paid or the fair value of other consideration that have been given instead of cash, to acquire an asset at the time of its acquisition or construction. Business entities some times construct by them selve susing their available materials and manpower, assets such as buildings, plant and equipment, furniture,fixtures and fittings.This may be done in order to save costs, meet their own preferred specification or simply because they wish to make use of their idle capacity.Fair value is theprice to bereceived or orderly transaction between market participants at the measurementdate (IFRS 13).Transactions in which two or more unrelated parties agreed to do business, acting independently and in their self- interest is referred to as arm ’slength transaction. In otherwords, the price at which the item was exchanged between them is free and fair and market-determined. Both buyer and seller are independent, possess equal bargaining power, are not under pressure or duress from the opposing party, and are acting in their own self-interest to attain the most beneficial deal.

6.3.2 Components of Acquisition Costs

Generally, the cost of anitem of property, plantand equipment comprises of:

i. Its purchase price plusimport and other non-recurring levies (e.g.development levies, consentfee,etc) less any trade discounts and rebates.

ii. The directly attributable costs of bringing the asset to its location and working condition for the purpose them anagementintended to use the asset (IAS16).

These directly attributable costs may include the cost of laboure engaged in its installation or construction, cost of preparing the site for construction, carriage inwards, installation and assembly expenses,cost of testing the asset on completion and relevant professional charges(e.g.architectsfee,surveyor'sfee,)etc.

Illustration 6.1

Flatworks (Sierra Leone) Ltd, orders a machine from a Nigerian tools manufacturer at an invoice price of Le100, 000,000.Payment will be made in 48 monthly installments of

Le2, 500,000(includingLe20, 000,000interest charges) .Othe rrelevant costs include:

	Le
ValueAddedTax	12,500,000
FreightCharges	10,250,000
Installationandotherstart-upcosts	4,000,000
Tradediscountgiven	1,000,000

What is the cost of the machine to be capitalized in Flat works (Sierra Leone)Ltd?

Solution to Illustration 6.1

	Le
Invoiceprice	100,000,000
Tradediscount	(1,000,000)
	99,000,000
VAT	12,500,000
Transportationcharges	10,250,000
Costofinstallation	4,000,000
TotalCost	125,750,000

* The interest charges of Le20, 000,000 on the installment purchase will be

recognised as interest expense overth enext 48 months and written-off in the statement of profit or loss.

Elements of cost of different types of items of property, plant and equipment.

Capitalisation: means to recognize an amount of cost or part of the cost of an item as an asset. So when anitem of cost is‘capitalised’, it is treated as an asset and not an expense.

6.3.2 Land

When land is purchased, certain incidental costs are generally incurred, in addition tothe purchase price. These incidental costs may include commissions to real estate brokers, legal fees for examining and in suring the titlean dfees for surveying, draining, clearing and grading the property. All these expenditures are part of the costof the land since they are intended to get theassets ready for use. Any proceed sobtain edin the process of getting the land ready for its intended use, such as the sale of cleared timber, are treated as reduction in the price of the land.

Local improvements, such as pavements, streetlights, sewers, drainage system and land- scaping requires special treatment. These are usually charged to the land account because they are relatively permanent in nature. However, expenditures on land such as private drive ways, fences, and car parks are recorded separately. These expenditures should be recorded as land improvements and depreciated over their estimated use fullifes because they have limited useful lifes.

6.3.3 Cost of building

The cost of building should include all expenditures related directly otheiracquisition orconstruction. These costs include materials, labour, over heads costs incurred during construction, professional fees and building permit. An entity may engage the services of contract or to have its building constructed. All costs incurred by the contractors from excavation to completion are considered part of the building cost.

There are occasions where land purchased as a building site has on it an old building Which is not suitable for the buyer’s use.In this case, the only useful “asset” being acquired, is the land. Where this happens, any cost incurredin demolishing the old building should be charged to land together with the purchase price of the land it self. This is because the cost of demolition less its salvage value is a costof getting the land ready forits intended use.

6.3.4 Cost of equipment

The term “equipment” in accounting includes delivery equipment, office equipment, machinery, furniture and fittings, factory equipment and similar assets. The costs of these assets include the purchase price, freight and handling charges incurred insurance on the equipment while in transit and costs of conducting trial runs. Coststherefore include all expenditures incurred in acquiring the equipment and preparing it for use.

6.4 Capital expenditure and Revenue Expenditure

6.4.1 Capital Expenditure

Capital expenditure may be defined as the cost of acquiring a non-current asset for use in an entity.Capitalexpenditureincludessuch costsasareincurred inaddingvalue to existing non-current assets in order to improve their earning capacity and to prolong their life’s for more than one accounting period.

Examples of capital expenditure are:

i. Purchase price of non-current assets such as motor vehicles, buildings, furniture and fittings, plantand machinery;
ii. Extension or anyimprovement of a permanentnaturemade to any structure
iii. Legal fees of acquiringland or buildings;
iv. Thecostincurred in bringing any non-currentasset toits presentlocation; and
v. Any other cost that must be incurred in getting the non-current assets ready for its intended use.

6.4.2 Revenue Expenditure

Revenue expenditure on the other hand is any cost in which its earning potential is exhausted with in one accounting period. Such expenditures are not made to increase or improve the value of non-current assets butrather, are made for the maintenance and day-to-day running of the business.

Examples of revenue expenditure are:

i. The cost incurred in acquiring trading inventories for sale;
ii. Cost of repairing any non-current assets;
iii. Discount allowed on creditsales;
iv. Expenses in connection with rent, insurance, telephone and electricity; and.
v. Staff salaries and emoluments.

6.4.3 Differences between capital and revenue expenditure Differencesdueto time:

Where the benefitthatisderivedfromanitemofexpenditureisuseduporexhausted With in one accounting period, then such expenditure is revenue expenditure. Howeverif the benefit derived from an item of expenditure extends to more than one period ofaccount,it should bereferred toas capital expenditure.

Differences due to type of account:

An increase incapital expenditure is added or debited to an on-current asset account, which is finally disclosed in the statement of financial position. All revenue expenditures are charged to the Statement of profit or loss. An organisation should be careful not to incorrectly classify capital and revenue expenditure. As it can be seen fromtheabove, the classification of capital and revenue expenditure has a direct impact on the resulting profit figure in the statement of profit or loss and also the assets values in the statement of financial position. This is true because if organisations wrongly classify revenue expenditure as a capital expenditure, the total expenses figure in the statement of profit or loss will be understated. This will result in over stating the net profit of the business. Should the owner appropriate the profit for his personal use, it might lead to the collapse of the business since the owner is spending his capital in stead of the profits orgains from the business.

6.5 Depreciation

Capital expenditure like building, plant, fixtures and fittings do normally last for more than one year. It is obviously possible that these assets may deteriorate withthepassageoftimeduetoitsusage.Thereisthereforetheneedtorecognisethelossi nthe value of non-current assets in the books of accounts.If this is not done, the value of non-current assets in the statement of financial position will be incorrectly stated.

The process of recognising the loss in the value ofnon-current assetsasa resultofusingsuchassetsiscalleddepreciation.IAS16defineddepreciationandsomec onceptsrelevant to depreciation accounting as follows:

i. **Depreciation**

This is the systematic allocation of the depreciable amount of an asse to verits useful life.

ii. **Depreciableamount**

This is the cost of an asset (or its revalued amount, in cases where a non-currentassetis revalued duringits life) lessits residual value.

iii. **Residualvalue**

This is the expected disposal value of the asset (after deducting disposal costs) at the end of its expected useful life

iv. **Usefullife**

This is the period over which the asset is expected to be available for use by the business entity.

Non-current assets produce revenue through house rather than throughresale. They canbe viewed as quantities of economic service potential to be consumed over time in the earning of revenues .Depreciation recognition transfers apportion of acquisition cost and capitalised post-acquisition cost ofnon-current asset to an expense accountcalled depreciation expense. The corresponding credit is the accumulated depreciationaccount, a contra non-current assets account that reduces gross assets value to the carrying amount. This expenseis recorded as an adjustingentryattheend ofeach accountingperiod. Depreciation expense could be classified as aselling or administrative expense, depending on the use to which the asset is put. 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.

Certainty of non-current assets have unlimited useful economic life's, and so do not require depreciation. This is usually true of land unless the land is an agriculturallandorlandacquiredfor extractive purposes.By contrast, buildings will normally have limited useful economic life, and therefore, will normally be subjected to depreciation.

It is important to point out/emphasise that theaccumulated depreciation account does no trepresentcashsetasideforreplacementofnon-current assetsn or does it srecognitionimplythe creationofreservesforasset replacement.

6.5.1 Causes of depreciation

There are several factors that contribute to depreciation of non-current assets. These factors or causes can be classified as follows:

i. **Physical deterioration**

This is where the fall in value of a non-current asset is due to wear and tear as a result of its constant use. Natural occurrences such as erosion, rust and decay also reduce the value of any non-current asset.

ii. **Obsolescence**

This is where an asset is put out of use even though it is in good workingcondition. This occurs where an asset becomes out of date as a result of newinventions or technological advancement.For example bakers used clay-molded oven in baking bread.Theinvention of gas-molded ovens has certainly rendered theuse of the lay mould out of date. This factor of depreciation is known as obsolescence.

iii. **Inadequacy**

Another situation closely linked with obsolescence is where a non-current asset is rendered useless as a result of the growth and changes in thesize of abusiness.Afisherman who uses canoe may have to acquire a large fishing boat when the demand for fish increases beyond the capacitythat the canoe can cope with. In this situation an organisation can clearly deduce that I twould be more efficient and economical to operate a large fishing boat than the canoe, and as are sul the canoe will be put out of use, though it is in good working condition. This factor of depreciation is known a sin adequacy.

iv. **Depletion**

Natural resources such as mines, quarries, oil, coal and gas deposits becomeworthless when the deposits or resources are depleted. These assets are calledwasting assets. The process of providing for the consumption of such assets is called depletion.

- ♦ **Time factor**

  There are certain assets that have specific period of legally determined life span. Assets such as patent, copy rights, finance

  Leases have a legal life fixed in terms of years. As and when the years elapse, the value of these assets reduces. The cost of these assets must be spread over their legal lives. The termused in recognizing the fallin value of these assets is termed amortisation.

6.5.2 Methods of calculating depreciation

There are several methods of calculating depreciation.These include:

v. Straight Line Method or Fixed Installment Method or Equal Installment method
vi. Reducing Balance Method or Diminishing Balance Method
vii. Sum-of-the-Years'-DigitsMethod
viii. Units-of-OutputMethod
ix. Revaluation Method
x. Machine Hour Method
xi. Depletion of Unit Method

The syllabus for which this manual is prepared covers only two of the methods listed above: Straight Line or fixed installment or equal installment method and the reducing balance or diminishing balance method. There maining methods will be treated in the next stage of the course.

Before the two methods are discussed, but is important to note the elements of depreciation that will be put in to use while illustrating the depreciation methods the elements include:

- The cost (orrevaluedamount) of the non-current asset.
- The estimated residual value of the non-current asset.
- The estimated useful economic life of the non-current asset.
- The method of depreciation considered appropriate for the business by management

This method becomes the accounting policy of the business entity.

All the elements mentioned above in volve a certain amount of subjectivity. As a result of the subjective nature of the depreciation computation.

6.5.3 Straight Line Method

The straight line method is the most widely used method of computing depreciation charge for financial statements purposes. Under this method, an equal amount of depreciation is charged ineach accounting period over the useful life of the non-current asset. The depreciation amount I scomputed by dividingthe original cost of the non-current asset lesses timated residual (salvage) value by the use ful life of the asset. A mathematical for mulacan be deduced as follows:

Annual Depreciation = <u>Original cost of Asset–SalvageValue</u>

Use ful Life of Asset

Illustration 6.5.3

On January 1, 2022 Hyde Limited purchased a motor vehicle for Le250, 000,000. The motor vehicle has an estimated useful life of fivey ears withasalvagevalueof Le5, 000,000.

You are required to calculate the depreciation charge and accumulated depreciation for each of the years and show the net book value as at the end of 2026 accounting period using thestraight-linemethod.

SolutiontoIllustration 6.5.3

Annual Depreciation = <u>Le250,000,00</u>

<u>Le5,000,000</u>

5

= Le49, 000,000

Year	Carrying amount at start of year	Depreciation for the year	AccumulatedDepreciation	Carrying amount at end of year
	Le	Le	Le	Le
2022	250,000,000	49,000,000	49,000,000	201,000,000
2023	201,000,000	49,000,000	98,000,000	152,000,000
2024	152,000,000	49,000,000	147,000,000	103,000,000
2025	103,000,000	49,000,000	196,000,000	54,000,000
2026	54,000,000	49,000,000	245,000,000	5,000,000

In the example above, the cost of the non-current asset is **Le250, 000,000; the depreciable amount is Le245,000,000; the residual value is Le5,000,000; the use ful life is 5 years and the depreciation per year is Le49,000,000. The carrying amount at the end of 2026 equals the residual value (Le5, 000,000).**

6.5.4 Reducing Balance Method

Under this method of depreciation, the book value of a non-current asset at the beginning of the year is multiplied by a fixed percentage to determine the depreciationfor the accounting year. This procedure is repeated in subsequent accounting periods so a store duce the depreciable amount of the non-current asset to its residual value or to zero if it has no residual value.

Illustration 6.5.4

On January 1, 2022 John Kay Limited purchased plant for Le250, 000,000. It is the policy of John Kay to depreciate Plant at 20% per annum. You are required to calculate carrying amount as at the end of 2026 accounting period using the reducing balance method.

SolutiontoIllustration 6.5.4

Year	Carrying amount at start of year	Depreciation Rate	Depreciation for the year	Accumulated Depreciation	Carrying amount at end of year
	Le		Le	Le	Le
2022	250,000,000	20%	50,000,000	50,000,000	200,000,000
2023	200,000,000	20%	40,000,000	90,000,000	160,000,000
2024	160,000,000	20%	32,000,000	122,000,000	128,000,000
2025	128,000,000	20%	25,600,000	147,600,000	102,400,000
2026	102,400,000	20%	20,480,000	168,080,000	81,920,000

When a non-current asset is purchased during theyear, depreciation is calculated to the nearest month. In some organisations, a full year's depreciation charge is provided on non-current assets acquired during the year irrespective of the date in the year in which they were purchased. Where this is the case any assets old in they ear will also not attract depreciationin the year of saleir respective of the time of sale with in the accounting period.

Computing Reducing Balance Depreciation Rate

Where the percentage rate is not given, this can be calculated by using a formula, provided the residual value, the cost and the estimated useful life of the non-currentasset is known.

The formula that can be used to derive the percentage depreciation rate per annum towrite down the asset to the residual value or zero (where the asset has no residual value) is:

Depreciation Rate =l –n $\sqrt{\frac{Residual\ Value}{Cost\ of\ Asset}}$Where

n= estimated use fullife of the asset.

Illustration6.5.4.1

A non-current asset cost **Le1, 000,000 and its estimated value is Le200, 000 at the end of5years.Thereducingbalancedepreciationrateis**

Depreciationrate=l-n $\sqrt{\frac{R}{C}}$=l-5 $\sqrt{\frac{¢200,000}{1,000,000}}$

=l – 5 $\sqrt{0.2}$

=1 – 0.7248

=0.2752 or27.52%

Using this rate to depreciate the non-current asset using the diminishing balance method, we have

Year	Cost/Carrying amountat Beginning	Rate	Depreciation for the year	Accumulated Depreciation	Carrying amount of at end year
	Le	%	**Le**	**Le**	**Le**
1	1,000,000	27.52	275,200	275,200	724,800
2	724,800	27.52	199,465	474,665	525,335
3	525,335	27.52	144,572	619,237	380,763
4	380,763	27.52	104,786	724,023	275,977
5	275,977	27.52	75,949	799,972	200,028

Note: The excess of **Le28 over the residual value of Le200,000 is due to rounding error.**

6.6 Accounting for depreciation

After calculating the depreciation charge for the accounting year, you must record the amount in the books of account. It is important for you to remember that the process of making allowance for depreciation is charging to revenue the cost of the non-current asset consumed during the accounting period. This, therefore ,means that Depreciation is revenue expenditure and as such must be recorded in the same manner that accountants record normal business expenses.

The doubleentry method of recording depreciation expense in the books of account is as follows:

i. Depreciation expense charged for the year

Dr Depreciation expense account

Cr AccumulatedDepreciationAccount

ii. At the end of the year or at any time during year when all ledger account are closed to prepare financial statements:

Dr Statement of profit or loss

Cr Depreciation expense account.

This implies that depreciation is treated as a contra to the non-current asset account. The non-current asset account is maintained at its original cost. Aledger account called "Accumulated Depreciation account" is opened and all depreciationcalculations are credited to that account, the corresponding entry being passed into the Depreciation charge Account as a debit.

Illustration 6.6

On January1, 2018 Bragado Limited purchased Equipment for Le800, 000. It is the policy of the Companyto depreciate all equipment at 20% perannum using redundancy balance method. **Required**:

Record the above in the under listed ledger accounts for the years ending December 31,2018, 2019, 2020, 2021 and 2022:

a. The Equipment account
b. The Accumulated Depreciation on Equipment Account
c. The Depreciation Expense Account
d. The Statement of Profit or Loss (Extracts)for the respective years.

e. The Statement of Financial Position(Extracts)as at December 31,2018–2022.

(a) **Solution to illustration 6.5**

EquipmentAccount

			Le				Le
2018 Jan	Bank		800,000	2018 Dec31	Balance	c/d	800,000
2019 Jan	Balance	b/d	800,000	2019 Dec31	Balance	c/d	800,000
2020 Jan	Balance	b/d	800,000	2020 Dec31	Balance	c/d	800,000
2021 Jan	Balance	b/d	800,000	2021 Dec31	Balance	c/d	800,000
2022 Jan	Balance	b/d	800,000	2022 Dec31	Balance	c/d	800,000

(b) **Accumulated Depreciation on Equipment Account**

31/12/2018	Balancec/d	160,000	31/12/2018	Depreciation expense	160,000
31/12/2019	Balancec/d	288,000	01/01/2019	Balanceb/d	160,000
			31/12/2019	Depreciation expense	128,000
		288,000			288,000
31/12/2020	Balancec/d	390,400	01/01/2020	Balanceb/d	288,000
			31/12/2020	Depreciation expense	102,400
		390,400			390,400
31/12/2021	Balancec/d	472,320	01/01/2021	Balanceb/d	390,400
			31/12/2021	Depreciation expense	81,920
		472,320			472,320
31/12/2022	Balancec/d	537,856	01/01/2022	Balanceb/d	472,320
			31/12/2022	Depreciation expense	65,536
		537,856			537,856
			01/01/2023	Balanceb/d	537,856

(c) **DepreciationExpenseAccount**

		Le16			Le16
31/12/2018	Accum.Depr.Equipt	0,000	31/12/2018	Profitorloss	0,000
31/12/2019	Accum.Depr.Equipt	128,000	31/12/2019	Profitorloss	128,000
31/12/202	Accum.Depr.Equi	102,400	31/12/202	Profitorloss	102,400

0	pt		0		
31/12/2021	Accum.Depr.Equipt	81,920	31/12/2021	Profitorloss	81,920
31/12/2022	Accum.Depr.Equipt	65,536	31/12/2022	Profitorloss	65,536

StatementofProfitorLoss(extract)foryearended December 31,

		Debitside
		Le
2018	DepreciationExpense	160,000
2019	DepreciationExpense	128,000
2020	DepreciationExpense	102,400
2021	DepreciationExpense	81,920
2022	DepreciationExpense	65,536

The balance on the equipment account will be shown on the statement of financial position atthe end of the accounting year less the balance on the Accumulated Depreciation Account asfollows:

Statement of Financial Position (Extract) at December 31,

	Assets	Cost **Le**	Accumulated Depreciation **Le**	Carrying amountatendyear **Le**
2018	Non-current AssetsEquipment	800,000	160,000	640,000
2019	Equipment	800,000	288,000	512,000
2020	Equipment	800,000	390,400	409,600
2021	Equipment	800,000	472,320	327,680
2022	Equipment	800,000	537,856	262,144

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6.7 Disposal of non-current assets

An entity can dispose of its non-current 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 the organisation must remember to take out the asset disposed from themain non-current asset account. This is done by opening an account for the purpose ofthe disposal. Into this account is debited the cost of thenon-current asset and itsassociated accumulateddepreciationis credited into the same account.A profitorloss may arise from the disposal of the non-current asset when compared with thecarryingcost (cost less accumulated depreciation).

Accounting Entries

On the disposal of non-currentasset, the following entries must be passed: Open a Non-current Asset DisposalAccount and;

i. Transfer the cost of the non-current asset sold to the non-current asset disposal account thus:

   Dr.Non-current assetdisposalaccount
   Cr.Non-currentassetaccount

ii. Transfer the accumulated depreciation on the asset sold to the non-current asset disposal account as follows:

   Dr. Accumulated depreciation account Cr.Non-current asset disposal account

iii. The amount realized from the sale of the non-current asset must be recorded thus:

   Dr. Cash, Bank or Sundry receivables account Cr. Non-current asset disposal account

Where the non-current assets disposal account ends in a credit balance, it means that the amount received from the sale is more than the carrying amountofthe non-current asset; hence a profit is the resulting figure.

Dr. Non-current asset disposal Account Cr.

Statement of Profit or Loss

Where the non-current asset disposal account ends in a debit balance, it means that the amount received from the sale is less than the carrying amount of the non-current asset sold; hence, the loss must be recorded.

Dr. Statement of Profitor Loss

Cr.Non-current asset disposal Account

The entries above can be illustrated by assuming that the equipment purchased by Bragado in Illustration 6.6 was sold for cash amounting to Le295, 000 at January 2, 2023. The cost of the equipment as at January 2, 2023 was Le800, 000, its associated accumulated depreciation amounted to Le537,856 leaving a carrying amount of

Le262,144 (Le800,000-Le537,856). Since the equipment was sold for Le295, 000 it means that a profit amounting to Le32, 856 will be calculated as thus:

Calculation of profit on sale of equipment	Le
Cost of equipment	800,000
Less Accumulated depreciation	537,856
Carrying Amount	262,144
Proceeds from sale of equipment	295,000
Less Carrying amount	262,144
Profit on disposal of equipment	32,856

If one again assumes that the equipment purchased by Bragado in Illustration 10.5 was soldfor cash amounting to Le200, 000 on January 2, 2023.The balance on the equipment account asat January 2, 2023will show cost of Le800,000,with its associated accumulated depreciationofLe537,856 leaving a carrying amoun of Le262,144(Le800,000-Le537,856).Since the equipment was sold for Le200,000,a loss amounting to Le62,144 will be calculated as thus:

Calculation of loss on sale of equipment	Le80
Cost of equipment	0,000
Less Accumulated depreciation	537,856
Carrying amount	**262,144**
Proceeds from sale of equipment	200,000
Less carrying amount	262,144
Loss on disposal of equipment	**(62,144)**

The transaction involving the sale of assets at aprofit as per Illustration10.5 will be recorded as:

EquipmentAccount

		Le			Le
01/01/2023	Balanceb/d	800,000	02/01/2023	Equipment disposals	800,000

AccumulatedProvisionforDepreciationAccount-Equipment

		Le			Le
02/01/2023	Equipment disposals		01/01/2023	Balanceb/d	537,856

Equipment Disposals Account

02/01/2023	Equipment account	800,000	02/01/2023	Accumulated provisionfor depreciation	537,856

31/12/2023	Statement ofProfitor Loss	32,856	02/01/2023	Cash	295,000
		832,856			832,856

StatementofProfitor Loss(extract)fortheyearended December 31, 2023

GrossProfit	xxxx
Add profit on sale of equipment	32,856

6.8 Non-current asset register

A non-current asset register is used to records information about a business' non-current assets. This enables the business to maintain control over its assets and reduces the risk of loss from theft and the risk that assets are under utilised. The non-current asset register provides details of the cost and depreciation for each non-current asset of the business. The register can therefore be used to check the General Ledger balances relating to the cost and depreciation of its non-current assets.The non-current asset register will usually be sub-divided into sections which will record different classes or types of non-current assets. For example, a business might have the following sections in its register:

- Property
- Plant and machinery
- Fixtures and fittings
- Motor vehicles

Information to be recorded for each asset

A non-current asset register would typically record the following information for each of its non-current assets:

- A description of the asset (to enable it to be identified)
- The date it was acquired
- The cost of the asset
- How the asset was funded
- The depreciation that has been charged for each accounting period
- The carrying value of the asset at the end of each accounting period
- The date of disposal (if appropriate)

- Details of the disposal proceeds

Many businesses will also include additional information if they believe it will be useful to do so; e.g

- The gain or loss made on disposal
- The location of the asset (or who it has been assigned to)
- The asset's servicing regime to help in its maintenance
- Details of any impairments or damage done to the asset
- Purchase and, if appropriate, sale invoice references

A typical non-current asset register will contain the following information about all items of Property, plant and equipment:

Description:

Acquisition date: Cost: Depreciation charges:

Carrying amount:

Funding method: Disposal date; and Disposal proceed.

6.9 Asset Coding

Asset coding is a process of attaching a unique identification number (ID) to an item of property, plant and equipment for identification and verification purposes. Property Control is charged with identifying equipment that meets non-current asset criteria, assigning an inventory control number, affixing an inventory control tag, and recording it in the banner non-current asset system.

Asset coding can be created following these steps:

- Identify the asset type and category
- Assign a unique ID number
- Choose the appropriate tag type
- Enter basic information about the asset
- Apply assets tags
- Implement quality and verification process

6.10 Summary

In thischapter the distinction between capital expenditure and revenue expenditure has been clearly explained. The item of cost or expenditure to be capitalised shouldinclude all the activities that are intended to put the asset in a condition ready for use.We have also defined depreciationtomean the processof spreading the cost of a non-current asset over its use ful life and that whe rean asset is fully depreciated and it is still in use one must not continue depreciating the asset. We again learnt thatwhere an asset is disposed off during the year the carrying amount at the time of sale should be deducted from the sale proceeds and either a profit or loss on disposal posted to the Statement of Profit or Loss.

Non-current asset register and coding were described in the later part of the chapter.

6.11 MultipleChoiceQuestions (MCQ)

1) The lossinvalueofnon-currentin tangible assets as a result of passage of time is referred to as?

   a. Depletion
   b. Deterioration
   c. Wasting
   d. Amortisation
   e. Obsolescence

2) Depreciation of an asset with fixed period of legallife is of ten referred to as?

   a. Obsolescence
   b. Amortisation
   c. Diminishing balance method
   d. Depletion
   e. Deterioration

3) Which of the following assets will not be shown on the statement of financial position of abusiness entity?

   a. In tangible asset such as management services

b. Intangibleassetsuch as goodwill

c. Tangible asset such as machinery

d. Tangibl easset such as buildings

e. Intangible asset such as research and development

4) Which of the following is an example of revenue expenditure?

a. Expenditure on non-current assets bought by the firm

b. Expenditure on the repairs of buildings

c. Formation expenses before a company commenced business

d. Tax paid to the Internal Revenue Service

e. Repairs to vehicle withhooked engine

5) Every asset should haveat least

a. Tangible and in tangibl equalities

b. Monetary cost and future benefit

c. An adequate monetary value

d. An in adequate monetary value

e. Durabl equalities

Use the information below to answer Questions 6and 7.

A motor van was purchased by a bookshop on 1 July 2020 for Le10, 000,000 and sold on 30June 2022 for Le8, 200,000.The firm's accounting year end son December 31, each year. Motor vans are depreciated at 10% per annum on cost. Full year depreciation is charged in the year of purchase but none in the year of sale. The asset is not expected to have any residual value on date of sale.

6) What is the profit or loss on disposal of the

motor van?a. Le100,000(loss)

b. Le200, 000(loss)

c. Le200, 000(profit)

d. Le1, 200,000(loss)

e. Le1, 200,000(profit)

7) What is the accumulated depreciation on the motor van as at June

30, 2021?a. Le500,000

b. Le1,000,000

c. Le1,500,000

d. Le2, 000,000

e. Le3, 000,000

6.12 Short Answer Questions (SAQ)

1) A company has business premises worth Le80, 000,000. An additional amount of Le20, 000 was used to provide metal gate for the building. The cost of the gate should be treated as____________________________________

The following information relates to Questions 2and 3.

- Motor vehiclesat cost(1/1/2022)Le50,000,000
- Accumulated depreciation(1/1/2022)Le18,000,000
- Depreciation is at the rate of 20% per annum using reducing balance method

2) What would be the depreciation charge for 2022?

3) What would be the carrying amount of the motor vehicles as at December, 312022?

4) The value of a non-current asset is recorded in a ______________________

5) The provision made for the loss in value of non-current assets that is of a was ting nature is referred to as____________________________

6.13 Examinationtype questions

I. Kokou Ltd. Made the following non-current asset purchases in 2022 accounting year.

Type of Asset	Cost(Le)	Date
Motor vehicle	70,000,000	January,1
Furniture and fittings	120,000,000	March,1
Furniture and fittings	40,000,000	July,1

Motor vehicle	208,000,000	October,1

The company's policy is to depreciate motor vehicle and furniture and fittings a the rates of 25% and 20%, using the fixed installment and reducing balance methods respectively.

Depreciation is calculated on

monthly basis. **Required**:

a) The Motor Vehicle Account

b) Furnitu reand Fittings account

c) The respective Accumulated depreciation accounts

d) A statement of financial position (extract) for each of the years 2022and2023

2. Koffi is a trader dealing in the sale of second hand clothes and prepare saccount to December 31, of each year. The following transactions in assets have taken place:

2022	January,1	Purchased Office Equipment for Le150.000,000
2022	July,1	Purchased Plant and Machinery costing Le500.000,000
2023	October,1	Bought Plant for Le300.000,000
2023	December,1	Purchased Office Equipment for Le200.000,000

Koffi maintains its non-current assets at cost and depreciates its asset at a constant rate of 20% using the straight line method of providing for depreciation. Assets purchased attract full year depreciation charge in the year of acquisition, whilst any asset disposed off attracts no depreciation charge in the year of sale.

You are required to prepare the following accounts for year 2022to2023:

a) The Office equipment account

b) The Plant and Machinery account

c) The respective accumulated Provision for depreciation accounts

d) A statement of financial position(extract) as at December 31,2022 and2023

6.14 Solution to Multiple Choice Questions

1. D
2. B
3. A
4. B
5. B
6. C
7. B

6.15 Solutionto short answered questions

1. Capital Expenditure
2. Le6,400,000
3. Le25,600,000
4. Realaccount
5. Depletion

6.16 Solution to Examination type questions

Kokou Limited

1. Motor Vehicle Account

		Le'000			Le'000
1/1/2022	Bank	70,000	.	.	.
1/10/2022	Bank	208,000	31/12/2022	Balancec/f	278,000
		278,000			278,000
1/1/2023	Balanceb/d	278,000	31/12/2023	Balancec/d	278,050
1/1/2024	Balanceb/d	278,000			

Furniture&Fittings Account

		Le'000			Le'000
1/3/2022	Bank	120,000	.	.	.
1/7/2022	Bank	40,000	31/12/2022	Balancec/d	160,000
		160,000		31/12/2023balc/d	160,000
1/1/2023	Balanceb/d	160,000			160,000
1/01/2024	Balb/d	160,000			

Depreciation account–Motor vehicles

		Le'000	Le'000		
31/12/2022	Balc/d	30,500	31/12/2023	Depreciation Expense	30,500
		30,500	30,500		
				Balanceb/d	30,500
			01/01/2023	Depreciation Expense	69,500
31/12/2023	Balc/f	100,000			
100,000					100,000
			01/01/2024	Balanceb/d	100,000

Accumulated Depreciation Account–Furniture&Fittings

		Le'000	Le'000		
31/12/2022	Balancec/f	24,000	31/12/2022	Depreciationexpense	24,000
		24,000	24,000		
31/12/2023	Balancec/f	51,200	1/1/2023	Balanceb/d	24,000
			31/12/2023	Depreciationexpense	27,200
		51,200			51,200
			1/1/2003	Balanceb/d	51,200

Statement of Financial Position (Extract) as at 31Dec.

2022	Cost **Le'000**	Accumulated Depreciation **Le'000**	Carrying amount **Le'000**
Non-currentAssets			
Motorvehicles	278,000	30,500	247,500
Furniture&Fittings	160,000	24,000	136,000
	438,000	54,500	383,500
2023			
Non-currentAssets			
Motorvehicles	278,000	100,000	178,000
Furniture&Fittings	160,000	51,200	108,800
	438,000	151,200	286,800

2. <u>Koffi</u>

Office Equipment Account

		Le'000			Le'000
01/01/2022	Bank	150,000	31/12/2022	Balancec/f	150,000
		150,000			150,000
01/01/2023	Balanceb/d	150,000	31/12/2023	Balancec/f	350,000
01/12/2023		200,000			
		350,000			350,000
01/01/2024	Balanceb/d	350,000			

Plant&MachineryAccount

		Le'000			Le'000
01/07/2022	Bank	500,000	31/12/2022	Balancec/f	500,000
		500,000			500,000
01/01/2017	Balanceb/d	500,000	31/12/2017	Balancec/f	800,000
01/10/2017	Bank	300,000			
		800,000			800,000
01/01/2018	Balanceb/d	800,000			

Accumulated Depreciation Account-Office equipment

		Le'000			Le'000
31/12/2022	Balancec/f	30,000	31/12/2022	Depreciationexpense	30,000
		30,000			30,000
31/12/2023	Balancec/f	100,000	01/01/2023	Balanceb/d	30,000
31/12/2023	Depreciationexpense	70,000			
		100,000			100,000
			01/01/2024	Balanceb/d	100,000

Accumulated for DepreciationAccount-Plant&machinery

		Le'000			Le'000
31/12/2022	Balancec/f	100,000	31/12/2022	Depreciationexpense	100,000
				100,000	
				100,000	
31/12/2023	Balancec/f	260,000	01/01/2023	Balanceb/d	100,000
			31/12/2023	Depreciationexpense	160,000
		260,000			260,000
			01/01/2024	Balanceb/d	260,000

Depreciation ExpenseAccount-Officeequipment

		¢'000			¢'000
31/12/2016	Accumulated depreciation Account	30,000	31/12/2016	StatementofProfitor Loss	30,000
		30,000			30,000
2017					
31/12/2017	Accumulated depreciation Account	100,000	31/12/2017	Statement of Profit or Loss	100,000
		100,000			100,000

Depreciation Expense Account-Plant & Machinery

		Le'000			Le'000
31/12/2022	Accumulated depreciation Account	100,000	31/12/2022	Statement of Profit or Loss	100,000
		100,000			100,000
2023					
31/12/2023	Accumulated depreciation Account	160,000	31/12/2023	StatementofProfitor Loss	160,000
		70,000			160,000

Statement of Financial Position (Extract) as at December 31,

2022	Cost **Le'000**	Accumulated Depreciation **Le'000**	Carrying amount **Le'000**
Non-currentAssets			
Office Equipment	150,000	30,000	120,000
Plant &Machinery	500,000	100,000	400,000
	650,000	130,000	520,000
2023			
Non-currentAssets			
OfficeEquipment	350,000	100,000	250,000
Plant &Machinery	800,000	260,000	540,000
	1,150,000	360,000	790,000

6.17 Examination like question without solutions

1. A company depreciates its fleets of motor vehicle sat the rate of 25%, using there ducing balance method. From the information given below, you are required to draw up the following accounts for year ended December 31, 2021 and 2022:

   a) The Motor vehicles Account
   b) The accumulated depreciation account –Motor Vehicle
   c) The Motor vehicle disposal account
   d) A statement of financial position (extract)asat December 31,2021and2022

2021	January,1	Purchased6carsforLe50.000,000each
2021	September,1	Purchased2truckscostingLe500.000,000
2022	November,1	Sold 2 ofthe cars boughtonJanuary1,2021forLe90,000,000
2022	December,1	Purchasedonetruckfor Le200.000,000

2. Kossi commenced business on March 1, 2010 selling mobile phones and prepares accounts to December 31, of each year. The following transactions in assets have taken place

Date	Asset	Details	Cost	Scrapvalue	Dep.rate
Jan,12020	Land&Buildings	Purchase	Le980,000,000	Le80,000,000	4%
Jan,12020	Plant &Machinery	Purchase	Le550,000,000	Le20,000,000	10%
June,302022	Building	Sale	Le480,000,000	Le20,000,000	
Aug,12022	Plant &Machinery	Purchase	Le475,000,000	Le65,000,000	10%
Oct,12022	Building	Purchase	Le550,000,000	Nil	4%

Included in the land and buildings account is Le100, 000,000 representing the cost of land with a scrap value of Le40, 000,000. The scrap values of the various assets above were determined by a firm of professional valuers. The depreciation method used is the straight line methodand it is the policy of the company to provide depreciation on the basis of one monthownership one month depreciation charge. The building with a scrap value of Le20, 000,000 was sold for Le

400, 000,000 on June 30, 2022.

Required:

a) The respective non-current assets accounts

b) The disposal of asset account

c) There spective accumulated depreciation accounts

3 On January1, 2018 Adrion Limited purchased Equipment for Le 450, 000. It is the policy of Adrion Limited to depreciate Plant at 20%. You are required to show the Equipment account in thebooks of Adrion Limited as at the end of 2022 accounting period using the reducing balance method.

CHAPTER SEVEN
ADJUSTMENT FOR SIMPLE FINANCIAL STATEMENTS

- Allowances for doubtful and irrecoverable receivables
- Accruals and prepayments
- Drawings in goods and cash
- Non current and current liabilities

Accounting for inventories

Learning Objectives

After you have studied this chapter, you should be able to:

- *Calculate Allowances for irrecoverable and doubtful receivables;*
- *Calculate Allowances for discounts on trade receivables*
- *Explain prepayments and accruals;*
- *Identify and Calculateprepayment and accruals;*
- *Explainaccounting for goods and cash drawings;*
- *State the differences between current and noncurrent liabilities; and*
- *Explain Accounting for inventories.*

7.1 Allowances for Recoverable and Doubtful Receivables

In a financial year, from day-to-day financial transactions, many change soccur in the management of an entity’s economic resources. These changes bring about financial obligations from customers to pay up outstanding trade receivables, commitment to pay certain current and liabilities as and when due.Examples of these financial obligations and commitment include interest accrues daily on debts,as rent expense payable/outstanding for use of an office building, prepaid stationery expense, income receivable and other related financial items in day-to-day management of a business entity. Similarly, other resources and obligations such as employeesalaries originate as service is rendered, customers buy goods on credit, supplier supplies goods for sale on credit, lenders give loans to a business entity obligations with payments to followat specified dates. In most cases, the end of the accounting period generally does not coincide with thereceipts orpayments of cash associated with all types of resource changes indicated in the preceding paragraphs.

Consequently, adjusting entries are used to record such resource changes (expenses accrued, prepaid, incomes receivables and provisions for doubtful debts are made where necessary) to ensure the accuracy and truthful representations of the economic phenomena reported in the financialstatements.This chapter will consider some of the adjustments most commonly made in the preparation of the final accounts and also discuss why such adjustments are required. Also, their treatments in both the Statement of Profit and Loss and StatementofFinancialPosition will betreated indetail in the chapter. Accountants rely on two principles in the adjusting process–**revenue recognition** and **matching principles**.The revenue recognition concept requires that revenue bereported when earned, not before and not after. Revenue is earned for most entities at the timewhen services and products are delivered to customers and not when cash was eventually paid. If an entity sells goods on 31 December, 2021 to a customer, despite the fact that the customers have not paid as at this date; therevenuewasearnedinthe year 2021andthisshouldbe reported as revenuein the2021StatementofProfitorLossforyear ended 2021,evenifthecustomerpaidforthe goodslater in the year2022. The value of goods bought by the customers will be recorded as trade receivable in the Statement of Financial Position as at 31 December, 2021. Besides, where there is a likelihood of default on the credit sales to the customers in 2021, the entity will make a provision for doubtful debts as an expense in the StatementofProfitorLossforyear ended 2021 and this will reduce the total value of the trade receivable in the Statement of Financial Position as at 31 December, 2021.

Furthermore, the matching principle aims to report expenses in the same accounting period as therevenues that are earned as a result of incurring these expenses. The matching ofexpenses with revenue is a major part of the adjusting process. As an example if abusiness earn smonthly revenuewhileoperatingoutofrentedstorespace,the matching conceptstipulatesthatrentmustbe reportedonthe statement of profit orloss for a particular period, December,evenifrentispaidinaperiodearlier thanor afterDecember. This ensures that the rent expense for December is matched withtherevenueoftheparticularmonth. At the end of an accounting period, it is likely that an entity will find that someexpenseshave been paid which relate to the next accounting period,whils to ther amounts, which relateto the current period remain outstanding.In order that the account shows a true and fair view of the entity’s Financial Performance, adjustments for such items are necessary. The simple adjustments affecting the Statement of Profit or Loss for the year ended and the Statement of Financial Position as at a given date are classified into three categories:

(1) Allowances for irrecoverable and doubtful trade receivables;

(2) Allowances for discounts on trade receivables;

(3) Deferralsandprepayments;

(4) Accrued Expenses and Revenues;

(5) Drawings of goods and cash by proprietor;

(6) Current and noncurrent liabilities;

(7) Inventories(Closing and Opening); and

(8) Other adjustments

Revenue in the Statement of Profit consists of cash and credit sales of goods to customers.The credit sales occur when goods are sold to customers and payments made in a latter day in the accounting year (within 12 months) or outside the accounting year (outside 12 months).

The accounting entries for credit sales are: debit entry in customer/trade receivable account and credit entry in sales account. The debit entries (total debit balances) in all customers account/trade receivable, if unpaid at the end of an accounting year is known as trade receivable which is reported in the debit side of a trial balance. In the final account, in anticipation of payment at a latter day, trade receivable is recognized under current asset in the Statement of Financial Position as at a given date. To apply the prudency concept, that is, anticipating all probable future loss of incomes, certain proportion of the trade receivables (total unpaid credits of customers) are set aside by debiting Allowances for Irrecoverable/Doubtful receivables with a corresponding credit entry in the Provision doubtful Trade Receivables' Account. In such a situation, the net trade receivable (trade receivable minus total provision for doubtful trade receivables (balances of provision for doubtful debt on the credit side of the trial balance plus debit entry in the Statement of Profit or Loss) will be recognized under current asset in the Statement of Financial Position. On the other hands, there is increase or decrease in allowance for doubtful debt or a situation where the earlier doubtful trade receivables provisions on the credit side of a trial balance is no longer required.

- **Accounting entries for an Increase in Provision in Allowances for Doubtful Debt**

  If there is an increase in provision for doubtful debt in the trial balance, debit amount of increase into the Statement of Profit or Loss and credit accumulated provision for doubtful debt in the trial balance. In the SOFP, under current asset, the net trade receivable in the SOFP will be trade receivable minus accumulated provision for doubtful debt.

- **Accounting entries for a Decrease in Provision in Allowances for Doubtful Debt**

  Assume that there is a decrease in provision for doubtful debt in the trial balance, credit the amount of decrease to Gross Profit in the Statement of Profit or Loss and debit accumulated provision for doubtful debt in the trial balance. In the SOFP, under current asset, the net trade receivable in the SOFP will be trade receivable minus balance (amount in the credit side of trial balance minus amount of reduction) in the provision for doubtful debt.

- **Accounting entries when Allowances Provision for Doubtful Debt are no longer necessary**
  Where the provision for doubtful debt reported on the credit sides of the trial balance is no longer necessary, credit the amount no longer required to Gross Profit in the Statement of Profit or Loss and debit accumulated provision for doubtful debt in the trial balance. In the SOFP, under current asset, the net trade receivable in the SOFP will be trade receivable minus the provision for doubtful debt in the trial balance.

Bad Debts

Anentitythatsellsitsgoodsonpurelycashbasis,does not have to worry about customers not paying for such goods.This is notalwaysthecase.Goodsand services are usually sold or rendered on credit, giving rise to trade receivables. The business entity is there fore taking the risk of some customers defaulting in the payment of their debts. Trade receivables that cannot be collected are called bad debt sorirre cover able debts, which is the risk of doing business on credit terms. Where a customer's debt is found to be irrecoverable, steps must be taken to remove such debts from the list of customer so wing the business entity.This is doneby completely writing off the debt from the receivables account. Writing off of a particular debt from the list of receivables accounts means that the value of the assets (receivables) of the business has reduced or diminished.This has the effect that thebusiness entity has incurred losses that must be accounted for by increasing the expense account of irrecoverable debt, which will eventually reduce profit and alsoreduce assets of receivables.This also translates to a reduction of the net assets of thebusiness. Where an account containing a debt is declared 'irrecoverable' a journal entry must be passed as follows:

	Dr.	**Cr.**
	₦	₦
Bad /Irrecoverable debts expense account (Statement of Profit or Loss)	x	x
To: Trade receivables account (Statement of financial position)		

It is important for entities to review their receivables periodically and identify those debts that are unlikely to be collected in full.These irrecoverable debts may thenbewritten-off in the statement of profit or loss.This practice prevents overstatement of both profit and assets and is always required if irrecoverable debts are probable andcan be estimated. At the end of the accounting periodthe totaldebtwrittenoff istransferredfromtheirrecoverable debts accounttotheStatement of

Profit or Lossas follows:

Dr.	Cr.
	x
Statement of Profit or Loss	Irrecoverable debts account

Illustration 7.1

Kumasi Venture extracted Trial Balance

	Debit	**Credit**
	¢	**¢**
Trade Receivables	500,000	
Allowances for doubtful debt		50,000
Trade Payable		100,000
Gross Profit		150,000
Capital		200,000
	500,000	**500,000**

Assume the following situations that there are:

i. Increase in allowances for doubtful receivables to 15%

ii. Increase in allowances for doubtful receivables by 2 ½ %

iii. Allowances for doubtful receivables increase to ¢62,000

iv. Allowances for doubtful receivables reduce by ¢10,000

v. Allowances for doubtful debt reduce to 7 ½ % of Trade Receivables

vi. Decrease in allowances for doubtful debt by 3% of Trade Receivables

vii. Allowances for doubtful receivables are no longer required

viii. A customer with outstanding of ¢80,000 in the above trial balance is declared bankrupt by a competent court of jurisdiction

Required:

With appropriate ledger entries, post items i-v and under each assumption; prepare the extracts of Statement of Profit or Loss Account and Statement of Financial Position.

Situation I:

Increase in allowance for doubtful debt to 15%: 15% of ¢500,000 = ¢75,000

Original provisions allowance for doubtful debt(trial balance) = ¢50,000

Increase in provision = ¢125,000

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Bal c/d (SOFP)	125,000	Bal b/f	50,000
125,000		P or L	75,000
		125,000	
		Bal b/d	125,000

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Less Expenses:	
Increase in Allowance for doubtful debt	(75,000)
Profit for the year	**75,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢125,000)	375,000
Capital	200,000
Profit for the year	75,000
Total Capital	**275,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	375,000

Situation II: Increase in allowances for doubtful receivables by 2 ½ %

Increase in allowance for doubtful debt to **2 ½** %: **2 ½** % of ¢500,000 = ¢12,500

Original provisions allowance for doubtful debt (trial balance) = ¢50,000

Increase in provision **= ¢62,500**

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Bal c/d (SOFP)	62,500	Bal b/f	50,000
62,500		P or L	12,500
		62,500	
		Bal b/d	62,500

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Less Expenses:	
Increase in Allowance for doubtful debt	(12,500)
Profit for the year	**137,500**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢62,500)	437,500
Capital	200,000
Profit for the year	137,500
Total Capital	**337,500**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	437,500

Situation III: Allowances for doubtful receivables increase to ¢62,000

Increase in allowance for doubtful debt to ¢62,000	=	¢62,000
Original provisions allowance for doubtful debt (trial balance)=		¢50,000
Increase in provision	**=**	**¢112,000**

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Bal c/d (SOFP)	112,000	Bal b/f	50,000
112,000		P or L	62,000
		112,000	
		Bal b/d	112,000

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Less Expenses:	
Increase in Allowance for doubtful debt	(62,000)
Profit for the year	**88,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢112,000)	338,000
Capital	200,000
Profit for the year	88,000
Total Capital	**288,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	338,000

Situation IV: Allowances for doubtful receivables reduce by ¢10,000

Reduction in allowance for doubtful debt by ¢10,000(debit)	=	(¢10,000)
Original provisions allowance for doubtful debt (trial balance)	=	¢50,000
Increase in provision	=	**¢40,000**

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Gross Profit	10,000	Bal b/f	50,000
Bal c/d	40,000	50,000	
50,000		Bal b/d (SOFP)	40,000

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Add:	
Decrease in Allowance for doubtful debt	10,000
Profit for the year	**160,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢40,000)	460,000
Capital	200,000
Profit for the year	160,000
Total Capital	**360,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	460,000

Situation V: Allowances for doubtful debt reduce to 7 ½ %

7 ½ % of ¢500,000 = ¢37,000, ¢50,000-¢37,500 = ¢12,500

Reduction in allowance for doubtful debt by ¢10,000(debit) = (¢12,500)

Original provisions allowance for doubtful debt (trial balance) = ¢50,000

Decrease in provision = ¢37,500

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Gross Profit	12,500	Bal b/f	50,000
Bal c/d	37,500	50,000	
50,000		Bal b/d (SOFP)	37,500

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Add:	
Decrease in Allowance for doubtful debt	12,500
Profit for the year	**162,500**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢37,500)	462,500
Capital	200,000
Profit for the year	162,500
Total Capital	**362,500**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	462,500

Situation VI: Decrease in allowances for doubtful debt by 3% of Trade Receivables

3% of ¢500,000 = ¢15,000

Reduction in allowance for doubtful debt by ¢10,000(debit) = (¢15,000)

Original provisions allowance for doubtful debt (trial balance) = ¢50,000

Decrease in provision = ¢35,000

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Gross Profit	15,000	Bal b/f	50,000
Bal c/d	35,000	50,000	
50,000		Bal b/d (SOFP)	35,000

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Add:	
Decrease in Allowance for doubtful debt	15,000
Profit for the year	**165,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢35,000)	465,000
Capital	200,000
Profit for the year	165,000
Total Capital	**365,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	465,500

Situation VII: Allowances for doubtful debt no longer required

3% of ¢500,000 = ¢15,000

Allowance for doubtful debt not required (debit) = (¢50,000)

Original provisions allowance for doubtful debt (trial balance) = ¢50,000

Decrease in provision = ¢0.0000

Allowance/Provision for Doubtful Trade Receivables' Account

	¢		¢
Gross Profit	50,000	Bal b/f	50,000
Bal c/d	0.000	50,000	
50,000		Bal b/d (SOFP)	0.000

Statement of Profit or Loss Extract	**¢**
Gross Profit from trial balance	150,000
Add:	
Decrease in Allowance for doubtful debt	50,000
Profit for the year	**200,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000- ¢0.000)	500,000
Capital	200,000
Profit for the year	200,000
Total Capital	**400,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	500,500

Situation VIII: A customer with outstanding of ¢80,000 in the above trial balance is declared bankrupt by a competent court of jurisdiction

Trade Receivables' Account

	¢		¢
Bal b/d	500,000	Bad Debt	82,000
500,000		Bal c/d	418,000
Bal. b/d (SOFP)	418,000	500,000	

Statement of Profit or Loss Extract	¢
Gross Profit from trial balance	150,000
Add:	
Bad Debt	82,000
Profit for the year	**68,000**

Statement of Financial Position Extract	**¢**
Current Assets:	
Net Trade Receivables (¢500,000-¢50,000- ¢82,000)	368,000
Capital	200,000
Profit for the year	68,000
Total Capital	**268,000**
Current Liability:	
Trade Payable	100,000
Total Capital and Liability	368,000

Illustration7.2

Jack Terr or has been in business for several years dealing in the sale of second hand clothes. During the three year sended October,312016, he presented the following

	Creditsales	Irrecoverable Debts
	¢	¢
October,312014	4,500,000	1,200,000
October,312015	8,750,000	3,850,000
October,312016	12,200,000	6,300,000

You are required to show the above information for the year ende October,312014,2015and2016 in the following accounts:

a) Tradereceivables account

b) Irrecoverable debts account

c) Statement of Profit or Loss

Solutionto Illustration7.2

(a) **Trade Receivable Account**

	¢		¢
		31/10/2014	
31/10/2014Sales	4,500,000	Irrecoverabledebts	1,200,000
		31/10/2014Balancec/f	3,300,000
	4,500,000		4,500,000
1/11/2014Balanceb/f	3,300,000		

Trade Receivable Account

	¢		¢
	8,750,000	31/10/2015 Irrecoverabl debts	3,850,000
31/10/2015 Sales		31/10/2015 Balancec/f	4,900,000
	8,750,000		8,750,000
1/11/2015 Balanceb/f	4,900,000		

TradeReceivablesAccount

	¢		¢
31/10/2016Sales	12,200,000	31/10/2016	6,300,000
		Irrecoverabledebts	
		31/10/2016Balancec/f	5,900,000
	12,200,000		12,200,000
1/11/2016 Balanceb/f	5,900,000		

(b) Irrecoverable debt Account

¢

31/10/2014

31/10/2014 Statement

Trade Receivables 1,200,000 of Profit or Loss
1,200,000

31/10/2015 31/10/2015 Statement

3,850,000

Trade Receivables 3,850,000 of Profi tor Loss

31/10/2016 31/10/2016 Statement

Trade Receivables 6,300,000 of Profit or Loss 6,300,000

c. Statement of Profit or Loss (extract)endedOctober,31xxxxxx

	¢	¢
2014 Grossprofit	Xxxxxx	
Less Irrecoverable debts	1,200,000	X
2015 Gross profit	xxxxxx3,850,000	
Less Irrecoverable debts		X
2016 Grossprofit	xxxxxx6,300,000	
LessIrrecoverabledebts		X

7.2 Allowance and Discounts on Trade Receivables

In certain businesses allowance is made for cash discount that is expected to be offered to customers on the trade receivables balance at the reporting period end.Proponents of this concept argue that since entities allow discounts on credit sale for prompt payment, recording gross realizable value of receivables as the balance on receivables account less allowance for doubtful debts alone will not give the best estimate of the amount expected to be collected from trade receivables. They argue that the best estimate of the value of receivable is that one that gives effect to cash discounts. Hence, making the determination of allowance for discounts on receivables.

The way in which allowance for discount on receivables is calculated is almost thesame as when calculating allowance for doubtful debts alone.You must howeverremembertoapplythesamerateorpercentagetothenetamountoftradereceivables less allowance for doubtful debts. This is so because discounts are allowedondebts expected to bepaid andnot irrecoverabledebts.

Itis the process of making allowancefor the possibilityofadebtbecomingirrecoverable in the future but by what amount cannot be calculated with substantialaccuracy. In the case of doubtful debts, the amount or its estimate still remains in thelist of receivables and is not cancelled from thereceivablesaccountunlike thecaseof debts that have actually become irrecoverable. Doubtful debt does not relate to anyspecific debtor, but the business entity recognizes the fact that not all the existing debts will be collected and as such, it is prudent that such uncertainty is reflected in the Statement of Profit or Loss and the statement of financial position. The account treatment necessary to make aprovision for doubtful debts is:

1. When a provision is made for the first time:

Debit: Statement of Profit or Loss

Credit: Allowance for doubtfuldebts Account

With the initial allowance made.

In this way the current year's profit is reduced, whils in the statement of financial position the allowance is clearly shown and deducted from trade receivables. In subsequent accounting period's new estimate must be made inrespect of debts that may be considered doubtful. The new allowance should becom pared with the existing one and where the current allowance is greater than the previous one, the difference representing nincreasein allowance for doubt fuldebts should be accounted for as follows:

Debit: Statement of Profit or Loss with the increase

Credit: Allowance for doubtful debts (current allowance less previous allowance)

However,if the current allowance is less than the previous one,the difference representing a decrease in allowance for doubtful debts should be accounted for asfollows:

Debit:Allowance for doubtful debts account With the reduction in allowance made

Credit:Statement of Profit or Loss (Previous allowance less current allowance)

Illustration7.3

Viscosity Ltd. has been in business since 2014 dealing in the sale ofmobile phones.During thethree-yearsperiodendedDecember,312016 the companypresentedthefollowinginformation relatingtoreceivables:

	Receivables	Irrecoverable Debts (excluding Irrecoverabledebts)
	¢	¢
31December,2014	7,000,000	1,000,000
31December,2015	18,250,000	2,500,000
31December,2016	10,000,000	4,300,000

Viscosity Ltd. makes provision for a doubtful debt at the rate of 6% on receivables.There was no balance on the provision for doubtful debt at the beginning of 2014financial year.

You are required to show the above informationfor theyear ended31 December,2014,2015 and

2016 in the following accounts:

(a) Irrecoverabledebt

(b) Allowancefordoubtful debts account

(c) StatementsofProfitorLoss(extracts)

(d) Statements of financial position(extracts)

Solutionto Illustration7.3

(a) **Irrecoverable debts account**

		¢			¢
31/12/2014	Trade Receivables	1,000,00	31/12/2014	StatementofProfitorLoss	1,000,000
31/12/2015	Trade Receivables	2,500,000	31/12/2015	StatementofProfitorLoss	2,500,000
31/12/2016	Trade Receivables	4,300,000	31/12/2016	StatementofProfitorLoss	4,300,000

(b) **Allowancefordoubtfuldebtsaccount**

		¢			¢
31/12/2014	Balancec/f	420,000	31/12/201	StatementofProfitor Loss	420,000
		420,000			420,000
			1/1/201	Balanceb/f	420,000
31/12/2015	Balancec/f	1,095,000	31/12/201	StatementofProfitorLoss	675,000
		1,095,000			1,095,000
31/12/201	Statemento ProfitorLos f	495,000	1/1/201	Balanceb/f	1,095,000
31/12/2016	Balancec/d	600,000			
		1,095,000	1/1/201	Balanceb/f	600,000

(c) Statement of Profit or Loss(extract) for the year ended 31December xxxxxxx

	¢	¢	¢
2014 Gross profit			xxxxxx
LessIrrecoverabledebts	1,000,000		
Increaseinallowancefordoubtfuldebt	420,000	(1,420,000)	X
2015 Grossprofit		xxxxxx	X
Less bad debts	2,500,000		
Increase in Provision for doubtful debt	675,000	3,175,000	X
2016 Gross profit		xxxxxx	
AddDecreaseinProvisionfordoubtfuldebt	495,000		
Lessbaddebts	(4,300,000)	(3,805,000)x	

(d) **StatementofFinancialPosition(extract)at31Decemberxxxxxxx**

	¢	¢
2014 TradeReceivables	7,000,000	
Lessallowancefordoubtfuldebts	420,000	6,580,000
Increaseinallowancefordoubtfuldebt		
2015 TradeReceivables	18,250,000	
Less allowance for doubt ful debts	675,000	17,575,000
2016 TradeReceivables		
Lessallowancefordoubtfuldebts	10,000,000	
Lessbaddebts	675,000	9,400,000

Illustration 7.4

Mahatma Ltd. has been in business since 2014 dealing in the sale of Italian executive shoes. During the three years ended 31 December 2016 the company presented the following information relating to receivables:

	Trade Receivables	Allowancefor doubtfuldebts	Allowancefor cashdiscount allowed
	¢	¢	%
31December2014	17,000,000	1,000,000	4
31December2015	28,550,000	4,500,000	4
31December2016	22,000,000	2,800,000	4

You are required to show the above information for the years ended31December, 2014, 2015,and 2016 in the following accounts:

a. Allowancefordiscountsonreceivables

b. Statements of Profitor Loss(extracts)

c. Statements of financial position(extracts)

Solutionto Illustration11.8

(a) Allowancefordiscountsonreceivablesaccount

		Notes	¢'000			Note	¢'000
31/12/2014	Balancec/f		640,000	31/12/2014	StatementofProfit orLoss	(1)	640,000
				1/1/2015	Balance		640,000
31/12/201	Balancec/f	(2)	962,000	31/1/2015	b/dStatementofPr of it orLoss	(4)	322,000
			962,000				962,000
31/12/201	Statemento f Profit or Loss	(5)	194,000	11/1/201	Balanceb/f	(2)	962,000
31/12/201	Balancec/f	(3)	768,000				962,000
			962,000	1/1/201	Balanceb/f		768,000

Statement of Profit or Loss(extract)for the year ended31Decemberxxxxxxx

¢		¢	¢
2014 Grossprofit		xxxxxx	x
Less allowance for doubtful debt	1,000,000		
Allowance for discount on receivables	640,000	(1,640,000)	x
2015 Grossprofit		xxxxxx	x
Less allowance for doubtful debts(Note4)	4,500,000		
Allowance for discount onreceivables	322,000	4,822,000	x

2016 Grossprofit		xxxxxx	
Less:Allowance for doubtful debts.	2,800,000		
Decrease in allowance for discounts on receivables(Note6)	(194,000)	2,606,000	x

(c)Statement of Financial Position(extract) as at 31Decemberxxxxxxxx

2014	¢	¢	¢
Receivables		17,000,000	
Lessallowancefordoubtfuldebts	1,000,000		
allowancefordiscountsonreceivables	640,000	1,640,000	
15,360.000			
2015			
Receivables		28,550.000	
Lessallowancefordoubtfuldebts	4,500,000		
allowancefordiscountsonreceivables	962,000	(5,462,000)	
23,088,000			
2016		22,000,000	
Receivables			
Lessallowancefordoubtfuldebts	2,800,000		
allowancefordiscountsonreceivables	768,000	(3,568,000)	
		18,432,000	

Note1:¢(1,7000,000–1,000,000)x4%=¢640,000

Note2:¢(28,550,000–4,500,000)x4%=¢962,000

Note3:¢(22,000,000–2,800,000)x4%=¢768,000

Note4:¢(4,500,000–1,000,000)=¢3,500,000(Increase in allowance)

Note5:¢(4,500,000–1,000,000)=¢3,500,000(Increase in allowance)

Note6:¢(768,000–962,000)=-194,000(decrease in allowance)

Irrecoverable Debts Recovered

It is a common occurrence that a debt, which has previously been written of finprevious accounting periods, may be paid or recovered. In such a situation, the recovered debt should be reinstated. The debt is reinstated in the sale ledger account to ensure that a detailed and concise history of the customer is availableas a guide for granting credit to the same customer in future. It will also assist the entity in its credit rating of all customers that buy goods from them oncredit.

The accounting entries when a debt is recovered are:

Debit: Trade Receivables account with the amount of debt reinstated
Credit: Irrecoverable debts recovered account

Debit: Cash or bank account With the amount recovered from the customer
Credit:Trade Receivables accountinfullorpartsettlemento fall of debt owed

At the end of the accounting period the balance in the irrecoverable debts recovered account will either be transferred directly to the Statement of Profit or Loss or to the main irrecoverable debts account. Whichever way thetransfer will produce the same result.

7.3 Accrual and Prepayments

a) Accrued Expenses

Accrued expenses and accrued revenues reflect transactions where cash is paid orreceived after a related expense or revenue is recognized. It represents an item, the use of which the firm has already benefitedfromduringthecurrentaccountingperiod,but whichwillnotbepaidforuntilthenext accountingperiod.Ifwedonotmakean adjustment the profit for the current period will be overstated.Examples of items thatneed to be accrued for include electricity, since it is not likely that these bills willexactly coincide with the entity's accountingyear-end.The accounting entry foraccruedexpenseis:

	Dr.	Cr.
Expense (Statement of Profit or loss)	x	
To: Accrued expense(Statementoffinancialposition)		x

In this case, the relevantexpense in theStatement of Profit or Lossis increased by the accrued amount whilst in the Statement of Financial Position, a ccruals appear under current liabilities, reflecting an amount owing by the business entity.

Illustration7.5

Assume Santo Ltd's Trial Balance recorded electricity expenses of ¢600,000 which cover theperiod Jan 1 to 31 October 2016.A careful examination of the previous electricity bills ofSantoLtdshowsthatthecompany'sconsumptionofenergyiseventhroughouttheperiod.

The above example tells us that the electricity charge in theTrial Balance does not cover the entire year. This mean that an accrualis required for the period of November 1 to 312016.Sinceelectricityisusedevenlythroughouttheyear, we can estimate the out standing amount basedonthebills received todate. The ¢600,000 recorded in theTrial Balance represents 10 months of electricity charge,there fore ,the accrual is estimated as follows:

Accrual=¢600,000 x2/10 =¢120,000

Theelectricityexpenserecordedas follows:

ElectricityExpensesAccount

		¢'000			¢'000
1/1/2016	Cash	600,000	31/1/2016	ProfitorLoss	720,000
31/12/2016	Balancec/f	120,000			720,000
		720,000	1/1/2017	Balanceb/f	120,000

The balance carried forward of ¢120,000 in 2017 represents accrued expense and will berecognized as currentliabilities in theStatementof Financial Position.The adjusting entry will be as follows:

		¢	¢
Electricity expenseA/c	Dr.	120,000	
To: Accrued ExpenseA/c			120,000

b) Prepayments

Deferrals or prepayments refer to transactions where cash is paid or received before arelated expense or revenue is recognized. These transactions are recorded when cashis paid for expenses that apply to more than one accounting period or when cash isreceived for revenue that relates to more than one accounting period.The portion oftheexpenseorrevenuethatappliestothefutureperiodis deferredasaprepaidexpense (asset) or unearned revenue (liability).If we do not make adjustments for prepayments and unearned revenues, profit or the current period will be understatedor overstated respectively.Items, which normally need to be prepaid, include rentandrates, insurance and road licensing fee.

The accounting entry requires the prepayment to reduce the relevant expense in the Statement of Profit or Loss there by increasing profit. The same applies to the un earned revenue, where the adjusting entry reduces the relevant revenue in the Statement of Profit or Loss there by decreasing profit. Since concept ually the prepayment represents an amount owned byanentityfromathirdpartyandunearned revenuerepresents amounts owed by the business to third party, they are included under current assets and current liabilities respectively in the statement of financialposition. The accounting entries areas follows:

Debit: Prepayments (Statement of financial position)

Credit: Expenses (Statement of profit or loss)

Debit: Revenue (Statement of profit or loss)

Credit: Unearned revenue (Statement of financial position)

Illustration7.6

Assume that SantoLtd.paid¢240,000for two years insurance protection beginning on December 1, 2016.

The cash payment of ¢240,000 will be debited to the insurance account. With the passage of time, the benefit of the insurance protection gradually expires and apportion of the unexpired insurance is transferred to the next accounting period as a prepaid expense.For instance, one month’s insurance coverage expires by December 31, 2016.This expense is ¢10,000 ,240,000x$^{1}/24$ The insurance account will be as follows:

InsuranceAccount

31/12/2016 Profit or loss ¢

1/12/2016Cash ¢

240,000

10,000

240,000 Prepaidc/f 230,000

1/1/2017 Prepaidb/f

230, 000

230,000

240,000

110,000

31/12/2017 Profibt or Loss 120,000

(240,000x^{12}/24)

31/12/2017 Prepaidc/f 110,000

1/1/2018 Prepaidb/f

230,000

The balance scarried forward of ¢230,000, and ¢110,000 represents insurance prepaid to be shown under current assets in the Statement of Financial Position for the years 2016 and 2017 respectively.

The adjusting entries will be journalized as follows:

2016	Dr	Cr
	¢	¢
Insurance Prepaid	230,000	
Insurance expense		230,000
2017		
Insurance Prepaid	110,000	
Insurance expense		110,000

Let us now illustrate the treatment of deferred revenue as follows: Illustration11.2

Assume that Santo Ltd rented a small office in its building to a customer on January 1, 2016.

The rental agreement required the payment of ¢180,000 cash in advance for 18 month's rent.Thistransaction is recorded as

Dr: Cash.Cr:Rent Received.

On December 31, 2016, the unadjusted Trial Balance will report ¢180,000 as rent received, which is overstated by ¢60,000 (6/18 x ¢180,000) relating to 2017.The rentreceivedaccount will beas follows:

Rentreceivableaccount

		¢'000			¢'000
31/12/2016	Profitorloss	120,000	1/1/2016	Cash	180,000
31/12/2016	Balancec/f	60,000			180,000
		180,000	1/1/2017	Balanceb/f	60,000

The balance carried forward of ¢60,000 in 2016 represent unearned revenue which will berecorded under current liabilities in the Statement ofFinancial Position for theyear 2016.Theadjustingentrywillbejournalised as follows:

	Dr.	Cr.
	¢	¢
Rent receivableA/c	60,000	
Deferred Rent Revenue		60,000

Accrued Revenue

Accrued revenue refers to transactions where cash is received after related revenue is recognized. It represents an item, the use of which the entity has already dispensed with during the curren accounting period,but which will not be received until the next accounting period. If we do not make an adjustment the profit for the currentperiod will be understated.Examples of items that need to be accrued for include interest earned on treasury bills of which payment has not been received, since it is not likely that the maturity of these bills will exactly coincide with the entity's accounting year-end. The accounting entry for accrued revenue is:

		₦	₦
Accrued income (Statement of Financial Position)	Dr.	x	
To: Interest Receivable (Statement of Profit or Loss)	Cr.		x

In this case the relevant income in theIncome statement is increased by the accrued amount.In the statement of financial position the accrued income will appear under current assets,reflecting an amount owned by the business entity.

Illustration7.7

AssumethattheTrialBalanceofSky Ltd.showsinterestreceivableof¢855,000.Excluded from the Trial Balanceis a 182 days Bank of Ghana Bond purchased onAugust,1 2015 at an interest rate of 15% per annum at a cost of ¢12,000,000. Sky Ltdpreparesaccount toDecember, 31 each year.

From the illustration above, Sky Ltd. will receive a total of ¢900,000 (15% x ¢12,000,000 x6/12) representing interest that will be earned on the bond for the period August, 12015 to January, 312016. Since five monthsinterestamountingto¢750,000(5/6x¢900,000) relates to 2015 financial year, it must be accrued in the Statement of Profit or Loss for 2015 though the amount will be received after 2015. The interest receivable account will be recorded as follows:

Interest Receivable Account

			2015		¢'00085
2015			Dec31	Cash	5,000
Dec31	Statement of profit or Loss	1,605,000	Dec31	Int. Receivables(Unearnedincome)c/d	750,000
		1,605,000	2016		1,605,000
2016			Jan 31	Cash	900,000
Jan 1	Balanceb/d	750,000			
Dec31	Statement of Profit or Loss	150,000			
		900,000			900,000

The adjusting entry will be as follows:

	Dr.	Cr.
	¢	¢
Interes taccruedA/c	750,000	
To: Interest receivableA/c		750,000

Drawings of goods and cash by proprietor

When a proprietor withdrew cash for private or family use, the accounting entry is:

	Dr.	Cr.
	¢	¢
Drawing (StatementofFinancialPosition, Capital)	X	
To:Cash Account		X

When a proprietor withdrew goods for private or family use, the accounting entry is:

	Dr.	Cr.
	¢	¢
Drawing (Statement of Financial Position, Capital)	X	
To: Purchases Account		X

Noncurrent and Depreciation Expenses

As stated earlier, the non-current assets (both tangible and intangible) reduce in valueof their expected useful life due to factors identified in an earlier chapter of this book.The reduction in value is accounted for using depreciation.The depreciable value ofthe non-current assets are spread over its useful life.

The accounting treatment is asfollows:

	Dr.	Cr.
	¢	¢
Depreciation expense (StatementofProfitor Loss)	X	
To: Accumulated Depreciation (Statement of financial position)		X

The effect of the entry is to show depreciation as a business expense in the Statement of Profit or Loss, there by reflecting the proportion of cost or valuation attributable to the current period.The fact must not be forgotten that depreciation is a non-cash item. This means it is a book adjustment only, which does not involve the physical movement of cash.

Illustration7.8

Given below is the record of depreciation extracted from the books of Santos Ltd. At the end of 2015 under the straight-line method.

Assets(Cost) ¢		**ResidualEstimatedValue** ¢	**Usefullife**	**Proportionalusebyfunction**	
				Selling& Distribution	**Administrative**
Building	1,600,000	100,000	15yrs	46%	54%
Equipment	910,000	10,000	10yrs	40%	60%

Computation:

		Selling ¢	Administration ¢
Building[(¢1,600,000-¢100,000)÷15yrs]	100,000	46,000	54,000
Equipment[(910,000-10,000)÷10yrs]	90,000	36,000	54,000
Totals	190,000	82,000	108,000

The adjusting entry for the set two assets is:

		Dr. ¢	Cr. ¢
Depreciation Expense	Sellingexpense	82,000	
	Administrationexpense	108,000	
Accumulated Depreciation:	Building		100,000
	Equipment		90,000

The adjusting entry reduces the carrying amount of the building and equipment accounts.The Accumulated Depreciation account is a contra account that has a stated balanceagainst that of the assets account to which it relates.Thus, the accumulated depreciation account is deducted from the gross building and equipment accounts, leaving the carrying amounts of ¢1,500,000 (¢1,600,000-¢100,000)and¢820,000(¢910,000-¢90,000)forbuildingandequipment respectively in the Statement of Financial Position.

Summary

In this chapter we have considered some of the adjustments that are often made toimprove the quality of the year-end accounts used to prepare the financial statements.We should also understand that these adjustments are needed in order to record theactual expenses incurredand the actual revenue earned for the accountingyear.Itmust also be remembered that each of the adjustments considered will impact upon the Statement of Profit or Loss and the Statement of Financial Position. We have learnt that depreciation is a business expense that must be charged in the statement of profit or loss of any period that a non-current asset has been in use.In additionwe learnt that any business debt that an entity is unable to collect is called a irrecoverable debt and that there is the need to also record allowance for irrecoverable debts so that the receivable figures in the statement of financial position will reflect the amount that the business is likely to collect from receivables. Finally we have also learnt how to record irrecover able debts, allowance for doubtful debts, allowance for cash discounts in the ledger, Statement of profit or loss and the statement of financial position. It is hoped that, readers will have better under standing of the purpose and accounting treatment for depreciation, irrecoverable debts allowance and accruals and prepayments.

Multiple Choice Questions (MCQ)

1. Whichofthefollowingwouldresultfromanincreaseintheallowance fordoubtfuldebts?
    a. A decrease in gross profit
    b. An increase in gross profit
    c. A decrease in net profit
    d. An increase in net profit
    e. An increase in asset

Use the following details to answer Question 2.

Trade receivables control account balance	¢500,000.00
Allowance for doubtful debts	¢50,000.00
Allowance for discount allowed on receivables 5%	

2. The receivables figure to be shown under current assets in the Statement of Financial position is
   a. ¢425,000.00
   b. ¢427,500.00
   c. ¢447,500.00
   d. ¢450,000.00
   e. ¢475,000.00

3. During year 2016, Victor paid rent amounting to ¢500,000. He owed¢50,000 at the beginning of the year and by 31 December 2016, he had paid rent in advance of ¢100,000.His rent charge for 2016 was?
   a. ¢350,000
   b. ¢450,000
   c. ¢500,000
   d. ¢550,000
   e. ¢650,000

4. At the end of the first year of trading, atrader'sreceivablesamountedto¢5,000.This excludes ¢180 debts found to be irrecoverable. At the same date, it was estimatedthat ¢70 of the ¢5,000 would still turn out to be irrecoverable debts.Determine the net realizable value of receivables at the end of the first year of trading.
   a. ¢4,750
   b. ¢4,820
   c. ¢4,930
   d. ¢5,000
   e. ¢45,030

5. A trader had trade receivables of ¢50,000 at the end of his accounting period.Trade receivables at the beginning of the period was ¢60,000.His policy is to make allowance for doubtful debts at the rate of 5%.State the change in value of the allowance for doubtful debts at the end of the current accounting period.

   a. ¢500 decrease in allowance
   b. ¢500 increase in allowance
   c. ¢2,500 decrease in allowance
   d. ¢2,500 increase in allowance
   e. ¢3,000 decrease in allowance

6. When a debt thought to be irrecoverable and written off is subsequently recovered, which additional entry is required to complete the two entries given below?

   i. Debit Personal Account/Credit Irrecoverable Debts Recovered Account
   ii. Debit Cash/Bank Account/Credit Personal Account

      a) Debit Income statement/Credit irrecoverable debts recovered account
      b) Debit Statement of Profit or Loss/Credit Cash/Bank account
      c) Debit irrecoverable debts recovered account/Credit Statement of Profit or Loss account
      d) Debit irrecoverable debts recovered account/Credit personal account
      e) Debitcash/credit Statement of Profit or Loss

7. From the following information, calculate the cash paid by trade receivables during the year.Receivables at the beginning of the year ¢350,000 Receivables at close of the year ¢500,000, Credit sales for the year ¢510,000.

a. ¢340,000
b. ¢360,000
c. ¢380,000
d. ¢520,000
e. ¢660,000

8. The fact that allowances are made against doubtful debts upholds the concept of
   a. Consistency
   b. Prudence
   c. Materiality
   d. Business entity
   e. Realisation

9. Whichaccountingconceptdoesnotagreewithmakingallowancefordiscountreceivable?
   a. Prudence
   b. Businessentity
   c. Accruals
   d. Consistency
   e. Materiality

10. A customer owing ¢200,000 was allowed to pay ¢180,000 in full settlement of his indebtedness. This results in a

a) Decrease in liability, increase in asset and increase in capital
b) Decrease in asset, decrease in capital and decrease in liability Receivables/Cash/Capital
c) Decrease Receivables, increase cash and decrease capital'
d) Decrease in capital,decrease in asset and increase in liability
e) Increase in capital,decrease in asset and decrease in liability

11. When provision for doubtful trade receivable in the trial balance is no longer required, the accounting entry is:
   a. Debit P or L & Credit Trade Receivable Account
   b. Debit Trade Receivable & Credit P or L
   c. Debit Provision for doubtful Trade Receivable Account & Credit P or L
   d. Credit P or L & Debit Provision for doubtful Trade Receivable Account
   e. Debit Bad Debt Account and Credit P or L

12. Annual rent payable is ¢500,000.Rent prepaid at 1 January, 2016 was ¢80,000 and rentaccrued at 31December 2016 was ¢60,000.How much was paid in respect of rent in 2016?
   a. ¢360,000

b. ¢420,000

c. ¢480,000

d. ¢500,000

e. ¢520,000

Short Answer Questions

1. State the journal entries for allowances for bad and doubtful receivable that is no longer required in the trial balance.
2. An entity, which prepares account to December every year paid ¢150,000 as insurance for the period ended 31 March 2022. Calculate the amount of insurance prepared for the year ended 31 December, 2021.
3. State the journal entries for decrease in allowances for doubtful receivables.
4. An entity's allowance for doubtful receivable rose from ¢105,000 to ¢200,000. Raise the appropriate journal to record the transactions.
5. Which accounting concept allows for delay in payment for an expense, which has been supplied and used in the accounting period?
6. Prepaid expense is a _____ in the statement of financial position.
7. An expenses, which is outstanding during the year is a ____ in the statement of financial position.
8. An allowance to a credit customer to encourage prompt payment of cash is called____
9. A form of discount deducted from selling price of a product is called_____
10. State the journal entries to record discount received from a supplier.

THEORY AND CALCULATION QUESTIONS

1. On 1 January, 2016 the following balances amont go the rsstood in the books of Menntua Enterprise.

   Electricity and Water ¢15,000,000Cr.

   Insurance¢50,000,000Dr.

   During the year ended 31 December 2016, the following information relating to the above accounts have been provided:

a. Motor insurance of ¢870,000,000was paid on1June 2016 for a one year period.

b. Marine insurance of ¢190,000,000 covering the year ended 31March2017 was paid on 1st April 2016. The Entity had not insured one of its buildings in respect of fire after the insurance premium expired on31December2015.The Building was insured for ¢60,000,000 last year and the insurance company does not intend to renew the premium.

c. Electricity bill amounting to ¢750,000,000 was paid on1March2016 and also electricity bill amounting to¢250,000,000 in respect of November and December 2016 had not been paid by the end of the accounting period.On June 1,2016 ¢15,000,000 was paid in respect of an old building that is being used as ware house by the entity. This payment was made at a time when there was no meterin the building. The electricity bill for the building was arrived at by charging the entity ¢13,500,000 for total consumption in 2016.

You are required to record the above transactions in the appropriateledgeraccounts.

2. The following balances were extracted from the ledgers of Victor osky Ltd.

	01/04/2015	31/03/2016
	¢'000	¢'000
Rentreceivable–Prepayments	108,000	215,000
Ratesandinsurance-Prepayment	450,000	385,000
Accruals	103,000	185,000
Tradereceivables	798,000	985,000
Stationery:inventoriesinhand	235,000	275,000
Owingtosuppliers	109,000	97,500

Duringtheyear ended31March2016,the followingtransactionstookplace:

	¢'000
Rent receivedbycheque	418,000
Rates paid toAMAbycash	950,000
Paymenttosuppliersforstationery	205,000
Irrecoverabledebtswrittenoffonacustomerwhohasbeendeclaredbankrupt	50,000
Insurancepaidbycheque	550,000
Discountallowed	65,000
Chequereceivedfromcustomers	8,525,000

Youarerequiredtopostandbalancetheabovetransactionsintheappropriateledgeraccounts.

3. The Trial Balance of Santo Ltd.At31 December 2014 reported an amount of ¢750,000bywayof trade receivables. At the time of preparing the Trial Balance, theaccounts clerk discovered that a customer owing ¢150,000 would not beable to settle such debts. It is the policy of Santo Ltd. to make allowance for

doubtfuldebtsof5%ofalloutstandingtrade receivablesattheend ofeachaccountingperiod.During the accounting year ended 31December 2015 the company made a totalcredit sale of ¢980,000 out of which an amount of ¢550,000 was collected from trade receivables.Acourt in Accra declared a customer who owes the company an amount of ¢85,000 bankrupt in August 2015.Thecompany recorded three cheques amounting to ¢175,000 that were dishonoured.

The company recorded ¢1,500,000 and ¢850,000 in connection with cash sales andcredit sales respectively in the year 2016. The company received ¢1,250,000 from trade receivables and also showed ¢670,000 as the outstanding balance on the sales ledger account. A cheque was received from the customer whose debt was written off in 2014 in full settlement ofhis debt.

You are required to post and balance the following accounts:

a. Trade receivables account

b. Irrecoverable debts account

c. Allowance for doubtful debts account

4. The net profit of KumasaLtd. foryearsended3 1December2013, 2014,2015and2016were ¢450,000,000,¢598,000,000, ¢515,000,000 and ¢798,000,000respectively.It has now been found that the wrong method of depreciation has been used over the years for motor vehicles and Plant and Machinery.

Details on the assets areas follows:

	Date	Cost	Scrapvalue	Depreciation
		¢'000	¢'000	Rate
Plantand Machinery	1/1/2013	980,000	40,000	10%
Motorvehicles	1/1/2013	670,000	20,000	25%

The straight line method of depreciation was used with an estimated useful life of ten (10)yearsandfour(4)years for Plantand Machinery and Motorvehiclesrespectively.Thedirectors of the company have now decided to adopt the diminishing balance method ofprovidingfordepreciation as follows:

Plantand Machinery	15%
Motorvehicles	20%

You are required to re-compute the net profit of Kumasa Ltd. for the years ended

31December31 2013, 2014, 2015 and 2016

5. (a) Distinguish between provision for bad receivables and provision for doubtful receivables.

   (b) State the accounting entries for bad receivables and doubtful receivables.

Solution to Multiple Choice Questions

1. C.
2. B.
3. A.
4. C.
5. A.
6. C.
7. B.
8. B.
9. A.
10. C.
11. C
12. A.

Solutions to Short Answer Questions (SAQ)

1. A credit entry to the Gross Profit in the income statement.

2. ¢30,000

   3/15 x 150,000

   ¢30,000

3. DR allowances for doubtful receivable account

   CR Gross profit in the income statement.

   Being amount of decrease in allowance for doubtful receivable.

4.

		DR	CR
DR	Statement of P or L	¢95,000	
CR	Allowance for doubtful receivable		¢95,000

Being amount of increase in trade receivable in allowance for doubtful debt

5. Accrual

6. Current Assets

7. Current Liability

8. Discount Allowed

9. Quantity Discount

		DR ¢	CR ¢
10.	DR Supplier's Account	XX	
	CRD Discount Received Account		XX
	Being amount of discount received from a supplier.		

Solution to some Questions 15,000

MenntuaEnterprise 998,500

Question 1 1,500

WaterandElectricityAccount **1,015,000**

2016		¢'000	2016		
March1	Bank	750,000	Jan 1	Balanceb/f	
June1	Bank	15,000	Dec31	StatementofProfitorLoss	
Dec31	Balancec/d	250,000	Dec31	Balancec/d(15000-13,500)	
		1,015,000			
2017				2017	

¢'000

Jan1	Balanceb/f	1,500	Jan1	Balancec/d	250,000

InsuranceAccount

2016		¢'000	2016		¢'000
				StatementofProfitor	
Jan 1	Balanceb/d	50,000	Dec31	Loss	760,000
April1	Bank	190,000	Dec31	Balancec/d	
				- Marine	47,500
		870,000		- Motor	362,500
June1	Bank				
Dec31	Balance	60,000			
		1,170,000			**1,170,000**
2017				2017	
Jan1	Balance		Jan1	Balanceb/f	60,000
b/d:MarineMotor		47,500			
		262,500			

Solution to question 2

VictoroskyLtd.

Rent Receivable Account

2015		¢'000	2015		¢'000
	Statementof				
31/3/2015	Profitorloss	311,000	1/4/2015	Prepaidb/f	108,000
		215,000		Bank	418,000
31/3/2015	Prepaidc/f	526,000			
					526,050
2017			1/4/2016	Prepaidb/f	215,000

RatesandInsuranceAccount

2015		¢'000	2015		¢'000
April1	Balanceb/f	450,000	April1	Balb/f	103,000
	Cash	950,000		ProfitandLoss	1,647,000
	Bank	550,000		Prepaidc/f	385,000
	Owingc/f	185,000			
		2,135,000			**2,135,000**
					185,000
				Owingb/f (fire)	

TradeReceivablesAccount

2015		¢'000	2015	¢'000
April1	Balanceb/f	798,000	Balb/f	103,000
			Bank	8,525,000
	CreditSales	8,930,000	Irrecoverabledebt	50,000
			Discountallowed	65,000
			Balc/f	**985,000**
		9,728,000		**9,728,000**
	Balb/f	985,000		

StationeryAccount

2015		¢'000	2015		¢'000
April1	Balanceb/f	235,000	April1, 2016	Balb/f	109,000
		205,000			
2016	Bank		March31	Statement of Profit orLoss	153,500
March31	Owingc/f	97,500	March31	Prepaidc/f	275,000
2016		537,500	2016		537,500
April1	Prepaidb/f	275,000	April1	Owingb/f	**97,500**

Solutiontoquestion 3

SantoLtd.

TradeReceivablesAccount

a.

		¢'			¢
2014	Balanceb/f	750,000	2014	Irrecoverabledebt	150,000
				Balc/f	600,000
		750,000			750,000
2015	Balb/f	600,000	2015	Bank	550,000
2015	Creditsales	980,000	2015	Irrecoverabledebt	85,000
2015	Dishonouredcheque	175,000			1,120,000
			2015	Balc/f	
		1,755,000			1,755,000
2016	Balb/f	1,120,000	2016	Bank	1,250,000
2016	Creditsales	850,000	2016	Irrecoverabledebt	50,000
2016	Irrecoverable debt recovered account	150, 000		Bank (debt recovered)	150, 000
	Bal b/f		2016	Bal c/f	670, 000
		2,120,000			2,120,000
2017		670, 000			

IrrecoverableDebtsAccount

b.

		¢'			¢
		150,000	2014	StatementofProfitorLoss	150,000
		150,000			150.000
2015	Tradereceivables	85,000		StatementofProfitorLoss	85,000
					85,000
2016	Tradereceivables	50,000	2016	TradeReceivables(debtrecovered)	
	Statement of Profitor Loss	100,000			150,000

c. **Allowancefordoubtfuldebtsaccount**

		¢'			¢
2014	Balancec/d	30,000	2014	StatementofProfitorLoss	30,000
		30,000		(750,000– 150,000)x5%	30.000
2015	Balancec/d	56,000		Balanceb/d	30,000
				Statementofprofitorloss(	26,000
					56,000
2016	Statementofprofit or	22,500			
		33,500	2017	Balanceb/d	33,500

Solutionto question 4

KumasaLtd.

Straight line method–Plantandmachinery

Year	Beginning Depreciable Amount	Depreciation Rate	Depreciation fortheyear	Accumulated Depreciation
	¢		**¢**	**¢**
2013	940,000,000	10%	94,000,000	94,000,000
2014	940,000,000	10%	94,000,000	188,000,000
2015	940,000,000	10%	94,000,000	282,000,000
2016	940,000,000	10%	94,000,000	376,000,000

Straightlinemethod-MotorVehicles

Year	BeginningDepreciable Amount	DepreciationRate	Depreciationfortheyear	AccumulatedDepreciation
	¢		**¢**	**¢**
2003	650,000,000	25%	162,500,000	162,500,000
2004	650,000,000	25%	162,500,000	325,000,000
2005	650,000,000	25%	162,500,000	487,500,000
2006	650,000,000	25%	162,500,000	650,000,000

Reducingbalancemethod – Plant and Machinery

Year	Beginning Depreciable Amount	Depreciation Rate	Depreciation fortheyear	Accumulated Depreciation	Closing Depreciable Amount
	¢		¢	¢	
2013	940,000,000	15%	141,000,000	141,000,000	799,000,000
2014	799,000,000	15%	119,850,000	260,850,000	679,150,000
2015	679,150,000	15%	101,872,500	362,722,500	577,277,500
2016	577,277,500	15%	86,591,625	449,314,125	490,685,875

Motorvehicles

Year	BeginningDepreciableamount	Depreciation Rate	Depreciationfortheyear	AccumulatedDepreciation	ClosingDepreciableamount
	¢		¢	¢	¢
2013	650,000,000	20%	130,000,000	130,000,000	520,000,000
2014	520,000,000	20%	104,000,000	234,000,000	416,000,000
2015	416,000,000	20%	83,200,000	317,200,000	332,800,000
2016	332,800,000	20%	66,560,000	383,760,000	266,240,000

Computation of Adjusted Net profit for theyearsended31December2013,2014, 2015,and 2016.

	2013	2014	2015	2016
	¢000	¢000	¢000	¢000
Net profit before adjustment	450,000	598,000	515,000	798,000
Add Depreciation (wrong method)				
Motor vehicles Plant & equipment	162,500	162,500	162,500	162,500
	94,000	94,000	94,000	94,000
	706,500	854,500	771,500	1,054,500
Less Depreciation(correct method)	(130,000)	(104,000)	(83,200)	(66,560)
Motor vehicles Plant & equipment	(141,000)	(119,850)	(101,873)	(86,592)
Adjusted Net Profit	**435,500**	**630,650**	**586,427**	**901,348**

CHAPTER EIGHT
CONTROL OR TOTAL ACCOUNTS

- Receivables and payable control ledger accounts
- Suppliers and customers statements
- Reconciliation of suppliers and customers statements and ledger accounts

8.0 Learning Objectives

At the end of this chapter candidates should beableto:

- Explain control accounts and know their usefulness
- Know the main types of control accounts
- Prepare receivables and payables control accounts from given information
- Describe and prepare trade receivables and payables statements of account
- Reconciliation of Suppliers /Customers Statement of Account
- Purpose of Suppliers and Customers Statement of Accounts

8.1 Introduction

Control account is an account used to record the balances on a number of accounts and to provide a cross-check on them. It is a memorandum account because it does not follow double entry principle. It is also subsidiary referred to as mirror account. Since this account is used to record the total balances from the ledger account, it can be referred to as a total account. In a small entity it may be possible for one person to maintain all the ledger accounts. Where a business maintains a large numberofaccounts,it will become necessary to divide the ledger in to sections and assign the recording of each section to different persons for internal control purposes. The main areas towhich such ledgers can be divided are the Subsidiary Ledger, Trade receivables ledger, Trade payable ledger and General ledger.

In very large entities, the sub-division may further be divided among employees.Where this type of divisions takes place,it will be necessary to institute controls on the accuracy of the postings made to each ledger.This isachieved by maintaining total accounts for trade receivables and payables in the general ledger. These total accounts are referred to as control accounts.

8.2 The Nature and Functions of Control Accounts

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

The control account is a memorandum record only, andsodoes not form part of the double entry system. However,it is kept using doubleentryprinciple.Control accounts can be kept in respect of Customers accounts (Revenue (Sales) Ledger),Suppliers'accounts(Bought (Purchases) Ledger) and expenses.Control accounts are maintained to facilitate easy detection of errors.Consequently,they act as a check on the entries in the various subsidiary ledgers. Where the Trial balance totals arenot 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 investigate drather than all theledger accounts.

Control accounts are also called self-balancingledgers because the total trade receivables and total trade payables in the general ledger should be equal to the aggregate of the balances in the respective individual accounts in the subsidiary ledger.

8.2.1 Merits of ControlAccounts

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

- They can be used to locate errors more easily asthey are localized to specific Ledger(s).
- They make it difficult to commit fraud because they are normally under the control of responsible officers and their preparation is separate from the clerks who maintain the individual ledger accounts.
- They provide information about the total trade receivables and total trade payables thereby making management of the receivables and payables accounts easy.
- They allow for account set-off
- Reduce risk of errors by posting totals rather than individual items.
- Reducedelayinproducingfinalaccounts.

8.2.2 Sources of Information for Control Accounts

Information recorded in control accountsare obtained from:

- Receivables and Payables accounts
- Returnsin wards and outwards accounts
- Bills payable and receiable accounts
- Dishonoured cheques
- Cash paid to pay ables and cash received from receivables (obtained from the cash book).
- Discount received and discount allowed accounts
- Sales day book and purchases day book.

8.3 Trade Receivables or Sales Ledger ControlAccount

Sales ledger control account is the account containing the summary of allt rade receivables 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 receivables accounts. The same thing applies to the credi tside of the account.

Summary of Entries

(i)	Debit–(a)	Openingdebitbalances
	(b)	Credit Sales from sales day book
	(c)	Dishonoured bills and cheques from customers
	(d)	Debit notes issued
	(e)	Cash paid to Customers from the cash book
	(f)	Transfers and other items(Contra)
	Credits:(a)	Opening Credit Balances
	(b)	Cash received from customers as recorded in the cash book.
	(c)	Discounts allowed as recorded in the cash book
	(d)	Returns inwards as recorded in the sales return day book.
	(e)	Irrecoverable debts written off

(f) Bills receivable

(g) Set off between sales ledger control and purchases ledger Control accounts

(Contra)

The above listed item s are presented in aT- account below:

Sales (orTradeReceivables)Ledger Control Account

		₦		₦
Balb/d		X	Bal.b/d(ifany)	X
Creditsales		X	Cashreceived	X
Dishonouredbillsand Cheques		X	Discountsallowed	X
DebitNotes		X	Returnsinwards/salesReturn	X
Cashrefunds		X	Irrecoverabledebts	X
Contra		X	Billreceivable	X
Balancesc/d		X	Contra	X
			Bal.c/d	X
	XX			XX
Bal.b/d	X		Balancesb/d	X

8.4 Trade Payables or PurchasesLedgerControlAccount

This is the account containing the summary of all the accounts of the trade payables or suppliers in the purchase ledger. What is posted to the debit side of this account are the aggregate of all the items recorded on the debit side of the payables accounts. The same thing applies to the credit side of the account.'

Summary of entries in the Purchases Ledger Control

Accounts Debit entries

(a) Opening debit balance

(b) Payment to suppliers obtained from the cash book

(c) Return soutwards

(d) Bills payable

(e) Discounts received from the memorandum column on the credit side of the

(f) Credit notes

(g) Transfers between sales ledger control and purchases ledger control accounts.

Credit entries

(a) Opening Credit balances

(b) Credit purchases obtained from the purchases day book

(c) Cash refund from suppliers

(d) Dishonoured bills payable

(e) Transfers and other items

The above listed items are presented in a T–account below

Purchases (trade payables) ledger control account

b/d ifany	b/d(ifany)
PaymenttoSuppliers	Credit Purchase
ReturnsOutwards/Purchasesreturns	Dishonoured Cheques
Returns Payable	Dishonoured bills payable
Discount received	Cash refund Contra
Creditnotesreceivables	cec/d
Contra/setoff	
c/d	
	Bal.b/d

Transactions not to be posted into control account

- Cash sales should not be debited to the sales ledger control account rather, cash sales should be debited to the cashbook.
- Cash purchases should also not be credited topurchases ledger control account but should be credited to the cash book.
- Allowance fordoubtful debts.
- Cash discount allowed and received.
- Interest paid on bill discounted;
- All forms of provisions should be ignored in any question.

Illustration 8.1

Extracts from the books of JKO Ltd.shows the following balances for the month of June 2022

₦

’000

Sales ledger balances– June 1,2022	4,702
Purchases ledger balances– June 1,2022	2,757
Sales journal balances–June 30,2022	37,437
Purchases journal balances– June 30,2022	40,800
Returns Inwards	910
Returns Outwards	749
Receipts from Customers–Cash	38,529
Discount allowed	1,345
Payments to Suppliers	35,415
Discounts received	746
Irrecoverable debts written off	115
Sales ledger set off	209
Purchases ledger set off	110

On June 30,2022, it was discovered that a supplier was paid twice in error for ₦157. The amount was refunded on that date.

You are required to prepare the sales and purchases ledger balances control account as at July 1, 2022.

Solution to Illustration 8.1

JKO Ltd.

Sales Ledger Control Account

2022		₦’000	2022		₦'000
June			June		
1	Balb/f	4,702	30	Cash	38,529
30	Sales	37,437	30	Returnsinwards	910
30	Setoff	110	30	Discount sallowed	1,345
			30	Irrecoverable debts	115
			30	Set-off	209
			30	Balc/d	1,141
		42,249			42,249
July 1	Balb/d	1,141			

Purchases Ledger Control Account

2022 June		₦'000	2022 June		₦'000
30	Returnsoutwards	749	1	Balb/f	2,757
30	Cash	35,415	30	Purchases	40,800
30	Discountsreceived	746	30	Cashrefund	157
30	Set-off	209	30	Setoff	110
30	Balc/d	6,705			
		43,824			43,824
July1Balance b/d		6,705			

Illustration 8.2

Adebol Enterprises controls his Trade payables accounts by drawing up monthly Trade Payables Ledger Control Account in two parts Aand B. The following figures are available at January31,2022 when thereis a difference on theTrial balanceof ₦2,000,000.

	A	B
	₦'000	₦'000
Jan1BalancesonTradePayables(creditside)	18,400	13,600
Jan1BalancesonTradePayablesLedger(debitside)	150	184
Jan1– 31Purchases	114,512	17,372
Jan1 – 31Returns outwards	11,000	1,652
Jan1–31Sundry charges by suppliers	1,200	144
Jan1 – 31Cheques paidto suppliers	17,980	13,420
Jan1–31Discount received from suppliers	1,420	1,180

Jan31	Balances carried down to debitside	150	132

The book-keeper in charge of the A Ledger makes his Ledger accounts balance ₦103,712,000 while the clerk in charge of the B Ledger makes his Ledger balances total ₦16,812,000.

Required

Prepare the two Control Accounts and draw any conclusion you can from them.

Solution to Illustration 8.2

AdebolEnterprises
Trade Payables Ledger Control Account(A)

2022		₦'000	2022		₦'000
Jan	Balanceb/d	150	Jan1	Balanceb/d	18,400
1– 31	Return soutwards	11,000	1– 31	Purchases	114,512
1– 31	Bank	17,980	1– 31	Sundry charges	1,200
1– 31	Disc.Received	1,420	31	Balancec/d	150
31	Balancec/d	103,712			
		134,262			134,262
Feb1	Balanceb/d	150	Feb1	Balanceb/d	103,712

Trade Payables Ledger Control Account(B)

2022		₦'000	2022		₦'000
Jan	Balanceb/d	184	Jan1	Balanceb/d	13,600
1– 31	Bank	13,420	1– 31	Purchases	17,372
1– 31	DiscReceived	1,180	1– 31	Sundrycharges	144
1– 31	Returnsoutwards	1,652	31	Balancec/d	132
1– 31	Balancec/d	14,812			
		31,248			31,248
Feb1	Balanceb/d	132	Feb1	Balanceb/d	14,812

The Control Accounts reveal that there is a difference of ₦2,000,000 between the Control Account for the B Ledger (₦16,812,000 – ₦14,812,000) which is the total discovered by the bookkeeper in charge of that Ledger. The A Ledger seems to be correct. The error has been localised to the B Ledger, the entries in which can be re-checked carefully to detect the error. This is one of the numerous advantages of theTotal or Control account.

8.6 Trade Receivables Statement of Account

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

The statement may be kept for reference purposes or returned to the seller with the Customer's cheque. In either case neither the customer northe sellers' records the statement in his books.

Illustration 8.3

The following transactions took place betweenMaitama Enterprises of 2, Jalingo Street, Lagos and her customer Adeoti&Co of 10 Ibikunle Avenue, Ikeja in January2022.

Jan 2,2022 Invoice number426, with a value of ₦23, 120,000

Jan 9,2022 Invoicenumber489, with a value of ₦16, 240,000

Jan 16, 2022 Adeoti&Co paid asum of₦25, 140,000 with cheque No0493422

Jan.22, 2022 Invoice number 563 for ₦52, 910, 000

Jan 25. 20X1 Credit note number1326 for ₦6, 000,000 was sent

Required:

Prepare a Trade receivables statement to effect the setrans actions

Solution to Illustration 8.3

MAITAMA

Enterprises2,Jalingo

Street,Lagos

Adeoti&Co January2022
10,IbikunleAvenue,Ikeja

January		Ref	Debits	Credits	Balances
			₦'000	₦'000	₦'000
2	Goods	426	23,120		23,120
9	Goods	489	16,240		39,360
16	Payment	Chq04934		25,140	14,220
22	Goods	563	52,910		67,130
25	Creditnote	1326		6,000	61,130

AmountdueonJanuary312022

Cash discount terms:5% for payment with in15days

8.7. Reconciliation of accounts receivable Statement of Account

The reconciliation of accounts receivable is the process of matching the detailed amounts of unpaid customer balances to the accounts receivable total stated in the general ledger. This matching process is important, because it proves that the general ledger figure for receivables is correct. The two information sources for this reconciliation are:

General Ledger

There is usually an account in the general ledger that is specifically designated for the sole compilation of all receivables related to customers (known as trade receivables). After all transactions have been recorded for a reporting period and all subsidiary ledger balances have been posted to the general ledger, the resulting ending balance in the receivables account is the summary total to be verified through a reconciliation.

Receivables Detail

The detailed listing of unpaid customer balances that should match the ending balance in the general ledger is usually recorded in a subsidiary sales ledger. To extract this information for reconciliation purposes, print the aged accounts receivable report as of the final day of the reporting period. The totals on this report are then compared to the receivable total in the general ledger.

8.7.1 Accounts Receivable Reconciling Items

When the reconciliation is conducted, there may be differences between the two amounts. One reason is that a journal entry was made to the general ledger account that bypassed the subsidiary sales ledger. This is the most common reason for a difference. Another reason is that a billing was accidentally posted to an account other than the trade receivables account. This is the least common reason for a difference, since the billing module is set to automatically record all balances to the correct account. A final possibility is that the aged receivables report was run as of a different date than the date used to obtain the general ledger balance.

8.7.2 When to Reconcile Receivables

This reconciliation process is typically conducted as part of the month-end closing activities prior to issuance of the financial statements. If the reconciliation is not conducted and there turns out to be an error in the general ledger, this means there could be a material inaccuracy in the financial statements.

At a minimum, there should be a reconciliation of accounts receivable at the end of the fiscal year, so that any inaccuracies related to receivables will have been removed from the financial statements prior to their examination by the company's external auditors.

8.8 Summary

In this chapter importance of control accounts, have been explained in the detection of errors and in the management of the subsidiary accounts. It also revealed that, through illustrations, how errors in a Trial Balance that does not "balance"canbedetected easily through the control account. Receivables statements arealsodescribedand how they are prepared. Reconciliations are considered an important control activity. If they are not performed, the probability that an auditor will find errors will increase, which could trigger a judgment that a business has a material control weakness.

8.9 Review Questions

Multiple-choice questions (MCQ)

When there is a set off between trade receivables and trade payables, theamountis:

debited in sales ledger control account and credited in purchases ledgercontrolAccount

debited in purchase ledger control account and credited in sales ledger controlaccount

DebitedtotheCustomer'saccountandcreditedtopurchasesLedgerControl account

DebitedinthecashbookandcreditedinsalesledgercontrolAccount

CreditedinthecashbookanddebitedinthepurchasesledgerControlAccount

Which of the following will **NOT** be recorded in the sales ledger control account?

Amount received from receivables

Bills payable discounted

Cash sales

IV Discounts allowed

A I and II

B. IandIII

C. II and III

D. II and IV

E. II, III and IV

Control accounts are also called

Total accounts

Self balancing ledger

Three column cash book IV General Journal

A. IandII.

B IIandIII

C. IandIII

D. IIIandIV

E. I,III,and IV

(1) What is the effect of purchases set-off on control account?

A. It will reduce amount receivable from trade receivables

B. It will increase the amount receivable from trade receivable

C. It will require issue of creditnote to the trade payables.

D. It will require the supply of goods to the tune of the set-off in full settlement.

E. It will require issue of debit noteto trade receivable.

(2) What is the source of information for dishonoured cheques recorded in total account?

A. Bank statement credit side

B. Cash book credits ide

C. Cash book debit side

D. Debit note

E. Credit note

(3) Which of the following is not a feature of a control account?

A. It is maintained by the Chief Finance Officer (CFO)
B. It is used to check arithmetic accuracy of the ledger to which it relates
C. It contains the total of entries in individual accounts
D. The ledger to which it relates is known as self balancing ledgers
E. Entries therein appear on the same side as they do in the individual account.

(4) Which of the following would not be posted to the credit side of Payables control account?

A. Total credit purchases
B. Transfer of credit balances from receivables ledgers
C. Transfer of debit balances to receivables ledgers
D. Set-off (Contra)
E. Interest charged by the suppliers.

Short-answerquestions (SAQ)

(1) The account in the general ledger that shows the total amount owed to the business and agrees with the totals of the relevant subsidiary ledger account is termed the ....account.

(2) How often are postings made to the general ledger?

(3) A supplementary record used to provide detailed breakdown of control account balances in the general ledgers known as.....................

(4) List four items that are normally posted to the credit side of the purchases Ledger control account

(5) Dishonoured cheques credited to payables ledger control account represents

8.11 Examination like questions

1. (a) Give Six(6) sources of Information for Control accounts

   (b) Highlight four (4) Advantages of Control Accounts

2. The following information were extracted from the records of Agbato shopping complex for the month January, 2023

₦'000

Salesledgerbalance–1/1/23	5,805
Boughtledgerbalances–1/1/23	3,405
SalesJournalTotals–31/1/23	40,455
PurchasesJournalTotals-31/1/23	48,400
SalesReturn	950
PurchasesReturn	845
ReceiptfromCustomers–Cash	38,200
AllowancestoCustomers	1,450
AllowancesfromSuppliers	1,240
AllowancestoCustomerdisallowed	230
Irrecoverabledebts	145
Allowancefromsupplierswithdrew	125
Purchasesledgersetoff	190

On January 31, 2023, it was discovered that a supplier was paid thrice for ₦185, 000 on each occasion. The amount paid in excess was refunded on that date to him.

You are required to prepare the receivables and payables ledger balances on February 1, 2023.

3. (a) Give five (5) items each on the credit side of sales control account and debit side of purchases control account

(b) Why is control accounts are described asaself-balancing ledger?

8.12 Solution to Revision Questions

(1) B

(2) C

(3) A

(4) A

(5) B

(6) A

(7) D

8.13 Solutions to Short Answer Questions

1) Sales Ledger Control accountor Receivables ledger Control Account
2) Every month end
3) Subsidiary ledger
4) i. OpeningCreditbalances
   (ii) Credit purchases
   (iii) Cas hrefund from suppliers
   (iv) Dishonoured bill payable
5) Cheques issued in favour of suppliers but which were subsequently dishonoured.

CHAPTER NINE
BANKING SYSTEMS AND SERVICES

- Banking system
- Funds transfer
- Inter banks transfer
- Adjusted cash book
- Bank reconciliation statement

Learning objectives

At the end of this chapter candidates should be able to:

- *State the types of bank accounts an entity can open with the bank;*
- *Explain the procedures for banking of monies received and documentation;*
- *Explain funds transfer and forms;*
- *State the methods of handling, storing money and security aspects;*
- *Explain interbank transfer, settlements and clearing rules;*
- *Prepare Adjusted Cashbook;*
- *Prepare a bank reconciliation statement;*
- *Prepare manual and on-line bank reconciliation statement.*

9.1 Types of Bank Accounts

This section deals with bank reconciliation statement and reasons that account for it preparation. The entity should prepare a cashbook to record inflow and outflow of cash in the entity. The balance in the cashbook and the bank statements most times differ. On a monthly basis, bank reconciliation statement is usually engaged to reconcile differences between the cashbook and bank statements. One of the ways to guard against loss of cash through theft and fraud is to open and maintain a bank account. Apart from theprevention of theft, a business entity or customer analsoen joy some credit facilities and professional advice from its bank. To keep money in a bank, there are two main types of accountan entity or individualmaykeepwith thebank.Theseare**Savingsaccount**and **Currentaccount.**

To be able to transfer money from one account to the other, a customer must have a bank account, which are of many types. These are:

Savings Account

This type of account is meant for the small savers to keep their surplus funds. This account is usually opened by individuals such asclubs, associations, salary, earners, petty traders etc. A prospective customer who is a salary earner should bring a letter of introduction from his/her employer, upon which he/she will be given the bank's application forms to complete and supply the following information:

a) His full names and address(Not Postal Office Box)

b) Business or Occupation

c) Specimen signature or thumb print

d) Three (3) recent passport photographs,and

e) Customer's identity card or international passport or driver'slicense.

f) An initialed posit.This varies from bank tobank.The bankthen issuesthe paying-in-booklet to the customer to enter the initial deposit and other subsequent deposits.

Some other distinguishing features of savings accounts are:

i. No cheques are required for withdrawal

ii. Customers may not begranted over draft facilities onnthistypeofaccount

iii. Interest is payable on the sum standing to the customer's credit

iv. The balance standing to a customer's credit on savings account is repayableon demand. However, the bank reserves the right to demand 7 days notice for withdrawals of part or the whole deposit on theaccount.

v. Customers must be present physically whenwithdrawalismade.

vi. In the past, passbooks were issued to the customer to show both the credit and debit entries of the account. But now days, paying-in-slips and with drawal slips are issued to customers to make deposits to and withdrawals.

vii. No reference is required for this type of account except where cheques will be paid in to the account in the future,but a letter of introduction is required where the account will be used to receive the customer’s salary.

CurrentAccount

A current account is operated by the use of cheques.Money can be withdrawn from the account anytime with out giving prior notice to the banker. For this reason it iscalled “Demand Deposit.”The customer usually does not enjoy any interest on current account balances. In a few cases, little interest may be given by the bank. A current baccount customer may be granted an overdraft. A Cheque book containing cheque leaves is issued to the account holder when a current account is opened. The cheque leaves are serially numbered.The holder of the account can issue cheques to pay for goods and services rendered to the business with. However, the cheques must be duly signed by the drawer and thesignaturemust be regularoridenticalto thatonthemandatecard. Money is deposited into the bank account through pay-in-slips.The cheque and pay-in-slip numbers are printed in magnetic ink to facilitate theprocessingof transactions by the computer.
At intervals, usually every month, the bankers ends bank statements to its customers, detailing all cash lodgements, cheques paid, dishonoured cheques, bank charges,direct payments, dividend warrants received on behalf of the customer, etc.

Opening aBankCurrentAccount

Every business entity is required to open acurrent account to transactits business. To open acurrent account, most banks usually request for such items/informationas:

a) A written application to openan account, stating the type and purpose of the account.

b) Two or more reference letters from people who maintain current accounts with any branch of the bank or other banks.

c) Two or more passport photographs.

d) Copy of theArticle and Memorandum of Association if it is a corporate organization or deed of partnership for partnership firms and constitution In respect of an un-incorporated body.

e) An extract of the minutes of the meeting in which the decision to open the account was taken.

f) An initial deposit as maybestipulated bythebank from timeto time.

g) In some countries evidence of payment of tax by the sole trader, partner or the limited liability company.

h) Completed specimen signature card

i) The specimen signatures of the authorized person(s) must be on the mandate card. The signature(s) on cheques are compared with the specimen signature(s) each time the customer wants to makeawithdrawal.

Interest Bearing Accounts

Some business organisations transact a large volume of business through their current accounts every month, and they may not be able to earn any interest on their current account balances.Therefore some businesses usually open some other accounts on which they can earn interests; these could be referred to as interest-bearing accounts. These consist of savings accounts and fixed deposit accounts. They will transfer surplus cash from the current account to these accounts to earn interests.

Fixed Deposit Account

Afixed deposit account is an account kept with the bank inform of investment for a specific period of time usually 30 days, b60 days, 90 days or 180 days. Afixed rate of interest is payable by the bank on such deposits.

Adequate notice of with drawal from or termination of the investment must begiven to the bank or else the customer for feits his right to the next interestpayable on the investment or suffers penal charge for premature termination.

The features of this type of account are as follows:

a) The balance standing to a customer’s credit on deposit account is repayable at date of maturity but banks usually reservethe right to roll-over the investment and the accrued interest at the prevailing market rate if they do not receive any counter instruction from the accounts holder on or before maturity.

b) Thecustomerisnotissuedwithchequebookbutwithareceiptorcertificate indicating the terms and conditions of the deposit e.g. amount fixed, interest rate, date of maturity,etc.

c) Both the bank and the customer agree on the terms and conditions of the relationship, such as interest rate, amount and duration of the account.

d) No bank statement is issued to the customer.

e) No reference is taken since the account requires casht ransaction.But where lodgement of cheque is anticipated in thefuture, bank must ensure that references are takenand allthe necessary accountopeningproceduresarefollowed.

f) Although, commission is charged by the bank, accruedinterestontheinvestment is subject to withholding taxat the prevailing rate (currently10%).

9.2 Procedures for Banking Monies Received and Payments

In the modern day banking, an entity or individual can walk into a banking hall to make direct lodgement of cash to a bank cashier. Such a bank customer fills a cash deposit voucher or pay-in-slip to indicate various denominations (N1,000,N500, N200,N100, N50 and coins), on receipt of the cash and cash deposit form, the cashier does the physical counting using a cash counter or count manually to confirm the amount and sign, date and stamp the form. The stamped form and electronic receipts will be giving to the customer. These will be used to post into the debit side of the entity's cashbook. The cashier will debit bank account and credit the customer's personal ledger. On the other hand, rather than walking to the bank, a customer can at the comfort of his or her office/home transfer cash into the bank using online or mobile banking applications. The customer will generate and print the receipt for the payment to credit the cashbookand debit the bank account. A two-Column cashbook can be used to record cash and bank account together. Withdrawals can be made through a cheque, electronic transfer or ATM or debit or credit cards. If requested, bank issued Automated Teller Machine (ATM) card to holders of current and savings accounts to withdraw money from the machine and some of these machines can take savings from the customers. ATM will further be discussed below under Electronic Funds Transfer and Electronic Banking products

9.3 Funds Transfer and Forms

Technology has brought a lot of changes to the banking industry. One of these technological innovation in the banking industry are ATM. Electronic Funds Transfer and Point of Sales (POS) Machine among other notable innovations in the industry.

Funds Transfer can be done through technology, in this situation, funds are moved electronically through mobile application, internet banking or filling of Transfer Forms indicating names of owners of accounts, account type, account number (10 digits number) to debit, account number to credit, Paying Bank, Beneficiary Bank, Amount in figure and in words, date and signature. After the customer has filled all the information on the Electronic Transfer Form, a designated bank officer authorises by signing, dating and stamping the transfer form, the fund form is used to post into the customer's bank account and funds are instantly electronically transferred to beneficiary bank account, debit and credit alerts are received immediately. For internal control purposes, the electronic transfer forms are pre-numbered sequentially. Funds transfer can also be done manually through direct cash lodgement, cheques, pay-in-slip and bank draft among other methods. This will be discussed after electronic fund transfer methods.

i) **Automatic-TellerMachines(ATM)**

ATM is a cash dispenser which is designed toenable customersenjoybanking serviceswithoutcomingincontactwiththeBankTeller(Cashier).The machine,therefore,performsthe functionstraditionallyreserved for cashiers. It is electronically operated and as such response to request by customers is done instantaneously.

(a) ATM is user-friendly and it guides users through the instructions thathavebeen pre-programmed into it foreasyoperation.

(b) Access to the ATM is through the use of a Personal Identification Number(PIN) and aplastic card that contains magnetic strips with which the customer is identified. Banks usually hand over the PIN personally to the customer who is usually instructed not to disclose the number to a third party.

(c) It is essential for users to ensure that the ATM card is safe and that it isnot defaced. Otherwise, it may be rejected by the machine, even wherethe PIN has been correctly entered.

(d) The first step to take while using the ATM is to insert the Card and thereafter the PIN. Then the customer selects the service required e.g.withdrawal, in which case, he will depress the "Withdrawal Key" and then press the number keys to indicate the amount of money required and the preferred denominations. It is note nough topunchtheamount required, it is also necessary to press "ENTER" for the ATM to dispense cash.

Other functions that the machine is capable of performing are:

- It dispenses Cash;
- It receives deposits;
- Printingofstatements;
- Provisionofaccountbalances;
- Transferoffunds;
- Paymentofbills;
- CashAdvances;
- Display of Promotional messages; and
- Issuance of Receipts on withdrawa/payments

The objective of introducing the ATM in Nigeriais mainly to decongest the counter and encourage cashless economy.

ii) **Electronic Fund Transfer(EFT)**

EFTsystem allows customers account to be (instantly) credited electronically any where in the country especially in banks where there is on-line service. It provides a more suitable and cost-effective way of transferring funds when compared with the traditional modes such as Mail/Telegraphic transfers. It is more secure and time saving when money is transferred through EFT. Suchmoney is transferredelectronically by the bank throughtheirbranchesor accreditedagents.

iii) **ElectronicFundTransferAtPointofSale(EFTPOS)**

This is asy stem whichenablesacustomer'saccounttobedebitedinstantly with the cost of purchase in an outlet. The system requires thecustomertobean ATM Card holder.

iv) **Electronic Card Products(DEBITCARD)**

At present, most banks in Nigeria issue electronic debit cards. Debit Cards are like the EFTPOS that are supposed to be passed to acustomer's account immediately.

There are two popular debit cards; the Pass Card and the Smart Card.

(a) **PassCard**

On application by the customer, this product is processed in an IBM machineby debiting acustomer's bank account.

(b) **SmartCard**

This is a debit card whose micro-chips contain additional informationon the bio-data and financial position of the holder.

v) **Credit Card**

At present, most banks in Nigeria issue electronic debit cards. Debit Cardsare like the EFTPOS that are supposed to be passed to acustomer's account immediately. Acredit cardisaconvenientmethodofpaymentwhichembodiestwoessential aspects of basic banking functions; the transmission of payment and thegrantingofcredits.Thistypeof cardis notyetinoperationinNigeria. Another variant of a credit card is that which provides a bank customer with arevolving credit line via POS, Web and ATMs.The features of this type of cardinclude:

a. Cash withdrawals(throughATM)

b. Purchase s(through POS and internet)

c. Convenient access to are volvingline of credit, renewable and available through out card life span

d. Flexible repayment options–repayment could be infull or inpart(subject to interest on outstanding indebtedness).

Cheques

Cheque is a manual method of transferring money either physically (cash withdrawal) from one bank account to another bank account. A cheque is a written order upon a particular banker to pay acertainsum of money to a specified person or entity.

There are three parties to a chequen amely

i. The drawer-issues the cheque(Accountholder)

ii. The drawee- The bank on which the cheque is written and

iii. The payee-the person to whom the cheque is payable.

One of the means by which a bank customer can have an idea of the balance in his/her account is to record on the cheque counter foils the amount of money drawn and the amount of money deposited. Another means of knowing the balance is through the amount recorded in the bank columns of the cashbook.

Dishonoured Cheques

A business may deposit a cheque received from acustomer into its bank account but the bank may refuse to honour the cheque forvarious reasons.A cheque that the banker has refused to pay (for whatever reason) is referred to as a dishonoured cheque.

A cheque may be dishonoured for any of the following reasons:-

a) The cheque is not dated

b) The amountinwordsdoesnotcorrespondto thefigurewrittenonthecheque

c) Thebalance in the drawer's account is not sufficient to accommodate the amount to be drawn with the cheque.

d) Thechequehasbeenmutilated

e) Thechequehasbecomestale

f) Signatureonthe chequeisirregular

g) The cheque is post-dated

h) The cheque is not signed.

i) Where it Issus pected that the cheque has been stolen from the drawer and the bank wishes to seek further confirmation from the drawer as as afeguard.

Stale Cheque

The legal tenure of a properly endorsed cheque is 6 months from the date of issue. A cheque presented after 6 months is said to bestale. A stale chequewhenpresented to the bank will not be honoured. However, a stale cheque may be re-validated by altering the date but the authorised signatures have to endorse the altered date before the bank will accept to honour it.

Order Cheque

A cheque is described as an order cheque when it is only made payable to the person named on the cheque.The bank can only make payments to the personwhose name are written on the cheque.It is not negotiate, that is it cannot been dorsed to another person.

Bearer's Cheque

This refers to cheque paid over-the-counter to a specific name or to the presenter (bearer) of the cheque. A bearer cheque can be a cheque endorsed to another person. That is, it can be passed to another party by meredelivery.

Cross Cheques

It denotes a cheque that has two transverse lines drawn a cross the face of the cheque. This means the cheque can only be paid into there cipient bank's account. It can not be cashed over the counter in a bank.

Pay-In-Slip

A bank customer fills outpay-in-slip fore achdepositusually induplicateortriplicate. Some pay-in-slips are carbonized, thus providing automatic office copiesof the pay-in-slipfor posting into the cashbook.Pay-in-slips are sometimes referred to as cash lodgement tellers. It is used to pay cash into a bank account.
Items to be foundonapay–in-slip or cash lodgement steller are:-

i. Date
ii. Name of bank and the branch
iii. Account number
iv. Account name
v. Note and coined nomination
vi. A mountinfigures
vii. Amountinwords
viii. Totalamount

ix. Payer’snameandsignature

x. Payer’stelephonenumber

xi. Mother’s maiden name

Where the pay-in-slip is not the carbonized type, detailsof cheques are analyzed on thereverse side. The bank teller orcollecting cashier will sign the duplicate copy of thepay-in-slipandputsthebank’sofficialdatestamponit.

This will serve as documentary evidence of the amount deposited. The pay-in-slip can be compared with the amoun debited in the cashbook. Some banks now also confirm lodgement with machinegenerated slips.

Stop Payment Order

As soon as a bank customer becomes aware that a cheque is lost or stolen, heshould issue a stop payment orderonthe bank immediately.The order shouldstate the serial number of the cheque, the amount and the payee (if already issuedandsigned). Also, when holders of ATM, users of mobile banking application and internet banking loses his or her phone or suspects that the Personal Identification Number (PIN) has been exposed or hacked, such users should instantly blocked the online/internet banking to avert loss of money.

Methods of Handling, Storing and Security as aspects of Money

In the management of day-to-day business activity, an entity must keep an eye, monitor, track and control cash to ensure safety and security. The following are best practices of cash handling, storing and security of cash.

a) Organisation is crucial to effective cash management

The entity must be fully aware of its location, daily cash needs and threshold of cash to maintain for daily transactions. This will prevent the entity to prevent cash losses and cash mishandling problems from day to day operations of a business.

b) Keep an eye on your cash

It is crucial for an entity to at all time to know where its cash and how much of the is with who to put in in place necessary cash handling and management tools. An entity may engage technology to manage its cash to ease cash management problems.

c) Implement Policies and Procedures

The entity must implement and improve on the cash management procedures put in place to reduce cash mishandling. The staff must be well trained to be comfortable on the use of the policies and procedures to manage cash in an entity.

d) Keep less cash in vault

The entity must not keep large amount in in the vault to discourage staff from being dishonest and take away the cash for personal use or do teeming and lading by taking the same amount of money for personal use and return the same at the end of the month. The entity can set cash limit to be kept in the iron and fire proof safe.

e) Invest in Technology

The entity can invest in technology, for example, putting an alarm system in the fire proof iron vault such that when the maximum cash limit is reached, the alarm sounds and the cashier will go to the bank to deposit the excess cash in the safe.

f) Cash Storage System

Cash must be stored in the fire proof and secured safe located in a secured area with security luck to be controlled by the vault manager. Access to the cash storage system must be discouraged and physically restricted. The amount of cash in in the fire proof safe must not be in excess overnight and during weekends. Excess cash must be deposited in the money deposit bank. The fire proof safe must not be left unlocked even during working hours.

g) Use of Mercury Light

To detect counterfeit or fake money, the cash office must be equipped with mercury light to be used to detect fake money that a fraudulent customer may pay to the cashier. The cashier must be well trained to know the security features (security thread, polymer strip, micro printing, gold lines, colour ink, water mark) of a country's currency

h) Cash Register Balance

The entity must maintain a cash register ledger to record income received and payments made from day-to-day cash collection of the cashier. A good internal control system must be put in place and receiving cashier should be different from the payment cashier.

i) Insurance Policy

The cashiers must be well insured so that the entity will be indemnified when there is a loss of cash.

9.4 Inter-BankTransfers and Clearing Roles

Throughthe use of computer andthe internet,a lotof electronic equipmentisnow available which enables banks to transfer funds from the account of one customer to another without the need for exchangeofpaperdocuments.Thiselectronicequipment is turningthemonetarysystem to acashlesssociety. At presentin Nigeria, some of the available Electronic banking products are Auto- Teller Machine (ATM), Electronic Fund Transfer (EFT) and Electronic devicessuc has the MagneticInk Character Recognition(MICR).

Apartfromtheforegoing, there are some ot her forms of electronicbankingincluding Electronic Fund Transfer At Point of Sales (EFTPOS), Debit Cards and Smart Cards.

We shall now discuss the mode of operation of some of these products.

Bank'sClearingSystem

This refers to an established system of settling payments among banks.Clearing of chequesareusuallydone within 3 workingdaysin Nigeriabya 'clearing house'. It is now electronically done through Nigeria Inter-Bank Settlement System (NIBSS), which was incorporated in 1993. NIBSS is owned by all licensed banks, Central Bank of Nigeria (CBN) and Discount Houses. It started operations in 1994. It is a modern financial architecture to handle inter-bank payments. It was established to eliminate bottleneck, bureaucracy and delay in manual clearing system. It makes the money market and international payment system to be more efficient.

Bank Statement and Bank Reconciliation Statement

The bank usually sends a bankstatementtoitscustomerattheend of everymonth. The statement contains details of the receipts and payments by and onbehalf of the customer for that period. Receipts will include cash paid into thecustomer's account and those paid by third parties direct into the bank. Until the customer receives the bank statement or accredits advice transactionalertinrespect of the direct credit to his bank account, the business may not be aware of it or the amount involved.

Payment or with drawal will also included tails of cheques issued by the customer, bank charges and payments made automatically at given dates on behalf of the customer to third parties by the bank(on the customer's instruction).This is called a standing order. The balance at the end of the period represents the balance as per bank statement.This balance can be a credit balance (favourable) or a debit balance (overdraft).Remember that in the cash book of the customer, a favourable balance is a debit balanceand acredit balanceis anoverdraft.

On-Line Bank Reconciliation Statements

Where an entity uses on-line or internet banking facilities, a designated officer will be designated to monitor or keep an eye over direct transfer into the bank account, direct debit entries such as payment of bills, standing order instructions and various bank charges. The officer will be required to prepare electronic cashbook, electronic adjusted cashbook and electronic bank reconciliation statements. A formatted excel, QuickBooks, SAGE or Tally may be deployed to carry out processes of bank reconciliation.

Example of a Bank Statement

Illustration 9.1below isused as an example of a bank statement.

Illustration9.1

Mr.K.A.Afolabi maintains acurrent account No.0023456789withXYZ Bank Ltd. The balance on the account asat 31/12/2015was ₦15, 500 credit.

Mr.Afolabi'stransactions with the bank in the month of January2016 were as follows:

a) ₦10,000 cash deposited on2/1/2016.

b) A cheque of ₦2,500 issued to Mr. Afolabi by one of his receivables was lodged into his bank account on 6/1/2016.

c) He drew a 'cash' cheque number 000062 for ₦4,000 on 7/1/2016. The cheque was presented to thebankand payment received on that date.

d) He issued a cheque No.000063 for ₦5,000 to one of his payables, Mr. S. O.Babalola on 10/1/2016. Mr. Babalola presented the cheque to XYZ Bank Ltd.on13/1/2016 and received payment.

e) Received cheques totalling ₦22,000 from various customers and lodged theminto the account on 14/1/2016.All cheques matured forcredit to the accounton 19/1/2016.

f) There was a standing agreement between the bank and Mr. Afolabi that his monthly life assurance premium of ₦2,150 should bepaid direct to the insurance company by the bank. The bank remitted this on 25/1/2016.

g) A customer living up country deposited acash sum of ₦9,500 intoMr.Afolabi's account No 0023456789 with the local branch of XYZ Bank Ltd. on27/1/2016.The bank credited Mr. Afolabi's Account the same day.

h) On 31/1/2016 XYZ Bank Ltd. debited Mr. Afolabi's account with a service charge of

₦420.50.

You are required to prepare a statement as it would have been prepared by XYZ Bank Ltd reflecting the above transaction.

Solution to Illustration 9.1

Statement In respect of:

XYZ Bank Limited 202Marina, Lagos

Account No: 0023456789

Customer: Mr.K.A.Afolabi

Periodcovered: 01/01/2016 – 31/01/2016Date issued: 05/02/2016

Date	Transaction	Debit	Credit	Balance
		₦	₦	₦
01/01/2016	Balanceb/f			
02/01/2016	Cash deposit		10,000	25,500
06/01/2016	Cheque deposit		2,500	28,000
07/01/2016	ChequeNo 000062 –cash	4,000		24,000
13/01/2016	ChequesNo000063-	5,000		19,000
19/01/2016	Chequedeposit		22,000	41,000
25/01/2016	StandingOrder	2,150		38,850
27/01/2016	Cashdeposit		9,500	48,350
31/01/2016	Servicecharge	420.50		47,929.50

OpeningBalance	15,500.00
TotalDebit	11,570.50
Totalcredits	44,000.00
Closingbalance	47,929.50

9.5 Adjusted Cash Book

The bank andit scustomer (e.g.abusinessentity)maintainin dependent records in respect of the transactions taking place between them.Therefore it is necessary to reconcile the bankstatement balance with the bankbalance in the cashbook to be assured that the two are in agreement on the amount of money deposited and chequesdrawn.

Usually the bank column balance inthe cashbook andbankstatementbalancearenot alwaysin agreement andtheyneedto bereconciled. An adjusted cashbook is usually employed to post direct transfer by customers (debit entries in the cash book), standing order instructions, Commission on Transactions (COT), Bank Charges, Value Added Tax (VSAT) on COT SMS Alert credit and debit Charges, VAT on SMS debit and credit alerts and other bank charges.

The disagreement between an entity's cashbook and bank statements may betraced to the following factors:-

(a) Unpresented cheques:-These are the cheques drawn on the bank to the payees but have not been presented to the bank for payment. The cashbook of the business would have been credited (that is it has been treated as payment through the bank by the business). This transaction would appear on the creditsideofthecash book but missing from the debit side of the bank statement.

(b) Uncredited cheques:- These are cheques deposited in the business bank

Account and not yet recorded in the bank statement until three or four days thereafter,whereas it would have been recorded on the debitside of the cashbook.

The transaction will appear on the debitside of the cashbook but missing from the credit side of the bank statement.

(c) Bank charges:These are charges made by the bank to cover the expenses in Handling Bank account.The major charges are based on the volume(i.e.turnover) of the transactions on the account.It is sometimes called commission on turnover(COT).Other charges are charges for cheque book,interest charges on bank over draft facilities from the bank, administration expensesetc. These charges would have been recorded in the bank statement but will be missing on the credit side of the cash book.

(d) Standing Order: This is where the business entity has instructed its bank to

Make regular amounts of money at given dates to some other third parties.On due dates,the bank would have made the payments but the fact will not be known to the business.An example is where a business instructs its bank to make regular payments of insurance premiums on its policies to its insurance company.The bank would show the debit entries on the bank statement but the credit entries will be missing on the cash book of the business.

(e) Direct Debits: These are direct payments of expenses on behalf of the business by the bank, e.g electricity bills and telephone bills. These have the same effect as the bank charges.

(f) Direct Credits:These are amountsreceivedonbehalf of the businessdirectly by the bank. The bank account would have been credited and shown on the bankstatement but the entry will be missing from the debit side of the cash book e.g dividends on investments.

(g) Error of the customer or of the bank

Manual/On-line Steps InvolvedIn Reconciling theDiscrepancies

(a) Tick items on the debit side of the cash book against items on the credit side of the bank statement. Outstanding items on the debitside of the cash book that aremissing on the credit side of the bank statement are uncredited lodgements. List them out.

(b) Tick items on the credit side of cashbook against items on the debitside of the bank statement.Itemsoutstandingonthecreditsideofthecashbookbutmissing on the debit side of the bank statementare unpresentedcheques.Listthem out.

(c) The remaining items on the debit side of the bank statement are bank charges and standingorders.Listthem out.

(d) The remaining items on the credit side of the bank statement are amounts paid into the bank directly for the benefit of the business entity by its customers (i.e. direct credits).

After all these have been adjusted, it should be possible to reconcile the cash book balance with the balance on the bank statement.If it is not, and then there are some errors which further investigation would revealand be traced to their sources.

Preparation of Manual/On-line the Bank Reconciliation Statement

Two main steps are involved in the preparation of a bank reconciliation statement.

(1) Determine the adjusted cash bookbalance.This adjustment will notbe affected by items (a) and (b) above. The adjustment will be affected mainly by items (c) and (d).

(2) Reconcilingtheadjustedcashbookbalance with the bank statementbalance.

Step1-Determining the adjusted CashBook Balance

Format

Cash Book (with Adjustment)

	₦		₦
Direct credit	x	Directdebits	X
Balance b/d (debit bal.)	x	Standing order	X
		Cheque earlier lodged	
		Now dishonoured	x
Add:-Direct Credit	x	Bank charges	x
Understatement	x	Over statement of cash	x
	_	Adjusted cash balance	x
	xx		Xx

The adjusted cash book balance is the amount that will be shown in the statement of financial position as balance at bank (current asset).

Step2-Reconciling the adjusted cashbook balance with the bank statementbalance.

	₦
Adjusted Balance as per cash book	xx
Add: Unpresented cheques	xx
Errorofoverstatement by bank	xx
	xx
Uncredited cheques	(xx)
Errorreducingthebusiness balance	
Committed bybank	(xx)
Balanceasperbankstatement	xx

Using an Alternative Method

	₦
Balanceas perbank statement	xx
Add: Uncredited cheques	xx
Bankerrorreducingcashbalance	xx
	xx
Unpresented cheques	(xx)
Bank error overstating cashbalance	(xx)
Adjusted Balance as per cash book	xx

Formatted Excel Worksheet

1	**A**	**B**	**C**
2	**Electronic-Adjusted Cashbook in Excel Format**		
3	**Description**	**Amount**	**Amount**
3		**¢**	**¢**
4	Bal b/d (debit Balance)		xxxxx
5	Add/Direct Credit in Bank Account		
6	Electronic Transfer	xxxxx	
7	Electronic Dividend Received	xxxxx	
8	Fixed Deposit Interest Received	xxxxx	
9	=B6 + B7 + B8 or = sum(B6:B8) then press enter, answers supplied		xxxxx
10	=C4 +C9 OR =SUM(C4:C9) then press enter, answers supplied		xxxxx

11	Deduct direct debit in the bank account		
12	Standing order	xxxxx	
13	Direct payment of electricity	xxxxx	
14	Commission on Transactions (COT)	xxxxx	
15	Bank Charges	xxxxx	
16	VAT on COT	xxxxx	
17	=B12 + B13 +B14 + B15 +B16 or =SUM(B12:B16), then press enter		xxxxx
18	Closing Balance in the Cashbook: = C10-C17, then press enter, answers supplied		xxxxx

Formatted Excel Worksheet

1	**D**	**E**	**F**
2	**Electronic-Bank Reconciliation Statements**		
3	**Description**	**Amount**	**Amount**
3		**¢**	**¢**
4	Debit balance from Adjusted Cashbook		xxxxx
5	Add unpresented cheques		
6	Cheque 1	xxxxx	
7	Cheque 2	xxxxx	
8	Cheque 3	<u>xxxxx</u>	
9	=E6 + E7 + E8 or = SUM(E6:E8) then press enter, answers supplied		<u>xxxxx</u>
10	=F4 +F9 OR =SUM(F4:F9) then press enter, answers supplied		xxxxx
11	Deduct uncredited cheques		
12	Cheque 1	xxxxx	
13	Cheque 2	xxxxx	
14	Cheque 3	xxxxx	
15	Cheque4	xxxxx	
16	Cheque 5	<u>xxxxx</u>	
17	=E12 + E13 +E14 + E15 +E16 or =SUM(B12:B16), then press enter		<u>xxxxx</u>
18	Closing Balance in the Cashbook: = E11-E17, then press enter, answers supplied		<u>xxxxx</u>

Note: *If balance in the bank statement is used, in the excel work you add uncredited cheques and unpresented cheques*

Illustration9.2

The following bank account and bank statement relatet othe firm of Mohammed and Sons for the period of 1 to 12 June, 2022.

BankAccount

2022	₦	2022		₦
June1Balb/f	6000	June2	Cheque Owen	400
3Cash	500	2	Cheque Peter	150

5Cheque Kuku	85	6	Cheque Ringo	105
7Cheque Labe	220	8	Cheque Smith	365
9Cheque Michael	155	10	Cheque Thomas	1,120
11Cheque Ndidi	36	12	Balance c/d	5,180
	7,320			7,320
Balanceb/d	5,180			

Bank statement as at 12June,2022

2022		Debit ₦	Credit ₦	Balance ₦
June1	Balance			6,000
2	Cheque no. 98876	400		5,600
3	Cash		500	6,100
4	Charges	20		6,080
5	Cheque deposits		85	6,165
6	Cheque no.98877	150		6,015
7	Chequedeposit		220	6,235
8	Cheque deposit(byUmoru)	600		6,835
9	Cheque dishonoured	85		6,750
10	Standing order (InsurancePremium)	560		6,190
11	Cheque98878	105		6,085

You are required to effect the necessary adjustments to the bank account, prepare the adjusted balance and Preparea Bank Reconciliation Statement

Solution to Illustration 9.2

Adjusted Cash Book

Date	June2022	₦	June2022	₦
	Balance b/d	5,180	Bank charges	20
	Direct credit(Umoru)	600	Standing Order	560
			Dishonoured cheques	85
			Balc/d	5,115
		5,780		5,780
	Balanceb/d	5,115		

B. Bank Reconciliation Statement at 12 June,2022

			₦
Adjusted balance as per cashbook			5,115
Add:-unpresented cheques:-			
	Smith	365	
	Thomas	1,120	1,485
			6,600
	less:- Uncreditedcheques:		
	Micheal	155	
	Ndidi	360	515
	BalanceasperBankstatement		6,085

Illustration 9.3

The following is the summary of the cashbook of Akintola Enterprises for the month ended 31/5/2022

Cash Book

	₦		₦
Balanceb/d	2,110	Sundrypayments	23,280
Sundryreceipt	22,610	Bal.c/d	1,440
	24,720		24,720
Balanceb/d	1,440		

On investigation the following errors were discovered.

i. Bank charges of ₦53 on the bank statement had not been entered in the cashbook.

ii. A cheque drawn for ₦27 by the enterprise had been returned by the bank marked“Returned to drawer”but this had not been recorded in the cashbook.

iii. The opening balance in the cash book was wrongly brought down as ₦2,110 instead of ₦2,205.

iv. The cash book showed a deposit of ₦2,178 which had not yet been credited to the account by the bank.

v. The bank had debited a cheque for ₦108 in error to the entity’s account.

vi. The bank statement showed an over drawn balance of ₦50

vii. A payment of ₦70 cheque was treated as a receipt in the cashbook.

viii. Three cheques issued to suppliers for ₦321,₦555 and ₦45 had not been presented for payment.

You are required to

(a) Write up the adjusted cash book.

(b) Prepare a bank reconciliation statement.

Solution to Illustration 9.3

Akintola Enterprises

(a) AdjustedCashBook

	₦		₦
Balanceb/d	1,440	BankCharges	53
Difference in opening bal.	95	Errorin cheques drawn	140
Dishonoured cheque			27
Balancec/d			1,315
	1,535		1,535

Balanceb/d 1,315

(b) Bank Reconciliation Statement at 31 May,2022

	₦	₦
Adjusted balanceasper cashbook		1,315
Add:unpresented cheques	321	
	555	
	45	921
		2,236
Less:Uncredited cheque	2,178	
Debit in error by the bank	108	2,286
Balance as per Bank Statement(Overdraft)		(50)

Note: Payment of ₦70cheque recorded in error as receipt gave a correction of ₦140 in the cash book because the error will be cancelled first before the₦70 is reinstated on the credit side.

Illustration 9.4

The following information was extracted from the records of a petty trader as at 30 June 2022.

Balance as per Bank Statement was ₦1,000 credit. Cash Book balance showed ₦37,000 credit in the Bank Account column.

The following had been reflected in the Bank Statement but not in theCashbook.

Bank charges	₦5,000
Bank loan interest	₦1,000
Interest from investments	₦2,000
Dividends from shares	₦12,000

In addition, a cheque for ₦20,000 issued to Kete was dishonoured because of in sufficient fund. Another cheque for ₦30,000 issued to Jimoh remained unpresented. A cheque for ₦20,000 from Kudiratu was yet to be credited

You are required to produce an adjusted Cash Book and then a Bank Reconciliation Statement as at 30 June 2022.

Solution to Illustration 9.4

Adjusted Cash Book Account

	₦		₦
Intereston Investments	2,000	Balance b/f	37,000
Dividends	12,000	Bank charges	5,000
Kete(dishonouredCheque)	20,000	Interest on loan	1,000
Balance c/d	9,000		
	43,000		43,000
		Balanceb/d	9,000

Bank Reconciliation Statement as at 30 June 2022

	₦
AdjustedCashBook Balance	(9,000)
Add:unpresented cheques	30,000
	21,000
Less:Uncredited cheque	20,000
Balance per Bankstatement	1,000

Illustration 9.5

The following Cash Book and Bank Statement were extracted from the records of Dugbe Alawo Enterprise as at 31 January 2022.

Cash Book on 31 January 2022

Date	**Details**	**Cheque No.**	**Amount ₦**	**Date**	**Details**	**Cheque No.**	**Amount ₦**
3/1/22	Balb/d		18,500	6/1/22	Owen	000666	4,595
4/1/22	Elijah	007605	1,980	9/1/22	Mikel	000667	1,450
6/1/22	Roland	101005	3,700	16/1/22	George	000669	1,430
16/1/22	Bright	202808	3,600	27/1/22	Obama	000670	2,105
31/1/22	Bush	404003	2,880	31/1/22	Balc/d		21,080

		30,660	**30,660**
31/1/17	Balb/d	21,080	

Dugbe Alawo Enterprise

Bank Statements on 31 January2022

Date	Details	ChequeNo.	Debit ₦	Credit ₦	Balance ₦
4/1/22	-		-	-	18,500
5/1/22	Elijah	007605	-	1,980	20,480
9/1/22	Roland	101005	-	7,300	27,780
17/1/22	Mikel	000667	1,450	-	26,330
30/1/22	Obama	000670	2,105	-	24,225
30/1/22	CreditTransfer		-	1,680	25,905
30/1/22	Dishonouredcheque	007605	1,980	-	23,925
31/1/22	Cheque	909808	1,560	-	22,365
31/1/22	Bankcharges		548	-	21,817
31/1/22	StandingOrder		5,560	-	16,257
31/1/22	Bankcharges		28	-	16,229
31/1/22	VAToncharges		29	-	16,200

Note: Cheque number 101005 had been transposed in error in the CashBook as ₦7,300. Also, cheque number 909808 was debited in error in the Bank Statements.

You are required to prepare Dugbe Alawo Adjusted CashBook andBank Reconciliation on 31January, 2022

Steps to be followed:

a. Prepare Adjusted CashBook:

(i) Check debit entries in the Bank Statement not credited in the original cashbook; credit these in the Adjusted Cash Book. These are:

	₦
Dishonouredcheque	1,980
Bank charges	548
Standing order	5,560
Bank charges	28
VAT on charges	29

(ii) Check credit entries in the Bank statements not debited in the original cashbook; debit this in theAdjusted Cash Book. This is:

	₦
CreditTransfer	1,680

(iii) Correct transposition errors made in the Cash Book – Roland(₦7,300– ₦3,700 =₦3,600) Since the amount is understated in the cashbook, debit ₦3,600 into Adjusted Cash Book.

b. Prepare theBank Reconciliation Statement:

(i) Use either closing balance in the original cashbook (₦21,080) or closing balance in the BankStatements (₦16,200).

(ii) If the closing balance in the original cash book is used, add unpresented cheques and deduct uncredited cheques.

(iii) If the closing balance in the Bank Statement is used, adjust bank errors (₦1,550), add this back to the closing balance, add uncredited cheques and deduct unpresented cheques.

(iv) Identify uncredited cheques by checking cheques received(debited) in the Original cash book but not credited in the bank statement; where these cheques were not on the credit column of the bank statements, the cheque will be described as uncredited cheques.They are:

	₦
Bright–Chequenumber202808	3,600
Bush –Chequenumber404003	2,880
	6,480

(v) Identify the unpresented cheques by checking cheques that had been issued to customers, credited in the original cash book but not on the debit side of the bank statements.These cheques are described as unpresented cheques. They are:

	₦
Owen-Cheque number 000660	4,595
George –Cheque number 000669	1,430
	6,025

(vi) Reconcile all bank statements and cash book errors.

(vii) Prepare the Adjusted Cash Book to determine debit items credited in the bank statements but not debited in the original cash book because the cash book keepers did not have informationaboutthetransactions.

It also includes correction of errors in the original cash book:These are:

	₦
Bank charges	548
Standing Order	5,560
Bank charges	28
VAT on charges	29
	6,165

The items are all direct debit in the bank statements not credited in the cash book.These items are credited in the Adjusted Cash Book.This also includes dishonoured cheque 007605, earlier credited in the Bank Statements but now reversed as a result of unavailability of funds in Elijah's account in the bank, instructions not to pay the cheque and non-conformity with other banking procedures.

(viii) Correct errors in cash book (₦7,300–₦3,700) debiting Adjusted Cash Book.

(ix) Determine direct credit in the bank statements not debited in the original cashbook, this is:

	₦
Credit Transfer	1,680

This is debited in Adjusted Cash Book.

(x) Prepare the Bank Reconciliation Statements.

Solution

Adjusted Cash Book

	₦		₦
Balb/d	21,080	Bankcharges	548
Errorsincashbook		StandingOrder	5,560
		BankCharges	28
(₦7,300–₦3,700)	3,600	VAToncharges	29
CreditTransfer	1,680	Dishonouredcheque	1,980
		Balc/d	18,215
	26,360		26,360
Balb/d	18,215		

Dugbe Alawo Enterprise
Bank Reconciliation Statements on 31January 2022

	₦	₦
Balance as per Bank Statements		16,200
Add:		
Cheque No:909,808		1,560
		17,760
Add:Uncredited cheques:		
Bright	3,600	
Bush	2,880	6,480
		24,240
Less:Unpresented cheques:		
Owen	4,595	
George	1,430	
		6,025
Balance as per Cash Book		**18,215**

Dugbe Alawo Enterprise
Alternative Presentation: Bank Reconciliation 31/1/2022

	₦	₦
Balance as perAdjusted Cash Book		18,215
Add:Unpresented cheques:		
Owen	4,595	
George	1,430	6,025
		24,240
Less:Uncredited cheques:		
Bright	3,600	
Bush	2,880	6,480
		17,760
Less:Amount deducted in error		
Cheque number 909808		1,560
Balance as per Bank Statements		16,200

In February, 2022, Dugbe Alawo Enterprise should ensure ₦1,560 debited in error should be credited back to the Bank Statements.

Questions

Multiple choice and short-answer questions

(1) Whichofthefollowingreconciliationitemswillaffect the cashbookbalance?

i. Bank error over stating the bank balance

ii. Cash book error,overstating the bank balance

iii. Income received through the bank

iv. Imprest cheques

a. IandII

b. IIandIII

c. IIandIV

d. IandIII

e. IIIandIV

(2) A cheque, which was credited into an entity's cashbook but not debited by the bank is known as-------cheque

a. stale

b. order

c. bearer

d. unpresented

e. uncredited

(3) Which of the following kind of cheques describe customer's cheque not honoured in the bank?

(a) Stale cheque

(b) Crossed cheque

(c) Dishnoured cheque

(d) Order cheque

(e) Bearer cheque

(4) Which of the following cheques cannot be endorsed from one person to another?

(a) Bearer cheque

(b) Order cheque

(c) Crossed cheque

(d) Stale cheque

(e) Dishonouredcheque

(5) A cheque that has been recorded as a debit entry in the original cash bookbut not yet recorded as a credit entry in the bank statement is known as:

(a) Crossed cheque

(b) Dishonoured cheque

(c) Crossed cheque

(d) Unpresented cheque

(e) Uncredited cheque

(6) Given the following balance

	¢
Bank Statement	(100,000)
Unpresented Cheque	150,000
Uncredited Cheque	40,000

Calculate the balance in the cashbook

(a) ¢290,000

(b) (¢290,000)

(c) (¢210,000)

(d) ¢190,000

(e) ¢90,000

(7) Which of the following is not useful to prepare bank a bank reconciliation statement?

(a) Cash Register

(b) Used Cheque Stubs

(c) Bank Statements

(d) Cashbook

(e) Errors in the bank Statements

(8) Which of the following has a debit entry in the adjusted cashbook?

(a) Standing Order

(b) Dishonoured Cheque

(c) E-Dividend

(d) Bank Charges

(e) Direct payment of electricity

(9) An overdrawn balance in the cashbook is ------

(a) an expense in the Statement of Profit or Loss

(b) a noncurrent asset in the Statement of Financial Position

(c) a current asset in the Statement of Financial Position

(d) a current liability in the Statement of Financial Position

(e) a noncurrent liability in the Statement of Financial Position

(10) A bank reconciliation statement is a statement-------------

(a) sent by the bank when bank account is overdrawn

(b) sent by the bank when an entity makes an error

(c) drawn by the bank to verify an entity's cashbook and bank statement balances

(d) drawn by the bank to reconcile unpresented and uncredited cheques

(e) drawn up by an entity to verify cashbook and bank statement balances.

Short Answer Questions (SAQ)

1. An acronym EFTPOS means------
2. State any two (2) parties to a cheque
3. In the modern clearing system, state meaning of NIBSS
4. The person to whom a cheque is written is called------
5. The person to whom a cheque is payable over the counter is known as----
6. In the banking system, the tenure of a stale cheque is------

7. A cheque with two transverse line drawn over the face of the cheque is known as---

8. A cheque in which a debit entry was recorded in the cashbook without a corresponding credit entry by the bank is called-----

9. State the full meaning of ATM in electronic banking system

10. A specific instruction to the bank to pay a custom sum of money over a period of time is called------

1) Name and explain the two (2) main steps involved in preparing the bank reconciliation statement

2) When acustomer's cheque that is lodged is dishonoured by the bank, what is the effecton cash balance? Describe a dishonoured cheque

3)

(a) Name and explain the account that a business normally maintains with a bank when it has fund for investment for a relatively long period.

(b) **Use the following information to answer questions below**

	Given:	₦
i.	Balance as per cash book	223,760
ii.	Dividend received by bank on behalf of customers	1,170
	Bank charges	360
iv.	Unpresented cheques	21,600
v.	Uncredited cheques	3,300
vi.	Total lodgements credited by the bank	750,000

Determine the Adjusted Cash Book Balance and the balance as per bank statement.

4) Identify and explain Six (6) approaches that an entity can employ to handle, store and secure cash.

(5) (a) Write short notes on the following:

i. Credit card
ii. Electronic Fund Transfer(EFT)
iii. Automatic Teller Machine(ATM)
iv. Stale Cheque
v. Bank’s Clearing System

(a) Cash Book of Favour Ventures on 31/1/2022

		₦			₦
4/1/22	Balb/d	29,000	4/1/22	Oliver	12,500
Revenue		15,000	9/1/22	David	7,500
12/1/22	Abraham	5,000	16/1/22	Jacob	2,500
30/1/22	Sales–cheque501	30,000	30/1/22	PAYE	2,500
31/1/22	Sales–cheque101	15,000	30/1/22	Pension	2,500
			30/1/22	Emmanuel	1,000
		___		Balc/d	65,500
		94,000			94,000
Balb/d		65,500			

Favour Bank Statements on 31/1/2022

Date	**Details**	**Cheque No.**	**Debit ₦**	**Credit ₦**	**Balance ₦**
4/1/22	Balanceb/f	-	-	-	29,000
16/1/22	Abraham	-	-	5,000	34,000
17/1/22	Owen	-	12,500	-	21,500
18/1/22	Deposit	501		30,000	51,500
19/1/22	David		7,500	-	44,000
19/1/22	Standing Order		1,000	-	43,000
30/1/22	PAYE		2,050	-	40,950
30/1/22	Commission on transactions		115	-	40,835
31/1/22	VAT		6	-	40,829
31/1/22	SMS alert		105	-	40,724

Note: The cashier made transposition errors in recording PAYE in the CashBook

You are required to prepare Favour Ventures Adjusted Cash Book and Bank Reconciliation Statementson 31 January, 22.

Solution to Revision Questions

(1) B

(2) D

(3) C

(4) B

(5) E

(6) C (-¢100,000-¢150,000 + ¢40,000)= ¢210,000

(7) A

(8) C

(9) D

(10) E

Short Answer Questions (SAQ)

1. Electronic Fund Transfer at Point of Sales
2. Drawer

   Drawee

   Payee

   Any two (2)
3. Nigeria Inter Banks Settlement System
4. Drawee
5. Payee
6. 6 months
7. Cross cheque
8. Uncredited cheque
9. Automated Teller Machine
10. Standing Order

CHAPTER TEN

Chapter Ten Contents

- Procedures and importance of payroll and pay slips
- Types of payroll systems
- Calculations of gross earnings, deductions, net pament and pay slips
- Accounting for payroll

PAYROLL ACCOUNTING

Learning Objectives

After you have studied this chapter,you should be able to:

- *State the importance of payroll accounting;*
- *Explain the procedures of preparing payroll and pay slips;*
- *Identify and calculate incentive payment schemes;*
- *State types of payroll systems;*
- *Calculate gross earnings, deductions,net payments and prepare pay slips; and*
- *Record payroll transaction, journal preparation and postings to nominal ledgers.*

10.1 Importance of Payroll Accounting

In this chapter, you will learn how to calculate the salariesand wages with the various deductions that are made from the gross pay to derive net pay and calculate personal income taxes of employees. Thus, you will be able to know how to use the Progressive Personal Income Tax Schedule to calculate the income tax of an employee. Social security supports a variety of programmes such as employees' pension contributions, social Security Contributions, National Health Insurance Scheme, National Housing Fund, disability, Pension and survivor benefits among others for retired persons (senior citizens). Thus, students will learn how statutorydeductions are calculated and the reasons why they are deducted at source from the gross pay of employees.Also, you will understand what types of reliefs are available to employees and how they are adjusted before the employees'net pay is computed. Finally, students will comprehend how salaries and wages and deductions are posted into journal, nominal ledgers and their treatments in the Statement of Profit or Loss for the year ended.

Payroll

Payroll may be defined as a record showing the names of employees, rates of pay,hours worked, bonuses, allowances, gross earning (salaries), statutory deductions and other deductions during a given pay period.In simple terms,pay roll is a document in tabular format showing each worker's gross earning,deductions(statutory and otherwise) made from his gross earnings and the net amount payable to him in a particular pay period. In a computerised payroll system, mostly in a formatted Microsoft Excel, the computer stores variety of data such as employees' names, address, staff number, social security number, marital status, number of hours work, pay rate, housing allowances, transport allowance, responsibility allowance, other allowances, gross pay, statutory and non-statutory deductions and net pay. In such a computerised payroll system, the formatted Microsoft Excel, Personal Income Tax computation is completely automated. There is a provision for add, delete, promotion and demotion of employees to automatically update files in the computer to capture new employment, retirement, dismissal, termination, suspension, death, promotion and other day-to-day variations in employment contract. The formatted Microsoft Excel uses the payroll transaction date to accumulate total gross, net pay and Personal Income Tax weekly, monthly and annually. Thus, it is important that the correct employment date is inputted into the computer to ensure that the software automatically computes the correct net pay of employee from time to time.

The objectivesof either manual or computer is edpayroll accounting are to process information suchas; Hours Worked, Pay Rate, Gross Earning, Deduction and NetPay(salary).Pay roll usually constitutes the most significant or material obligation or expense in most business entities. Business entities are required by law to send returns on their payroll including the amount of income tax deducted at source to the tax authorities. Business organizations record information relating to employees'pay due to the following:

1) It is used for cost control purposes, usually in the form of variance analysis.
2) It is also the basis upon which most tax clearance certificates are prepared.

Employees are usually paid either wages or salaries for work done monthly in an entity. Wages refer to the type ofemployees' hourly, daily or weekly remuneration package that is time based. In this situation the rate of pay is given as a fixed amount per hour for the number of hours actually worked or of those who reported for duty.Salary,though time based,is quoted on an annual basis.

In Ghana and Nigeria all employees are taxed under the PAYE (Pay-as-You

Earn)system.This is a form of with holding tax system where the employer is legally required to deduct at source and the income tax and social security contributions from the wages or salaries of employees and pay/remit the same to the appropriate/relevant authorities. Therefore, it means that theemployee will not have to wait till the end of the year for him to personally pay his tax liabilities to the state. The PAYE tax is a monthly phenomenon which is seen as an estimate and as such may result in over payment or under payment of an employee's income tax liability at the end of the year.

Gross pay or earning is the total emolument or, pay/salary or total weekly wage thatemployees earn in a particular period before statutory and other deductions are made.In Nigeria and Ghana, gross pay is the consolidated income of an individual earned from employment.The consolidated salary of an employee may consist of the following components:

a) Basic Salary;
b) Leave allowance;
c) Responsibility allowance;
d) Transport allowance;
e) Overtime allowance;
f) Risk allowance;
g) Meal Subsidy;
h) Utility Allowance; and
i) Other Earned Allowances.

Procedures of Preparing Payroll and Pay Slips

In an entity, to prepare a payroll in either a manual or computerised system, the Payroll or Salaries and Wages Department keeps, update and maintain files of senior management staff, middle management staff, operational staff and other categories of staff. In the entity, the department also has general file where salary scales, allowances, bonuses, leave allowances, meal tickets, Personal Income tax rates and other information on benefits in kind for all categories of employees. The files in the Payroll or Salaries and Wages provide basic varieties of data such as names, sex, marital status, date of birth, employment letter, account details (i.e. names, account number and bank's name) acceptance of duty, time of resumption of duty, grade level, step, annual salaries and wages, hourly rate, hours to work per day, in a week and monthly, annual allowances, benefits-in-kind and perquisites of the offices. The information assists the payroll officers to accurately prepare salaries and wages of all employees of an entity weekly and monthly as may be required. Besides, it assists in the preparation of personnel annual budget and submission to relevant offices. After collecting useful information of every employee, the payroll officers prepare weekly wage, monthly salaries to calculate gross pay, deduct the statutory and non-statutory deductions and Personal Income Tax to derive net pay. The head of the Payroll section will collate the salaries and wages payable by preparing a schedule and summary of salaries and wages indicating total amount to pay as net salaries, statutory and non-statutory deductions. The summary of salaries schedule will show total amount of net salaries and wages, statutory and non-statutory deductions payable to Bank A, Bank B and Bank C among other banks. This will provide information to the Bursar, Chief Accountant of Chief Finance Officer on how much to pay to various banks as net salaries, payments of statutory and non-statutory deductions.

10.3 Methods of Computing Incentives Payment Schemes/Systems

An employee incentive scheme is employed to protect, motivate and encourage workers to more efficient, effective and productivity output to produce more with the least possible input costs. It gives good incentives to the efficient, effective and productive workers. The two main remuneration methods often used are: Time based system and Piecework system. Others include:Straight salary, bonuses, commission etc. Methods of remuneration refer to the basis used in calculating wages of workers.Inthe preparation of payroll, the organisation must initially determine the employee’s Gross Salary or wages using the most appropriate remuneration plan adopted by theentity. The employees’ incentive schemes are discussed below in turns:

TimeBasedSystem/Rate Based Scheme

In this system of remuneration, employees are paid according to number of hoursactually worked multiplied by a fixed amount or rate.This simply means that thelonger the period for which an employee works, the larger his or her gross pay will be.This method of remune ration is usually employed in the manufacturing industries.The payment to the employees is based on this formula:

Earnings=ClockhoursxRateperhour

Advantages

a) It is simple to understand and administer;

b) Wage negotiations(changes)can be easily effected;

c) It has stood the test of time;

d) It provides incentive for longer period of work; and

e) It facilitates cost control.

Disadvantages

a) There is no incentive to improve productivity and efficiency;

b) It is not a sound accounting practice to pay all employees in the grade the Same rate irrespective of performance;

c) Cost of supervision under this method is very high;

d) It is not a very good basis forcost control; and

e) It does not encourage innovation.

Performance related Systems/Performance Based Remuneration Method

Under this system, the remuneration in terms of wages or salaries that is paid to eachemployeeisdependentonhisorherlevelofoutput, performance or services rendered. Workers are normally given a fixed sum per unit of output so that the higher one's output the larger one's gross pay or salary.Casual labourers, cooks, painters, contractors, etc.are of ten paid by this method.

The payment to the employee is based on the formula below:

Earnings=Number of units produced x rate per unit

Advantages

a) It attracts higher grade workers;

b) It provides direct incentive for innovations, efficiency and high productivity with out the difficulties associated with individual piece work rates, schemes;

c) It is simple to understand and administer;

d) It facilitates cost control; and

e) It has stood the test of time.

Disadvantages

a) Cost of output may exceed budget if proper supervision is not carried out;

b) It results in competition for higher grade workers thereby increasing the cost per output;

c) Shoddy work or inferior goods may be made, if there is no proper supervision

d) Too much emphasis on productivity, this may be detrimental if the standard is premised on perfection ; and

e) It does not take into account individual disabilities, or abilities.

` **StraightSalary**

Under this method of remuneration, employees are paid a fixed amount annually with aconstant increase per annum.This is usually stated as follows:

Gross Pay=¢10,000,000x¢ 2,000,000– ¢18,000,000.

The above statement means that this employee will receive ¢10,000,000 for the first year of his engagement. There after his gross pay will increase by ¢2,000,000 every subsequent year following the date of his employment.This increment will continueuntil when it gets to ¢18,000,000.Thereafter, only if he is promoted will he earn further increments.

It must however be noted that the gross pay under this method does not depend on the number of hours worked or output produced.

Bonus Schemes

These are schemes which are used by employer store ward exceptional performance of employees. Bonuses are paid in addition to the normal earnings mentioned above. Such incentives vary from one company to the other. The main purpose of providing these incentives is to encourage workers toproduce their best for the company.

Typesof BonusSchemes

Halsey Premium Plan

This plan was introduced by F. A. Halsey in 1891. The plan simply combines the time and piece rate systems.Themainfeatures of this plan areas follows:

a) Workers are paid at a rate per hour for the actual time taken to perform atask;

b) A standard time is set for each piece of work,job or operation;

c) If a worker takes standard time or more than the standard time to Complete his work, heis paid wages for the actual timetaken byhim at The time rate; and

d) If a worker takes less than the standard time, he is paid a bonus equal to 50% of the time saved at thetimeratefixed.

Under this system, total earnings of a worker are equal to wages for the actual time taken by him plus a bonus. The formula for calculating bonus and total earnings under this incentive plan is:

Bonus=50%of[TimesavedxTimerate]

Total earnings = Time rate x Time taken + 50% of [Time saved x Time rate]

Illustration 10.1

Standard time (or Allowed time) = 250 hours.Wagesrateper hour =¢15

Actual timetaken =220 hours

Thustimesaved=250hrs– 220hrs=30hrs.

Bonus=50%[30hrsx¢15] =¢225

Tota learnings=¢15 x220hrs+50%[30hrs x¢15] =¢3,525

Advantages of HalseyPlan.

a) Itis easyto understand;

b) Itguaranteesaminimumtimewagestoalltheworkers.Thismeansthatsloworlazyandrelativelyinefficient workers havenothingto fearon theplan;

c) Thebenefits resulting from savingin time isequally divided betweenworkers andtheemployer; and

d) Bonusisseparatelycalculatedforeachjob.Asaresultanytimesavedbyaworkeronaparticularjob is not adjusted against excess timetaken byhim on anotherjob.

Disadvantages of HalseyPlan

a) Workersdo not liketheemployerto sharethebenefits oftimesavedbythem;

b) Itdoesnotprovidetheemployerwithfullprotectionagainsthigh ratesetting; and

c) Extraefficiencyofaworkerisnot fullyrecognised and rewarded.

Rowan Plan

ThisplanissimilartotheHalseyincentiveplanmentionedabove.Thedifferenceliesinthecalculationofbonus. Themain features ofRowan Plan areas follows:

a) Wagesarepaid ontimebasisfortheactual time worked bytheworker;

b) Astandardtimeisdeterminedforeachpieceofworkorjob;

c) Ifaworkercompleteshisworkinstandardtimeorinmorethanthestandardtime, heis paid wages forthetimeactuallytakenbyhim;

d) Ifaworkercompleteshisworkinlessthanthestandardtime,heisentitledtoabonus; and

e) TheBonusiscalculatedastheproportionofwagesofactualtimetakenwhichthetimesaved bears to thestandard time.

Theformulaforcalculatingbonusand totalearningsunderthis incentiveplanis:

$$\text{Bonus} = \frac{\text{Timesaved}}{\text{Timeallowed}} \times \text{Time taken} \times \text{Time rate}$$

$$\text{Totalearnings} = (\text{Timetaken} \times \text{Timerate}) + \text{Bonus}$$

Illustration10.2

Standard time (or Allowed time) =250 hours

.Wagesrateper hour =¢15

Actualtimetaken =220 hours

$$\text{Bonus} = \frac{30}{250} \times 220 \times ¢15 = ¢396$$

Total Wage =¢3,300+¢396= ¢3,696

AdvantagesofRowanPlan

a) Earnings=(220hrsx¢15)+¢396 = ¢3,696; just likeHalseyPlan, it provides guaranteed minimumwages to workers;

b) It protects the employers againstlooseratesetting;

c) ItpaysahigherbonusthanthatundertheHalsey planupto50%ofthestandardtimesaved;

d) Theworkerisnotinducedtorushthroughthework if time save dismore than 50% of thestandard time, thebonusincreasesat adecreasingrate; and

e) Itprovidesgoodincentives forcomparativelyslowworkersandbeginners.

DisadvantageofRowanPlan

a) Thecalculationofbonusiscomplicatedandmay notbeeasilyunderstoodbyworkerswhomaysuspect theemployers’motives; and

b) Incaseofextraefficientworkers, bonus is less than under Halsey Plan. This is true when the time saved is morethan thetimetaken.

Comparison of Halsey Plan and Rowan Plan

a) **Bonus:** WhentimesavedIncreases,bonusunderHalseyPlanalsokeepsincreasing.ButundertheRowanPlan,whentimesavedincreases,bonusincreasesonlywhentimesavedisupto 50%ofthestandardtimeallowed.Thereaftertheamountofbonusbeginstodecline.Bonusunderthetwoplansisthesamewhentimesavedisexactly50%.Before50%ofstandardtimesaved,bonusunderRowanPlanishigherthanthatofHalseyPlanandafter50%ofthetimesaved,bonusunderRowanplanislowerthanthatofHalseyPlan.ForexampleunderRowanplan, apersonwhohassaved60%oftimeallowedearnsthesameamountofbonusifhesaves40%ofthetimeallowed;

b) **Earningsperhour:** Underbothplansearningsperhourofworkerskeeponincreasing, but the rates of earnings under the two plans differ. When time saved is lessthan 50% of time allowed, the rate of increase in per hour earnings is higher in Rowan Planwhereaswhentimesavedismorethan50%oftimeallowed,therateincreaseinperhourearningsishigherinHalseyPlan.At50%timesaved,earningsperhourunderboth schemes arethesame;

c) **EffectonLabourCost**:Labourcostperunitdecreasesasproductionincreasesupto thestandardtimeallowed;thereafter,itcontinuestodecreasebutnotatafasterrate; and

d) Rowan plan cost per unit is higher than under Halsey Plan until time saved is 50% oftime allowed.Thereafter it is lower and soon becomes significantly lower. At 50%timesaved, labourcost perunit is thesameunderboth plans.

Allowabledeductionsandreliefs

These are statutory deductions and others that are expected to be deducted from thegrosssalaryofanemployeeattheendofagivenperiod.InGhana,these deductions include the following:

IncomeTax

a) 5%ofemployee’spayforSocialSecurityContributions;

b) Employees’providentfund;

c) Anypercentagecontributiontowards aSpecialretirementfundbyanemployee;

d) Medical Insurance;

e) Union/SeniorStaffDuesorWelfareFundContributions;

f) RepaymentofEmployeesAdvancesorLoanfromEmployers;

g) HirePurchaseDeductions;

h) Others deductions are:

i. The first two deductions (income tax and social security contribution) are compulsoryin

Ghana.However,theotherdeductionswilldependontheregulationsofthecompanyin question andtheemployee's own preferences;

ii. Children Allowance ¢2,500 per child subject to maximum of 4 children under the age of 18 still in the school;

iii. Dependent Relative Allowance, ¢2,000 each with maximum of two (2) dependents;

iv. InNigeria, the deductionsaresimilartowhatyouhaveinGhanainmanyrespects.

v. Someofthedeductions include:

a) Incometax;

b) 8%ofemployee'sgrosspayforcontributorypension;

c) 2 ½ % contributions to National Housing Fund (NHF);

d) Medicalinsurance;

e) Uniondues/welfarecontributions;

f) Cooperativecontributions/loanrepayments

10.4 Types of Payroll Systems

There are two (2) main types of payroll system. These are:

a) Manual Payroll System; and

b) Computerised bPayroll System.

Manual Payroll System

The employees in the salaries and wages department collect data, store in files in the cabinet files and, process employees' data (names, sex, staff number, department, hourly work, hour rate, bonus, Salaries and allowances) to manually compute gross pay; deduct Personal Income Tax, Statutory and Non-statutory deductions to calculate net pay of employees. The filing is done manually and computations are also done manually using calculators, adding machines and casting machines among other basic office machines.

Advantages of Manual Payroll System

a) Salaries and wages are prepared manually; and

b) The processes are easily comprehensible.

Disadvantages of Computerised Payroll System

a) The manual process of computation of salaries and wages is tedious, cumbersome and difficult;

b) The process is not reliable and it is inefficient;

c) The process of salaries and wages computation is very slow;

d) The rate of errors of addition is high;

e) Correction of error of addition and human error is inflexible and difficult;

c) It is not fast, it is inaccurate and unreliable; and

f) The filing and stationery costs are huge making it ineffective.

Computerised Payroll System

The computer through application packages store, process and automate employees' data (names, sex, staff number, department, hourly work, hour rate, bonus, Salaries and allowances) to compute gross pay; deduct Personal Income Tax, Statutory and Non-statutory deductions to calculate net pay of employees.

Advantages of Computerised Payroll System

a) Salaries and wages are automated;

b) It is fast, accurate and reliable;

c) It uses coding system for most of the data, so; it is more efficient;

d) It can back up large volume of data and information of many years on output devices such as flash drive, compact disc, hard disc, internet and cloud;

e) Casting error is eliminated, human errors can be easily corrected;

f) The data and information stored can be retrieved anytime even if there is fire or other natural disaster;

g) Training and retraining cost of employees may be huge;

h) It generates printed Payroll Report when it is needed to aid analyses;

i) It is assists in the preparation of personnel budget accurately timely and;

j) It cost efficient in the long run because less labour hours and stationery costs are required.

Disadvantages of Computerised Payroll System

a) Software, hardware and installation costs may be expensive in the short-run;

b) Labour union and employees may not want to change from manual to computerised payroll systems, so; the processes of the change may be difficult, controversial and this may hit up the system.

10.5 Calculations of Gross Earnings, Deductions, Net Py and Pay Slips

Gross pay/Gross earning is the quantum of basic salary and variety of allowances such as housing, transport, utility, responsibility and bonus among other allowances. The total of basic salary and allowances is called consolidated salaries and wages. Deductions are amount deducted at source from the gross earnings/gross pay. There are two types of deductions; these are statutory and non-statutory deductions. The statutory deductions are deductions in which employers have legal obligations to reduce at source from the gross pay/gross earnings. The entity has obligation to remit what was deducted to the owners that is the appropriate agency recognize by the law of the land to collect the deductions. These statutory deductions are:

a) Pension contributions by employers with minimum of three (3) staff, 10% by the employer and 8% from the salaries of employees, the amount deducted at source is remitted to the Pension Fund Administrator (PFA), employees are to have pension accounts with PFAs of their choice. Non-compliance/non-remittance attracts 2% of the unpaid amount;

b) 2 ½ % of employees' monthly basic salaries as National Housing Funds (NHF) and the amount deducted is remitted to the Federal Mortgage Bank. Employees with basic salary of less than ₦ 3,000 and expatriates are exempted. Non-compliance attracts of the amount deducted by the employer is ₦ 50,000, self-employed ₦ 5,000 or one (1) year imprisonment on conviction or both . Obstructing deduction or non-remittance is N5,000 or one (1) year imprisonment on conviction or both;

c) National Health Insurance Scheme (NHIS), employer contributes 10% and employees contribute 5% to provide easy access health care services for employees, spouse and four (4) biological children less than 18 years of age. A contributor with more than six family members can register one (1) additional person as a dependent relative;

d) Pay as You Earn (PAYE) Tax/Personal Income Tax, this is calculated based on the progressive Personal Income Tax rate provided in the Personal Income Tax Act, 2011. The progressive Personal Income Tax Rate is as follows:

Income	**Tax Rate**
First ₦300,000	7%
Next ₦300,000	11%
Next ₦500,000	15%
Next ₦500,000	19%
Next ₦1,600,000	21%

Above ₦3,200,000	24%

The above is the applicable Personal Income Tax Rate with effect from 2011. The consolidated relief is ₦200,000 or 1% of gross income, whichever is higher plus 20% of gross income. This is deducted from gross income as personal income relief, deductions are removed to have taxable income;

e) Industrial Training Fund (ITF), every employer with at least five (5) employees or an annual turnover of ₦50 million must contribute 1% of its annual payroll cost to Industrial Training Fund to equip indigenous workers with adequate skills for economic development and an employer can claim a refund of up to 50% of the amount contributed, if employees received necessary to assist him or her to acquire adequate skills. The due date to file return to ITF is within 3 months after year end. The penalty for delay in payment is 5% of the unpaid amount payable for every month of default; and

f) Nigeria Social Insurance Trust Fund (NSITF), 1% of employees' monthly payroll is contributed in the first two (2) years of the commencement of the Act in 2010 to the NSITF to provide a definite and adequate safer work condition and compensation for workers or their dependents in the events of death, injury, disease or disability occurring from employment. Payroll in this case means remunerations excluding pension contributions, bonuses, and overtime and one-off payments like 13th month salary.

The statutory deductions are also applicable in Ghana, Gambia and other West African countries. For example, at the beginning of eachGovernment fiscalyear (1stJanuary in the case of Ghana),the Minister of Finance presents the Budget to Parliament. In Nigeria, the Presidentpresents the Appropriation billto the National assembly a few months before thecommencement of a fiscal year (1stJanuary).After due processes the bill is passedintolawand becomes theAppropriation Act.

The budget statementscontain the rates of income taxand any deductible reliefs forthe following year. Due to the annual changes in rates and reliefs, the rates of incometaxused in the computationsin this book are for illustration purposes only.

The non-statutory monthly payroll deductions such as union dues, cooperative deductions, furniture, housing and motor vehicle loans repayment, which employers have no legal obligation to deduct. The employers deduct non-statutory deductions to protect the welfare of employees working in an entity. The monthly net pay of an employee is the excess of the gros spay or salary over deductions. It is often calleddisposableincomeor“takehomepay”.Itisthepaytheworkeractuallytakes homeforagivenperiod. It is monthly gross pay/gross earnings minus the monthly statutory and non-statutory deductions of employees working in an entity.

After the Payroll Department completed the preparation of monthly salaries and wages, the schedule of salaries, summary sheet and deductions of various banks will be dispatched to the Chief Finance officer/Bursar/Chief Accountant for payments into the bank account of various beneficiaries indicated on the salaries schedule. After the payments of Salaries and Wages and the Statutory and Non-Statutory Deductions, the Payroll Department issued a document known as Pay Slip to every employee in an entity. A Pay Slip is a document given to employees when they have been paid salaries and deductions paid or payable to various beneficiaries. It shows detailed of basic monthly salaries, allowances, Statutory and Non-Statutory Deductions to arrive at employees’ net pay for the month. The template of a Pay Slip of ABC Limited in May 2022 is presented below:

ABC Limited, Payroll Department in the Account and Finance Department:

Pay Slip of an Employee in January 2022:

Month	**Descriptions**	**₵**	**₵**
May 2022	Income		
	Gross Salary/Gross Earnings		xxxx
	Basic MonthlySalary		xxxx
	Housing Allowance		xxxx
	Transport Allowance		xxxx
	Meal Subsidy		xxxx
	Responsibility Allowance		xxxx
	Other Cash Allowances		xxxx
	Consolidated Salaries(Gross Income)		**xxxx**
	Less: Consolidated Reliefs		
	₦200,000 or 1% of gross income whichever is higher +20% of gross income		(xxxx)
			xxxx
	Less: Statutory Deductions		
	Total pension Contributions: (Employer & Employees)	xxxx	
	National Housing Funds (NHS)	xxxx	
	National Health Insurance Scheme (NHIS)	xxxx	
	PAYE/Personal Income Tax	xxxx	
	Industrial Training Fund (ITF)	xxxx	
	Nigeria Social Insurance Trust Fund (NSITF)	xxxx	
	Total statutory deductions (TST)	**xxxx**	
	Less: Non-statutory deductions (NST)		
	Union Dues	xxxx	
	Cooperative deductions	xxxx	
	Repayment of Motor vehicle loans	xxxx	
	Repayment of Housing Loans	xxxx	
	Repayment of Furniture Loans	xxxx	
	Total Non-Statutory deductions (TNST)	xxxx	
	Less: Total deductions = TST + TNST		(xxxx)
	Total Net Pay (Monthly)		**xxxx**

ThecalculationofGross Income/Gross Pay/Gross Earnings Less reliefs, Tax, Statutory and non-Statutory Deductions and Net Pay:

Month	**Descriptions**	**¢**	**¢**
Jan. 2022	Income		
	Gross Salary/Gross Earnings		Xxxx
	Basic MonthlySalary		Xxxx
	Housing Allowance		Xxxx
	Transport Allowance		Xxxx
	Meal Subsidy		Xxxx
	Responsibility Allowance		Xxxx
	Other Cash Allowances		Xxxx
	Consolidated Salaries(Gross Income)		**Xxxx**
	Less: Consolidated Reliefs		
	₦200,000 or 1% of gross income whichever is higher +20% of gross income		(xxxx)
			Xxxx
	Less: Statutory Deductions/Allowable Deductions		
	Total pension Contributions: (Employer & Employees)	xxxx	
	National Housing Funds (NHS)	xxxx	
	National Health Insurance Scheme (NHIS)	xxxx	
	Industrial Training Fund (ITF)	xxxx	
	Nigeria Social Insurance Trust Fund (NSITF)	xxxx	
		xxxx	
	Less: Total statutory deductions (TST)		**(xxxx)**
	Taxable Incomes		**xxxx**
	PAYE/Personal Income Tax derived with the applicable tax rate		(xxxx)
	Personal Income After Tax/Disposable Income		**xxxx**

Income	**Tax Rate**
First ₦300,000	7%
Next ₦300,000	11%
Next ₦500,000	15%
Next ₦500,000	19%
Next ₦1,600,000	21%
Above ₦3,200,000	24%

The above is the applicable Personal Income Tax Rate with effect from 2011. The consolidated relief is ₦200,000 or 1% of gross income, whichever is higher plus 20% of gross income.

Previous year Relief and Personal Income Tax Rates:

a) 1998: ₦5,000 + 20% of Earned Income;

b) 1997: N3,000 + 15% of Earned Incomes

c) Personal Income Tax Rates

Before 2011 PITA	Rate	1998	Rate	1997	Rate
First ₦30,000 at	5%	First ₦20,000 at	5%	First ₦10,000 at	5%
Next ₦30,000 at	10%	Next ₦20,000 at	10%	Next ₦10,000 at	10%
Next ₦50,000 at	15%	Next ₦40,000 at	15%	Next ₦20,000 at	15%
Next ₦50,000 at	20%	Next ₦40,000 at	20%	Next ₦20,000 at	20%
Above ₦160,000 at	25%	Above ₦120,000 at	25%	Above ₦60,000 at	25%

Other Personal Income Tax Rates used to solve illustrations in the pack to solve

Other Rates used to solve illustrations in the pack to solve	Rate
First ₦1,800,000 at	0%
Next ₦1,800,000 at	5%
Next ₦4,800,000 at	10%
Above ₦4,800,000 at	15%

10.6 Accounting for Payroll Transactions

For the purpose of Accounting, the entries in the pay slips are passed in through the general journal to record thepaymentsmadeattheendofthegiven payperiod.

1. WhenLiabilities/Expensesaredue
   a) DebitWages/SalariesAccountwiththeGrossSalary.
   b) CreditProvidentFundAccount.
   c) Credit IncomeTax Account.
   d) CreditMedicalInsuranceAccount
   e) CreditUnionDuesAccount
   f) CreditanyOther DeductionAccount
   g) CreditPayrollPayableAccountwithNetSalaryorWages.
   h) Credit12.5%Employer'sSocialSecurityFund Account
   i) DebitEmployer'sSocial SecurityexpensesAccount(i.e.contribution)
2. WhenExpensesorLiabilitiesarePaid
   a) DebitprovidentfundaccountandcreditCash/Bankaccountwiththeamountpaid
   b) DebitIncometaxaccountandcredit cash/bankwiththesumpaid.
   c) Debitanyotherdeductionaccountandcreditcash/bankaccountwiththeamountpai
   d) Debitpayrollpayableaccountandcreditcash/bankaccountwiththeamountpaid.
   e) Debit12.5%Employer'sSocialSecurityFundAccountandcreditcashorbankacco

untwith theamountpaid.

Salary JournalMonthOfJanuary2016

Date	**Particulars**	**Folio**	**Dr**	**Cr**
2016January31			₦	₦
	WagesandSalariesA/c		Xx	
	ProvidentFund			xx
	UnionDues			xx
	Otherdeductions			xx
	IncomeTax			xx
	Net pay			xx
	Payrollsummaryforthemonth of		Xx	xx
	ProvidentFund		Xx	
	MedicalInsurance		Xx	
	UnionDues		Xx	
	Otherdeductions		xx	
	IncomeTax		xx	
	Net pay		xx	
	Bank			xx
	Paymentofstaffsalariesandallowancesforthemonth of		xx	xx

The illustrations below are Examination type questions. It covers pay rolling, Rowan and Halsey Schemes, Personal Income Tax Computations, Statutory and Non-Statutory Deductions, Pay Slip and Journal Entries.

Illustration10.3

Mr. Attah Thomas is an employee of Kente Limited and he earns annual salaries and allowance in the year ended 31 December, 2021 as follows:

	¢
Basic Salaries	6,000,000
Housing Allowance	400,000
Transport Allowance	200,000
Benefits in Kind	500,000

The following information is relevant:

a) Mr. Attah Thomas contributes 2 ½ % of his basic salary to National Housing Fund (NHF);

b) He also contributes 8% of his emolument to approved contributory pension scheme under Pension Act;

c) He maintained aged mother and father and spent an annual sum of ¢36,000 each on the parents;

d) He maintained four children under the age of 18 in public schools spending ¢10,000 each per annum;

e) He has a life insurance policy paying ¢60,000.

You are required to calculate Mr. Attah's:

a) Gross Earnings

b) Consolidated Relief and Statutory Deductions

c) Taxable Income and Personal Income Tax for the Year of Assessment 2021.

a) Gross Income	**¢**	**¢**
Basic Salaries		6,000,000
Housing Allowance		400,000
Transport Allowance		200,000
Benefits in Kind		500,000
Gross earnings/Consolidated Salaries		**7,100,000**
b) Consolidated Relief		
Higher of ¢200,000 and 1% of ¢7,100,000		
¢200000 + 20% of ¢7,100,000	1,620,000	
National Housing Fund (NHF)		
2.5% of ¢6,000,000	150,000	
Contributory Pension		
8% of (¢6,000,000 +¢400,000 +¢200,000)	528000	
Statutory Deductions	**2,298,000**	
Less: Other Reliefs		
Children Allowance (¢2,500 *4)	10,000	
Dependent Relative Allowance (DRA) (¢2,000 *2)	4,000	
Total reliefs		2,312,000
c) Taxable Income		**4,788,000**

Personal Income Tax computation

c: continuation	Tax Rate		Tax
Income	**Percentage**	**¢**	**¢**
First ¢300,000	7%	300,000	21000
Next ¢300,000	11%	300,000	33000
Next ¢500,000	15%	500,000	75000
Next ¢500,000	19%	500,000	95000
Next ¢1,600,000	21%	1,600,000	336000
		3,200,000	560,000
Above ¢3,200,000	24%	1,588,000	381,120
Total Taxable Incomes		**4,788,000**	
Annual Personal Income Tax			**941,120**
Monthly Taxable income(¢4,788,000/12)		**399,000**	
Monthly Personal Income Tax(¢941,120/12)			**78,426.67**

Illustration10.4

Mr. Yeboah Partey works at Kumasi Limited in Ghana, the following annual information was extracted from his electronic personal emolument cards for the year ended 31 December, 2021.

	¢
Basic Salaries	24,000,000
Transport Allowance	2,000,000
Entertainment Allowance	900,000
Utility Allowance	600,000

Additional information:

a) Annual rent allowance is 40% of annual basic salary;

b) Meal Allowance is ¢5,000 per working day and assume 260 working days in the year ended 2021;

c) Annual leave allowance is 20% of basic salary;

d) Contributions to approved pension scheme in 2004 Pension Act is 8% of emoluments and emoluments are defined as basic salaries, transport and rent allowance;

e) Repayment of Vehicle loans to government ¢120,000 annually;

f) Cooperative deductions ¢50,000 monthly;

g) Union dues is 1 ½ % of annual emolument as defined in d above;

h) He is entitled to 13th month one month salary as Christmas bonus;

i) Mr. Yeboah has Life Assurance Policy of ¢150,000 per annum;

j) He contributes 2 ½ % of basic salary to National Housing Funds (NHF);

k) Assume that Leave Allowance and Christmas Bonus was paid along December Salary and they are part of Gross Earnings; and

l) Also, he maintained aged father and mother with a sum ¢100,000 each, 2 children above 20 years of age who graduated in University of Ghana and 4 other children in public schools in Ghana. He spent ¢20,000 each annually to maintain 6 children.

You are required to:

a) Compute Gross Earnings, Statutory/Allowable Deductions and Personal Income Tax Liability for the year ended 31 December, 2021.

b) Compute monthly net pay to capture the statutory, Personal and non-statutory deductions in December, 2022 Pay Slip.

a) Yeboah Partey Gross Earnings, Statutory/Allowable Deductions and Personal Income Tax Liability for the year ended 31 December, 2021

	¢	**¢**
Basic Salaries		24,000,000
Rent Allowance (40% of ¢24,000,000)		9,600,000
Transport Allowance		2,000,000
Meal Allowance (¢5,000 * 260)		1,300,000
Entertainment Allowance		900,000
Utility Allowance		600,000
Leave Allowance (20% of ¢24,000,000)		4,800,000
Christmas Bonus (¢24,000,000/12)		2,000,000
Gross Earnings		**45,200,000**
Less: Consolidated Reliefs		

Higher of ¢200,000 and 1% of ¢45,200,000		
Higher of ¢200,000 and ¢452,000		
¢452,000 + 20% of ¢45,200,000		
¢452,000 + ¢9,040,000	9,492,000	
National Housing Fund (2 1/2 % of ¢24,000,000)	600,000	
Pension Contribution		
8% of (¢24,000,000 +¢9,600,000 +¢2,000,000)	2,848,000	
Statutory Deductions	12,940,000	
Other Allowable Deductions		
Life Assurance Policy	150,000	
Dependent Relative (¢2,000 * 2)	4,000	
Children Allowance (¢2,500 *4)	10,000	
Total Allowable Deductions		**13,104,000**
Taxable Income		32,096,000

Personal Income Tax Computation for the Year of Assessment 2021

	Tax Rate		**Tax**
Income	**Percentage**	**¢**	**¢**
First ¢300,000	7%	300,000	21000
Next ¢300,000	11%	300,000	33000
Next ¢500,000	15%	500,000	75000
Next ¢500,000	19%	500,000	95000
Next ¢1,600,000	21%	1,600,000	336000
		3,200,000	560,000
Above ¢3,200,000	24%	28,896,000	6,935,040
Total Taxable Incomes		**32,096,000**	
Annual Personal Income Tax			**7,495,040**
Monthly Taxable income(¢4,788,000/12)		**2,674,667**	
Monthly Personal Income Tax(¢941,120/12)			**624,586.67**

b) Yeboah Partey monthly net pay to capture the statutory, Personal Deductions and non-statutory deductions in December, 2022 Pay Slip.

		Monthly
	Annual	**Annual/12**
	¢	**¢**
Basic Salaries	24,000,000	2,000,000
Rent Allowance (40% of ¢24,000,000)	9,600,000	800,000
Transport Allowance	2,000,000	166,667
Meal Allowance (¢5,000 * 260)	1,300,000	108,333
Entertainment Allowance	900,000	75,000
Utility Allowance	600,000	50,000
Leave Allowance (20% of ¢24,000,000) Note: Paid once in December	4,800,000	4,800,000
Christmas Bonus (¢24,000,000/12) Note: Paid once in December	2,000,000	2,000,000
Gross Earnings(Annual/Monthly)	**45,200,000**	**10,000,000**
Statutory Deductions		
National Housing Fund (2 1/2 % of ¢24,000,000)	600000	50,000
Pension Contribution		-
8% of (¢24,000,000 +¢9,600,000 +¢2,000,000)	2848000	237,333
PAYE/Personal Income Tax	7,495,040	624,586.67
Total Statutory Deductions	**10,943,040**	**911,920**
Non-Statutory Deductions		
Repayment of Vehicle Loans	120,000	10,000
Cooperative Deductions (¢*50,000 *12)	600,000	50,000
Union Dues (1 1/2% of (¢24,000,000 + ¢9,600,000 + ¢2,000,000)	534,000	44,500
Total Non-Statutory Deductions	**1,254,000**	**104,500**
Total Statutory and Non Statutory Deductions	**12,197,040**	**1,016,420**
Net Annual/Monthly Pay	**33,002,960**	**2,750,247**

Illustration10.5

Victor, Simon and Alata are in the employment of GYAN Enterprise in Kumasi Ghana. The Pay Roll annual information for the year ended 31 December, 2016 are as follows:

Staff		Responsibility	Bonus	Meal
Names	**Basic Salary**	**Allowance**		**Allowance**
	¢	**¢**	**¢**	**¢**
Victor	27,500,00	2,000,000	40%	500,000
Simon	26,200,000	1,800,000	35%	450,000
Alata	24,800,000	1,500,000	30%	400,000

The following information are relevant:

a) National Health Insurance Scheme, employee 5% and employer 10% of basic salaries.

b) The current Personal Income Tax Rate is applicable;

c) Monthly Cooperative Deductions: Mr. Victor, ¢150,000, Mr. Simon ¢120,000 and Mr. Alata ¢100,000;

d) Union Due is 2 ½ % of basic salaries;

e) Bonus is a percentage of basic salaries; and

f) Salaries and all deductions are paid on first day of every month

The company also operates an approved Retirement Pension Fund with a Pension Fund Administrator retirement fund to which allemployees are expected to contribute mandatory8% of basic salary. It is the policy of the employer to top up the pension ofeveryemployee'scontributionby10% of the total basic salaries of the basic salary. This represents the total emoluments (Basic Salaries, Housing and Transport Allowances) of the employees.

During the year 2016 the following loans were granted to each staff:

Staff		Distress	
Names	**Car Loan**	**Loan**	**Year**
	¢	**¢**	**Loan was Taken**
Victor	50,000,000	10,000,000	2,014

Simon	40,000,000	8,000,000	2,015
Alata	20,000,000	8,000,000	2,015

All loans taken in the Enterprise with the exception of distressed loans attract a concessionary interest at a rate of 5% simple interest on there duced balance at the beginning of the period . It is expected that the principal mount will be repaid or a mortisedonanequalbasisoveraperiod offiveyears.

You are required to prepare the payroll worksheet and relevant journal entries of Victor, Simon and Alata for the year 2016.

Descriptions	**Victor**	**Simon**	**Alata**	**Total**
	¢'000	**¢'000**	**¢'000**	**¢'000**
Basic Salary	**27,500**	**26,200**	**24,800**	**78,500**
Responsibility Allowance	2,000	1,800	1,500	5,300
Meals allowance	500	450	400	1,350
Bonus	11,000	9,170	7,440	27,610
Consolidated Salaries	**41,000**	**37,620**	**34,140**	**112,760**
Less: Statutory Deductions				
Contributory Pension (8%* Basic Salary)	-2,200.00	-2,096.00	-1,984.00	-6,280.00
National Health Insurance Scheme (5% * Basic Salaries)	-1,375.00	-1,310.00	-1,240.00	-3,925.00
	-3,575.00	-3,406.00	-3,224.00	-10,205.00
Taxable Pay	37,425	34,214	30,916	102,555
Less: Annual Personal Income Tax Approximately	-8,774	-8,003	-7,212	-23,989
Income After all Statutory Deductions	28,651	26,211	23,704	78,566
Annual Loan Repayments	10,000	8,000	4,000	22,000
Annual Cooperative Deductions (Monthly *12 in '000)	1,800	1,440	1,200	4,440

Union Dues (2.5% * Emolument i.e. Basic Salaries)	688	655	620	1,963
	12,488	10,095	5,820	28,403
Net Salary Pay	16,164	16,116	17,884	50,163

Victor's Personal Income Deducted at Source (Liability)

Victor's Personal Income Tax	**Tax Rate**		**Tax**
Income	**Percentage**	**¢**	**¢**
First ¢300,000	0.07	300,000	21,000
Next ¢300,000	0.11	300,000	33,000
Next ¢500,000	0.15	500,000	75,000
Next ¢500,000	0.19	500,000	95,000
Next ¢1,600,000	0.21	1,600,000	336,000
		3,200,000	560,000
Above ¢3,200,000	0.24	34,225,000	8,214,000
Total Taxable Incomes		37,425,000	
Annual Personal Income Tax			8,774,000
Monthly Taxable income(¢37,425,000/12)		3,118,750.00	
Monthly Personal Income Tax(¢8,774,000/12)			731,166.67

Simon's Personal Income Deducted at Source (Liability)

Simon's Personal Income Tax	**Tax Rate**		**Tax**
Income	**Percentage**	**¢**	**¢**
First ¢300,000	0.07	300,000	21,000
Next ¢300,000	0.11	300,000	33,000
Next ¢500,000	0.15	500,000	75,000
Next ¢500,000	0.19	500,000	95,000
Next ¢1,600,000	0.21	1,600,000	336,000
		3,200,000	560,000
Above ¢3,200,000	0.24	31,014,000	7,443,360
Total Taxable Incomes		34,214,000	
Annual Personal Income Tax			8,003,360

Monthly Taxable income(¢34,214,000/12)		2,851,166.67	
Monthly Personal Income Tax(¢8,003,360/12)			666,946.67

Alata's Personal Income Deducted at Source (Liability)

Alata's Personal Income Tax	**Tax Rate**		**Tax**
Income	**Percentage**	**¢**	**¢**
First ¢300,000	0.07	300,000	21,000
Next ¢300,000	0.11	300,000	33,000
Next ¢500,000	0.15	500,000	75,000
Next ¢500,000	0.19	500,000	95,000
Next ¢1,600,000	0.21	1,600,000	336,000
		3,200,000	560,000
Above ¢3,200,000	0.24	27,716,000	6,651,840
Total Taxable Incomes		30,916,000	
Annual Personal Income Tax			7,211,840
Monthly Taxable income(¢30,916,000/12)		2,576,333.33	
Monthly Personal Income Tax(¢7,211,840/12)			600,986.67

GYAN's Journal Entries for Outstanding Salaries and Deductions in the year 2016

	Debit	Credit
	¢	**¢**
Consolidated Salaries(P or L)	112,760	
Statutory Employer's Deductions (10% *¢112,760)	11276	
NHIS Employer's Deductions (10% *¢112,760)	11276	
Personal Income Staff (PAYE All Staff)		23,989
Staff Pension (All Staff)		6,280
Pension Employee's Contribution		11276

NHIS Total Staff Contribution		3925
NHIS Employee's Contributions		11276
Non-Statutory Deductions		0
Loan Repayment		22,000
Total Staff Cooperative		4,440
Union Dues		1,963
Total Staff Salaries (16,164 +16,116 + 17,884)		50,163
Being Salaries and Deductions Accrued for the year		
	135,312	**135,312**

GYAN Journal Entries for Payment of Salaries and Deductions for the year 2016

	Debit	Credit
	¢	**¢**
Bank		112760
Statutory Employer's Deductions (10% *¢112,760)		11276
NHIS Employer's Deductions (10% *¢112,760)		11276
Personal Income Staff (PAYE All Staff)	23989	
Staff Pension (All Staff)	6280	
Pension Employee's Contribution	11276	
NHIS Total Staff Contribution	3925	
NHIS Employee's Contributions	11276	
Non-Statutory Deductions	0	
Loan Repayment	22000	
Total Staff Cooperative	4440	
Union Dues	1963	
Total Staff Salaries (16,164 +16,116 + 17,884)	50163	
Being Salaries and Deductions Paid for the year		

	135312	135312

Working Notes: Loan Schedule of the three (3) Staff

VictorLoanRepaymentSchedule

Year	**Opening Balance**	**Loan Interest Due(5%)**	**Total Prin+Int**	**Principal**	**Repayment Interest**	**TotalRepayment**	**ClosingBalance**
	¢		**¢**	**¢**			
2014	50,000,000	2,500,000	52,500,000	10,000,000	2,500,000	12,500,000	40,000,000
2015	40,000,000	2,000,000	42,000,000	10,000,000	2,000,000	12,000,000	30,000,000
2016	30,000,000	1,500,000	31,500,000	10,000,000	1,500,000	11,500,000	20,000,000
2017	20,000,000	1,000,000	21,000,000	10,000,000	1,000,000	11,000,000	10,000,000
2018	10,000,000	500,000	10,500,000	10,000,000	500,000	10,500,000	-

SimonLoanRepaymentSchedule

Year	**Opening Balance**	**Loan Interest Due(5%)**	**Total Prin+Int**	**Principal**	**Repayment Interest**	**TotalRepayment**	**ClosingBalance**
	¢		**¢**	**¢**			
2015	40,000,000	2,000,000	42,000,000	8,000,000	2,000,000	10,000,000	32,000,000
2016	32,000,000	1,600,000	33,600,000	8,000,000	1,600,000	9,600,000	24,000,000
2017	24,000,000	1,200,000	25,200,000	8,000,000	1,200,000	9,200,000	16,000,000
2018	16,000,000	800,000	16,800,000	8,000,000	800,000	8,800,000	8,000,000
2019	8,000,000	400,000	8,400,000	8,000,000	400,000	8,400,000	-

AlataLoanRepaymentSchedule

Year	Opening Balance	Loan Interest Due(5%)	Total Prin+Int	Principal	Repayment Interest	TotalRepayment	ClosingBalance
	¢		¢	¢			
2015	20,000,000	1,000,000	21,000,000	4,000,000	1,000,000	5,000,000	16,000,000
2016	16,000,000	800,000	16,800,000	4,000,000	800,000	4,800,000	12,000,000
2017	12,000,000	600,000	12,600,000	4,000,000	600,000	4,600,000	8,000,000
2018	8,000,000	400,000	8,400,000	4,000,000	400,000	4,400,000	4,000,000
2019	4,000,000	200,000	4,200,000	4,000,000	200,000	4,200,000	-

Illustration 10.6

The tablebelowshowsthedatarelatingtothreeemployeesofWatongaLtdforthemonthending31 December,2016.

Name	Standard Hours Expected	Actual Hours Worked	Rate Per Hour (¢)
Amartey	255	215	40,000
Osibio	200	222	35,000
Morton	180	160	30,000

Included in the conditions of service of Watonga Ltd for the above named members of staff are the following:

(ii) Rent allowanceof18%of thebasicsalary

(iii) Riskallowanceequal to20%ofthebasicsalary

(iv) Social securitycontributionsand

(v) Personalincometaxliabilityat the rate of 17.5%.

You are required to prepare Payroll work sheet, showing the basic pay, deductions and net salary of each staff underthe following:

(a)HalseyPremium incentive plan of remuneration

(b)Rowan incentive plan of remuneration

Watongalimited

Payroll Worksheet for the month ended 31December2016.

	Amartey	Morton	Osibio	Total
	¢'000	**¢'000**	**¢'000**	**¢'000**
BasicSalary	**8,600**	**7,770**	**4,800**	**21,170**
Rentallowance	1,548	1,399	864	3,811
Riskallowance	1,720	1,554	960	4,234
Bonus(seeworkings)	800	-	300	1,100
ConsolidatedSalary	**12,668**	**10,723**	**6,924**	**30,315**
LessStatutorydeductions:				-
5%Socialsecurity	430	389	240	1,059
TaxablePay	12,238			
LessIncometax(17.5%)	2,142	10,334	6,684	29,256
NetSalary	10,096	1,808	1,170	5,120
		8,526	5,514	24,136

a) Rowanincentiveplan

PayrollWorksheetfor themonthended31st December2016

	Amartey	Morton	Osibio	Total
	¢'000	**¢'000**	**¢'000**	**¢'000**
BasicSalary	**8,600**	**7,770**	**4,800**	**21,170**
Rentallowance	1,548	1,399	864	3,811
Riskallowance	1,720	1,554	960	4,234
Bonus(seeworkings)	1,349	-	533	1,882
ConsolidatedSalary	**13,217**	**10,723**	**7,157**	**31,097**
LessStatutorydeductions:				-
5%Socialsecurity	430	389	240	1,059
TaxablePay	12,787	10,334	6,917	30,038
Less Income tax(17.5%)	2,238	1,808	1,210	5,256
NetSalary	10,549	8,526	5,707	24,782

Workingsonbonus

<u>Halse yincentive plan</u>

Bonus = 50% of [Time saved x Time rate] Thus time saved

Name	Standard Hours expected (A)255	Actualhours worked(B)	Time saved (A-B)
Amartey		215	40hrs
Osibio	200	222	Nil
Morton	180	160	20hrs

Bonus for Amartey = 50% [40hrs x ¢40,000] = ¢800,000 Bonus for Osibio=50% [0hrs x¢35,000]=¢Nil

BonusforMorton=50% [20hrsx¢30,000]=¢300,000

<u>Rowanincentiveplan</u>=

Bonus= Timesaved x Time taken x Time rateTime allowed

Bonus for Amartey= 40hrs x215hrsx¢40,000=¢1,349,020
255hrs

BonusforOsibio=0hrs x222 hrsx¢35,000 =¢Nil
200hrs

BonusforMorton =20hrs x160 hrsx¢30,000 =¢533,333
180hrs

Practice Questions
MultipleChoiceQuestions

Which document contains details of gross earnings made and the amount ofnetearnings payable to a specific employeeinaparticularpayperiod?

a. Payroll
b. Wagessheet
c. Payslip
d. Paymentvoucher
e. Salarycontrolregister

1. Which of the following payroll deductions is influenced by statutory legislation?
   a. Uniondues
   b. Incometax
   c. Co-operativecontribution
   d. Salaryadvance
   e. Loanrefund

2. Whichofthefollowingis notafunctionofapayrollvoucher?
   a. Itgives evidencethatanemployeehascollectedhissalary
   b. Itshowsthedateofpaymentofwagesandsalaries
   c. Itis usedto collect salaryon behalfofan employee
   d. Itshowsthetotaldeductionsfromthe grosssalary.
   e. It showsnet salarypayable

Usetheinformation belowtoanswer Questions 4and5.

Victor AkakpoworkswithacompanywhichoperatesRowanBonusschemetorewarditsworkers. His rate per hour is fixed at ¢250 with a standard time of 12 hours to perform ajob.Actualtimespent byhim to completethejob is 9hours.

3. WhatisthebonuspaidtoVictorAkakpo?
   a. ¢364
   b. ¢452

4. What isVictor Akakpo’s gross pay?.

a. ¢ 2,052

b. ¢ 2,161

c. ¢ 2,700

d. ¢ 2,813

e. ¢ 41,260

Use the information below to answerQuestions6 to8

ThepayslipofMusahBusangaforthemonthofAugust2016 revealedthefollowing: BasicSalary ¢100,000

IncomeTax15%of basic salary

Social SecurityContribution:

Employer:12½%of basic salary

Employee :5% of basic salaryProfessionalallowance: ¢25,000permonth

5 .Whatwastheamountoftotaldeductionsfrom MusahBusanga'sbasicpay?

a. ¢5,000

b. ¢14,250

c. ¢20,000

d. ¢23,000

e. ¢23,750

6. The total amount of social security contributions to the credit of Musah Busanga for August ,2016 was

a. ¢5,000

b. ¢12,500

c. ¢17,500

d. ¢19,250

e. ¢20,000

7. What was the net salary paid to Musah Busanga for August 2016?

a.¢82,000

b.¢89,500

c.¢102,000

d.¢105,000

e.¢477,000

8. In a pay roll system, which of the following is NOT a statutory deduction?

a. PAYE Tax
b. Union Dues
c. Industrial Training Fund (ITF)
d. Staff contributory Pension fund
e. Nigeria Social Insurance Trust Fund (NSITF)

9. The sum of money paid by employer to protect and motivate employees to be more efficient and productive is known as ---------

a. Bonus
b. Allowance
c. Incentive
d. Wages
e. 13th Month salaries

Short Answer Questions (SAQ)

Give the following Information:

Standard Time 500 hours

Actual Time 450 hours

Wage Rate ¢20

Using Halsey Premium Plan, Calculate the total earnings

1. A document, which shows employees' names, salaries, allowances, statutory and non-statutory deductions is called---

   A method of remuneration where employees are paid as a product of number of actual hours work daily and fixed wage rate is known as------
2. A kind of remuneration based on employees' output or service rendered from time to time is called-------

   In an entity, a payment mechanism put in place to reward an employee for outstanding and unexpected performance is referred to as--------
3. Mr.Kojo John in May 2022 for 700 actual hours, the standard time is 800 hours and standard rate is ¢30 per hour. Using Rowan Scheme, compute the gross earnings of Mr. Kojo John in May, 2022.
4. Give TWO (2) examples of emolument used in computing contributory pension funds.
5. A document issued by the pay roll department after the payment of monthly salaries

and wages is known as--------

6. State the current rate of contributory pension fund of employees.

7. Business entities are required by law to send returns on their statutory deductions on their payroll including the amount of incometaxdeductedat source to ....

Theory

1. Mr.VictorKakapohasbeenintheemployment of PachecoLimitedsince1 January, 2021on a salaryscaleof¢50,000,000perannum.He has 8% pension contributions and the employer contributes 10% annually as pension for staff. Other statutory deductions are: Staff National Health Insurance Scheme (NHIS) 5%, Employer's NHIS is 10% and PAYE Tax rate is the current rate of tax; or theyear2021hisannual entitlementswereasfollows:

	¢
Inconvenienceallowance	5,000,000
Leaveallowance	3,000,000
Riskallonce	4,000,000

He is marriedwithtwochildrenattendingsecondary schoolsinGhana.Hecontributestothesocialsecurityscheme.Hequalifies forthefollowingreliefs:

	¢
Marriage	300,000
Childeducation	480,000
Ageddependentrelatives –two	400,000

You required to compute the Personal Income Tax, Net Pay and relevant journal entries of Mr.VictorKakapo for the year ended 31 December, 2021.

Hints:

He is to pay union dues of 3% of the basic salaries, monthly loan repayment is ¢180,000 and monthly cooperative deductions, ¢150,000. Assume that the salaries and deductions are payable first week of January, 2022.

2. Explainbrieflywhat is meant by:

a. Timeratemethodofremuneration
b. Pieceratemethodofremuneration
c. State any three (3) advantages and two (2) disadvantages of each of the methods ofremunerationmentionedabove

3. Statebrieflythemain features of:
a. HalseyPremium incentiveplan ofremuneration
b. Rowanincentiveplanofremuneration
c. Comparethemainfeaturesoftheincentiveplansdiscussedabove.

4. Highlight SIX (6) advantages of computerised and FOUR disadvantages of Manual Pay roll systems.

5. The monthly salary structures of Five (5) managers due in May 2022 are presented in
6. the table below

Names	Basic	Housing	Transport	Utility	Responsibility	Entertainments
	Salaries	Allowance	Allowance	Allowance	Allowance	Allowance
	¢	¢	¢	¢	¢	¢
Mr. Gyan	700,000	300,000	100,000	80,000	200,000	160,000
Mr. Addo	600,000	300,000	100,000	90,000	200,000	160,000
Mr. Ibrahim	850,000	350,000	150,000	120,000	200,000	140,000
Mr. Dauda	940,000	400,000	180,000	150,000	300,000	180,000
Mr. Fatau	980,000	400,000	200,000	180,000	300,000	180,000

Additional Information:

a. Annual leave Allowance is 15% of basic salary each for the managers;
b. Every staff pays 2 ½ % Industrial Training Fund, Approved Pension Contribution 8%, National Health Insurance Scheme 5%;
c. Employer pays 10% each for Approved Pension Contribution and National Health Insurance Scheme as a support to employees;
d. Mr. Gyan and Mr. Dauda are responsible to maintain 5 Children each under the age of 18 in public schools in Ghana;
e. All the staff maintain aged mother, fathers and other dependent relatives and spent ¢200,000 monthly each on the relative;
f. The relevant Tax Authority agreed to give the current consolidated reliefs and other reliefs such as the approved Children and dependent relative allowances;

g. The current Personal Income Tax Rate is applicable, the union due is 2 ½ % annually of the emolument which consist of basic salary, housing and transport allowances. Besides, the monthly cooperative contribution of each of the five managers is ¢80,000.

Required:

a) Compute the Personal Income Tax Due and Net Pay of the five (5) Staff in May, 2022

b) Prepare the relevant journal entries to accrue for the salaries and deduction on 31 May, 2022

c) Prepare the relevant journal entries to pay the salaries and deductions on June 7, 2022.

Solution to Multiple ChoiceQuestions

1. C
2. B
3. C
4. D
5. D
6. C
7. C
8. D
9. B
10. C

Answers: Short Answer Questions

1. ¢9,500 = ¢20 x450 + 50% x (500-450 x¢20) = ¢9,000 + ¢500 = ¢9,500
2. Pay Roll
3. Time Rate System
4. Performance Remuneration System
5. Bonus
6. ¢23, 625 = 700 hours x ¢30 + 100/800 x 700 hours x ¢30 = ¢21,000+¢2,625 = ¢23,625
7. Basic Salary, Housing Allowance, Transport Allowance, any two
8. Pay Slip
9. 8% of emolument (Basic Salary + Housing Allowance + Transport Allowance)
10. Appropriate Authorities e,g. relevant state tax author

CHAPTER ELEVEN

PREPARATION OF SIMPLE FINANCIAL STATEMENTS

Chapter Eleven Contents

- Simple statement of profit or loss
- Simple statement of financial position

Manufacturing accounts

11.0 Learning Objectives

After you have studied this chapter, you should be able to:

- Define, explain and record returns inwards, returns outwards, carriage inwards and carriage outwards;
- identify items that will appear in the Statement of Profit or Loss and StatementofFinancial Position ofasoletrader;
- explain why carriage inwards and carriage outwards are recorded in theStatementofProfit orLoss;
- prepare the inventories account and show how the opening and closing inventoriesaretreated in theStatement ofProfit orLoss;
- preparea StatementofProfitorLossandStatementofFinancialPosition;
- explain and pass the necessary adjustments in respect of accruals, prepayments and provisionsthat affecttheStatement ofProfit or Loss;
- explain and calculate cost of goods sold taking into consideration the appropriateadjustments such as returns inwards and outwards, carriage inwards andoutwards;and
- prepare simple ManufacturingAccount.

11.1 Introduction

The information recorded in the book-keeping system (ledger records) is analysed and summarisedperiodically (usuallyeachyear) and thesummarisedinformationispresented in Financial Statements.The object of preparing financial statement is toprovideinformationthatisusefulfordecisionmaking by all stakeholders.

Thecomponentsoffinancialstatementsasearlierstatedinthismanualinclude:

(a) Astatementofprofit orlossand othercomprehensiveincome;

(b) Astatementoffinancial position;

(c) Astatementofchangesinequity;

(d) Astatementofcashflows;and

(e) Notes to the financial statements.

In this syllabus, the focus is on the statement of profit or loss and the statement of financial position but other

Comprehensiveincome isoutside the syllabushence it will not be discussed.

11.2 PreparationofFinancialStatements

The basic approach to preparing a statement of profit or loss (a performance statement) and a statement of financial position (a position statement) in practice is summarised as follows:

a. Thebalancesonalltheaccountsintheledgersare extractedintoatrialbalance
b. Adjustmentsaremadeforyear-enditems
c. Preparethestatementofprofitorlossfortheyearfromtheadjustedincomeandexpensesto determineprofit fortheyear
d. Afterthedeterminationofprofit,preparethestatementoffinancialposition.Thisisdoneusin gaccountingequation:Asset(Non-currentandcurrent)=Equity(Capital) +Liabilities (Non-currentandcurrent)

11.3 TheTrial Balance

A trial balance is a list of all general ledger accounts balances extracted from the books of account to ensure arithmetic accuracy of postings in the nominal ledgers.

The first step in the preparation of the final accounts is the compilation of a Trial Balance,with a view to:

(a) Confirmingthearithmetical accuracyoftheLedgerpostings, and

(b) Providing in one statement a concise summary of the items, which are to beincludedintheStatement of profit of lossandthe Statement of Financial Position.

Debit balances recorded in the Trial Balance normally represent either assets, losses or expenses. The assets are reported in the Statement o f F inancial Position, while losses and expenses are debited to the Statement of profit of loss.

Also, credi tbalances represent liabilities, allowances reserves, or revenues and gains. The liabilities are reported in the Statement of Financial Position while income and gains are credited to the Statemen tof profit or loss.

CandidatesmustremembertocarefullydistinguishbetweenbalanceswhichappearintheStatement of profit or loss,and those that appearintheStatement of Financial

Position.The Statement of profit or loss essentially closes of fall the nominal account balances during a particular accounting period. Any account, which remains in theTrial Balance after the Statement of profit of loss has been prepared, represents either assets or liabilitiesthatmustberecognisedinthe StatementofFinancialPosition.Thebalance ontheStatement of profit of loss willfinally betransferredtothecapitalaccount inthe Statement of Financial Position.

11.4 The Statement of Profit or Loss

This is a statement that summarises the revenues, costs, and expenses incurred during a specified period. The main objective of this Statement is the determination or calculation of the gross and net profits for the period. It is also in this account that the cost of obtaining thegoods, usually referred to as cost of goods sold or simply as cost of sales is calculated.

Another import ant function of this Statement is that it enablestheownerofabusiness entityto compare the gross and net profit of a current period with theresults attained in previous periods. It is pertinent that, the component items in theStatement or profit or loss do not vary in any material effect from previous and subsequent accounts, as this will make it impossible for any analyst to make meaning ful approximate comparison.ThisthereforemeansthattheStatement ofprofit or loss should be standardised so that the same items appear in similar form inthe successivefinalaccounts in order that an effective comparison may be made ofonefinancialyearand another.

A Statement or Profit or Loss is a Performance Statement

The actual items in the Statement of profit or loss of different classes of entities will necessarily vary depending on the nature of the nominal accounts in there spective business; for example, customs duty, licenses, and freight and insurance oninward shipments of raw materials will be essential items in the books of a cigarette manufacturer but these particular items would not appear in the Statement of profit or loss of aretail to bacconist.

The following is the usual method of preparing the Statement of profit or loss.

On the debit side are recorded:

i. Inventoriesatcommencementoftheperiod,whichisusually,calledopening

Inventories.

ii. Purchases during the period(less returns outwards) is netpurchases

iii. Allpurchaseexpenses, such as wages, carriage inwards, and other items which are incurred in putting the product in to as a liable condition or location.

The account is credited with-

1. Salesduringtheperiod (lessreturnsinwards) is net sales.
2. Inventories at end of period (it is the usual practice of deducting the closing inventories figure from the sum total of opening inventories and net purchases onthe debit side of the Statement of profit or loss so as to show on the face of theaccountthecost ofgoodssold).

Where there is a credit balance on the Statement of profit or loss, then the business entityhasrecorded a gain, which is referred to as gross profit and will be transferred to the net Incomesectionasacredit entry.

BeforeweattempttocompletetheStatementofprofit or lossofanentity in detail weneedto understand thefollowingaccountingterminologies:

11.4.1 Themovementofinventories

Entitiesusuallymaintainfourdifferentaccountsfortheinventoriesfunction.Theseare:

- Salesaccount
- ReturnsInwardsAccount orSalesReturnsAccount
- Purchasesaccountand
- ReturnsoutwardsaccountorPurchasesReturnsAccount

Goods sold are recorded in the Sales account and goods returned by customers (returnsinwards) are recorded in the returns inwards account.In the same vein, transactionsinvolving goods bought for sale are recorded in Purchases account while goods bought butreturnedto thesupplier arerecorded inthereturnsoutwards account.

Usually, sales are recorded separately on the credit side of the sales account; no furtherentries are debited into the account. The return inwards account is not recorded in thedebit side of sales account. The normal accounting entry for return inward is: Debitreturns inward and credit customer’s account or receivables account. The returns inwardsaccountservesasacontratothesalesaccountbyrecordingallsalesthathavebeen returned by customers. Return inward, being a contra entry to sales account has a debitbalance, which is usually deducted from sales at the end of the financial period in thestatementofprofitorlosstohavenetsales.Thus,sales minus return inwardaredescribedas net sales.

The accounting entries will be recorded as follows

a. Cash Sales

Dr.Cash

Cr.SalesAccount } Withgoodssoldforcash

b. CreditSales:

Dr.TradeReceivablesAccount

Cr.Sales Account } With goods sold on credit

c. ReturnsinwardsAccountDr.R eturnsinwardsAccount

Cr.TradeReceivablesAccount } Withgoodssoldbut returned by customers

d. Closing Balanceon Returns Inwards Account

Dr. Sales Account (by deduction)

Cr.ReturnsinwardsAccount } With the closing balance on the return inwards account

Similarly the purchasesaccount is maintained separately for recording all goods bought forthe sole purpose ofresale in theaccounting period.The returnsoutwardsaccount serves asacontratothepurchasesaccount.Intothisaccountisrecordedallpurchasesthat werereturnedtosuppliers.Beingacontraaccounttothepurchasesaccountmeansthatitiseventually deducted from purchases when preparing the statement of profit or loss.The neteffectshows thenet purchases oftheentityfortheperiod.

The accounting entries will be recorded as follows:

a. CashPurchases:

Dr.PurchasesAccount

Cr.BankTradePayables Account } With goods bought for cash

b. CreditPurchases
Dr.Purchases Account
Withgoodsboughtoncredit
CR.TradePayablesAccount

11.4.2 Carriageinwardsandoutwards

Carriage is an accounting terminology thatrefers to the cost of transport that a tradingentity incurs in moving goods meant for resale into or out of the entity. Where the carriage is charged for delivering goods purchased, it is called carriage inwards. Carriage of good suponsaleoutofafirmtocustomersiscalledcarriageoutwards.

Carriage inward: is a cost that is incurred in order to bring thegoods into thecompanyinaconditionthatisnecessaryforitssaleandassuchshouldbechargedto the Statement of Profit or Loss. This is done by adding the carriage inwards to thepurchases figure in the Statement of Profit or Loss. This ensures that the true cost ofbuyinggoodsforresaleistakeninto account in calculating the gross profit of anentity.

Carriageoutwardshowever,is not consideredasarelevantcostforthepurpose of putting the asset into a saleable condition. It is therefore, not added (i.e.debited) to purchases in the trading section of the Statement of Profitor Loss.Assuch,carriage outwards is not included in the calculation of gross profit. This is becausecarriage outwards is seen as expenses on sales; and as a result is charged against thegrossprofitalongwithotherexpensesintheStatementofProfitorLoss.

11.4.3 Goods (Inventories) taken by the Proprietor

In the last chapter, the reader’s attention was drawn to the practice of taking out for their personal uses, goods or other tangible assets of their businesses by sole proprietor’s andpartners.The use of such products or goods (inventories) by the proprietors and partners is termed“ drawings” and this constitutes a part withdrawal of the owner’scapital.

The accounting effect of proprietor’s drawings is a reduction in the cost of goodsavailableforsalebythevalueofinventoriesdrawn.Thistransactionshouldthereforebep ostedinthebooksthus:

	Dr	Cr
Inventoriesdrawings	XX	
ToPurchasesAccount		XX

Goods for sale take nout by the owner.
Alternatively, this can be shown as a deduction from purchases on the Statement of Profit or Loss be fore arrivingat the gross profit from trading activities.

The total of all drawings (goods or other tangible assets) are eventually deducted from the capital plus net profit in the Statement offinancial position.

Illustration11.1

From the following Trial Balance of Silver Key after his first year's trading, you are required to prepare a Statement of Profit or Loss for the year ended June 30,2022 and a Statement of Financial Position as on thesamedate..

	¢000	¢000
Sales		28,000
Purchases	20,000	
Carriageoutwards	800	
Electricity	400	
Salaries&Wages	3,100	
Insurance	150	
Buildings	50,000	
Fixtures	2,000	
Receivables	3,500	
Returnsinwards	450	
Payables		2,050
Bank	3,250	
Drawings	2,400	
Carriageinwards	650	
MotorVehicles	8,000	
Capital		64,405
Returnsoutwards		745
Rentofcomputers	500	
	95,200	**95,200**

SolutiontoIllustration11.1

Statementof Profit orLossfortheyearendedJune 30,2022

¢000		¢000
Sales		28,000
(Returninwards)		450
Netsales		27,550

Less:Costofsales		
Purchases	20,000	
Carriageinwards	650	
	20,650	
Returnsoutwards	745	19,905
GrossProfit		7,645
Expenses		
Carriageoutwards	800	
Electricity	400	
Salaries&Wages	3,100	
Insurance	150	
RentofComputers	500	
		50)
Profitforyear		5

StatementofFinancialPositionasatJune 30,,2022

Assets	**¢000**	**¢000**
Non-currentassets		
Buildings	50,000	
Fixtures	2,000	
Motorvehicles	8,000	
		60,000
CurrentAssets		
Receivables	3,500	
Bank	3,250	6,750
TotalAssets		**66,750**
EquityandLiabilities		
Capital(Equity)		64,405
NetProfit		2,695
Drawings		(2,400)
		64,700
CurrentLiabilities		
Payables	2,050	
TotalEquitiesand Liabilities	**66,750**	

11.4.4 Theaccountingtreatmentofinventories

From the above Statement of Profit or Loss, one can deduce that the entity is a new one as there were no inventories at the beginning of period and so only the goods that werepurchased during theyear were sold during the accounting period ended June 30,2022. The usual practice is for entities in trading activities to hold certain minimumlevelofinventories to meet futuredemand.

In practice,it isexpectedthatan entity would have as closing inventories, goodsthat were boughtinthecurrent accounting period buthave notbeen sold.Goodsthat were bought for the purpose of resale in an accounting period but have not beensold in that particularperiodandcarriedforwardtothenextaccountingperiodconstitutewhatis referred toasclosinginventories.

Itmustbenotedthattheclosinginventories ofanaccountingperiodisbroughtforwardastheopeninginventoriesofthenextaccountingperiod.Thisistreatedinthe Statement of Profit or Loss by adding the opening inventories to the purchasesfigure which gives rise to cost of goods available for sale and deducting the closinginventoriesfigureresultingincostofgoods sold.

Illustration11.2

The following is the Trial Balance of Adetom Trading Enterprise who has been inbusiness for several years. You are required to draw up the Statement of Profit or Lossfor the year ended December 31, 2022 and a Statement of Financial Position as at thatdate.

	Dr.	Cr.
	₦000	₦000
Sales		45,000
Purchases	38,000	
Carriageinwards	1,800	
Inventoriesat1/1/2022	4,000	
Returnsinwards	2,550	
Payables		2,050
Bank	3,250	
Receivables	6,450	
Motorvehicles	11,500	
Capital		18,750
Returnsoutwards		1,750
	67,550	**67,550**

Thefollowingadditionalinformationisavailable:

1. Inventoriesatthe endoftheperiod₦6,500,000
2. Theproprietor withdrew goodsvaluedat8,500,000bfor his house hold.

SolutiontoIllustration11.2

Adetom Trading Enterprise Statement of Profit or Loss for the year ended December 31,2022

	₦’000	**₦’000**
Sales		45,000
Returnsinwards		(2,550)
Revenue		42,450
Costof Sales		
Openinginventories	4,000	
Purchases	38,000	
Carriageinwards	1,800	
	43,800	
Returnsoutwards	(1,750)	
Drawings–inventories	(8,500)	
	33,550	
ClosingInventory	(6,500)	(27,050)
GrossProfit		15,400
Expenses		(-)
NetProfit		15,400

StatementofFinancialPositionasatDecember 31,2022

Assets	**₦’000**	**₦’000**
Non-currentassets		
Motorvehicles		11,500
CurrentAssets		
Inventories	6,500	
Receivables	6,450	
Bank	3,250	16,200
TotalAssets		**27,700**
EquityandLiabilities		
Equity		18,750
NetProfit		15,400
Drawings		8,500
		25,650
CurrentLiabilities		
Payables	2,050	
TotalEquitiesand Liabilities	**27,700**	

11.5 Statementof Profitor Loss

The mainfunction oftheStatementofProfitor Loss is to ascertain the net profit resulting from the trading activities of the accounting period.

It isdebitedwiththe grosslossandwiththe general,Selling,DistributionandAdministration expenses for the period, and is credited with the gross profit and anymiscellaneous gains made, such as interests, discounts received and allowances for irrecoverable and doubt fuldebts nolongerrequired.

The following format of IAS1 Is recommended for use.

IAS1: Presentation of Financial Statements:

Statement of Profitor Loss account for the year ended.............

	₦	
Revenue	XX	
Returninwards	XX	
NetRevenue(A)	(XX)	
Costofgoods sold:		
Openinginventories	XX	
Purchases	XX	
Carriageinwards	XX	
Inventoriesdrawings	(XX)	
Returnoutwards	(XX)	
Costofgoods availableforsale	XX	
Less closinginventories	(XX)	
Costofgoodssold(B)	XX	
Grossprofit(A–B) =C	XX	
Decreaseinprovisionforirrecoverabledebts	XX	
Commissionreceived/receivable	XX	
Discountreceived/receivable	XX	
Otherincome	XX	
Totalprofitfromoperation(D)	XX	
Expenses:		
Administrativeexpenses:		
Salariesandwages	XX	
Accruedsalaries	XX	
Stationery	XX	
Prepaidstationery	(XX)	
Depreciationofofficebuilding	XX	
	XX	
Distributionexpenses:	XX	
Advertising	(E)	XX

Baddebt	XX	
Allowanceforirrecoverabledebt	XX	
Discountallowed	XX	
Salescommission	XX	
Depreciationofdeliveryvan	XX	
	XX	
Financecosts:	(F)	XX
Interestonloan	XX	
Interestonoverdraft	XX	
	XX	
Totalexpense(E +F+G)=H	XX	
Netprofitfromoperation(D-H)	XX	
PersonalIncomeTax	(X)	
NetProfitAfterTax	XX	

Examiners may require candidates to prepare the Statement of Profit or Loss and Statement ofFinancial Position, from a Trial Balance, which already contains the gross profit figure. Theinventories that appear in the Trial Balance in this situation are the closing inventories, whichmust be recorded in the Statement of Financial Position as a current asset and should not betreated as an adjustment in the Statement of Profit or Loss. The opening inventories will not be recorded because I that salready been accounted for in the inventories prior to the extraction of theTrial Balance.

The balance on the Statement of Profit or Loss represents net profit or loss of the business ofthe entity. Theresultingbalanceinthestatementwhether debit or credit will be transferredto the debit or credit ofthecapitalaccountoftheproprietor. Theeffectofthis entry is tocloseofftheStatement ofProfit or Loss to thecapital account.

11.5.1 AdjustmentsintheFinalAccounts

The ultimate objectiveof preparing the Statement of Profitor Los an the Statement of Financial Position, is to enablethemanagement of an entity determine:

(a) Theresultofoperationsduringagivenperiod;and

(b) Thefinancialpositionattheendofthatperiod.

It must also be noted that, in order to obtain these results accurately, it is necessary to makeadjustmentsfor:

(1) Expenses incurredbutnotyetpaid.

(2) Expensespaidinadvance,that isaproportionofitrelatetosubsequent

Accounting period(s).

(3) Incomeearnedinrespectofthecurrentaccountingperiodbuthasnotyetbeenreceived.

(4) Incomereceivedduringthecurrentaccountingpartofwhichrelatetothenextaccounting period.

(5) Allowance for possible losses, e.g., Irrecoverable debts, and discounts onreceivables.

(6) Necessaryadjustmentsfordepreciationinthevaluesofthenon-currentassetsattheendofthetradingperiod.

11.6 TheStatementofFinancialPosition

It is a position statement that shows the net worth of an entity.This Statement showstheFinancialPositionofanentityasattheendofanaccountingperiod.Itistherefore a concise summary of assets and liabilities of an entity so arranged that thefinancialpositionoftheentityon thedateofthestatementmaybeclearlyascertained.

The arrangement of theStatement of Financial Position isnothing but the expressionof the accounting equation (i.e. Assets = Capital (Equity) +Liabilities) and as suchmust alwaysagree or balance. This means the totalcarrying amountof assetsmustbe equal to the sum of the values of Capital/Equity and Liabilities. The assets of abusiness are usually arranged in order of their permanence and for this reason' theymayconvenientlybeclassifiedintonon-currentandcurrent assets.

11.6.1 Non-currentassets

These are assets whichby their nature or the type of business in which they areemployed, are held with the aim of earning revenue and not for the purpose of sale inthe normal course of business.Non-current assets are generally valued at cost, lessallowancesforaccumulateddepreciationthatissufficienttoreducethecarryingamount of theassettoitssalvage or scrapvalue by the endof itsusefulworkinglife. Examples of non-current assets are land, buildings, motor vehicles and officeequipment.

It must be emphasised that the amount at which non-current assets are shown in theStatementdoesnotreflectthe amountthatwillberealisedifsoldorthecostthatwillbeincurred whentheyarereplaced,butratheritisahistoricalrecordoftheircostless allowances made for accumulateddepreciation.Depreciationrepresentsthatpartofthecostofanon-currentassettoit2s7oowner,whichisnotrecoverablewhentheasset is finally scrapped or sold. Allowance against this loss of capital must be made beforecalculatingtheamount ofprofit orloss madebya business entity.

11.6.2 Currentassets

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.They are there fore not permanent in nature, but are continually changing in the ordinary course of business.Examplesof current assets are cash, receivables, closing inventoriesandbillsreceivable. The professionally accepted basis ofvaluing inventories is “cost price ornet realisable value, whichever is the lower.” The fundamental reason for this basis ofvaluation is that anticipated losses should always be provided for as far as possible,whileanticipated profits should beignored until actuallyrealised.

Although, examples of current and non-current assets have been mentioned above, itmust be remembered that the dividing line between current and non- current assets is athin one. This is due to the fact that what is considered a non-current asset in onebusiness may be a current asset in another, and any classification must depend upon thenature of the particular business carried on by the entity. For example a business thatmanufactures and sells furniture will certainly record a motor vehicle purchased as a non-currentassetandfurnitureasacurrentassetbutifheusesanyofthefurnitureintheofficesuch furniturewill beclassifiedas anon-currentasset.

11.6.3 Liabilities

Aliabilityis defined as:

- apresentobligationof an entity
- arisingfrompastevents
- the settlement of which is expected to result in an outflow of resources thatembodyeconomicbenefits

A liability is an obligation that already exists. An obligation may arise also fromnormal business dealings usually from past transactions or events.Trade payables for example,arise out of past purchase transactionssoalsoanobligationtopayabankloanmust havearisen outofpast borrowings.

In the Statement of Financial Position, liabilities are usually presented under two maincategories.

a. **CurrentLiabilities**

Current liabilities represent amounts payable by the entity within twelve months(i.e.)withintheentity’snormaloperatingcycle),forexampletradepayable s,accruals,bank overdrafts and outstandingtaxobligation.

b. **Non-currentLiabilities**

Non-current liabilities refer to those obligations that will mature for settlementmore than one year after the period end.Examples are long term borrowings, bankloansand loan notes.

11.6.4 CapitalAccount

This represents the contribution of the proprietorofan entity to the assets that the entity has acquired.It ismadeup ofthefollowing:

i. Theinitial amount thattheownerusedin startingthebusiness
ii. Anyadditionalamountthatheinvestedinthebusinessduringanyaccounting period
iii. ThenetprofitfromtheStatementofProfitor Loss,whichhastheeffectofincreasingthecapital oftheownerat theend oftheaccountingperiod
iv. ThenetlossfromtheStatementofProfitor Lossthathastheeffectofreducingthecapital account balanceat theend oftheperiod, and
v. Drawings,which event ually resultsinthereductionofthecapitalbalance.

11.7 ManufacturingAccount

In the performance reporting (Statement of Profit or Loss) of trading entities, wea scertain operating profit or loss in the financial year. This statement does not provideany information that explains cost of goods manufactured. We shall then proceed todetermineprofit orloss in a manufacturing entity.

ManufacturingentitiesusuallyprepareasupplementarystatementcalledManufacturingAccount This account shows the cost of good sproducedormanufactured. The cost of goods manufactured, normally called the productioncosts is transferred from the Manufacturing Account into the Statement of Profitor Loss by crediting theManufacturing Account and debiting the Statement of Profitor Loss. The production cost effectively replaces purchases found in the Statement of Profit or Loss of are tailentity. It must however be noted that whereamanufacturingentityproduces more than one product a separate Manufacturing Account should be prepared fore a ch product, usually informof a department account.

Thesequenceand groupingofitemsin a ManufacturingAccount dependsonthecosting system of the entity.It is usually designed to yield the maximum amount ofinformationonthecomposition ofthetotalcostofproduction.Theclassification,sequencingandgrouping oftheManufacturingAccountis as follows:

- Primecost
- Factoryoverhead
- Productioncost
- Work-in-progress

11.7.1 Primecost

(1) This is the cost of raw materials consumed. These consist of the cost of directmaterials that the entity purchased and used in the manufacturing process. It iscalculatedas follows:

	¢
Openinginventoriesofrawmaterials	500,000
AddPurchasesofrawmaterials	2,500,000
	3,000,000
Lessreturnsoutwardsofrawmaterials	200,000
Costofrawmaterials available	2,800,000
Less closinginventoriesofrawmaterials	600,000
Costofrawmaterials consumed	2,200,000

(2) **<u>Directlabourcosts</u>**:Theseconsistofthecostoflaboursuchaswagesofoperativesandworkers (bothcasualandregular)whoseeffortsaretraceabledirectlytothemanufactured product.

(3) **<u>Direct Expenses</u>**: These consist of all direct costs other thandirectmaterialsanddirectlabour.Examplesincluderoyaltiesand costofhiringmachine. Allthe abovecostssum upto“Prime Cost”.

11.7.2 FactoryOverheads:

This sub-heading is shown immediately below the prime cost figure and consists of allindirect costs inrespect of materials, labour and expenses. They may include rent ,rates, electricity, and depreciationofplantandequipment,insurance, wagesofforemenin thefactoryand researchand development costs.

Expenses that are common to the manufacturing process as well as to the general administration of the entity are to be apportionedbetweentheFactory, Administration, Selling and Distribution costs. The method or basis commonly used in apportioning these common expenses willusuallybe providedinanexaminationquestion.

11.7.3 ProductionCost:

This is the summation of the prime costs and factory overhead figures. The factoryoverheads consist of indirect materials, indirect labour and indirect expenses.Thisrepresents thetotalcostthatamanufacturingentity incursintheproductionprocessand is transferred to the Statement of Profit or Loss for that accountingperiod.

Illustration11.3

Nkrumah Enterprises, a manufacturing entity has presented the following balances for theyearended June 30,2022.

	¢
Inventoriesof rawmaterialsat1/7/2021	30,000
Purchasesof rawmaterials	40,000
Returnoutwards	2,000
Manufacturingwages	40,000
Carriageoutwards	28,000
DepreciationofPlant	5,600
Rentandrates	16,000
Inventoriesof rawmaterialsof30/06/2022	26,000
Factoryexpenses	16,800
80%ofrent andratesrelates tothefactory	

You are required to prepare the Manufacturing Account for the year ended June 30, 2022.

Solutionto Illustration12.3

TheManufacturingAccount willbepreparedasfollows:

NkrumahEnterprises

ManufacturingAccountfortheyearendedJune 30,2022.

	₦	₦
Openinginventories		30,000
Addpurchases	40,000	
Returnsoutwards	(2,000)	38,000
		68,000
Less closinginventories		26,000
Costofrawmaterial consumed		42,000
Manufacturingwages		40,000
Primecost		82,000
FactoryOverheads:		
DepreciationofPlant	5,600	
Factoryexpenses	16,800	
Rentandrates(Factory)80%	12,800	35,200
Manufacturingcostc/f		117,200

Work-in-progress

The time spent by manufacturing entities to complete a unit or batch of production isnot the same; it varies from one entity to another.It is therefore possible that at thetime that the accounting period of a manufacturing entity ends there might be someproducts that are not fully complete. Those products that have not been completed a t the date of the statement of financial position are called inventories of work-in-progress.

The costof productionmustbe adjustedforwork-in-progressatthe end at and he beginning of the accounting period.This is due to the fact that the amount to be transferred to the Statement of Profit or Loss mustcontainthecostofonlyproductsthatarefullycomplete.Anyitemorproductthathasnotbe enfullyprocessedcannot besold; hencetheymust not appearin theStatement.

Illustration11.4

Koiki Enterprise is a manufacturing entity and has presented the following balances for theyearended June 30,2022.

	¢
Inventoriesof rawmaterialsat1/7/2021	80,000
Purchasesof rawmaterials	240,000
Work-in-Progress1/7/2021	58,000
Returnoutwards	35,000
Manufacturingwages	160,000
Officesalaries	67,000
Carriageinwards	44,000
DepreciationofPlant	56,000
Insuranceexpenses –factory	28,000
Inventoriesof rawmaterialsasat30/06/2022	48,000
Factoryexpenses	66,000
Work-in-Progress30/06/2022	50,000
Royaltiespaid	72,000

Required:PreparetheManufacturingAccount for theyear endedJune 30,2022

Solutionto Illustration11.4

Thecostofproductiontakinginto'consideration'',work-in-progresswouldbepreparedasfollows:

KoikiEnterprises

ManufacturingAccountforthe yearendedJune 30,2022

	₦	₦
Rawmaterials		
Openinginventories		80,000
Purchases	240,000	
Carriageinwards	44,000	
	284,000	
Returnsoutwards	(35,000)	249,000
Costofrawmaterials available		329,000
Closinginventories		(48,000)
Costofrawmaterials consumed		281,000
Manufacturingwages	160,000	
Royaltiespaid	72,000	232,000
PRIMECOST		513,000
FactoryOverheads		
DepreciationofPlant	56,000	
Insuranceexpenses –factory	28,000	
Factoryexpenses	66,000	150,000
		663,000
Work-in-Progress		

Openinginventories	58,000
Closinginventories	(50,000)
Costofmanufactured goodsc/fwd	671,000

11.7.3 Transfer Pricing

The usual practice in the preparation of Manufacturing Account is to transfer theproduction cost to the Statement of Profit and Loss at historical cost.This means thatthe Manufacturing Account will not record any profit or loss and for that matter itbecomesdifficulttoknowwhetherthemanufacturingprocessisprofitable.

To ascertain the profit or loss on the manufacturing operation, goods manufactured aretransferred to the Statement of Profit and Loss at the market value of the finishedproducts.The market value must have taken care of any relevant margin on themanufactured goods.The rationale for this technique is that the entity would want toassess its efficiency in manufacturing by comparing the cost of manufacture with theprice of acquiring the products in the open market instead of going through the processofmanufacturing.

In this situation, the Manufacturing Account will show a balance, which will revealeither a profit or loss on production. This will therefore inform management whetherthe production department is a profitable one.If the answer tothisquestionisnegative management may have to decide whether to close the production departmentor institute cost-cutting measures that will result in lower cost of production by meansofstrict supervision andeconomiesto cheaperproduction.

Illustration11.5

Giventhesamequestioninillustration12.4above,let us assume that the production department transfers the finished product from the factory to the marketing department at costplus 25%. Thesolutionin 12.4canthen berepresentedthus:

TheManufacturingAccountwillbepreparedinthehorizontalformatasfollows:

ManufacturingAccountfortheyearendedJune 30,2022.

Rawmaterials:	**¢**	**¢**		**¢**
Opening inventories	80,000		Marketvalueofgoods	
Purchases	240,000		completedc/f	838,750
Add:Carriageinwards	44,000			
	2 4,000			
LessReturnoutwards	35,000	249,000		
Costofrawmaterialsavailable		329,000		
Lessclosinginventories		48,000		
Costof rawmaterialsconsumed		281,000		
Manufacturingwages	160,000			
Royaltiespaid	72,000	232,000		
Primecost		513,000		
FactoryOverheads:				
DepreciationofPlant	56,000			
Insuranceexpenses-factory	28,000			
Factoryexpenses	66,000	150,000		
		663,000		
Work-in-progress:				
AddOpeninginventories		58,000		
		721,000		
Lessclosinginventories		50,000		
Costofcompletedgoodsc/f		671,000		
Grossprofitonmanufacurec/f		167,750		
		838,750		838,750

11.8 Summary

We have learned that the purpose of the Statement of Profit and Lossof a soleproprietoristodeterminehisperformancefortheaccountingperiod.Theperformance is determined by calculating the net profit or net loss as the case may be.Important terms such as carriage inwards, carriage outwards, returns inward andreturnsoutwardhavealsobeenexplained.Thestatementoffinancialpositionwasalso mentioned and explained as a statement that shows the financial position of anenterpriseasat aparticulartimeordate.

We also saw that entities that manufacture products for sale will need an additionalaccount called Manufacturing Account to record the total cost incurred in producingtheproducts.

11.9 Multiplechoicequestions (MCQ)

1. Whichofthefollowingarefactoryoverheads?
   - I. Factoryrent
   - II. Carriageonpurchases
   - III. Factoryworkers'basicwages
   - IV. Basicrawmaterials
   - V. Plantrepairs

   a. I,IIIandV
   b. III,IVandV
   c. IandVonly
   d. IVandV
   e. I,IIand V

Use thedatabelowto answerQuestions2 and 3
TractorLtdhasthefollowinginformationat31/12/2022

	₵
Costofrawmaterials	4,500,000
Manufacturingoverheads	2,300,000
Productivewages	2,600,000
Workinprogress1/12/2022	800,000
Workinprogress31/12/2022	300,000
Paymentofroyalties	800,000
Closinginventoriesoffinishedgoods	450,000

manufactured goodstransferredtoSalesDeptatcostplus25%

2. Primecostis
   a. ₦2, 675,500
   b. ₦6, 650,000
   c. ₦7, 600,000
   d. ₦7, 900,000
   e. ₦9, 750,000

3. The manufacturing profit
   isa. ₦1,862,500
   b. ₦2, 000,000
   c. ₦2, 050,000
   d. ₦2, 562,500
   e. ₦2, 675,000

4. A statement offinancialpositionis usuallyprepared with
   a. Assetsandliabilitiesattheendoftheperiod
   b. Assetsand liabilitiesat thebeginningoftheperiod

c. Liabilitiesandsalesattheendoftheperiod
d. Assetsandequities atthebeginningoftheperiod
e. Inventoriesandpayables attheendoftheperiod

Use the information belowto answerQuestions 5 to 7

	¢
Returnsinwards	40,000
Sales	820,000
Openinginventories	200,000
Purchases	740,000
Grossprofit	200,000

5. The closing inventories figure is

6. a. ₦160,000
   b. ₦320,000
   c. ₦360,000
   d. ₦400,000
   e. ₦580,000

7. Thecostof goodssoldis

   a. ₦580,000
   b. ₦620,000
   c. ₦640,000
   d. ₦660,000
   e. ₦740,000

8. Themark-upofthebusinessis

   a. 24.39%
   b. 25.64%
   c. 32.26%
   d. 34.48%
   e. 36.32%

11.10 Short Answers Questions (SAQ)

1. Whatistheeffectof adecreaseinallowanceforbaddebtsonthefinalaccount...
2. InpreparingaStatementofProfitorLoss,interest on overduereceivablesbalanceistreatedas
3. When preparing financial statement for a trading entity, rentprepaidis shown in statement of financial position as……………
4. Unearnedcommissionreceivedin a trading entity is shown statement of financial position as……………
5. A statement that shows thestateofaffairsofabusinessentityatapointintimeisreferred to as a ……………………………

11.11 Examination like questions with solution

1. Thefollowing TrialBalancewasextractedfromthebooksofNyakpoo Enterprise as at December 31, 2022.

	DR ¢000	CR ¢000
Capital		112,000
MotorVan	40,000	
Inventories	32,800	
Balanceatbank	24,800	
Purchases	320,000	
Sales		446,000
Tradereceivables	58,000	
Tradepayables		33,120
Rentandrates	11,216	
Salaries	70,080	
Generalexpenses	8,944	
Motorexpenses	5,120	
Discountallowed	8,080	
Discountreceived		7,920
Insurance	3,920	
Irrecoverabledebts	6,080	
Drawings	10,000	
	599,040	599,040

Thefollowingmatters areto betakeninto account:

a) InventoriesintradeasatDecember 31,2022was¢40,320,000

b) Salariesandwagesoutstandingasat31/12/2022amountedto¢24,000,000.

c) Insurancepaidinadvancewas¢1,400,000

One four the of the generalexpenseswereforprivatepurposes.

Required:

PrepareaStatementofProfitorLossfortheyearendedDecember 31,2022andaStatementof Financial Position as at that date.

Question2

The following Trial Balance was extracted from the books of Adetomade alerin second hand clothes.

TrialBalance asatJune 30,2022.

	DR	CR
	¢000	¢000
Capital		553,500
Purchases	1,255,500	
Sales		1,644,300
Repairstobuilding	22,896	
MotorCar	25,650	
Carexpense	8,586	
Freeholdlandandbuildings	270,000	
Balanceatbank	14,580	
Furnitureandfittings	39,420	
Wagesandsalaries	232,362	
Discountallowed	28,647	
Discountedreceived		21,978
Rateandinsurance	6,696	
Irrecoverabledebts	9,693	
Allowancefor doubtful debts		3,780
Drawings	64,800	
Tradereceivables	140,751	
Tradepayables		108,945
Generalexpenses	42,822	
Inventories 283	170,100	
	2,332,503	2,332,503

After adjusting for the following matters, you are required to prepare aStatement of Profit or Loss for they earended30th June2022and aStatementofFinancialPositionasat that date:

i.Inventoriesintradeat30/06/2022,¢237,600,000

ii. Wagesandsalariesoutstandingat30/06/2022,¢9,720,000

iii. Ratesandinsurancepaidinadvanceat30/06/2022,¢1,620,000

iv. Theallowancefordoubtfuldebtsis tobeincreasedto¢4,860,000

v.During the accounting year ended30/06/2022,Adetom with drew goods value

vi.dat ¢16,200,000

for his own consumption. He instructed the accounts clerk not to record the transaction in thebooks.

11.12 Examination like questions without solution

1

Yafeu Enterprise is a dealer in special traditional medicine. He imports similar medicines from Abroad whenever there is shortage in the local market. The Trial Balance of the entity as at December 31,2022 is as detailed below:

	Dr.	**Cr.**
	¢’000	**¢’000**
Investmentincome		550
Purchases	7,970	
Sales		40,250
ReceivablesandPayables	4,850	2,380
Inventoriesoffinishedgoods	1,140	
Motorvehicles	3,800	
Electricityexpenses	325	
Land andbuildings(costofland¢2,000)	14,000	
OfficeEquipment	4,550	
Drawings	1,825	
Returns	930	485
Carriageinwards	300	
Administrativeexpenses	980	
Salariesandwages	3,650	
Vehiclerunningexpenses	320	
Allowanceforirrecoverabledebts		450
Investments	8,500	
Bankand cashbalances	4,380	
Sellingexpenses	4,785	
Furniture&fittings	5,000	
Capital		13,455
AllowanceforDepreciation:		
- OfficeEquipment		2,250
- Motorvehicles		2,270
- Land &Buildings		5,500
Discountallowed	285	
	67,590	**67,590**

The following additional information is relevant:

1. The inventories at December 31,2022were recorded at ¢950,000.
2. The Enterprise depreciates its assets on cost as
3. follows:

Assets:	%
Buildings	4
MotorVehicles	20
OfficeEquipment	15
Furniture&fittings	10

4. Administrativeexpensesincluderentof¢250,000. This represents rent for the period of July 1,2022 to May 31,2023.
5. TheEnterpriseistomakeallowanceof¢345,000inrespectofPersonalincometaxfor2022 accountingyear.
6. Amountowinginrespectofelectricity andvehiclerunningexpensesare¢55,000and ¢75,000respectively.
7. Allowanceforirrecoverabledebt is ¢500,000.

Required:

Preparestatementofprofitorlossforyearended December 31,2022

and astatementoffinancialposition as at that date.

2

SUCCESS Ltd is a Manufacturing Entity. The following is an extract from its books for the year ended December 31,2022.

	¢
StockofrawmaterialsasatJanuary 1,2022	30,000
Purchasesofrawmaterials	240,000
Manufacturingwages	40,000
Officesalaries	28,000
Royalties	10,000
Openingstockoffinishedgoods	13,000
Carriageoutwards	2,400
Printingandstationery	5,600
Rentandrates	16,000
Generalexpenses	26,000
Travellingexpenses	16,800
Factoryexpenses	10,000
Sales	480,000

You are also supplied with the following additional information:

a. Depreciation of 10% is to be charged on Plant and machinery worth ¢20,000

b. The following are inventories on hand at 31/12/2022: Inventories of Raw materials ¢16,000

Inventories of finished goods ¢15,000

c. Half of the rent and rates is chargeable to the Manufacturing Account

You are required to prepare the Statement of Manufacturing and Profit or Loss for the year ended December 31, 2022.

11.13 Solution to Multiple Choice Questions (MCQ)

1. C.
2. D
3. E.
4. A.
5. C.
6. A.
7. D.

11.14 Solution to Short Answer Questions (SAQ)

1. Increase in assets, increase in revenue
2. An income
3. Current asset
4. Current liability
5. Statement of financial position

11.14 Solution to Examination type questions

Question 1

NyakpooEnterprise

Statementof ProfitorLossfortheyearendedDecember 31,2022

	¢'000	¢'000	¢'0004
Sales			46,000
Lesscost of sales:Openinginventories		32,800	
AddPurchases		320,000	
		352,800	
Lessclosinginventories		40,320	312,480
Grossprofit			133,520
AddDiscountreceived			7,920
			141,440
Lessexpenses:			
Salaries	70,080		
AddOwings	24,000	94,080	
Rentandrates		11,216	
General expenses	8,944		
Lessdrawings	2,236	6,708	
Motorexpenses		5,120	
Discountallowed		8,080	
Irrecoverabledebts		6,080	
Insurance	3,920		
Lessprepaid	1,400	2,520	
			133,804
NetProfit			7,636

Statement of Financial Positionas at December 31,2022

Assets		**¢'000**	**¢'000**
Non-currentAssets			
Motorvan			40,000
CurrentAssets			
Inventories	40,320		
TradeReceivables	58,000		
Insuranceprepaid	1,400		
Balanceatbank	24,800	124,520	
TotalAssets		**164,520**	
EquityandLiabilities			
Capital/Equity		112,000	
NetProfit		7,636	
Drawings(10,000+2,236)		(12,236)	
		107,400	
CurrentLiabilities			
TradePayables	33,120		
Accruals(Salaries)	24,000	57,120	
TotalEquityandLiabilities		**164,520**	

Question 2

(a) Adetom

StatementofProfitorLoss fortheyearendedJune 30, 2022

	¢'000	¢'000	¢'000
Sales			1,644,300
Lesscostofsales:Opening		170,100	
AddPurchases	1,255,500		
Lessinventoriesdrawings	16,200	1,239,300	
		1,409,400	
Lessclosinginventories		237,600	1,171,800
Grossprofit			472,500
AddDiscountsreceived			21,978

			494,478
Lessexpenses:			
Salaries	232,362		
Addowings	9,720	242,082	
Rates&Insurance	6,696		
Lessprepaid	1,620	5,076	
Generalexpenses		42,822	
Carexpenses		8,586	
Discountsallowed		28,647	
Irrecoverabledebts		9,693	
Allowanceforbaddebts		1,080	
Repairstobuilding		22,896	360,882
Netprofit			133,596

Adetom

(b) StatementofFinancialPositionasatJune 30,2022

Assets	**¢**	**¢**	**¢**
Non-currentAssets			
Freeholdlandandbuildings			270,000
Motorcar			25,650
FurnitureandFittings			39,420
			335,070
CurrentAssets			
Inventories		237,600	
TradeReceivables	140,751		
Allowance	4,860	135,891	
Prepaidexpenses		1,620	
Balanceatbank		14,580	389,691
TotalAssets			**724,761**

EquityandLiabilities

		¢
Capital/Equity		553,500
NetProfit		133,596
		687,096
		81,000
Less Drawings(64,800 +16,200)		606,096
Liabilities		
Non-current		-
Current		
TradePayables	108,945	
Accruals-wages&salaries	9,720	118,665
TotalEquitiesand Liabilities		724,761

CHAPTER TWELVE

PREPARATION OF SIMPLEINCOMPLETERECORDS AND SINGLE ENTRIES

Chapter Twelve Contents

- Incomple records/single entry
- Simple statement of pofit or loss
- Simple statement of financial position

Learning Objectives

Afteryoustudyingthischapter, you should be able to:

- *Derivation of profit from incomplete records and single entries transactions;*
- *Determine unknown figures such as sales and purchases uses receivable and payable control accounts in the Statement of Profit or Loss*
- *Determine unknown figures as expenses in the Statement of Profit or Loss;*
- *Derive proprietor's cash drawings, capital or additional capital as a missing figurewhereallotherinformationrelatingtocashpaymentsand receiptsareknown*
- *Determine additional noncurrent assets and accumulated depreciations in the Statement of Financial Position;*
- *Prepare detailed statementofprofitorloss from records that were not kept on double entry system; and*
- *Prepare simple incompleterecords and singleentries;*

12.1 Profit or Loss with Adjustments

The term 'single entry' s applied to any system,which does not provide for the twofold aspects of transactions; while the alternative term ' incomplete records' is oftenapplied to books of account kept on such a single entry or incomplete double entrysystem. Pure 'single entry' recognises only the personal aspect of transactions, and, consequently, the only essential books are personal ledgers for recording transactionswith receivables and trade accounts payables. In practice, however, a cash book isordinarilykept, but,with this exception, the impersonal as pectoftransactionsisusuallyleftentirelyunrecorded. To prepare a set of accounts under incomplete methods and single entries, it is unlikely that examination questions provide students with all the needed information to prepare financial statements. In such situations, you may need to engage the balancing figure, cash and bank data, profit mark-up, profit margin, accounting equation and control account previously discussed in the study text to derive the values of the missing information. The chapter extensively deals with procedures and methods that can be employed to derive missing information to prepare the Statement

Therefore, in this chapter, readers will earn the procedures and the techniques involved in preparing the statement of profitor loss and statemen of financial position for an entitythathasonlyopeningandclosingnetassetsandperhapscashbook informationastheonlyknownfigures.Readers will also understand and learn how to ascertain the proprietor's drawings, capital and additionalcapitalcontributed if any during an accounting period from thescantyinformation provided byacash book summary.

Questionsonincompleterecordsandsingleentryarepopularwithexaminersbecausethey enablethemtotestimportant principles and techniques suchas accounting equation and ledgercontrol accounts,which have earlier been discussed in the study text..It alsoprovidesthe basic information necessary to prepare final accounts but without the examinerpresenting it in the form of a Trial Balance.Ability to manipulate single or incomplete records to produce final accounts is a true test of knowledge of the primary doubleentryprinciple.

TheAscertainmentofProfitor Loss fromIncompleteRecords

Generally speaking, profits (or losses) are ascertained, under the single entry system,by a comparison of the values of the net assets at two specified dates (i.e. closing andopening dates), after taking into accountadditions to, or withdrawals from, capitalduring the period. The difference between these two values represents the profit orloss, according to whether there is an increaseordecreasein thefigures.

Remembertheaccountingequation, whichstatesthat:

BusinessAssets=Owner'sCapital+BusinessLiabilities

Theequationabovecanberestatedas:

Owner'sCapital=Business Assets–BusinessLiabilities

Notice that the business assets consist of noncurrent assets (physical or tangible assets), for example building, equipment, furniture and machinery; current assets such as closing inventories, trade receivables, prepaid expenses and commission or interest receivables. The liabilities are noncurrent liabilities (long term loan) and current liabilities such as trade payable, accrued or outstanding expenses, bank overdraft and other payables. Duringan accounting period,thebusinessrealisedanexcessofincomeoverexpenditure,the additional cash or assets generated belong to the owner(s), thus increasing the capital. The accounting equation willnowbecome: Opening capital+profit=opening net assets+increase innetassets. Theintroductionorwithdrawalofresourcesbytheownerwillalsoincreaseordecreasetheowner’scapitalrespectively.

As aresult,profit can becalculatedusingtheformatbelow:

	¢
Closingcapital	XXX
Lessopeningcapital	XXX
Increaseinnetassets	XXX
Owners’Drawings	XXX
AdditionalCapital	(XXX)
Netprofitfortheyear	XXX

IllustrationtoIllustration12.1:

Calculatethenetprofitfortheyearended31 May2022fromthefollowinginformation:

	1/6/2021 **¢’000**	**31/5/2022** **¢’000**
Property	200,000	200,000
Equipment	60,000	90,000
TradeReceivables	40,000	80,000
Cash	10,000	15,000
Overdraft	60,000	90,000
TradePayables	50,000	30,000

Drawingsduringtheyeardrawingwas¢45,000,000andadditionalcapitalintroducedwas ¢50,000,000.

SOLUTION	**1/6/2021**	**31/5/2022**
	¢	**¢**
Property	200,000	200,000
Equipment	60,000	90,000
Tradereceivables	40,000	80,000
Cash	10,000	15,000
TotalAssets	310,000	385,000
Overdraft	60,000	90,000
Tradepayables	50,000	30,000
Totalliabilities	(110,000)	(120,000)
Capital/Netassets	200,000	265,000
		¢
Closingcapital		265,000
Openingcapital		(200,000)
Increaseinnetassets		65,000
Additionalcapitalintroduced		(50,000)
Owner’sdrawings		45,000
Netprofitfortheyear		60,000

Alternative Solution:

	1/6/2021	**31/5/2022**
	¢	**¢**
TotalAssets	310,000	385,000
TotalLiabilities	(110,000)	(120,000)
NetAssets	200,000	265,000

	¢
Closingcapital	265,000
Lessopeningcapital	200,000
Increaseinnetassets	65,000
Owners’Drawings	45,000
AdditionalCapital	(50,000)
Netprofitfortheyear	60,000

Bolu's Venture, is sole trader selling consumables in Lagos Island. The proprietor consulted you to prepare his financial statements from its incomplete records. The entity did not keep full records, however, you were able to obtain the following information from his cheque counterfoils and diary for the year ended 31st December, 2022.

	1/1/2021	**31/12/2022**
	₦'000	**₦' 000**
Cash in hand	1200	2,670
Bank	5400 CR	42,000 CR
Furniture	6000	6,000
Motor vehicle	10,800	8,640
Inventory	61,200	67,200
Trade Receivables	37,200	29,400
Trade Payables	27,360	25,200
Bills payable	6,630	6,600
Bills Receivable	9,300	9,600

During the financial year, Bolu consumed inventory worth ₦3,600,000 with his family. He drew cash for private expenses frequently and this was estimated to ₦4,140,000 for the year. The proprietor agreed to the following advice:

a) To write off as bad receivables ₦900,000 owed buy a customer who is bankrupt in May, 2022.

b) To depreciate:

Furniture	15% P.a
Motor vehicle	20% P.a

You are required to:

a) Determine the profit of Mr. Bolu's for the year ended 31st December, 2021.

b) Prepare the Statement of Financial Position as at that date.

Solution

		Opening Capital 1/1/2021		**Closing Capital 31/12/2021**
	~~N~~'000	**~~N~~'000**	**~~N~~'000**	**~~N~~'000**
Assets:				
Furniture			6,000	5,100 (85% x 6000)
Motor vehicles		10,800	8,640 (10,800-8,640)	
Inventory		61,200		67,200
Trade Receivable		37,200		28,500 (29,400 – 900)
Bill Receivable		9,300		9,600
Cash in hand		1,200		2,670
		125,700121,710		
Liabilities:				
Trade Payable	27,360	–	25,200	
Bills payable	6,630	–	6,600	
Bank overdraft	54,000	(87,990) 42,000		73,8000
		37,710	47,910	

Profit for the Year Ended 31/12/21

	₦'000	
Closing Capital		47,910
Add: drawing (3600 + 4140)	7,740	
	55,650	
Deduct: Capital introduced	0	
Opening capital	(37,710)	
Profit for the year	17,940	

Mr. Bolu

Statement of Financial Position as at 31 December, 2021

Noncurrent Assets (Carrying Amount)

	₦'000	**₦'000**	**₦'000**
Furniture			5,100
Motor vehicles			8,640
			13,740
Current Assets			
Inventory		67,200	
Trade Receivables (29,400 – 900)	28,500		
Bills Receivable		9,600	
Cash in hand		2,670	
		107,970	
Total Assets		**121,710**	

Financed by:		
Opening capital		37,710
Add: Profit		17,940
		55,650
Less: Drawings		(7,740)
		47,910
Current Liabilities		
Trade Payables	25,200	
Bills payable	6600	
Bank overdraft	42000	73,800
Total Capital and Liabilities		**121,710**

PreparationofdetailedfinalaccountsfromIncompleteRecords

Really, to calculatetheprofitofanentityusingthe methodpresentedabove, students must have familiarised themselves with basic principles in control accounts, which will be used to determine unknown or missing figures such as sales, purchases and expenses. Also, the basic principles of accounting equation, that is Capital (C) plus Liabilities (L) equal Assets (A), C + L = A. This implies that C = A – L. A student who had painstakingly studied these in the previous chapters would be in comfort zone to prepare Statement of Profit or Loss and Statement of Financial Position in the current chapter.Itisimportantforyoutonotethatthe accountantdoesnotonlypreparethefinalaccountsofanenterprisebutalsocommunicatesaccounting and *financial information to stakeholders.* It is therefore much more informative when Statement of Profit or Loss is drawn. It is important for the accountant to convert these scanty and incomplete records into the acceptable double entry form.

Foronetobeabletopreparethestatementofprofitorlossandstatementoffinancialpositionfromsingle entry and incompleterecords,the procedu resdetailed below are recommended:

Techniques and Procedurestopreparefinancialstatementsunder IncompleteRecords:

- Prepareastatementofaffairs;
- Analyzeunbankedcashsales;

- Postthecash andbank summarytotheledgeraccounts;
- Prepareschedulesoftradepayablesandtradereceivables;
- Extractatrialbalance; and
- Drawupthefinalaccounts–statement of Profitor Loss and Statement of Financial Position

12.2 PreparationofStatementofAffairs at the beginning and at the end including computation of opening capital

First step is to constructa Statement of Financial Positionat the beginning of the accounting ear. This means that theassetsminusliabilitiesofthebusinessmustberecorded to show the Statement of Financial Position at start of the period and how opening capitalwill be derived or calculated.The statementpreparedtoshowthe Statement of FinancialPositionof the business at the beginningof theyear istechnicallycalled 'Statementof Affairs'

Inmost practical situations, the owner of the entity will provide lists of values ofnon-current assets that he uses in the entity together with the dates ofacquisition. It should there forebe easy for one to calculatetheaccumulated allowance fordepreciation on the non-current assets from the date of their purchase to the date ofreporting. Values of such items as inventoriesin trade, receivablesand liabilities mayhaveto beestimated withthehelp oftheowner.

From the information provided in illustration 13.1, a journal can be opened and accountingentries effected. The aim is to ensure the recording of the accounting entries following theduality principle. This means that appropriate debit entries must be posted into assetsaccountand creditentriesenteredinto capitalorliabilitiesaccounts.

The difference between the assets and liabilities, which usually end supwiththeassets exceeding the liabilities may be assumed to be the initial amount that the ownerusedinstartingthebusiness.Therefore, itwillberecordedasthecapitaloftheentity.Itispossiblethattheownermaybeabletomentiont heinitialamountheused 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 statement of profit or loss.

PreparationofCashandBankSummary

The first task is to as certain the cash position of the business,in the cashbook.Thisis usuallydone by carefully examining the available bank statements, pay-in-slips and the cheque counter foils. The bank statements together with the chequecounterfoils could reveal information concerning purchases, payment of rent, bankcharges, wages, insurance, interest earned,the acquisition of non-current assets, and any personal with drawals. Information extracted from the pay-in-slips will helpdetermine the amount of money paidin by customers to whom goodswere sold oncreditandalsodirectsalesby cheque instead of cash. The above information may be used to preparea cash summary or a receipts and payments account for thebusiness.

Analysisofunbankedcashsales

Onemustatthisstagedeterminetheamountofcashsaleswhichhavenotbeenbankedbytheowner,but which might have beenused by the owner to payfor business expenses, cash purchases, and perhaps personal drawings.It is possiblethatthe owner might have made use of some of the physical inventories in trade for hisor her personal use. In such a situation conducting an informal interview with the owner would confirm the existence of such occurrences. Thus, it will help thebookkeeper make an appropriate estimate for inventories drawings. Physical inventories taken by (i.e.counting) of items of inventories in the store at the close of business will give the actua closing inventories figure and there fore may not need to be estimated.

PostingfromtheCash andBankSummary

After the analysis of the cash book has been made, necessary postings are then made into the ledger. Noteth at instepone, opening entries were made through the ledger ,andthereforesome of these new entries will be made into existing ledger accounts.

Fromtheanalysisofthedebitsideorreceiptssideofthecashandbank summaryandinformation obtained fromthepay-in-slips:

a. Opening cash balance in thedebitside is added too pening asset at the beginning and opening cash balance in the credit side is added to opening liabilityty to detemmine capital of the entity in the financial year.

b. Allcashsalesortakingsshouldbecreditedtothetradereceivablesaccountinthesales ledger;

c. Anyproceedsfromthesaleofnon-currentassetsshouldbecreditedtotherespectiveasset accounts;

d. Anyinterestorincomefrominvestmentmustalsobecreditedtotheappropriaterevenueaccount

e. Any other item should be posted to the credit of the relevant account;

f. Closingbalanceinthecashbookisrecognisedasacurrentliability inthestatementoffinancial position

Fromtheanalysisofthecreditsideorpaymentssideofthecashandbanksummaryandinformationobtained from thechequecounterfoils:

i. Allpaymentsforgoodspurchasedshouldbedebitedtothetradepayablesaccountinthepurchases ledger;

ii. Payment of expenses should be debited to the relevant nominal account;

iii. Allpurchasesinconnectionwithnon-currentassetsshouldbedebitedtotheappropriate asset accounts;

iv. Anycharges shouldbepostedto debit of the bank charges account;

v. Anyotheritem should beposted to thedebit oftherelevant account;

vi. Closingbalancein thecashbook isrecognisedas acurrentasset inthestatement ofposition

Where any difference exists on the cashbook summary necessary adjusting entries should beposted to balance the difference. If the difference is on the credit side then the cashbook should be credited and the proprietor's drawings account debited. If the differenceisonthe debit side then one can safely presume that the owner of the business has introducedadditional capital. This differenceshouldbedebitedtocash and credited to thecapitalaccountofthebusiness.

PreparationofTradereceivablesandPayablesSchedule

At this stage we need to determine year-end adjustments and balances.

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 receivables therefore represent debts owed to the entity and as such must be carried forward to the credit of the total sales ledger control account. There is likely to be a difference in the debit side of the total receivables account, which represent total sales on credit for the period and is to be transferred to the credit of the statement profit or loss as sales or turnover (revenue). The cash sales if any in the debit side of the cash book should also be taken to the statement of profit or loss. Another schedule that should be prepared to have a list of amounts owing by the entity to its suppliers for goods purchased on credit. The total of this schedule represents total liabilities by way of trade payables 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 Statement of Profit or Loss. In addition, cash purchases on the credit side of the cash book if any is also taken along to the Statement of Profit or Loss.Similarly, accruals and prepayments will be carried forward as closing balances in the appropriate expense accounts, the actual expense amount which has been incurred for the accounting period being accounted for as a balancing figure.

Extractionof TrialBalance

Thisisthefinalstagesinceallthetransactionswouldhavebeenrecordedandthedouble entries completed. It is now possible for the business to extract a Trial Balancewhichwillformthe basisfor the preparationofthe Statement of Profit or Loss and the statement of financial position as at the period end.

Please, recall the Formats ofReceivable and Payable Control Accounts

Receivable's/Sales Ledger Control Account

	₦		₦
Debit all items that can increase trade debit examples include:		Credit all items that can reduce trade debt examples include:	
Bal b/d	x	Bal b/d	x
Credit sales	x	Discount allowed	x
Interest charged to customers	x	Bad Receivable	x
Dishonoured bills receivable	x	Bills receivable	x
Others	x	Bal c/d	
	x	Cash received from customers	x
		Returns inwards	x
		Purchase ledger Contra (set-off)	x

		Others	x
		Bal c/d	x
	xx		xx
Bal b/d	x	Bal b/d	x

Payable's Purchases Ledger Control Account

	₦		₦
Debit all items that can reduce Trade Payable:		Credit all items that can increase trade Payable:	
Bal b/d	x	Bal b/d	x
Bills payable	x	Credit purchases	x
Discounts received	x	Dishonoured cheques	x
Cash and cheques paid to customers	x	Dishonoured Bills payable	
Returns outward	x	Interest charged by:	
Sales ledger contra (set-off)	x	Suppliers	x
Others	x	Others	x
Bal c/d	x	Bal c/d	x
	xx		xx
Bal b/d	x	Bal b/d	x

Note the following in preparing Control Account

a) Receivable Control Accounts

i. Where bills receivable and bills receivable accepted are both given, you should make use of the bills receivable accepted because the obligation on the bills arise if and only if the bills are accepted;
ii. Discounted bills receivable should be ignored;
iii. Honoured bills receivable should be ignored;
iv. Bad Receivable recovered should be ignored;
v. Unless item iv has been earlier credited to the Receivable control account and in this case should be debited to the sales ledger control account;
vi. Cash sales should be ignored in the control account because it records transactions affecting both credit sales and credit purchases;
vii. However, it is important to note that the addition of cash and credit sales will be transferred to the trading account;
viii. Bad and doubtful Receivable provisions should be ignored;
ix. Provision for discount allowable should also be ignored.

b. Payable's Control account:

i Cash purchases should be ignored but the addition for both the credit and cash purchases are transferred to the trading account.
ii Honoured bills payable should be ignored.
iii Where both bills payable and bills payable accepted are given, the latter should be used because the obligation for the creditor on the bills arise if and only if the bills are accepted.

Illustration12.2

Boakye, a sole proprietor, trading as KKB Enterprise requested Oko & Associates, a firm of Chartered Accountants to prepare the accounts of his business for the year ended 31 December 2021. The assignment has been given to you by Oko & Associates as their trainee accountant. Your interview with Boakye revealed the following:

i. He did not maintain a double book-keeping system.
ii. All sales were on credit or cash basis. During the year, Boakye received ¢9,025,000 and

iii. ¢475,000 in cheques and cash respectively from his customers.

iv. Suppliers of goods during the year were paid ¢6,840,000 by cheque.

v. Boakye used a prepaid electricity meter in the business. On 1 July2020, he paid ¢480,000 as one year in advance for electricity used in the business. Again, on 1 July, 2021, he paid ¢600,000 in advance to cover one more year for electricity consumption. The payments were made using cheques.

vi. The rent for the premises was ¢60,000 per month payments were by cheque.

vii. General business expenses paid by cheques amounted to ¢106,200. He took cash of ¢38,000 every month for his private use. Boakye provided you with the following additional information:

	31/12/2021	**31/12/2020**
	¢	**¢**
Tradereceivables	1,254,000	1,045,000
Tradepayables	617,500	380,000
Rentowing	60,000	120,000
Bankbalance	3,000,000	1,073,500
Cashinhand	60,000	76,000
Inventories	1,700,500	1,510,500
Fixtures&Fittings(atcost)	-	920,000

i) Depreciation is provide dannually at therate of 20% on Fixtures and Fittings.

ii) Boakyehadagreedtopay¢100,000asaccountancyfeesasat31December,2021having received invoice from Oko&Associatesforthisamount.

iii) Differencesincashandbankbalanceasattheendof31December2021representadditionaldrawingsandcapitalrespectively.

Youarerequiredto:

(a) Compute the profit of Boakye using the net worth approach.

(b) Cashand bank summaryfor2021.

(c) Statementofprofitorlossfortheyearended31December,2021.

(d) Statementoffinancialpositionasat31December,2021.

SolutiontoIllustration12.2

You may wish to attempt the question before reading this explanation. You should proceedalongthis lineto solvetheproblem.

(a) Calculate opening net assets to arrive at opening capital

It is necessary to determine opening capital to enable us calculate the closing balance inthe statement of financial position. All that is required is to **pick up all openingbalancesnotforgettingtheopening cashbalance.**

Statement of Financial Affairs: Capital=Assets– Liabilities

	31/12/2021	31/12/2020
Assets	**¢**	**¢**
Furniture&fittings(cost)	920,000	920,000
Accumulateddepreciation	(184,000)	-
Inventories	1,700,500	1,510,500
Prepaidelectricity	300,000	240,000
Tradereceivables	1,254,000	1,045,000
Cashinhand	60,000	76,000
BankBalance	3,000,000	1,073,500
	7,050,500	4,865,000
LiabilitiesTradepayables		
	617,500	380,000
Rentowing	60,000	120,000
Accountancyfeeoutstanding	100,000	100,000
	777,500	600,000
Capital(Networth)	6,273,000	4,265,000

IncreaseinNetworth:¢6,273,000-¢4,265,000 = ¢2,008,000

ComputationofprofitusingNetworthApproach

	¢
Increaseinnetworth	2,008,000
Adddrawings	491,000
	2,499,000
Lessadditionalcapital	1,227,700
Profitforyear	1,271,300

Increaseinnetworth.. ¢5,973,000 -¢4,125,000=¢1,848,000

Computationofprofitbythenetworthmethod

¢

Increaseinnetworth	2,032,000
Add Drawings(456,000+600,000+35,000)	1,091,000
	3,123,000
Less Additional Capital	1,227,700
NetProfit	**1,895,300**

(b) Constructionofcashandbanksummary

Even if some of the information in the question is given in the form of a cash or bank summary, it is usually necessary to build upone or both of these summaries to calculate amissing figure such as payment for purch ases and owner's drawings.

CASH BOOK SUMMARY

	Cash ¢	Bank ¢		Cash ¢	Bank ¢
Balb/d	76,000	1,073,500	Suppliers	-	6,740,000
Receivedfromcustomers	475,000	9,025,000	Drawings	456,000	-
Capital(missingfigure)	-	1,227,700	Rent	-	600,000
			Gen.Bus.Exp.	-	106,200
			Drawings(medicals)	-	780,000
			Drawings(missingfigure)	35,000	-
			Bal.C/d	60,000	3,000,000
	551,000	11,326,200		551,000	11,326,200
Balb/d	60,000	3,000,000			

(c) Statementofprofitorlossfortheyearended31December2021

	¢	¢
Revenue		9,709,000
CostofSales		(6,887,500)
Grossprofit		2,821,500
Less expenses: Electricity		

	540,000	
Rent	720,000	
Depreciation	184,000	
Generalexpenses	106,200	
		(1,550,200)
Netprofit		1,271,300
Cost of SalesOpeninginventories		1,510,500
Purchases		7,077,500
		8,588,000
Closing inventories		1,700,500
		6,887,500

(d) StatementofFinancialPositionasat31December2021

	¢
Assets:	
Non-currentAssets:	
niture&FittingsAtcost	
AccumulateddepreciationCarryingamount	920,000
	184,000
	736,000
CurrentAssets:	
Inventories	1,700,500
Prepaidelectricity	300,000
TradeReceivables	1,254,000
Cashinhand	60,000
Bankbalances	3,000,000
Totalcurrent assets	6,314,500
TotalAssets	7,050,500

EquityandLiabilities

Capital1/1/2021	4,265,000
Additionalcapitalintroduced	1,227,700
	5,492,700
Profitfortheyear	1,271,300
	6,764,000
Less: Drawings	491,000
Totalequity	6,273,000
Currentliabilities	
Tradepayables	617,500
Rentoutstanding	60,000
Accountancyfeenotpaid	100,000
Totalliabilities	777,500
TotalEquityandLiabilities	7,050,500

WORKINGS

Construct sale and purchases ledge rcontrolaccounts

Inadoubleentry-system, control accounts are used to confirm the arithmetical accuracy of the sales and purchases ledger system. This technique will be usedtocalculatesales and purchases as amissingfigure.

PurchasesLedgerControlAccount

	¢		¢
Bank	6,840,000	Bal.B/d	380,000
		Purchases(missingfigure)	7,077,500
Bal.C/d	617,500		
	7,457,500		7,457,500
		Bal,b/d	617,500

SalesLedgerControla/c

	¢		¢
		Customers:	
Balb/d	1,045,000	Bank	9,025,000
Balancingfigure:		Cash	475,000
Sales	9,709,000	Balc/d	1,254,000

	<u>10,754,000</u>		<u>10,754,00</u>
Balanceb/d	1,254,000		

1. Workings for accruals and prepayments

In addition to these four techniques I t will be necessary to construct figures for the Income statement by adjusting cash paidforexpensesforopeningandclosingaccrualsand prepayment.

RentExpenseControl

Electricitya/c

Balanceb/d(6/12x480,000)	240,000	Profitor loss	540,000
Bank	<u>600,000</u>	Balancec/d(6/12*600000)	<u>300,000</u>
	<u>840,000</u>		**<u>840,000</u>**
Balance b/d	300,000		

Renta/c

Bank	780,000	Balance b/d	120,000
Balancec/d	<u>60,000</u>	Profitor loss	<u>720,000</u>
	<u>840,000</u>		<u>840,000</u>
		Balance b/d	60,000

Accountancyfeesa/c

Balancec/d	<u>100,000</u>	Balance b/d	
			<u>100,000</u>
		Balance b/d	100,000

AccumulateddepreciationonFixturesandFittingsa/c

Balancec/d	<u>184,000</u>	Depreciationa/c	<u>184,000</u>
		Balance b/d	184,000

Depreciationaccount

AccumDepreciationon F&F	184,000	Profitor loss	184,000

ComputationofDepreciation	¢
Fixture and fittings at cost(1/1/2016)	920,000
LessDepreciation(20%@¢920,000)	184,000
Carryingamount(31/12/2016)	736,000

Illustration12.3:

Damask is a retailer who deals in spare parts at Kokompe. He paid into his bank account amount of his cash takings, after retaining ¢10,000 per week for personal use and after payment of wages and expenses,which for the accounting period of 31December2021 ,wereas follows:

	¢
Staffwages	1,200,000
Goods	220,000
Cleaning	75,000
Carriage	35,000
Others	20,000

ThetransactionsinhisBankAccountduringtheperiodwere:

	¢2,000,000
Balanceasat1stJanuary2021	
Lodgements:	
fromtakings(cash)	30,130,000
Bulksalesaccount(cheques)	4,800,000
Interestontreasurybills	30,000
	36,930,000

Withdrawals:	¢

Goodspurchased	30,830,000
Rent	400,000
Ratesinconnectionwithstore	345,000
Ratesinconnectionwithownhouse	55,000
Airconditionerexpensesforstore	200,000
Airconditionerexpensesforhouse	20,000
Telephoneandelectricity	150,000
Otherexpensesforstore	70,000
Fireinsurance	60,000
Lifeassurancepolicy	30,000
Repairs	150,000
Fixturesandfittings	600,000
Consultancyfees	70,000
Incometax	900,000
Owner'scurrentaccount	180,000
Balanceasat31stDecember2021	2,900,000
	36,960,000

The following information were also provided:

	31/12/2020	31/12/2021
Receivables– Bulksales	490,000	430,000
Payables:Goodspurchased	2,900,000	3,195,000
Rent	80,000	30,000
Electricity	25,000	65,000
Telephone	45,000	-
Consultancyfees	40,000	40,000
Inventoriesintrade	2,050,000	1,875,000
Fixtures&Fittings		540,000

You are required to prepare statement of Profit or Loss for the year ended31December2021 and a Statement of financial positionas at that date.

Hint: There are52weeksina year.