MODULE TITLE : INTRODUCTION TO FINANCIAL ACCOUNTING

Module Code: ACC1131

Dr Gasheja Faustin
Senior Lecturer
0788305615

CONTENTS

RECOMMANDED READINGS

- Text Book: Business Accounting Volume 1 by Frank Wood and Allan Sangster
- CPA Study text: Financial Accounting for CPA
- ACCA study text: Financial accounting Paper F3 or Preparing financial statements Paper 1.1

CHAPTER ONE: Introduction to Financial accounting

I.1 NATURE OF FINANCIAL ACCOUNTING

Accounting is defined as the process of **identifying, recording, classifying** and **summarizing** economic data so as to come up with useful information to help users make decisions.

Many businesses carry out **transactions** With a financial implication i.e. either cash is received or paid out. Examples: selling goods, buying goods, paying employees.

Accounting is involved with identifying these transactions measuring (attaching a value) and reporting on these transactions.

FINANCIAL ACCOUNTING

- **Financial accounting** (or **financial accountancy**) is the field of **accounting** concerned with the summary, analysis and reporting of financial **transactions** pertaining to a business. This involves the preparation of **financial statements.**

- Financial accounting is used to prepare accounting information for people outside the organization or not involved in the day-to-day running of the company,

- **Accounting** has variously been defined as the keeping or preparation of the financial records of an entity.

FINANCIAL TRANSACTION

- **A financial transaction** is an ***agreement***, ***communication***, or movement carried out between a ***buyer*** and a ***seller*** to ***exchange*** an ***asset*** for ***payment*.**

- **payment** is the transfer of an item of value from one ***party*** (such as a person or company) to another in exchange for the provision of ***goods, services*** or both, or to fulfill a ***legal obligation***.

I.2.USERS OF ACCOUNTING INFORMATION

- Accounting information is produced in form of *financial statements.* These financial statements provide information about an entity financial position, performance and changes in financial position.
- *Financial position* of a firm is what the resources the business has and how much belongs to the owners and others.
- *The financial performance* reflects how the business has performed, whether it has made profits or losses.
- *Changes in financial positions* determine whether the resources have increased or reduced.
- The users of accounting information have an interest in the existence of the firm. Therefore, the information contained in the financial statements will affect the decision-making process.

The following are the users of accounting information:

Owners:

- They have invested in the business ; Examples : sole traders (individual), partners (partnerships) and shareholders (company).

  This information will enable them to assess how the managers of the business are performing whether the business *is profitable* or not and whether to make drawings or put in additional capital.

  Need information in order to assess the quality and the price of shares of a company

Customers

- Customers rely on the business for goods and services. They would like to know how the business is *performing* and its *financial position*.
- This information would enable them to assess whether they can rely on the firm for future supplies.

Suppliers

- They supply goods or services to the firm for cash or credit. The suppliers would like to have information on the financial performance and position to assess whether the business would be able *to pay up for the goods and services provided.*

Managers

- The managers are involved in the day-to-day activities of the business. They would like to determine whether the business is *operating as per the plans.*
- In case the plan is not achieved then the managers come up with *appropriate measures* (controls).

The Lenders

- They have provided loans and other sources of capital to the business. Such lenders include banks and other financial institutions.
- They would like to assess whether the business is profitable enough to *pay the interest on loans* and whether it has enough resources to *pay back the principal amount* when it is due.

The Government and its agencies

- To be able to assess *the tax to be collected* in the case there are any *profits* made by the business.
- The other government agencies are interested : to be able to come with *National Statistics*. This statistics measure the average performance of the economy.

The Financial Analyst and Advisors

- To *interpret the financial information*. Examples include stockbrokers who advise investors on shares to buy in the stock market
- To advise their clients on how much is *the value their investment* i.e. whether it is profitable or not and what is the value.
- Other advisors would include the press who will then *pass the information to other relevant users.*

The Employees

- They work for the business/entity. They would like to have information so as *to make decisions on their terms of employment*.

- This information would be important as they can use it *to negotiate for better terms including salaries, training and other benefits.*

- They can also use it to assess whether the firm is *financially sound* and therefore *their jobs are secure*.

The Public

- Institutions and other welfare associations and groups represent the public. This information will be important for them to assess how *socially responsible* is the firm.

- This responsibility is in form the employment opportunities the firm offers, charitable activities and the effect of firm's activities on the environment.

I.3. FORMS OF BUSINESSES

Sole trader business

- Is owned by *one person*, the sole trader. Sole trader is *not legally separate* from the business.

Partnership

- Is owned by *two* or *more persons, the partners*. Partners are legally *not separate* from the partnership.

Company

- Is a *legally separate* business owned by two or more persons, *the shareholders*.

Other forms of businesses

- **Cooperatives** – members come together to start the business to satisfy their needs(to improve the economic interests of members)
- **Not for profit entity** – they are started to just offer a given service or goods but they do not have the motive of making profit.
- **Parastatal** – is a company wholly owned by the government

I.4.QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION

Understandability:

- information provided in the financial statements must be readily understandable by users.
- users are assumed to have a reasonable knowledge of business and economic activities and accounting.

Relevance:

- Information has the quality of being relevant when it influences the economic decisions of users by helping them *evaluate past*, *present* or *future events* or *confirming* or *correcting their past evaluations*.
- (e.g. should I invest, should I lend money to this business? Should I work for this business?)

Reliability:

To be reliable then the information should:

- Be represented faithfully (truly, really),
- Be accounted for and presented in accordance with their substance and economic reality and not only their legal form,
- Be neutral i.e. free from bias(without favoritism, impartial, fairness)
- Prudence i.e. where alternative procedures or alternative valuations are possible, the one selected should be the one that gives the most helpful presentation of the business's financial position or results.

  example: Assets and profits should not be overstated/understated

- Be complete i.e. omission can cause information to be false.

Comparability:

- **Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance.**

- **Compliance with accounting standards also helps achieve this comparability.**

CHAPTER TWO: ACCOUNTING CONCEPTS

- Accounting is the language of business, and it is used to communicate financial information.

- For that information to make sense, accounting is based on fundamental concepts. These fundamental concepts then form the basis for all the Generally Accepted Accounting Principles (GAAP).

- By using these concepts as the foundation, readers of financial statements and other accounting information do not need to make assumptions about what the numbers mean.
- Those concepts include:

1. The going concern concept:

- Implies that the business will continue in operational existence for the projected future, and there is no intention to put the company into liquidation.
- Financial statements should be prepared under the going concern basis unless the entity is being (or is going to be) liquidated or if it has ceased (or is about to cease) trading.
- A business firm will continue to carry on its activities for an indefinite period of time. it means that every business entity has continuity of life.
- This concept facilitates preparation of financial statements.

2. The Business entity concept:

- The concept is that accountants regard a business as a separate entity, distinct from its owners or managers. The concept applies whether the business is a limited company (and so recognized in law as a separate entity) or a sole proprietorship or partnership (in which case the business is not separately recognized by the law.
- Example. Suppose Mr. John started business investing Rwf 100,000. He purchased goods for Rwf 40,000, Furniture for Rwf20,000 and plant and machinery of Rwf30,000. Rwf10,000 remains in hand. These are the assets of the business and not of the owner.

2. The Business entity concept(cont.)

According to the business entity concept Rwf100,000 will be treated by business as capital i.e. a liability of business towards the owner of the business.

- Now suppose, he takes away cash or goods worth Rwf5,000 for his domestic purposes.
- This withdrawal of cash/goods by the owner from the business is his private expense and not an expense of the business. It is called Drawings.
- Thus, the business entity concept states that business and the owner are two separate/distinct persons.

3. The money measurement concept:

- The money measurement concept states that accounts will only deal with those items to which a monetary value can be attributed.
- For example, in the balance sheet of a business, monetary values can be attributed to such assets as machinery (e.g. the original cost of the machinery; or the amount it would cost to replace the machinery) and stocks of goods (e.g. the original cost of goods, or, theoretically, the price at which the goods are likely to be sold).
- As per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts.

- For example, sale of goods worth Rwf200,000, purchase of raw materials Rwf100,000, Rent Paid Rwf10,000 etc. are expressed in terms of money, and they are recorded in the books of accounts.

- But the transactions which cannot be expressed in monetary terms are not recorded in the books of accounts.

- For example, *sincerity, loyalty, honesty* of employees are not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern.

4. Accounting period concept

- All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be determined for a specified period. This is known as accounting period concept.
- Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals.
- This is necessary for different purposes like, calculation of profit, determining Financial position, tax computation etc.

4. Accounting period concept(cont)

Further, this concept assumes that indefinite life of business is divided into parts. These parts are known as Accounting Period. It may be of one year, six months, three months, one month, etc.

But usually, one year is taken as one accounting period which may be a calendar year or a financial year.

5. The historical cost convention:

- A basic principle of accounting is that resources are normally stated in accounts at historical cost, i.e. at the amount that the business paid to acquire them.
- An important advantage of this procedure is that the objectivity of accounts is maximized: there is usually objective, documentary evidence to prove the amount paid to purchase an asset or pay an expense.
- Historical cost means transactions are recorded at the cost when they occurred.
- In general, accountants prefer to deal with costs, rather than with ‘values’. This is because valuations tend to be subjective and to vary according to what the valuation is for.

5. The historical cost convention(cont):

- For example, a machine was purchased by XYZ Limited for Rwf500,000, for manufacturing shoes. An amount of Rwf60,000 were spent on transporting the machine to the factory site. In addition, Rwf72,000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e. Rwf632,000.
- Suppose the market price of the same is now Rwf 290,000 it will not be shown at this value. Further, it may be clarified that cost means original or acquisition cost only for new assets and for the used ones, cost means original cost less depreciation.

6. Duality aspect concept:

- Every transaction has two-fold effect in the accounts and is the basis of double entry bookkeeping.

  This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. the transaction should be recorded at two places.

  For example :

  - Goods purchased for cash has two aspects :
    (i) Giving of cash
    (ii) Receiving of goods
  - Capital brought in by the owner of the business
    (i) Receipt of cash
    (ii) Increase in Capital (owners' equity)

- Purchase of machinery by cheque

  (i) Reduction in Bank Balance

  (ii) Owning of Machinery

- Goods sold for cash

  (i) Receipt of cash

  (ii) Delivery of goods to the customer

- Rent paid in cash to the landlord

  (i) Payment of cash

  (ii) Rent (Expenses incurred).

7.The realization concept:

- Realization: Revenue and profits are recognized when realized.
- The concept states that revenues and profits are not anticipated but are recognized by inclusion in the income statement only when realized in the form of either cash or of other assets.

Example :

- N.P. Gold received an order to supply gold ornaments worth Rwf500,000. They supplied ornaments worth Rwf200,000 up to the year ending 31st December 2015 and rest of the ornaments were supplied in January 2016.
- The revenue for the year 2015 for N.P. Gold is Rwf200,000. Getting an order is not considered as revenue until the goods have been delivered.

example

- Motors PLtd is a car dealer. It receives orders from customers in advance against 20% down payment. Motors PLtd delivers the cars to the respective customers within 30 days upon which it receives the remaining 80% of the price.
- In accordance with the revenue realization principle, Motors PLtd must not recognize any revenue until the cars are delivered to the respective customers as that is the point when the risks and rewards incidental to the ownership of the cars are transferred to the buyers.

8. The accruals concept (or matching concept):

- States that revenue and costs must be recognized as they are earned or incurred, not as money is received or paid.

- The accrual concept under accounting assumes that revenue is realized at the time of sale of goods or services irrespective of the fact when the cash is received.

- Example: a firm sells goods for Rwf 55,000 on 25th March 2015 and the payment is not received until 10th April 2015, the amount is due and payable to the firm on the date of sale i.e. 25th March 2015.

8.The accruals concept(cont)

- It must be included in the revenue for the year ending 31st March 2015. Similarly, expenses are recognized at the time services provided, irrespective of the fact when actual payment for these services are made.
- **Example:** the firm received goods costing Rwf20,000 on 29th March 2015 but the payment is made on 2nd April 2015
- The accrual concept requires that expenses must be recorded for the year ending 31st March 2015 although no payment has been made until 31st March 2015.

9. The Prudence Concept:

- The prudence concept states that where alternative procedures or alternative valuations are possible, the one selected should be the one that gives the most helpful presentation of the business’s financial position or results.

- Assets and profits should not be overstated, but a balance must be achieved to prevent the material overstatement of liabilities or losses.

9.The Prudence Concept(cont):

Example :

- A company begins trading on 1 January 2015 and sells goods worth Rwf100,000 during the year to 31 December 2015.
- At 31 December there are outstanding debt of Rwf15,000. Out of which, the company is doubtful whether Rwf6,000 will ever be paid.
- The company should make a provision for doubtful debts of Rwf6,000. Sales for 2015 will be shown in the profit and loss account at their full value of Rwf100,000,
- but the provision for doubtful debts would be a charge of Rwf6,000 which should not be included in the profit for the year.

10. The consistency concept:

- The consistency concept states that in preparing accounts consistency should be observed in two respects.
- a) Similar items within a single set of accounts should be given similar accounting treatment.
- b) The same treatment should be applied from one period to another in accounting for similar items. This enables valid comparisons to be made from one period to the next.
- Example:
  - Method of depreciation(see later)
  - Stock valuation (see later)

11. The separate valuation principle:

- The separate valuation principle states that, in determining the amount to be attributed to an asset or liability in the balance sheet, each component item of the asset or liability must be determined separately.
- These separate valuations must then be aggregated to arrive at the balance sheet figure.
- For example, if a company's stock comprises 50 separate items, a valuation must (in theory) be arrived at for each item separately;
- the 50 figures must then be aggregated and the total is the stock figure which should appear in the balance sheet.

12. The materiality concept:

- An item is considered material if it’s omission or misstatement will affect the decision making process of the users.
- Materiality depends on the nature and size of the item. Only items material in amount or in their nature will affect the true and fair view given by a set of accounts.
- In preparing accounts it is important to assess what is material and what is not, so that time and money are not wasted in the pursuit of excessive detail

12. The materiality concept(cont)

Example :

- If a business has a bank loan of Rwf50,000 balance and a Rwf55,000 balance on bank deposit account, it might well be regarded as a material misstatement if these two amounts were displayed on the balance sheet as ‘cash at bank FRw5,000’.
- Small payments such as postage, stationery and cleaning expenses should not be disclosed separately. They should be grouped together as sundry expenses
- In other words, incorrect presentation may amount to material misstatement even if there is no monetary error.

13. Objectivity (neutrality):

- Objectivity means that accountants must be free from bias. They must adopt a neutral attitude when analyzing accounting data. In practice objectivity is difficult..

- The result of this should be that any number of accountants will give the same answer independently of each other.
  - The accounting information should be free from bias and capable of independent verification
  - The information should be based upon verifiable evidence such as invoices or contracts

14. Substance over form:

- **The principle states that transactions and other events are accounted for and presented in accordance with their substance and economic reality and not simply their legal form.**

Example :

- **A non current asset on Hire purchase although is not legally owned by the enterprise until it is fully paid for, it is reflected in the accounts as an asset and depreciation provided for in the normal accounting way.**

CHAP.THREE: DOUBLE ENTRY CONCEPTS

3.1. THE ACCOUNTING EQUATION

- A business owns properties. These properties are called assets. The assets are the business resources that enable it to trade and carry out trading.

  They are financed or funded by the owners of the business who put in funds. These funds, including assets that the owner may put is called capital.

Other persons who are not owners of the firm may also finance assets. Funds from these sources are called **liabilities**.

- The total assets must be equal to the total funding i.e. both from owners and non-owners. This is expressed in form of accounting equation which is stated as follows

ASSETS = LIABILITIES + EQUITY

Example

- Justine decides to open a retail shop selling greetings cards and gifts. Her uncle lends her Rwf300,000 to help her with financing the venture.
- Justine buys shop premises costing Rwf500,000, a motor vehicle for Rwf100,000 and stock of goods for 50,000. Justine did not pay for her stock of goods in full and still owes 21,000 to her supplier in respect of them.
- After the events described above and before she starts trading, Justine has Rwf 1,000 cash in hand and 70,000 cash at bank. You are required to calculate the amount of capital that Justine invested in her business.

a. Assets

- Asset is a resource controlled by a business entity/firm as a result of past events for which economic benefits are expected to flow to the firm.

  Assets consist of property of all kinds, such as buildings, machinery, equipments, stocks of goods and motor vehicles.

  Other assets include debts owed by customers and the amount of money in bank account.

Assets are classified into two main types:

i) Non current assets (formerly called fixed assets).

ii) Current assets.

Assets (cont)

- **Non current assets** are acquired by the business to assist in earning revenues and not for resale. They are normally expected to be in business for a period of more than one year. Major examples include:
  - ❑ Land and buildings
  - ❑ Plant and machinery
  - ❑ Fixtures, furniture, fittings and equipment
  - ❑ Motor vehicles

- Current assets are not expected to last for more than one year. They are in most cases directly related to the trading activities of the firm. Examples include:
  - Stock of goods – for purpose of selling.
  - Trade debtors/accounts receivables – owe the business amounts
  - Other debtors – owe the firm amounts other than for trading.
  - Cash at bank.
  - Cash in hand.

b. Liabilities:

- These are obligations of a business as a result of past events settlement of which is expected to result to an economic outflow of amounts from the firm.
- An example is when a business buys goods on credit, then the firm has a liability called creditor.
- The past event is the credit purchase and the liability being the creditor the firm will pay cash to the creditor and therefore there is an out flow of cash from the business. Liabilities are also classified in
- i) Non-current liabilities (or long term liabilities)
- ii) Current liabilities.

Liabilities

- **Non-current liabilities** are expected to last or be paid after one year. This includes long-term loans from banks or other financial institutions.
- **Current liabilities** last for a period of less than one year and therefore will be paid within one year. Major examples:

  Trade creditors/or accounts payable – owed amounts as a result of business buying goods on credit.

  Other creditors - owed amounts for services supplied to the firm other than goods.

  Bank overdraft - amounts advanced by the bank for a short-term

c. Equity:

- This is the residual amount on the owner's interest in the firm after deducting liabilities from the assets.

- Items like introduced capital, profit/loss and drawings appear under equity.

- The Accounting equation can be expressed in a simple report called the Balance Sheet. **The basic format** is as follows(vertical format):

ASSETS		
Non Current Assets	Rwf	Rwf
Land & Buildings	xx	
Plant & Machinery	xx	
Fixtures, furniture & fittings	xx	
Motors vehicles	xx	
Total non-current assets		**Xx**
Current Assets		
Stocks/inventories	xx	
Debtors/ trade receivables	xx	
Cash at bank	xx	
Cash in hand	xx	
Total current assets		**xx**
Total assets		**XX**
EQUITY AND LIABILITIES		
Capital		
Opening balance	xx	
Profit/(Loss)	xx/(xx)	
Drawings	(xx)	
Closing balance		**xx**
Non Current Liabilities		
Long term loan	xx	
Current Liabilities	xx	
Creditors/trade payables	xx	
Bank Overdraft	xx	
Total current liabilities		**xx**
Total liabilities		**xx**
Total equity and liabilities		**XX**

Balance sheet using vertical format

- The Non Current assets are listed in order of permanence as shown i.e. from Land and Buildings to motor vehicles.
- The Current Assets are listed in order of liquidity i.e. which asset is far from being converted into cash.
- Example: stock is not yet sold, (i.e. not yet realized yet) then when it is sold we either get cash or a debtor (if sold on credit). When the debtor pays then the debtor may pay by cheque or cash.

- The Current Liabilities are listed in order of payment i.e. which is due for payment first. Bank overdraft is payable on demand by the bank, then followed by creditors.

- Note that in the vertical format, current liabilities are deducted from current assets to give

  net current assets.

- This is added to Non Current assets, which give us net assets.

- Net assets should be the same as the total of Capital and Non Current Liabilities.

Example 2

Draw up John's balance sheet using the vertical presentation method, from the following information as at 31 December 2017.

items	Rwf
Capital	3,482,300
Delivery van	1,200,000
Debtors	1,089,200
Office furniture	864,000
Stock of goods	422,000
Cash at bank	1,172,200
Creditors	1,265,100

Example 3

Draw up Tom's balance sheet as at 31 March 2017 from the following information

items	Rwf
Premises(property)	5,000,000
Plant and machinery	2,650,000
Debtors	2,879,000
Creditors	3,232,000
Bank overdraft	362,500
Stock	2,100,000
Cash in hand	3,500
Capital	9,038,000

Exercise: QUESTION 11(handout of questions) :

Jump has the following assets and liabilities as on 30/11/2017:

- Creditors FRw39,500; Equipment FRw115,000; Motor vehicle FRw62,900; Stock FRw61,500; Debtors FRw57,700;Cash at bank FRw72,800 and Cash in hand FRw400.

Compute the balance on the capital account as at 30/11/2017.

During the first week of December 2017, Jump:

Bought extra equipment on credit for FRw13,800.

Bought extra stock by cheque FRw5,700.

Paid creditors by cheque FRw7,900.

Received from debtors FRw8,400 by cheque and FRw600 by cash.

Put in an extra FRw2,500 cash as capital.

You are to draw up a balance sheet as on 7 December 2017 after the above transactions have been completed.

3.2. DOUBLE ENTRY ASPECTS

- The Accounting equation forms the basis of double entry and therefore it should always be maintained.
- Any change in assets, liabilities or capital will have a double effect such that assets will always be equal to liabilities plus capital.
- If the owners put in additional capital then this will increase the cash at bank and the capital amount therefore the equation is still maintained.
-

The T account

- For the double entry to be reflected in the accounts, every debit entry must have a corresponding credit entry.
- The transactions affecting these accounts are posted in the account as debit entry and credit entry to complete the double entry.

Debit/Dr				**Account Name**				**Credit/Cr**
Date	Detail	Folio	Amount		Date	Detail	Folio	Amount

- **The T account**
- In this account the date will show the opening period of the asset, liability or capital i.e. the balance brought forward(b/f) or brought down(b/d).
- It will also show the date when a transaction took place (i.e. either an asset was bought or liability incurred). The balance carried forward (c/f) or carried down(c/d).
- The detail column (also called the particulars column) shows the nature of the transaction and reference to the corresponding account.

The T account(cont)

- The Folio Column for purposes of detailed recording shows the reference number of the corresponding account. The amount column shows the amount of the asset, liability or capital.
- The left side of the account is called the **debit** side and the right side is called the **credit side**.
- All assets are shown or recorded on the debit side while all the liabilities and capital are recorded on the credit side.

The T account(cont)

- Each type of asset or liability must have its own account whereby all transactions affecting them are recorded in this account.
- Therefore there should be an account for Premises, Plant and Machinery, Stock, Debtors, Creditors, etc…
- Under the accounting equation if all assets are represented by liabilities and capital therefore all debits should be the same as credits.

When we make a debit entry we are either:

- Increasing the value of an asset.
- Reducing the value of a liability.
- Reducing the value of capital.

CAPITAL ACCOUNT	
Decreases -	Increases +

ASSET ACCOUNT	
Increases +	Decreases -

LIABILITY ACCOUNT	
Decreases -	Increases +

When we make a credit entry we are either:

- Reducing the value of an asset.
- Increasing the value of a liability.
- Increasing the value of capital.

Examples

Ex1. Paid cash Rwf 200,000 to buy machinery

EFFECT	ACTION
Machinery comes IN	A debit entry in the Machinery A/c
Cash goes OUT	A Credit entry in the cash A/c

- **Ex2. Took Rwf50,000 out of the cash in hand of the business and paid it into the bank account of the business**

EFFECT	ACTION
Money comes IN to the bank	A debit entry in the Bank A/c
Cash goes OUT	A Credit entry in the cash A/c

Ex3. The proprietor starts the business with Rwf 300,000 in cash on 1/8/2010

EFFECT	ACTION
Increases the assets of cash	**Debit the cash A/c – cash goes IN**
Increases the capital	**Credit the capital A/c- cash comes OUT of the owner's money**

Dr	CASH ACCOUNT	Cr
1/8/2010 capital 300,000		

Dr	CAPITAL ACCOUNT	Cr
		1/8/2010 cash 300,000

Exercise: Write up the various accounts needed to record the following transactions for May 2018

- May 1, Started a business putting Rwf1,000,000 in Bank a/c
- May 3, Bought machinery on credit from Unique Machines Rwf 275,000
- May 4, Withdrew Rwf 20,000 cash from the bank and placed it in Cash book
- May 7, Bought a secondhand motor van paying by cheque Rwf180,000
- May 15, Sold some of the machinery for 155,000 on credit to Barnes
- May 24, May 28, Barnes pays for the business Rwf 105,500 by cheque
- May 30, Bought another motor van for Rwf420,000 on credit to Bob
- May 31, Paid Rwf275,000 to Unique Machines by cheque

- **Exercise2 : Write up the various accounts needed to record the following transactions for October 2018**
- 1 Oct Started in business with capital of FRw70,500 in the bank
- 4 Oct Bought a machine for FRw40,000, paying by cheque
- 6 Oct Bought office equipment for FRw20,250, paying by cheque
- 11 Oct Paid rent FRw4,000, by cheque
- 12 Oct Obtained a loan of FRw30,500 from a friend, Grace, and put the money into the bank
- 15 Oct Paid wages FRw5,000, by cheque
- 18 Oct Commission received FRw12,000, by cheque
- 20 Oct Drawings FRw2,500, by cheque
- 25 Oct Paid wages FRw4,500, by cheque

EXTENDED ACCOUNTING EQUATION

- To know the financial performance and position to be determined, the opening and closing capital information is obtained and compared.
- Any other information like drawings and additional capital is also obtained.
- The extended accounting equation is then used to determine the profit or loss for the period.
- The accounting equation in extended format is as follows

Opening capital + additional capital + Profit(loss) – Drawings = Closing capital

- Example 1
- From the extended accounting equation, what is the profit or loss from the following given information for each of the business of Abas, Bob, Come and Dan.

	Abas	Bob	Come	Dan
	Rwf	**Rwf**	**Rwf**	**Rwf**
Capital (at the beginning of the year)	186,000	235,500	0	567,000
Capital (at the end of the year)	274,000	201,400	254,000	423,000
During the year :				
Cash taken by the owner	68,000	16,000	45,000	170,000
Additional capital	50,000	125,000	200,000	0
Goods taken by the owner	20,000	0	10,000	25,000

- **Example 2**
- The following information is provided for Jane traders.

(i) Capital at 1 October 2008, FRw230,000.

(ii) Total assets at 30 September 2009, FRw1,010,000.

(iii) Total liabilities at 30 September 2009, FRw530,000.

(iv) Inventory taken by Jane, the proprietor, for her personal use on 1 April 2009, FRw50,200.

(v) Cash drawings by Jane during the year to 30 Sept. 2009, FRw3,500 per week(52 weeks the whole year).

(vi) Legacy received by Jane on the death of a relative and paid into the business bank account on 1 sept. Rwf 70,300.

- **Required: Calculate the profit of Jane Traders for the year to 30 September 2009.**

Example 3: Compute the Profit(loss) for Brian traders

During the year Brian had taken money from the business for his own private use to the value of FRw70,000 per month.

During the financial year Brian had a small win on the football game amounting to Rwf200,000, which he paid into the business.

	1.1.2010	31.12.2010
Inventory	108,000	122,000
Accounts payables for goods	130,900	141,000
Accounts receivables for goods	212,000	198,000
Bank	144,200	156,400
Fixtures at valuation	180,000	160,000

B. ACCOUNTING FOR SALES, PURCHASES, INCOMES AND EXPENSES.

Sales:

- This is the sell of goods that were bought by a firm (bought for resale). Sales are divided into cash sales and credit sales.

For a cash sale, the entries to be made are.

- Debit cash either at bank or in hand.
- Credit sales account.

For a credit sale:

- Debit debtors/ Accounts receivable account.
- Credit sales account.

Purchases:

- Buying of goods meant for resale. Purchases can also be for cash or on credit.

- For cash purchases:
- Debit purchases.
- Credit cash at bank/cash in hand

- For credit purchases
- Debit purchases.
- Credit creditors for goods.

Note: No entry is made into the stocks account.

Incomes:

A firm may have other incomes apart from that generated from trading (sales). Such incomes include:

- Rent
- Bank interest
- Discounts received.

When the firm receives cash, from these incomes, the following entries are made:

- Debit cash in hand/at bank.
- Credit income account.

- Incomes increase the value of capital and that is the reason why they are posted on the credit side of their respective accounts.

Expenses:

These are amounts paid out for services rendered other than those paid for purchases. Examples include:

- **Postage and stationery**
- **Salary and wages**
- **Telephone bills**
- **Motor vehicle running expenses.**
- **Bank charges.**

When a firm pays for an expense, we:

- **Debit the expense account.**
- **Credit cash at bank/in hand.**

- **Expenses** decrease the value of capital **and thus the posting is made on the debit side of their accounts.**

C. RETURNS INWARDS AND RETURNS OUTWARDS

RETURNS INWARDS

These are goods that have been returned by customers due to various reasons e.g.

- They may be defective/damaged,
- Being of the wrong type.
- Excess goods being delivered.

For Goods returned that relate to cash sales :

- Debit returns – inwards
- Credit cashbook.

For goods returned that relate to credit sales :

- Debit returns inwards.
- Credit debtors.

RETURNS OUTWARDS

These are goods returned to suppliers/creditors. They may be for cash purchases or for credit purchases.

For cash purchases , a cash refund is given to the firm by the supplier :

- Debit the cashbook (cash at bank/hand).
- Credit returns outwards.

For credit purchases and no refund has been made:

- Debit creditors.
- Credit returns outwards.

D. ACCOUNTING FOR DRAWINGS, DISCOUNTS ALLOWED AND DISCOUNTS RECEIVED.

Cash or bank drawings :

When the owner withdraws money from the business we debit drawings and credit cashbook (cash in hand or cash at bank).

Taking goods for own use :

- **We debit drawings and credit purchases**
- *Personal expenses, paid by the business :*
- **We debit drawings and credit expense account**
- *Taking some of the other assets from the business :*
- ***We* debit drawings and credit the relevant asset , e.g. motor vehicles**

Discounts received.

- A discount received is an allowance by the creditors to the firm to encourage the firm to pay the amount due within the agreed time. It is an amount deducted from the invoice price.
- When a discount is given by the supplier then we debit creditor's account and credit discounts received
- E.g. A. Ltd sells some goods on credit to B Ltd. £1,000 under the terms of sale, B Ltd, will receive a discount of 5% if they pay the amount due within one month.
- B decides to take up the offer and pays the amount within the given time. B will record the transaction as follows.
- Debit: Creditor – A Ltd
- Credit: Discounts Received

Discounts Allowed

- These are the allowances made by a firm on the amounts receivable from the customers to encourage prompt payment.
- The amounts deducted from the sales invoice. In the previous example when A Ltd issued the discount and was taken up by B the entries will be:
-
    - Debit - Discount allowed
    - Credit - Debtors - B Ltd.

E. TRIAL BALANCE

- The trial balance is a simple report that shows the list of account balances classified as per the debits and credits.

- The purpose of the trial balance is to show the *accuracy of the double entries* made and to *facilitate the preparation of Final accounts* i.e. the trading, profit & loss account and a balance sheet.
- The debits of the trial balance should be the same as the credits; if not then there is an error in one or more of the accounts.

TRIAL BALANCE(cont)

- From the trial balance please note that assets and expenses are on the debit side.
- Capital, liabilities and incomes are normally listed on the credit side.
- The next example is a detailed one that shows extracting of trial balance once all the postings have been made in the relevant accounts.

	DEBIT	CREDIT
ASSETS	XXX	
CAPITAL		XXX
LIABILITIES		XXX
INCOME		XXX
EXPENSES	XXX	
DRAWINGS	XXX	

Ex: Trial balance of ….. as at 31 march 2009

Designation	Debit **Rwf**	Credit **Rwf**
Rent – income		5,000
Debtor – U Foot	7,000	
Motor vehicle	300,000	
Bank	1,555,000	
Purchases	289,000	
Wages	187,000	
Capital		2,000,000
Creditor– M Rooks		152,000
Furniture & Fittings	150,000	
Sales		352,000
Cash in hand	72,000	
Creditor – P Scot		114,000
Expenses – Rent	15,000	
Expenses – Stationery	27,000	
Returns Outwards		23,000
Drawings	44,000	
TOTAL	**2,646,000**	**2,646,000**

QUESTION 1: RECONSTRUCT THE TRIAL BALANCE AFTER MAKING NECESSARY CORRECTIONS

Capital	199,560	
Sales		1,194,390
Stationery	12,000	
General expenses	27,450	
Motor expenses		44,760
Cash at bank	19,500	
Stock 1 July 2008	76,680	
Wages and salaries		94,920
Rent and rates(charges)	105,000	
Office equipment	60,000	
Purchases	817,530	
heating and lighting		22,080
Rent received	21,390	
Debtors	103,530	
Drawings		42,000
Creditors		102,300
Motor vehicle	75,000	
Interested received	17,250	
Insurance		34,440
Total	1,534,890	1,534,890

- **Exercise : Q19** **Record the following for the month of January, balance off all the accounts, and then extract a trial balance as at 31 January 2009:**
- 1 Started business with FRw305,000 cash
- 2 Put FRw208,000 of the cash into a bank account
- 3 Bought goods for cash FRw15,000
- 4 Bought goods on credit from: Clothier FRw36,000; Burton FRw49,000; Hill FRw11,000; Small FRw34,000
- 5 Bought stationery on credit from Swift Ltd FRw17,000
- 6 Sold goods on credit to: Willis FRw90,000; Beeley FRw 150,000; Howard FRw190,000; Pearson FRw160,000
- 8 Paid rent by cheque FRw5,500
- 10 Bought fixtures on credit from Mallik Ltd FRw48,000
- 11 Paid salaries in cash FRw12,000
- 14 Returned goods to: Burton FRw4,000; Hill FRw6,000
- 15 Bought motor cycle by cheque FRw70,000
- 16 Received loan from Hawks by cheque FRw60,000
- 18 Goods returned to us by: Willis FRw2,000; Howard FRw4,000
- 21 Cash sales FRw9,000
- 24 Sold goods on credit to: Beeley FRw10,000; Pearson FRw34,000; Smart FRw11,500
- 26 We paid the following by cheque: Burton FRw45,000; Hill FRw5,000
- 29 Received cheques from: Smart FRw11,500; Beeley FRw25,000
- 30 Received a further loan from Hawks by cash FRw20,000
- 30 Received FRw50,000 cash from Pearson.

- **The following are the business transactions of Weston Traders for the month of May 2017:**
- 1 May Started in business with capital of FRw75,000 in the bank
- 3 May Bought goods, FRw10,000, paying by cheque
- 4 May Sold goods, FRw7,500, a cheque being received
- 6 May Bought shop fittings for FRw20,000, paying by cheque
- 7 May Bought goods, FRw12,500, on credit from Bristol Supplies Limited
- 10 May Paid rent, FRw7,500, by cheque
- 12 May Sold goods, FRw15,000, on credit to Gordano Giftware
- 14 May Returned goods, FRw1,500, to Bristol Supplies Limited
- 16 May Paid wages, FRw15,000, by cheque
- 18 May Paid the amount owing to Bristol Supplies Limited by cheque
- 21 May Gordano Giftware returned goods, FRw2,500
- 24 May Paid rent, FRw7,500, by cheque
- 26 May Sold goods, FRw5,500, a cheque being received
- 28 May Received a cheque from Gordano Giftware for the amount owing
- You are to record the transactions in the books of account balance the accounts and extract a trial balance.

F. SOURCE DOCUMENTS AND BOOKS OF ORIGINAL ENTRY

- From the source documents that record the evidence of transactions,
- Whereby the documents are recorded in books of prime entry and the postings to are be made in ledgers.

SOURCE DOCUMENTS

Source documents show the evidence of transactions. They are collected, filed and recorded in the books of prime entry.

Example, if a firm sells goods on credit, then an invoice is raised. The source documents include:

- Sales invoice
- Purchases invoice
- Credit note
- Debit note
- Receipts, cheques and petty cash vouchers
- Other correspondences.

- **(i) Sales Invoice**

- The sales invoice is raised by the firm and sent to the debtor/customer when the firm makes a credit sale.

- The sales invoice contains the following:
  - Name and address of the firm
  - Name and address of the buying firm
  - Date of making the sale – invoice date.
  - Invoice number
  - Amount due (net of trade discount)
  - Description of goods sold
  - Terms of sale

- **(ii) Purchases Invoice**

- A purchase invoice is raised by the creditor and sent to the firm when the firm makes a credit purchase. It shows the following:
  - Name and the address of the creditor/seller
  - Name and address of the firm
  - Date of the purchase (invoice date)
  - Invoice number
  - Amount due
  - Description of goods sold
  - Terms of sale

- **(iii) Credit note**
- A credit note is raised by the firm and issued to the debtor when the debtor returns some goods back to the firm. It's contents include:
  - Name and address of the firm
  - Name and address of the debtor
  - Amount of credit
  - Credit note number
  - Reason for credit e.g. if goods sent but of the wrong type.
- The purpose of the credit note is to inform the debtor or customer that the debtor's account with the firm has been credited i.e. the amount due to the firm has been reduced or cancelled.
- The credit note may also be issued when the firm gives an allowance of the amounts due from the debtors.
- From the context we can assume that all credit notes are issued when goods are returned.

(iv) Debit note

- This is raised by the creditor and issued to the firm when the firm returns some goods to the creditor. It includes the following items:
  - Name and address of the firm
  - Name and address of the creditor
  - Amount of debit
  - Debit Note number
  - Reason for the debit
- The purpose of the debit note is to inform the firm that the amount due to the creditor has been reduced or cancelled.
  - Credit sales (sales invoice)
  - Returns inwards (credit note)
  - Credit purchase (purchase invoice)
  - Returns outwards (debit note)

(v) Receipts

- A receipt is raised by the firm and issued to customers or debtors when they make payments in the form of cash or cheques. It shows:
  - The name and address of the firm
  - The date of the receipt
  - Amount received (cash or cheque or other means of payment)
  - Receipt number.

Cheques

- When a firm opens a current account with the bank, a cheque book containing cheques is issued.
- The cheques allow the firm to make payments against the account with the bank.
- When a firm issues a cheque to its creditors for payments, it authorizes the bank to honor payments against the firm's account with the bank.
- The cheque contains the following information:
  - Name and account number of the firm (account holder)
  - The date of the cheque
  - Name of the payee (creditor)
  - Name of the firm's bank
  - Amount payable in words and figures
  - The cheque number
  - The authorized signature(s)

Petty cash vouchers

- A petty cash voucher is raised by a cashier to seek(request) authority for payments (payments of small value in the firm ;

which require cash payments e.g. fuel, bus-fare, office snacks),

which is approved by a senior manager and filed for recording purpose. It shows:

  - Date of payment
  - Amount paid
  - Reason for payment
  - Authorized signature(s):
  - Person approving
  - Person receiving

- The person receiving the money must then return a document supporting how the money was utilized e.g. fuel receipt, bus ticket e.t.c.

- **(vii) Other correspondence**
- These include information received within or outside the firm that has a financial implication in the accounts.

- Examples are:
  - Letters from the firm’s lawyers about debtors balance.
  - Hire - purchase/credit sale or credit purchase agreements that relate to non-current assets.
  - Memorandum from a senior manager requiring changes to be made in the accounts.
  - Bank statement from the bank, e.g. bank charges.

Books of Original Entry

- They record the source documents.

Sales Journal

- It is also called a Sales Day Book. It records all the sales invoices issued by the firm during a particular financial period.
- It shows
  - Date of sale
  - Name of customer to whom the goods have been sold
  - Folio
  - Final amount of invoice
- The format is as follows (with simple records of invoice).

SALES DAY BOOK			
Date	**Detail**	**Folio**	**Amount Rwf**
1st March 3rd March 5th March	S. Spikes T. Binns L.Thompson	SL.10 SL.19 SL,8	200.00 350.00 150.00
Total			700.00

The individual entries in the sales journal are posted to the debit side of the debtor's accounts in the sales ledger and the total is posted on the credit side of the sales account in the general ledger. This is shown below

Dr		S Spikes	Cr
1/3	Sales	200	

Dr		T Binus	Cr
3/3	Sales	350	

Dr		L Thompson	Cr
3/3	Sales	150	

Sales account		
	5/3 Credit sales for period	700

Purchases Journal

- Purchases journal is also called a purchases day-book.

- It records all the purchases invoices received by the firm during a particular financial period.
- It has the following format (including records of invoices).

PURCHASES JOURNAL

Date	Detail	Folio	Amount Rwf
1st May 2nd May	C. Kelly L. Smailes	PL.10 PL.20	400.00 350.00
Total			750.00

The individual entries in the purchases journal are posted to the credit side of the creditor's accounts in the purchases ledger and the total is posted on the debit side of the purchases account in the general ledger. This is shown below

- Purchases ledgers

Dr C. Kelly	Cr
	Purchases 400

Dr L. Smailes	Cr
	Purchases 350

- General ledger

Dr Purchases account	Cr
Sundry(various) 750 creditors	

RETURNS INWARDS

Date	Detail	Folio	Amount Rwf
1st March 3rd March 5th March	S. Spikes T. Binns L.Thompson	SL.22 SL.18 SL. 9	20 18 15
Total			53

The individual entries in the Returns inwards journal are posted to the credit side of the debtor's accounts in the sales ledger and the total is posted on the Debit side of the Returns inwards account in the general ledger. This is shown below

Sales ledger

S Spikes

Dr	Cr
	1/3 Returns In 20

C Kelly

Dr	Cr
	2/3 Returns In 18

T Bills

Dr	Cr
	5/3 Returns In 15

Returns In account

Dr	Cr
Sundry Debtors 53	

RETURNS OUTWARDS

Date	Detail	Folio	Amount Rwf
2 May	L. Thompson	PL. 15	14
3 May	M. Hyatt	PL. 10	12
4 May	T. Bills	PL. 7	19
Total			45

The individual entries in the Returns inwards journal are posted to the debit side of the CREDTORS's accounts in the purchase ledger and the total is posted on the Credit side of the Returns outwards account in the general ledger. This is shown below

Dr L. Thompson Cr

2/5 Returns out 14	

Dr M. Hyatt Cr

3/5 Returns out 12	

Dr T Bills Cr

4/5 Returns Out 19	

Returns Out account

	Sundry creditors 45

- **EXAMPLE**
- F. Bolton is selling the following items, the recommended retail prices as shown: white tape FRw1,000 per roll, green baize at FRw400 per metre, blue cotton at FRw600 per sheet, black silk at FRw2,000 per dress length. He makes the following sales:
- May 2017
- 1 To Grant: 30 rolls white tape, 50 sheets blue cotton, 10 dress length black silk.
- 4 To Grav, 60 rolls white tape, 30 metres green baize. .
- 8 To Huphes.: 10 dress length black silk.
- 20 To Bradshaw, I0 rolls white tape, 60 sheets blue cotton, 30 dress lengths black silk, 11 metres green baize. .
- 31 To Clough: 12 rolls white tape. 14 sheets blue cotton. 9 metres green baize
- You are to (a) Enter them up in the Sales Journal, post to the personal accounts, (b) transfer the total to the Sales Account in the General Ledger.

CASH BOOK

- A cashbook records all the receipts (cash and cheques from customers or debtors or other sources of income) and

- all the payments (to creditors or suppliers and other expenses) for a particular financial period.

- The cashbook will also show us the cash at bank and cash in hand position of the firm.

Two-column cashbook

Receipts				**cash book**			**Payments**	
Date	Detail	Cash (Rwf)	Bank (Rwf)		Date	Detail	Cash (Rwf)	Bank (Rwf)

Additional columns for discounts allowed and discounts received can be included with the cash at bank columns to get a 3 – column cashbook. The format is as follows:

Receipts					cash book				Payments	
Date	Detail	Discount allowed	Cash (Rwf)	Bank (Rwf)		Date	Detail	Discount received	Cash (Rwf)	Bank (Rwf)

Write up a two-column cashbook from the following details, and balance off as at the end of the month:

- May 1 Started business with capital in cash FRw1,000.
- " 2 Paid rent by cash FRw100.
- " 3 F Lake lent us FRw5,000, paid by cheque.
- " 4 We paid B McKenzie by cheque FRw650.
- " 5 Cash sales FRw980.
- " 7 N Miller paid us by cheque FRw620.
- " 9 We paid B Burton in cash FRw220.
- " 11 Cash sales paid direct into the bank FRw530.
- " 15 G Moores paid us in cash FRw650.
- " 16 We took FRw500 out of the cash till and paid it into the bank account.
- " 19 We repaid F Lake FRw1,000 by cheque.
- " 22 Cash sales paid direct into the bank FRw660.
- " 26 Paid motor expenses by cheque FRw120.
- " 30 Withdrew FRw1,000 cash from the bank for business use.
- " 31 Paid wages in cash FRw970.

Two column Cash book

Receipts Payments

	Cash	Bank		Cash	Bank	
Capital	1000		Rent	100		
F. Lake (Loan)		5000	B McKenzie		650	
Sales	980		B Burton	220		
N Miller		620	Bank C	500		
Sales		530	F Lake(loan)		1000	
G Moores	650		Motor Expenses		120	
Cash C		500	Cash C		1000	
Sales		660	Wages	970		
Bank C	1000		Balances c/d	1840	4,540	
	3,630	7,310		2,630	7,310	

The followings transactions are written up in the form of a cash book.

2016	Rwf('000')
Sept. 1 Proprietor puts capital into a bank a/c	10,940
Sept. 2 received cheque from M Boon	115
Sept. 4 cash sales	1,102
Sept. 6 bought stationery and paid by cash	35
Sept. 7 banked of the cash held by business	400
Sept. 15 cash sales paid direct into the bank	40
Sept. 23 paid cheque to S Willis	277
Sept. 29 Withdrew cash from bank	120
Sept. 30 paid wages in cash	518

	Cash	Bank		Cash	Bank
1Capital		10,940	6 stationery	35	
2 M Boon		115	7 banked (c)	400	
4 sales	1,102		23 S Willis		277
7 cash (c)		400	29 cash(c)		120
15 Sales		40	30 wages	518	
29 cash	120(c)		30 Balance	269	11,098
	1,222	11,495		1,222	11,495

Exercise

A Two column is to be written up from the following

- 2010 Rwf('000')
- March . 1 started business with 4,000 in the bank
- March. 2 paid fixtures by cheque 660
- March. 4 cash sales 225: paid rent by cash 140
- March 6 Tom paid us by cheque 188
- March 8 Cash sales paid direct into the bank 308
- March 10 King paid us in cash 300
- March 12 paid wages in cash 275
- March 14 walters lent us 500 paying by cheque
- March 15 withdrew 200 from the bank for business use
- March 20 bought stationery paying by cash 60
- March 22 and 28 Paid French by cheque 166,
- March 28 cash drawings 100
- March 30 Scott paid us by cheque 277
- March 31 cash sales 66

Example on Three column cash book(Q.28)

- Balances b/d 1: Cash FRw211,000 ; bank FRw3984,000

2 We paid each of the following accounts by cheque, in each case we deducted a 5%discount: Adams FRw80,000; Bibby FRw260,000; Clarke FRw440,000

- 4 Potts pays us a cheque for FRw98,000
- 6 Cash Sales paid direct into the bank FRw49,000
- 7 Paid insurance by cash FRw65,000
- 9 Pay us their accounts by cheque, in each case they
- deducted a discount of 2.5%: Smiley FRw160,000; Turner
- FRw640,000; Pimlott FRw520,000
- 12 Paid motor expenses by cash FRw100,000
- 18 Cash Sales FRw98,000
- 21 Paid salaries by cheque FRw120,000
- 23 Paid rent by cash FRw60,000
- 28 A cheque for FRw500,000 being a loan from Godfrey
- 31 Paid for stationery by cheque FRw27,000.

Petty Cash Book and the imprest system of Accounting.

- Petty Cash Book is a record of all the petty cash vouchers raised and kept by the cashier.

- The petty cash vouchers will show summary expenses paid by the cashier and this information is listed and classified in the petty cash book

- The headings of the relevant expenses are for example :
  - Postage and stationery
  - Traveling
  - Cleaning expenses.

The format is as shown:

Petty Cash Book							
Receipts	Date	Detail	Payments Rwf	expenses			The Ledger
				Postage Rwf	Stationery Rwf	Travel Rwf	

The balance c/d of the petty cash book will signify the balance of cash in hand or form part of cash in hand. The totals of the expenses are posted to the debit side of the expense accounts. If a firm operates another cashbook in addition to the petty cash book, then the totals of the expenses will also be posted on the credit side of the cash in hand cashbook.

The Imprest system

- This system of accounting operates on a simple principle that the cashier is refunded the exact amount spent on the expenses during a particular financial period.
- At the beginning of each period, a cash float is agreed upon and the cashier is given this amount to start with.
- Once the cashier makes payments for the period he will get a total of all the payments made against which he will claim a reimbursement of the same amount that will bring back the amount to the cash float at the beginning of the period.
- This is demonstrated as follows:

	FRw
Start with (float)	100,000
Expenses paid	(72,000)
Balance	28,000
Reimbursement	72,000,
Cash float	100,000

Example

- A cashier in a firm starts with FRw20,000 in the month of March (that is the cash float). I n the following week, the following payments are made:

	FRw
1st March – bought stamps for	800
2nd March – paid bus fare for	1,200
2nd March – cleaning materials	2,400
3rd March – bought car oil	1,500
3rd March – cleaning wages	3,000
4th March – bought stamps	2,000
4th March – paid L. Thompson (creditor)	4,000
5th March – car oil for	1,500

- On the 5th of March the cashier requested for a refund of the cash spent and this amount was reimbursed back.

Required:

- Prepare a detailed petty cash book showing the balance c/f to the next period and the relevant expense accounts, as they would appear on the General Ledger.

ANSWER

Petty Cash Book

Receipts	Date	Detail	Payments	expenses			The Ledger
Rwf			Rwf	Postage Rwf	cleaning Rwf	Travel Rwf	
20,000	1/3	Bal b/d					
	1/3	Stamps	800	800			
	2/3	Bus Fare	1200			1200	
	2/3	Cleaning Materials	2400		2400		
	3/3	Car oil	1500			1500	
	3/3	Cleaning wages	3000		3000		
	4/3	Stamp	2000	2000			
	4/3	Thompson	4000				4000
	5/3	Car oil	1500			1500	
16,400	5/3	CASH BOOK	16,400	2800	5400	4200	4000
3,600	5/3	Bal c/d	3,600				
20,000			20,000				
	6/3	Bal b/d					

Exercise : Simon Hunt is a sole trader who keeps his petty cash on the imprest system-the imprest amount being FRw35,000. His petty cash transactions for the month of March 2017 were as follows:

- 1 Petty cash in hand FRw4,730
- 1 Petty cash restored to imprest amount
- 4 Paid wages FRw5,450
- 8 Cost of telegrams FRw2,190
- 10 Bought foolscap paper FRw2,480
- 11 Paid wages FRw5,600
- 15 Cost of postage stamps FRw2,250
- 18 Paid wages FRw5,300
- 23 Paid to Smith, a creditor, FRw2,800
- 25 Paid wages FRw5,700
- 29 Bought envelops FRw1,370.
- Required:
- Draw up the petty cash book for the month of March 2017, giving also the entry, on 1 April 2017,
- Note. columns headings should be for: (a) Wages; (b) Postage and Stationery; (d) Ledger

Exercise 2

You are employed as accountant for Kitchen designs who operate their petty cash using the imprest system. At the beginning of the month there was Rwf 1,852 left in the Petty Cash from the previous month and the cashier has just given the necessary amount to restore the imprest to Rwf15, 000.

The following are details of the petty cash vouchers that have been authorized for payment by the cashier for June 2010, together with a receipt for cash received.

Date	Designation	Amount
1/6	Window cleaner	1,000
3/6	Postage stamps	760
4/6	Petrol	3,760
6/6	Stationery	975
10/6	Sold stamps to Jane	200
14/6	Office cleaner	2,000
16/6	Parcel postage	435
19/6	Magazine for reception	795
23/6	Petrol	1,410
27/6	Refreshments for clients	420
29/6	Officer cleaner	2,000

Required:

- Enter the balance brought forward and the cash received to restore the imprest in the petty cash book on 1 June 2010.
- Enter the above transactions into the petty cash using the following analysis column: postage, cleaning, motor expenses, stationery and sundry expenses.
- Total and balance the petty cash book on 30 June 2010 and bring down the balance on 1 July. Show the amount of cash received from the cashier to restore the imprest to Rwf 15,000.

The General Journal

- It records information from other correspondence (information that is not recorded in the above books of prime entry).
- It explains the type of entries that will be made in the ledger accounts giving a reason for these entries.
- Example : writing off assets from the accounts ; e.g. bad debts
- - drawings for goods or other assets from the business
- - purchase or sale of non current assets on credit

For each transaction the following details are recorded

i. The date
ii. The name of the accounts to be debited and credited and the amount
iii. A description and explanation of the transaction, which is known as the narrative
iv. a reference number for the source document as proof of the transaction

Journal entries

- The type of transactions recorded here are:

  1. The purchase and sale of fixed assets on credit
  2. Writing off bad debts
  3. Opening entries – the entries needed to open a new set of books
  4. Drawings for goods or other assets from the business by the owner, not cash drawings.
  5. The correction of errors
  6. Other items: adjustments to any of the entries in the ledgers

The format is as shown:

Date	Detail	Debit	Credit
	The name of the account to be debited	X	
	The name of the account to be credited		X
	The narrative		

1. Purchase and sale of fixed assets on credit

- **Ex. A machine was bought on credit from Toolmakers Ltd for Rwf 550,000 on 1/7/2010**
- General ledger

Dr		Machinery a/c	Cr
1/7	Toolmakers	550,000	

Purchase ledger

Dr	Toolmakers ltd a/c		Cr
		1/7 Machinery	550,000

- Journal

Date	Detail	Debit	Credit
	Machinery	550,000	
	Toolmakers		550,000
	Purchase of milling machine on credit		

2. Writing off bad debts

- **Ex.** A debt of Rwf78,000 owing to us from Mander is written off as a bad debts on 31 /8/2010
- General ledger

Dr	Bad debts a/c	Cr
31/8	Mander	78,000	

Sales ledger

Dr	Mander a/c	Cr
	31/8 Bad debts	78,000

Journal

Date	Detail	Debit	Credit
2010 Aug.31	Bad debts Mander Debts written off as bad	78,000	78,000

3.Opening entries

Ex. John, after being in business for some years without keeping proper records, now decides to keep a double entry set of books. On 1 July 2009 he establishes that his assets and liabilities are as follows:

Assets : Motor van Rwf 484,000; Fixtures Rwf 70,000 ;
Stock Rwf 39,000; Debtors – Young Rwf 9,500,
Bob Rwf 4,500; Bank Rwf 508,000; cash Rwf 2,000

Liabilities : Creditors – Quinn Rwf 12,900; Walter Rwf 4,100

N.B. - The capital has to be calculated.
- The General ledger shows the assets
- The sales ledgers : all debtors
- The purchase ledger : all creditors

We must start the writing up of the books on 1 July 2009 :

Open assets accounts : each opening asset is shown as a debit bal

Open Liabilities accounts : each opening liability is shown as a credit balance

Open an account for the capital. Show it as a credit balance

Date	Detail	Debit	Credit
1/7/ 09	Motor van	484,000	
	Fixtures	70,000	
	Stock	39,000	
	Debtors – Young	9,500	
	- Bob	4,500	
	Bank	508,000	
	Cash	2,000	
	Creditors - Quinn		12,900
	- Walter		4,100
	Capital		1,100,000
	Assets and liabilities at the date entered to open the books		
		1,117,000	1,117,000

Hope’s financial position at 1 may 2017 is as follows

- Bank – Rwf29,100; Cash – Rwf1,600; Equipment – Rwf 59,000; Premises – Rwf 250,000; Creditors : Simon- Rwf8,900, Thomas – Rwf 6,100; Debtors : Carlos- Rwf 5,400; Loan from Hans – Rwf 40,000

a) you are required to show the opening entries and the necessary accounts in Hope’s ledger to record the above

During May, Hope’s transactions were as follows:

2/5 Bought goods from Thomas Rwf 21,000; 5/5 Paid Simon by cheque, Rwf 5,000; 12/5 Repaid Hans by cheque Rwf 10,000; 24/5 Sold goods to Carlos on credit Rwf 22,200; 31/5 cash sales Rwf 85,600, banked Rwf 80,000; Carlos returned goods Rwf 4,000; paid loan interest to Hans by cheque 2,000

b) You are required to post all transactions in Ledgers and extract a trial balance

C) Prepare income statement and balance sheet as at 31May 2017

- Q32 Show the journal entries necessary to record the following items: April 2017
- 1 Bought fixtures on credit from Harper FRw180,900
- 4 We take FRw50,000 goods out of the business stock without paying for them
- 9 We now return FRw2,800 worth of the goods taken by us on 4 April back into stock. We do not take any money for the return of the goods
- 12 Lucas owes us FRw50,000. He is unable to pay his debt. We agree to take some office equipment from him at the value and so cancel the debt
- 18 Some of the fixtures bought from Harper, FRw6,500 worth, are found to be unsuitable and are returned to him for full allowance
- 24 A debt owing to us by Beamish of FRw6,800 is written off as a bad debt
- 30 Office equipment bought on credit from Secam for FRw219,000.

Exercise 2

Provided below are transactions of James enterprises ltd for the period of March 2016

- 1st started business with capital 2,000,000Frw, 30% of this capital in cash and 70% by cheque
- 2nd purchased land for business's location at Frw 300,000 paying by cash
- 5th purchased office furniture on credit from HOLLY-WOOD Enterprises for Frw 200,000
- 6th Purchased goods on credit from XYMS suppliers, amount Frw310, 000
- 9th obtained a bank loan of Frw 1,600,000 from BPR and deposited it on the business's bank account
- 17th bought a motor van from YUASA Motors at accost of Frw1,500,000, paid 200,000Frw by cash, 1000, 000Frw by cheque and promised to pay the balance later.
- 18th paid effected part payment to HOLLY-WOOD ENTERPRISES of Frw 150,000
- 21st Sold part of the land that was un-utilized to raise more money for Frw 50,000
- 26th Amount due to YUASA Motors was made paying all by cheque
- 27th Made payments to XYMS Suppliers; 65% by cheque and 35% by cash
- 30th His daughter graduated from UR-CBE and he withdrew cash 80,000 for the party function

Required: a) Show the necessary journal entries of the above transactions;

CHAP. FOUR: BANK RECONCILIATIONS

- The cashbook for cash at bank records all the transactions taking place at the bank i.e. the movements of the account held with the bank.

- The bank will send information relating to this account using a bank statement for the firm to compare.

- Ideally, the records as per the bank and the cashbook should be the same and therefore the balance carried down in the cashbook should be the same as the balance carried down by the bank in the bank statement.

- **In practice however, this is not the case and the two (balance as per the bank and firm) are different.**

- **A bank reconciliation statement explains the difference between the balance at the bank as per the cashbook and balance at bank as per the bank statement.**

CAUSES OF DIFFERENCES

i. Items Appearing In The Cashbook And Not Reflected In The Bank Statement.

- **Unpresented Cheques**: **Cheques issued by the firm for payment to the creditors or to other suppliers but** have not been presented to the firm's bank for payment.

- **Unaccredited deposits/cheques**: **These are cheques received from customers and other sources for which the firm has** banked but the bank has not yet availed the funds by crediting the firm's account.

Errors made in the cashbook , these include:

  - Payments over/understated
  - Deposits over/overstated
  - Deposits and payments misposted
  - Overcasting and undercasting the Bal c/d in the cashbook.

CAUSES OF DIFFERENCES(cont’d)

ii) Items appearing in the bank statement and not reflected in the cashbook:

- **Bank charges**: These charges include service, commission or cheques
- **Interest charges on overdrafts.**
- **Direct Debits** (standing orders) e.g. to pay Alico insurance. Regular payments done to creditors
- **Credit transfer:** regular payments received from Debtors
- **Dishonored cheques**

A cheque would be dishonored because:

  - Stale cheques(cheques over 6 months old)
  - Post – dated cheques
  - Insufficient funds
  - Differences in amounts in words and figures.

Errors of The Bank Statement (Made By The Bank).

Such errors include:

- Overstating/understating Deposits and Withdrawals

The Purposes of a bank reconciliation statement.

1. To update the cashbook with some of the items appearing in the bank statement e.g. bank charges, interest charges and dishonored cheques and make adjustments for any errors reflected in the cashbook.

2. To detect and prevent errors or frauds relating to the cashbook.
3. To detect and prevent errors or frauds relating to the bank.

Steps in preparing a bank reconciliation statement.

1. To update **the cashbook** with the items appearing in the bank statement and not appearing in the cashbook except for errors in the bank statement. Adjustments should also be made for errors in the cashbook.

2. Compare the debit side of the cashbook with the credit side of the bank statement to determine the **uncredited deposits** by the bank.

3. Compare the credit side of the cashbook with the debit side of the bank statement to determine the **unpresented cheques**.

4. Prepare the bank reconciliation statement which will show:
   a) Unpresented cheques
   b) Uncredited deposits
   c) Errors on the bank statement
   d) The updated cashbook balance.

The format is as follows: (Format 1)

Bank Reconciliation Statement as at date

	Frw	Frw
Balance at bank as per cashbook (updated)		X
Add:		
Un presented cheques	X	
Errors on Bank Statement (see note 1)	X	
		X
Less:		
Un-credited deposits	(X)	
Errors on Bank Statement (see note 2)	(X)	
		(X)
Balance at bank as per bank statement		X

Note 1: These types of errors will have an effect of increasing the balance at bank e.g. an overstated deposit or an understated payment by the bank.

Note 2: These types of errors will have an effect of decreasing the balance at bank e.g. an understated deposit or an overstated payment by the bank, or making an unknown payment.

Format 2: Bank Reconciliation Statement as at date

	Frw	Frw
Balance at bank as per bank statement		X
Add:		
Un-credited deposits	X	
Errors on Bank Statement (see note 2)	X	
		X
Less:		
Un presented cheques	X	
Errors on Bank Statement (see note 1)	X	
		(X)
Balance at bank as per cashbook (updated)		X

Note 1: These types of errors will have an effect of increasing the balance at bank e.g. an overstated deposit or an understated payment by the bank.

Note 2: These types of errors will have an effect of decreasing the balance at bank e.g. an understated deposit or an overstated payment by the bank, or making an unknown payment.

Example

- Draw up a bank reconciliation statement, after writing the cashbook up to date, ascertaining the balance on the bank statement, from the following as on 31 March 2017:

	FRw
Cash at bank as per bank column of the cashbook (Dr)	38,960
Banking made but not yet entered on bank statement	6,060
Bank charges on bank statement but not yet in cashbook	280
Un presented cheques C Clarke	1170
Standing order to ABC Ltd entered on bank statement, but not in cash book	550
Credit transfer from A Wood entered on bank statement, but not yet in cashbook	1,890

Dr		Cash book – bank	Cr
31/3 Bal b/d	38,960	Bank charges	280
		ABC (standing order)	550
A Wood (credit transfer)	1,890	31/3 Bal C/D	40,020
	40,850		40,850

Bank Reconciliation as at 31/03/2003

	Rwf
Balance at bank as per cashbook	40,020
Add: Unpresented cheques	1,170
	41,190
Less: Uncredited deposits	(6,060)
Balance at bank as per Bank statement	35,130
	=====

Example : a) Write up the cash book to date and the new balance as on 31/12/17. b) Draw up a bank reconciliation statement as on 31/12/17

Dr	Cash book – bank column		Cr
Dec 1 Bal b/d	1,740,000	Dec 8 Daily	349,000
Dec 7 Masters	88,000	Mason 15	33,000
Dec 22 Ellis	73,000	Dec 28 Small	115,000
Dec 31 Wood	249,000	Dec 31 Bal C/D	1,831,000
Dec 31 Barret	178,000		
	2,328,000		**2,328,000**

Bank statement

2017	Dr	Cr	Balance
Dec 1 Bal b/f			1,740,000
Dec 7 Cheque		88,000	1,828,000
Dec 11 Dailey	349,000		1,479,000
Dec 20 Mason	33,000		1,446,000
Dec 22 Cheque		73,000	1,519,000
Dec 31BGC : Walters		54,000	1,573,000
Dec 31 Bank charges	22,000		1,551,000

a) cash book to date and the new balance as on 31/12/17

Dr	Cash book – bank		Cr
Dec 31 Bal b/d Dec 31BGC : Walters	1,831,000 54,000	Dec 31 Bank charges Dec 31 Bal c/d	22,000 1,863,000
	1,885,000		1,885,000

Bank reconciliation statement as at 31/12/17

Balance per cash book		1,863,000
Add unpresented cheque		115,000
		1,978,000
Less Un credited cheques	(249,000+178,000)	(427,000)
Balance per bank statement		1,551,000

Bank reconciliation statement as at 31/12/09

Balance per bank statement		1,551,000
Add Uncredited cheques	(249,000+178,000)	427,000
		1,978,000
Less unpresented cheque		(115,000)
Balance per cash book		1,863,000

The bank columns in the cashbook for June 2017 and bank statement for that month for C Gatero are as follows:

Cashbook

	FRw		FRw
June 01 Balance b/f	237,900	June 05 Blake	15,000
June 07 Green	15,800	June 12 Gray	43,300
June 16 Silver	9,300	June 16 Stephens	8,800
June 28 Brown	30,700	June 29 Golf Club	5,700
June 30 Black	62,400	June 30 Balance c/f	283,300
	356,100		356,100

Bank statement for the month of June 2017

	Debit FRw	Credit FRw	Balance FRw
June 01 Balance b/f			237,900
June 07 Cheque		15800	253,700
June 08 D Blackness	15,000		238,700
June 16 Cheque		9300	248,000
June 17 Gray	43,300		204,700
June 18 Stephens	8,800		195,900
June 28 Cheque		30700	226,600
June 29 UDT standing order	4,400		222,200
June 30 Johnson : trader’s credit		9000	231,200
June 30 Bank charges	7,000		224,200

Required : **Write the cashbook up to date to take the above into account, and then**

- **Draw up a bank reconciliation statement as on 30 June 2017**

- **Exercise :** On 31 December 2017 the bank columns of Tom’s cash book showed a balance of Rwf 4,500,000. The bank statement as at 31 December 2017 showed a credit balance of Rwf 8,850,000 on the account. After checking the bank statement with the cash book and found that the following had not been entered in the cash book.
- A standing order to RB insurance for Rwf 600,000 had been paid by the bank
- Bank interest receivable of Rwf 720,000 had not been entered into the account
- Bank charges of Rwf 90,000 had been made.
- A credit transfer of Rwf 780,000 form KB ltd had been paid direct into the account
- Tom’s deposit account balance of Rwf 4,200,000 had been transferred into his bank current account
- A returned cheque of Rwf 210,000, dishonored by Hope, had been entered on the bank statement
- It also found that two cheques payable to Young Rwf 750,000 and Clerk Rwf 870,000 had been entered in the cash book but had not been presented for payment. In addition a cheque for Rwf 2,070,000 had been paid into the bank on 31/12/2017but had not been credited on the bank statement until 2 January 2018.

Required: Starting with the cash book balance and write the cash book up to date ; b) Draw up a bank reconciliation statement as on 31 December 2017.

Q36. On 30 November 2016, the bank current account in Sylvia’s nominal ledger had a credit balance of FRw15,503, while the bank statement showed cash at bank of FRw3,628.

You have obtained the following information from Sylvia’s records:

A cheque paid to a supplier for FRw4,595 has been recorded as FRw5,495.

Cheques written by Sylvia in November totalling FRw22,865 were presented at the bank in December.

A lodgement for FRw5,634 made on 29 November was credited on the bank statement on 2 December.

A customer’s cheque for FRw400 which had been lodged on 18 November was not honoured by the drawer’s bank. Sylvia’s bank had debited the cheque on her statement on 25 November.

Standing orders with FRw3,600 had been debited on the bank statement but had not been included in Sylvia’s records.

Included on the current account is a lodgement for FRw5,000. This should have been credited to Sylvia’s deposit account.

- **Required:**
- Show the adjusted bank account
- Prepare a bank reconciliation statement as at 30 November 2016.

FINANCIAL STATEMENTS
without adjustments

Sales returns and Purchase returns

- **When firms deal with the purchase and sale of goods it is inevitable that there are occasions when goods have to be returned by the purchaser to the supplier.**

- **Because they are damaged, faulty or perhaps not the specification ordered.**

Purchases returns(returns outwards)

- **When a business returns goods to a supplier for one of the above mentioned reasons they are known as purchases returns or returns outwards. The book keeping entries are as follows:**
  - **Debit : supplier's account(creditor)**
  - **Credit : the purchases returns (returns outwards)3**

The purchases returns a/c are kept separate from the purchases a/c to enable a check to be made on the amount of goods being returned to the firm.

Sales returns(returns inwards)

If goods are returned by a customer (debtor) then they are referred to as sales returns or returns inwards

The entries are as follows:

debit : sales returns(returns inwards)

Credit : customer's (debtors)a/c

The sales returns a/c are kept separate from the sales a/c to enable a check to be made on the amount of goods being returned to the firm.

Example

Sales	40,000,000
Purchases	27,350,000
Sales returns	350,000
Purchases returns	200,000

Sales returns should be deducted from sales(or debited)

Purchases returns should be deducted from purchases (or credited)

Sales		40,000,000
Less Sales returns		350,000
Net sales		39,650,000
Purchases		27,350,000
Less Purchases returns	200,000	
Net purchases		27,150,000

TRIAL BALANCE AS AT 31/12/2010

	Dr	Cr
Sales		40,000,000
Sales returns	350,000	
Purchases	27,350,000	
Purchases returns		200,000

Income statement as at …..

Sales		40,000,000
Less returns inwards		350,000
		39,650,000
Purchases	27,350,000	
Less returns outwards	200,000	
Less Cost of goods sold(CGS)		27,150,000
Gross profit		12,500,000

Carriage

- When a firm buys goods from a supplier the cost of delivering or transporting the goods also has to be paid. This cost of transport is often referred to as “carriage”.

Carriage inwards

- When goods are purchased, the cost of carriage inwards may included as part of the price.

Carriage outwards

- Carriage outwards is the cost of delivering the goods to the firm’s customers. It is an expense and not part of the selling price of the goods.

Dealing with carriage in Income statement

Sales		40,000,000
Less returns inwards		350,000
		39,650,000
Purchases	27,350,000	
Less returns outwards	200,000	
	27,150,000	
Add carriage inwards	150,000	
Less Cost of goods sold		27,300,000
Gross profit		12,350,000
Less expenses		
General expenses	2,150,000	
Carriage outwards	400,000	2,550,000
Net Profit		9,800,000

ACCOUNTING FOR INVENTORY

Trading account for period	Year ending 31.12.2019	Year ending 31.12.2020
Closing stock 31.12.2019	3,000,000	
Opening stock 1.1.2020		3,000,000
Closing stock 31.12.2020		5,500,000

$$\text{Cost of goods sold} = \underbrace{\text{opening stock} + \text{purchases}}_{\text{stock available for sale}} - \underbrace{\text{closing stock}}_{\text{unsold stock at year end}}$$

Example : Trial balance as at 31 December 2019

	(Rwf ‘000’)	(Rwf ‘000’)
Sales		67,000
Purchases	42,600	
Electricity	1,900	
Rent	2,400	
Wages store assistant	5,200	
General expenses	700	
carriage outwards	1,100	
Buildings	20,000	
Fixtures and fittings	7,500	
Debtors	12,000	
Creditors		9,000
Bank	1,200	
Cash	400	
Loan from J Matt		10,000
Drawings	9,000	
Capital		21,000
Stock (at 1.1.2019)	3,000	

Additional information; Stock at 31.12.2019 : 5,500

Required : Income statement and Balance Sheet at date

Income statement for the year ended 31.12.2019

	(Rwf '000')	(Rwf '000')
Sales		67,000
Opening stock	3,000	
Add Purchases	42,600	
	45,600	
Less Closing stock	(5,500)	
Less Cost of good sold		(40,100)
Gross profit		26,900
Less expenses		
Electricity	1,900	
Rent	2,400	
Wages	5,200	
General expenses	700	
carriage outwards	1,100	
		(11,300)
Net Profit		15,600

Balance sheet as at 31 December 2019

	(Rwf ‘000’)	(Rwf ‘000’)
Fixed assets		
Buildings		20,000
Fixtures and fittings		7,500
		27,500
Current assets		
Stock	5,500	
Debtors	12,000	
Bank	1,200	
Cash	400	19,100
Total assets		46,600
Equity and liabilities		
Current liabilities		
Creditors		9,000
Long term liabilities		
Loan from J Matt		10,000
Equity		15,600
Capital		21,000
Add Net Profit		
Less Drawings		9,000
Total Equity and liabilities		46,600

From the following trial balance of Suzanne, draw up an Income statement account for the year ended 31 June 2019 and Balance sheet as at the date. N.B. Closing stock : 17,700,000

	Dr	Cr
Stock 1.7.2018	14,208,000	
Carriage outwards	1,200,000	
Carriage inwards	1,860,000	
Sales returns	1,230,000	
Purchases returns		1,932,000
Purchases	71,244,000	
Sales		111,600,000
Salaries and wages	23,172,000	
Rent and rates	1,824,000	
Insurance	468,000	
Motor expenses	2,656,000	
Telephone and internet	2,624,000	
Electricity	996,000	
General expenses	1,884,000	
Buildings	50,000,000	
Motor vehicles	10,800,000	
Fixtures and fittings	2,100,000	
Debtors	23,376,000	
Creditors		20,386,000
Cash at bank	2,892,000	
Drawings	7,200,000	
Capital		85,816,000
	219,734,000	**219,734,000**

CHAPTER FIVE : ADJUSTMENTS TO FINANCIAL STATEMENTS

5.1. ACCRUALS, PREPAYMENTS

A. ACCRUALS

- Revenue and costs must be recognized as they are earned or incurred, not as money is received or paid.

,

- Therefore all incomes and expenses that relate to a particular financial period will be matched together to determine the profit for the year.

A.1 Accrued Income

- This is income that relates to the current year but cash has not yet been received.
- An accrued income should be reported in the profit & loss account and the same income will be shown in the balance sheet as a current asset.

Example

- A firm lets out part of its properties and receives rent of USD2,000 per month, assuming that this is the first year of renting and rent is received in arrears (rent for January is received early Feb).
- The ledger accounts of the firm will be as follows:

Cashbook

Year 1	USD
Feb (rent for Jan)	2,000
Mar (rent for Feb)	2,000
April (rent for Mar)	2,000
May (rent for Apr)	2,000
June (rent for May)	2,000
July (rent for Jun)	2,000
Aug (rent for July)	2,000
Sept (rent for Aug)	2,000
Oct (rent for Sept)	2,000
Nov (rent for Oct)	2,000
Dec (rent for Nov)	2,000
	22,000

Rent – Income

Year 1		USD	Year 1		USD
			Jan	C/B	2,000
			Feb	C/B	2,000
			Mar	C/B	2,000
			April	C/B	2,000
			May	C/B	2,000
			Jun	C/B	2,000
			July	C/B	2,000
			Aug	C/B	2,000
			Sept	C/B	2,000
			Oct	C/B	2,000
31/12	P&L	24,000	Nov	C/B	2,000
			Dec.	Accrued c/f	2,000
		24,000			24,000

- Although the cashbook is showing that rent received amounts USD22,000, the full rental income of USD24,000 will be reported in the Profit & Loss a/c as rent income and the accrued rent for Dec of USD2,000 will be reported in the balance sheet as a current asset.

Example 2.

A business rents a part of its warehouse for Rwf 800,000 per year. Details for payments are detailed below:

AMOUNT Rwf	RENT DUE	RENT RECEIVED
200,000	31 March 2009	4 April 2009
200,000	30 June 2009	6 July 2009
200,000	30 September 2009	9 October 2009
200,000	31 December 2009	7 January 2010

Rent – Receivable account

		April 4 bank	200,000
Dec 31 P/L	800,000	July 6 bank	200,000
		Oct 9 bank	200,000
		Dec 31 Accrued c/d	200,000
	800,000		800,000

The rent received of Rwf 200,000 on 7 January 2010 will be entered in the books in 2010(not shown). Any rent received is transferred to the credit side of the Profit and Loss account , since it is an income.

The amount to be transferred for 2009 is that earned for 12 months , i.e. Rwf 800,000. The rent received account is completed by balance C/d. The Rwf 200,000 owing is an asset on 31 decembre 2009.

A.2 Accrued Expenses

- **An accrued expense is an expense that is payable or due for payment but has not yet been paid during that period.**
- **An accrued expense should be charged in the P&L account and shown in the balance sheet as a current liability.**

Example : assume that the rent of Rwf 1,000,000 is payable at the end of every three months but that rent is not always paid on time.

AMOUNT Rwf	RENT DUE	RENT PAID
250,000	31 March 2009	31 March 2009
250,000	30 June 2009	2 July 2009
250,000	30 September 2009	4 October 2009
250,000	31 December 2009	5 January 2010

Rent – paid account

Mar. 31 bank	250,000	Dec 31 P/L	1,000,000
Jul 2 bank	250,000		
Oct 4 bank	250,000		
Dec 31 Accrued c/d	250,000		
	1,000,000		1,000,000

The rent paid of Rwf 250,000 on 5 January 2010 will be entered in the books in 2010. the amount of rent for 2009 is obviously Rwf 1,000,000, and this is the amount transferred to the debit side of the Profit and Loss account , since it is an expense.

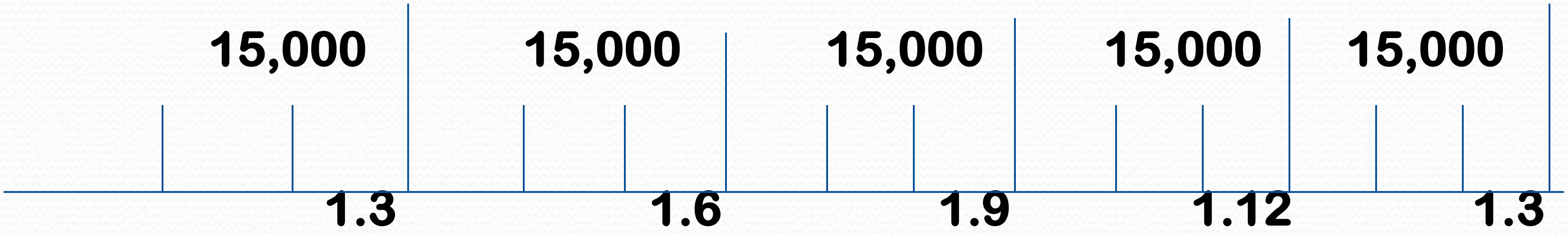
B. PREPAYMENTS

B.1. Prepaid Income

- This is income that is not yet due but cash has been received for it. This happens where an income is payable in advance e.g. Rent payable 3 months in advance.
- A prepaid income should not be reported in the current financial period but should be carried forward and reported in the period it relates to.
- The accounting treatment will be to show it as a current liability.

Example

- A firm receives rent income of FRw5,000 per month payable quarterly in advance.
- Assuming that the firm's rental income began in 1st March and the financial year, end is on 31st Dec. The ledger accounts will be:



Cashbook

Year 1	FRw	Year 1	FRw
1/3 Rent	15,000		
1/6 Rent	15,000		
1/9 Rent	15,000		
1/12 Rent	15,000		

Rent – Income

Year 1	FRw	Year 1	FRw
		1/3 Cashbook	15,000
		1/6 Cashbook	15,000
P&L (10 x 5,000)	50,000	1/9 Cashbook	15,000
31/12 Bal c/d	10,000	1/12 Cashbook	15,000
	60,000		60,000

- Rent for the 4 quarters of 12 months has been received as per the cashbook but because the end of the financial year is at 31 Dec, rent for 2 months is pre-paid.
- This FRw10,000 is not charged in the P&L but is carried forward as current liability in the balance sheet.

B.2. Prepaid Expenses

- A prepaid expense is an expense that is not payable but cash has already been paid.

- A prepaid expense should not be charged in the P&L a/c but should be carried forward to the next financial period and should be shown in the balance sheet as a current asset.

Example

- Assume as in the previous illustration, that all the facts are as stated except that rent is an expense. The ledger accounts is as follows:

Cashbook

Year 1	FRw	Year 1		FRw
		1/3	Rent	15,000
		1/6	Rent	15,000
		1/9	Rent	15,000
		1/12	Rent	15,000

Rent – Expenses

Year 1	FRw	Year 1	FRw
1/3 C/B (Mar, April, May)	15,000		
1/6 C/B (June, July, Aug)	15,000		
1/9 C/B (Sept, Oct, Nov)	15,000	P&L(10 x 5,000)	50,000
1/12 C/B (Dec, Jan, Feb)	15,000	31/12 Bal c/d (2 x 5,000)	10,000
	60,000		60,000

Example: Insurance for a business rate of Rwf840,000 a year, starting from 1 January 2010. the business has agreed to pay it at the rate of Rwf 210,000 every three months , however, payments were not made at the correct times. Details were :

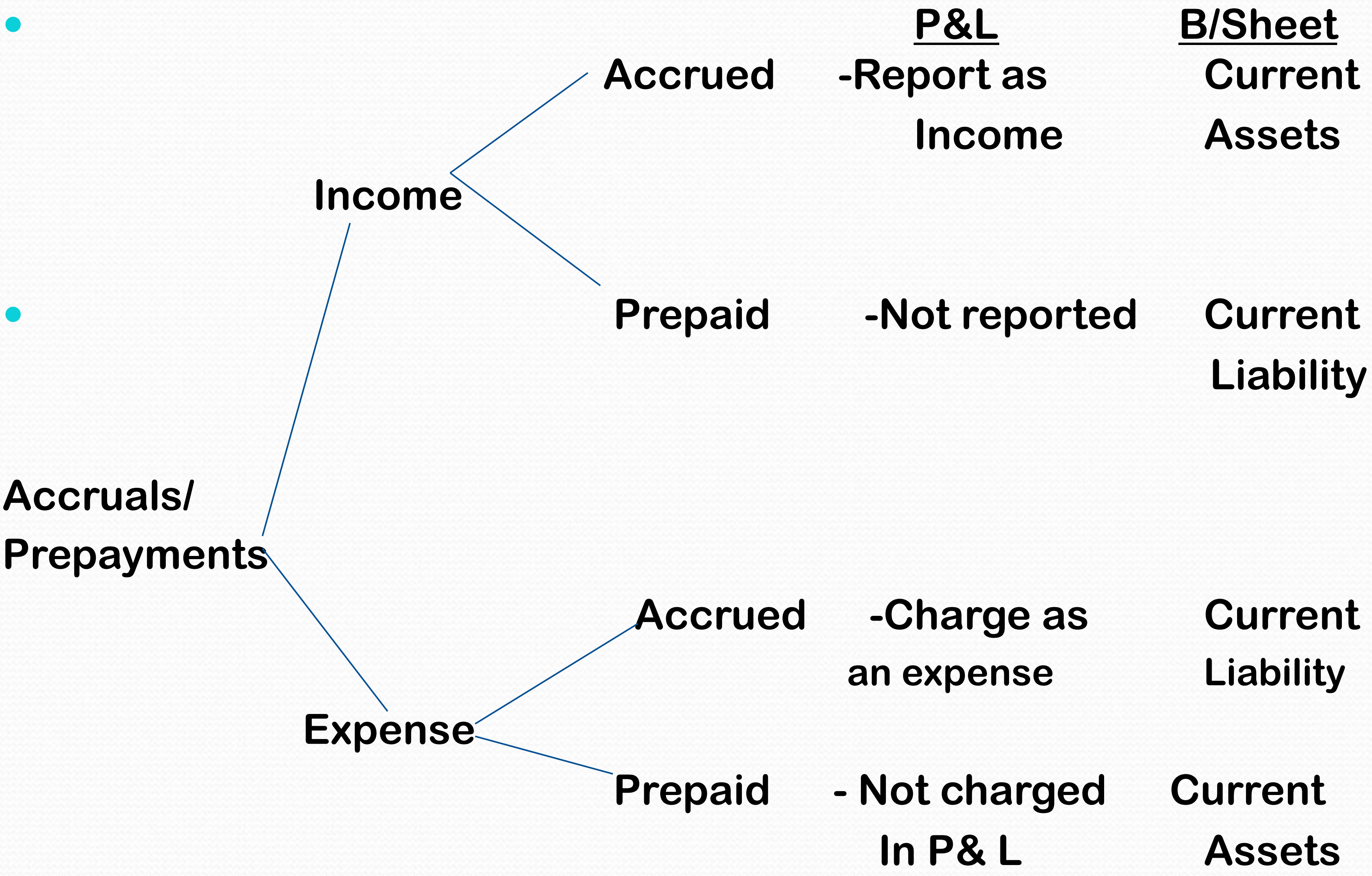
AMOUNT Rwf	INSURANCE DUE	INSURANCE PAID
210,000	31 March 2010	Rwf 210,000 ; Feb 28 2010
210,000 210,000	30 June 2010 30 September 2010	Rwf 420,000 ; Aug 312010
210,000	31 December 2010	Rwf 420,000 ; Nov 18 2010

Insurance account

Mar. 31 bank	210,000	Dec 31 P/L	840,000
Jul 2 bank	420,000		
Oct 4 bank	420,000	Dec 31 Prepaid c/d	210,000
	1,050,000		1,050,000

The last payment shown of Rwf 420,000 is not just for 2010; it can be split as Rwf 210,000 for the 3 months to 31 Dec 2010 and Rwf 210,000 for the three months ended 31 March 2011. For the year the cost of insurance is Rwf 840,000 and this the amount to be transferred to the P/L account

The following is the summary of treatment for Accruals and Prepayments:



			P&L	**B/Sheet**
Accruals/ Prepayments	Income	Accrued	-Report as Income	Current Assets
		Prepaid	-Not reported	Current Liability
	Expense	Accrued	-Charge as an expense	Current Liability
		Prepaid	- Not charged In P& L	Current Assets

- **Accrued Incomes and Expenses and Prepaid Incomes and Expenses are shown in the Balance Sheet as follows:**
- **Balance Sheet Extracts**

	FRw	FRw
Current Assets		
Stock		x
Debtors		x
Accrued Incomes/Prepaid Expenses		x
Cash at bank		x
Cash in hand		x
		x
Current Liabilities		
Bank overdraft		x
Creditors		x
Prepaid Incomes/Accrued Expenses		x
		X

Question1 : TRUST ,Account balances as at 31 March 2019	FRw
Sales	608,000
Purchases	314,000
Shop fittings	260,000
Equipment	60,000
Capital	290,000
Opening Inventory (1 April 2018)	94,000
Bank	12,200
Cash	1,900
Shop wages	92,000
Commission income	60,000
Accounts receivable	2,300
Drawings	70,000
Accounts payable	45,500
Returns out	3,500
Light and heat	5,200
Rent expense	85,000
Carriage in	600
Insurance	1,800
Returns in	8,000

In preparing the year-end accounts, the following should be accounted for:

i) The inventory at the end of the year was valued at FRw8,800; b) Insurance prepaid amounted to Frw400; iii) Shop wages accrued FRw6,700; iv) Commission income prepaid FRw 4,600

You are required to:

(a) prepare TRUST's List of account balances as 31 March 2019 (Before adjustments)

(b) prepare TRUST's Income statement for the year ended 31 March 2019

(c) Draft TRUST's Balance sheet as at 31 March 2019

From the following Account balances as at 30 April 2017 extracted from the books of Adolph

	Rwf
Capital	75,000
Fixtures and fittings	95,000
Motor cycle	32,000
Opening inventory	2,000
Cash	450
Bank overdraft	4,300
Bank loan (repayable in 2019)	30,000
Purchases	190,250
Sales	300,000
Accounts payable	5,000
Loan (repayable on 30 December 2017)	1,000
Wages	46,000
Rental income	24,000
Drawings	25,000
Carriage out	1,000
Carriage in	600
Returns in	400
Returns out	400
Rent expense	29,800
General expenses	17,200

You should also take the following additional information into account:

i) Closing inventory was FRw1,600 ; ii) Interest on loans unpaid amounted to FRw 2,700; iii) Rent expense accrued FRw1,200; iv) Rental income accrued FRw3,400 ; v) General expense prepaid FRw2,400

You are required to prepare the List of account balances as at 30 April 2017, the income statement for the year ended 30 April 2017 and the balance sheet as at that date.

Determine the subscription for the year from the following information

	FRw
Rental income received in cash	4,300,000
Rental income accrued b/f	432,000
Rental income prepaid b/f	315,000
Rental income accrued c/f	231,000
Rental income prepaid c/f	250,000

Determine the stationery expense for the year from the following information

Stationery	FRw
Amount paid in cash and cheques	5,340,000
Accrued b/f	630,000
Stationery inventory b/f	410,000
Accrued c/f	550,000
Stationery inventory c/f	360,000

5.2. BAD AND DOUBTFUL DEBTS

- Some debtors may not pay up their accounts for various reasons e.g. a debtor may go out of business. When a debtor is not able to pay up his/her account this becomes a bad debt.

- Therefore the business/firm should write it off from the accounts and thus it becomes an expense that should be charged in the profit & loss account.

- In practice a firm may also be unable to collect all the amounts due from debtors. This is because a section of the debtors will not honor their obligations.

BAD AND DOUBTFUL DEBTS(cont')

- The problem posed by this situation is that it is difficult to identify the debtors who are unlikely to pay their accounts.
- Furthermore the amount that will not be collected may also be difficult to ascertain. These debts that the firm may not collect are called doubtful debts.

- A firm should therefore provide for such debts by charging the provision in the profit and loss account. Provision for doubtful debts maybe specific or general.
- Specific relate to a debtor whom we can identify and we are doubtful that he may not pay the debt (if one of our debtor goes out of business).

Accounting for Bad & Doubtful Debts.

A. Bad debts

- When a debt becomes bad the following entries will be made:
- Debit: Bad debts account
- Credit: Debtors account with the amount owing.
- Debit: Profit and Loss Account.
- Credit: Bad debts account to transfer the balance on the bad – debts account to the Profit and Loss Account.

B. Accounting for Doubtful Debts

- A provision for doubtful debts can either be for a specific or a general provision. A specific provision is where a debtor is known and chances of recovering the debt are low.

- The general provision is where a provision is made on the balance of the total debtors i.e. Debtors less Bad debts and specific provision.

- The accounting treatment of provision for doubtful debts depends on the year of trading and the entries will be as follows. If it is the 1st year of trading (1st year of making provision):

- Debit: P&L A/c.
- Credit: Provision for doubtful debts (with total amount of the provision).

- In the subsequent periods, it will depend on whether it is an increase or decrease required on the provision.
- If it is an increase:

  Debit: P&L A/c.

  Credit: Provision for doubtful debts (with increase only).

  If it is a decrease:
- Debit: Provision for doubtful debts.
- Credit: P&L A/c (with the decrease in provision only).

Example : A firm started trading in the year 2009, the balance on the debtor's account was FRw400,000. Bad debts amounting toFRw40,000 were written off from this balance; there was a specific provision of FRw5,000 to be made to one of the debtors and a general provision of FRw5% was to be made on the balance of the debtors. The ledger accounts of 2009 were as follows:

Debtors

2009	Rwf		
Bal B/d	400,000	Bad debts	40,000
		Bal c/d	360,000
	400,000		400,000

Provision for doubtful debts

2009	Rwf	2009	Rwf
31/12 Bal c/d	22,750	31/12 P&L	22,750

Bad debts

2009	FRw	2009	FRw
Debtors	40,000	31/12 P&L	40,000

	Rwf
Debtors	400,000
Bad debts	(40,000)
	360,000
Specific Provision	(5,000)
	355,000
General Provision (5%)	(17,750)
	337,250

Profit & Loss A/C (Extract) for the year ended 31/12/2009

EXPENSES	FRw	FRw
Bad debts	40,000	
Provision for D/debts	22,750	

Balance Sheet (Extract) as at 31/12/99

	FRw	FRw
Current Assets		
Stocks	x	
Debtors	360,000	
Provision for D/debt	(22,750)	
Net Realizable		337,250

Example(cont')

In the year 2010, the debtors balance goes up to FRw500,000 from which bad debts of FRw50,000 needs to be written off there is no specific provision but the general provision is to be maintained at 5%. The ledger accounts will be as follows:

Debtors	500,000
Bad debts	(50,000)
	450,000
General Provision (5%)	22,500
	427,500

Debtors

2010	FRw	2010	FRw
Bal b\d	500,000	Bad Debts	50,000
		Bal c\d	450,000
	500,000		500,000

Provision for Doubtful Debts

2010	FRw	2010	FRw
P\L	250	1\1 Bal b\d	22,750
Bal c\d	22,500		
	22,750		22,750

Bad Debts

2010	FRw	2010	FRw
Debtors	50,000	31\12 P& L	50,000

- **Profit And Loss Account (Extract) for year ended 31/12/2010.**

	Rwf	Rwf
Incomes		
Decrease in provision for D/debts		250
Expenses		
Bad debts	50,000	

Balance Sheet (Extract) as at 31/12/2000

	Rwf	Rwf
Current Assets		
Debtors	450,000	
Provision for bad debts 5%	(22,500)	
		427,500

Example(cont’)

- In the year 2011 the debtors balance goes up to FRw600,000 from which bad debts of FRw50,000 need to be written off, there is no specific provision but the general provision is to be maintained at 5% the ledger accounts is as shown:

	FRw
Debtors	600,000
Bad debts	(50,000)
	550,000
General provision 5%	(27,500)
	522,500

Debtors

2001	FRw	2001	FRw
Bal b\		Bad Debts	50,000
600,000			
		Bal c\d	550,000
	600,000		600,000

Provision for Doubtful Debts

2001	FRw	2001	FRw
		1\1 Bal b\d	22,500
Bal c\d	27,500	P& L	5,000
	22,500		27,500

Bad Debts

2001	FRw	2001	FRw
Debtors	50,000	31\12 P& L	50,000

Profit And Loss Account (Extract) for the year ended 31/12/2001

	FRw	FRw
Expenses		
Bad debts	50,000	
Increase in provision	5,000	

Balance Sheet (Extract) as at 31/12/2001

	FRw	FRw
Current Assets		
Debtors	550,000	
Less: Provision for Doubtful Debts	(27,500)	522,500

Exercise : Question 52

- In a new business during the year ended 31 December 2012 the following debts are found to be bad, and are written off on the dates shown:

30 April	H Gordon	FRw1,100
31 August	D Bellamy Ltd	FRw640
31 October	J Alderton	FRw120

- On 31 December 2012 the schedule of remaining debtors, amounting in total to FRw68,500, is examined, and it is decided to make a provision for doubtful debts of FRw2,200.
- You are required to show:
- The Bad Debts Account, and the Provision for Doubtful Debts Account.
- The charge to the Profit and Loss Account.
- The relevant extracts from the Balance Sheet as at 31/12/2012

Question 53

- A business started trading on 1 January 2011. During the two years ended 31 December 2011 and 2012 the following debts were written off to the Bad Debts Account on the dates stated:

31 August 2011	W Best	FRw 850
30 September 2011	S Avon	FRw1,400
28 February 2012	L J Friend	FRw 1,800
31 August 2012	N Kelly	FRw 600
30 November 2012	A Oliver	FRw 2,500

- On 31 December 2011 there had been a total of debtors remaining of FRw405,000. It was decided to make a provision for doubtful debts of FRw5,500.
- On 31 December 2012 there had been a total of debtors remaining of FRw473,000. It was decided to make a provision for doubtful debts of FRw6,000.
- **You are required to show:**
- **The Bad Debts Account and the Allowance for Doubtful Debts Account for each of the two years.**
- **The relevant extracts from Income statement and the Balance Sheet as at 31 December 2011 and 2012.**

5.3. DEPRECIATION AND DISPOSAL OF NONCURRENT ASSETS

Capital and Revenue expenditure

Capital Expenditure: This is the amount spent on the acquisition of a non-current asset or adding value to a non-current asset.

Examples of expenses incurred in acquisition:

- Purchase price/cost of the asset.
- Delivery/carriage inwards costs (e.g. shipping charges or import taxes).
- Costs incurred to get the asset in use (e.g. assembly, testing)
- Installation
- Demolition costs in order to construct a new building.
- Architect fees for construction and supervision
- Legal fees incurred in acquisition of a new asset (e.g. lease agreement)

Examples of expenses incurred in adding value to an asset:

- Modify plant to increase its useful life.
- Upgrading plant to improve quality of output.
- Adopting or upgrading the production process to improve or reduce costs`

A. Depreciation of noncurrent assets

- It is the loss of value of a non-current asset throughout its period of use by the firm. Depreciation is the allocation of a depreciable amount of a non-current asset over its estimated useful life.
- Under the matching concept, all incomes or revenues and expenses for a particular period should be reported in the financial statements and because depreciation is an expense of the business therefore, it will be charged in the Income statement

Causes of Depreciation

1. ***Physical Factors***

a) Wear and tear: Some non-current assets depreciate or lose value due to use overtime e.g. machinery and motor vehicles.

b) Rot/decay/rust : This happens on assets that are not well maintained by the firm e.g. Some machines.

Land may be eroded or wasted away by the action of wind, rain, sun and other elements of nature. Similarly, the metals in motor vehicles or machinery will rust away. Wood will rot eventually.

2. ***Economic Factors***

a) **Inadequacy** : Some assets lose value due to the fact they are becoming inadequate e.g. when a business grows or expands then some buildings may become inadequate due to space. Also some machines that are unable to manufacture a large number of goods.

b) **Obsolescence:** Some assets become obsolete due to change in technology or different methods of production e.g. computers.

3. *Time Factors*

Some assets have a legal fixed time e.g. properties on lease.

4. *Depletion*

The depletion deduction allows an owner or operator to account for the reduction of a product's reserves.

This occurs when some assets have a wasting character due to extraction of raw materials, minerals or oil. Such assets include mines, oil wells, and quarries. (reduction in the number or quantity)

Methods of Calculating Depreciation

- These are the methods developed to assist in estimating the amount of depreciation to be charged in the P&L a/c as an expense.

The methods chosen by a firm should be in accordance with the agreed accounting practice, accounting standards and suit the firm's non-current assets. There are 2 main methods of estimating depreciation and 5 others that will apply in a firm's situation.

- The main methods are: *Straight-line method* and *Reducing Balance method*.

The other 5 methods include:

1. Sum of the digits methods – uses a formula.
2. Revaluation method – applies to a non-current asset of low value.
3. Machine-Hour method – depreciation is based on number of hours a machine is expected to operate (manufacturing process).
4. Unit of output method – depreciation is based on the number of units a machine is expected to produce.
5. Depletion of units – depreciation is based on number of units extracted from the asset.

Straight-Line Method

This method ensures that a uniform amount of depreciation is charged in the P&L a/c for a particular asset and is based on the following formula:

$$\text{Depreciation for year} = \frac{\text{Cost of asset} - \text{Residual Value}}{\text{Estimated useful life}}$$

Residual Value

The amount the firm expects to sell the asset after the period of use in the firm, also called Salvage Value / Scrap Value.

Estimated Useful Life

The period the asset is expected to be used in the firm.

Example

A firm buys a machine for Rwf 100,000 which it expects to use in the firm for eight years. After the eight years the machine will be sold for FRw20,000. Under the straight-line method, the depreciation amount will be computed as follows:

Solution : Depreciation for year $= \dfrac{\textbf{Cost of asset – Residual Value}}{\textbf{Estimated useful life}}$

Cost of assets : 100,000; Residual value = 20,000;

estimated life = 8 years;

depreciation for year $= \dfrac{\textbf{100,000– 20,000}}{\textbf{8}} =$ Rwf 10,000 per year

This means for this asset FRw10,000 will be charged in the P&L account as depreciation expense on the machine.

The straight line method assumes that benefits accruing on use of a non-current asset are spread out evenly over the life of the asset e.g. buildings use straight-line method.

Percentage rate based on cost as opposed to number of years can also be used to calculate the depreciation.

Reducing Balance Method

- The firm determines a fixed percentage rate that is applied on the cost of the asset during the first period of use.
- The same rate is applied in the subsequent financial periods but the rate is applied on the reduced value of the asset. (Cost of asset – total depreciation provided to date).
- This method ensures that higher amount of depreciation are charged in the P&L account in the earlier periods of use and lower amounts in the latter periods of use as shown in the following example:
- Reducing balance method (diminishing balance method) assumes that benefits accruing from the use of an asset are higher in the first periods of use and lower in the latter periods
- e.g. Fixtures, furniture and fitting; Plant and machinery; Motor vehicles.

Example

Assume a firm buys machinery for Rwf100,000 and provides depreciation on machines at 20% p.a. on reducing balance method. The depreciation charged to the Income statement will be as follows for the next 3 years.

Year 1			
	FRw		
Cost		100,000	
Depreciation 20% of 100,000		(20,000)	→ P&L YR 1
Balance to YR 2	80,000		
Year 2			
Depreciation 20% of 80,000		80,000	
		(16,000)	→ P&L YR 2
Balance to YR 3	64,000		
Year 3			
Depreciation 20 % of 64,000		64,000	
		(12,800)	→ P&L YR 3
Balance to YR 4	51,200		

Accounting entries for depreciation of non current assets

The entries will be as follows:

Debit – P&L a/c with FRw10,000

Credit – Provision for depreciation. Machines a/c with FRw10,000 being depreciation provided for the machine.

The ledger accounts will be as follows:

Machinery

	Rwf		Rwf
cashbook	100,000	31/12 Bal c/d	100,000

Accumulated Depreciation

	FRw		FRw
31/12 Bal c/d	10,000	P&L	10,000

The final accounts extracts will be shown as follows:

(a) Income statement (Extract) for the year ended

Expenses	FRw	FRw
Depreciation:		
Buildings	x	
Plant and machinery	10,000	
Furniture, Fixtures and Fittings	x	
Motor vehicles	x	

(b) Balance sheet (Extract)

Name of business

Balance sheet as at date.

ASSETS	Cost	Acc Dep	Net
Non Current Assets	FRw	FRw	FRw
Land & Buildings	Xx	(xx)	xx
Plant & Machinery	100,000	(10,000)	90,000
Fixtures, furniture & fittings	Xx	(xx)	xx
Motors vehicles	Xx	(xx)	xx
Total non-current assets			xx

Exercise: Q58

- A company starts in business on 1 January 1999, the financial year end being 31 December.

You are to show:

a) The plant account

b) The provision for depreciation account.

c) The balance sheet extracts for each of the years 1999, 2000, 2001, 2002.

The machinery bought was:

1999 1 January	1 plant costing FRw8,000
2000 1 July	2 plant costing FRw5,000 each
1 October	1 plant costing FRw6,000
2002 1 April	1 plant costing FRw2,000

Depreciation is at the rate of 10 % per annum, using the straight-line method, plant being depreciated for each proportion of a year.

Exercise: Q59

CBE acquired a photocopier with the following details

Date of acquisition: 01 January 2016

Cost: FRw 1,200,000

Estimated residual value: FRw200,000

Estimated useful life: 5 Years [250,000 copies]

[1] Calculate depreciation using each of the following methods each of the four years from 2016 to 2019

- Straight line method
- Reducing balance method 30%
- Sum of digits
- Units of output method (80,000; 40,000;20,000; 50,000)

Types of non-current assets

- Non-current assets can be classified to the following:
- Tangible non-current asset – is asset with physical existence (they can be touched) e.g. land and buildings, plant and machinery, equipment, motor vehicle. They are depreciated.

- Intangible non-current assets – those without physical existence e.g. goodwill, copyright, patent, computer software, long term license, franchise, research and development cost. They are amortized (the depreciable amount is spread over the useful life of the intangible asset.
- Long-term investments – these are assets that cash or other investments are expected to be received in future

e.g. acquired shares of another company, acquired bonds/debentures, long term loans advanced to others. They are not depreciated. They are measured at market values.

Types of non-current assets

- Investment property – assets acquired primarily for renting/leasing to others or for price appreciation. e.g. land, building, equipment, machinery acquired for leasing or just for price appreciation. They are measured at market values or depreciated.

- Agricultural assets – these are biological assets (living animal or plant) e.g. tea/coffee/cassava plantation, cows/goats/chicken/rabbit. They are measured at market value less cost to sell.

Assumptions on depreciation for assets acquired or disposed during the year

- Proportional depreciation for assets acquired or disposed during the year (pro rata basis – according to the number of months the asset was used)
- Full years depreciation in the year of acquisition but none in the year of disposal
- Proportional depreciation in the year of acquisition but none in the year of disposal
- Full years depreciation in the year of acquisition and proportional depreciation in the year of disposal

Example : Q61.

SOGEM acquired a motor vehicle for FRw 5,000,000 on 01 June 2007. SOGEM depreciates motor vehicles at 20% per annum straight line method.

The vehicle was sold for FRw3,200,000 on 31 December 2009 SOGEM has 31 March as year end.

[1] Calculate depreciation for each of the years ended 31 March 2008, 2009 and 2010 under the following assumptions

a) Pro-rata basis

b) Full years depreciation in the year of acquisition and none in the year of disposal

c) Full years depreciation in the year of acquisition and proportional depreciation in the year of disposal

d) Proportional depreciation in the year of acquisition and no depreciation in the year of disposal

[2] Show the disposal account assuming pro-rata basis is used

B. Disposal of non-current assets

- On disposal of non-current assets, the profit or loss from the disposal has to be determined. The following steps are followed.

Step 1: Transfer cost of non-current asset to disposal account

- Dr Disposal a/c X
- Cr Non-current asset a/c X

Step 2: Transfer accumulated depreciation so far to disposal account

- Dr Accumulated depreciation a/c X
- Cr Disposal a/c X

Step 3: Record sales proceeds from the disposal

- Dr Cash/bank/Account receivable/Asset a/c X
- Cr Disposal a/c X

Step 4: Determine profit or loss from disposal

- Profit exists if the credit totals exceed the debit totals
- Dr Disposal a/c X
- Cr Profit and loss a/c/Income statement X
- Loss exists if the debit exceeds the credit totals
- Dr Profit and loss a/c/Income statement X
- Cr Disposal a/c X

- **Example**
- Unipharm, at 31 December 2006 had a balance on its equipment a/c of FRw.100,000. This balance represents the equipment at cost. The balance on the accumulated depreciation account was FRw.40,000.
- On 31 December 2007 the company sold one of its equipment for FRw.1,500. It had been purchased five years earlier on 1 January 2003, for FRw.15,000, at which time the company had estimated its useful economic life at five years and its residual value after that time of FRw.1,000.
- The company policy is to write off such equipment at 20% straight line. The vehicle had been subject to a depreciation charge of (FRw.15,000 – FRw.1,000)/5 = FRw.2,800 per annum. The company policy is also to depreciate assets in the year of purchase but not in the year of sale.
- Solution
- There is a need to determine the profit or loss on disposal and the current year must reflect that

Solution

- There is a need to determine the profit or loss on disposal and the current year must reflect that.

This is determined as:

	FRw
Purchase Cost (1 Jan 2003)	15,000
Depreciation (03, 04, 05 & 06) 4 years x FRw.2,800	11,200
Net Book Value 31 December 2006	3,800
Sale Proceeds	1,500
Loss on Disposal	2,300

- The depreciation charge for 2007 was agreed as 20% straight line on Rwf 85,000 i.e., Rwf 17,000.
- To account for this disposal the company would make the following entries to the accounts.

Equipment account

	FRw.		FRw.
Balance b/f	100,000	Disposal account	15,000
		Balance c/f	85,000
	100,000		100,000

Accumulated depreciation account

	FRw.		FRw.
Disposal account	11,200	Balance b/f	40,000
Balance c/f	45,800	Profit & loss a/c(deprec. 2007)	17,000
	57,000		57,000

Disposal account

	FRw.		FRw.
Motor cycle account	15,000	Accumulated depreciation	11,200
		Cash/bank (sales proceeds)	1,500
		Profit & loss a/c (Loss on Disposal)	2,300
	15,000		15,000

Extract from income statement for year:

	FRw
Depreciation	17,000
Loss on disposal of vehicle	2,300

Extract from Balance Sheet

	Cost	Depn	NBV
Non-current Assets	FRw	FRw	FRw
Motor cycles	85,000	45,800*	39,200

	FRw.
* NB: the Accumulated depreciation to previous year end	40,000
Additional Depreciation for current year	17,000
	57,000
Less accumulated depreciation on disposal of vehicle	11,200
Balance c/f	45,800

Exercise 2: Q62.

- A business buys a machine on 31 August 2005 for FRw 440,000. It has an expected useful life of seven years and an estimated residual value of FRw20,000.

- On 30 June 2009, the machine is disposed off for FRw 180,000. The business's year-end is 31 December.

- Its accounting policy is to charge depreciation using the straight line method with a proportionate charge in the years of acquisition and disposal.

- Calculate the profit or loss on the disposal of the machine.

- **Exercise 3: Q64.**

OCIR had the following balances as at 01/04/2009

	Cost Rwf	Accumulated depreciation Rwf
Motor vehicles	10,300,000	4,100,000

During the year the following transaction took place:

- On 30/09/2009 motor vehicle that cost FRw3,600,000 with net book value of FRw500,000 was returned to Rwanda motors the supplier. Rwanda motors accepted it at a trade in value of FRw400,000 for another new motor vehicle for FRw3,000,000 OCIR paying the difference in cash.
- The depreciation policy is as follows
- Motor vehicles: 20% Straight line basis
- Proportionate depreciation is charged in the year of acquisition and disposal

Required:

1. Motor vehicles at cost account
2. Accumulated depreciation – Motor vehicles
3. Disposal of motor vehicles account

Revaluation of non-current assets

- The revalued amount is the fair value (market value) at the date of revaluation. To show the fair market value of assets
- To negotiate fair price for the assets of the company before merge with or acquisition by another company
- In such case the revaluation should be done regularly and it should be for an entire class of the assets concerned.

- An asset could be carried at a revalued amount less any subsequent accumulated depreciation
- At the time of revaluation the accumulated depreciation is either reduced from the non-current asset before revaluation or transferred directly to the revaluation reserve.
- The increase/decrease in cost/carrying amount is then transferred to the revaluation reserve.
- The accounting entry for an asset that is not depreciated and there is a revaluation increase is as follows:

Dr Non-current asset	X	
Cr Revaluation reserve		X

Being Revaluation increase

Example 1

Ex1.1. Kurusha's business has some land that cost Rwf.1,000,000 and want to revalue it to Rwf.1,200,000

Solution

The revaluation increase is

	FRw.
Revalued amount	1,200,000
Cost	1,000,000
Revaluation increase	200,000

- The journal entries are as follows.

	FRw	FRw
Dr Land	200,000	
Cr Revaluation reserve		200,000

- Revaluation increase

The account will look as follows

Land account

	FRw.		FRw.
Balance b/f	1,000,000		
Revaluation account	200,000	Balance c/f	1,200,000
	1,200,000		1,200,000

Revaluation reserve account

	FRw.		FRw.
Balance c/f	200,000	Land account	200,000

For asset that is depreciated, and there is a revaluation increase.

- The revaluation is from the carrying amount at the time of revaluation.

In other words, depreciation already provided on the asset being revalued must be transferred out to the revaluation account as part of the revaluation process.

The main point to understand is that after the revaluation we start depreciating using the revalued amount. The revalued amount is apportioned over the remaining useful life.

The accounting entries are as follows : Either

Dr Accumulated depreciation a/c	X	
Cr Non-current asset a/c		X
Accumulated depreciation so far		
Dr Non-current asset a/c	X	
Cr Revaluation increase a/c		X
Revaluation increase from carrying amount		

Or

Dr Accumulated depreciation a/c	X	
Cr Revaluation reserve a/c		X
Accumulated depreciation so far		
Dr Non-current asset a/c	X	
Cr Revaluation reserve a/c		X
Revaluation increase from cost		

Ex. 1.2. Kurusha's business has a building that cost FRw.500,000 on which depreciation of FRw.100,000 has been provided. We want to revalue it to FRw.700,000 as at the current balance sheet date.

Solution

- The carrying amount of the asset so far is FRw.500,000 less FRw.100,000 = FRw.400,000. (500,000-100,000)
- The revaluation increase is then FRw.700,000 less FRw.400,000 = FRw.300,000. (700,000- 400,000)
- Using the first way of journal entries,

	FRw	FRw
Dr Accumulated depreciation a/c	100,000	
Cr Non-current asset a/c		100,000
Accumulated depreciation so far		
Dr Non-current asset a/c	300,000	
Cr Revaluation increase a/c		300,000
Revaluation increase from carrying amount		

The accounts will look as follows

Buildings account

	FRw.		FRw.
Balance b/f	500,000	Accumulated depreciation	100,000
Revaluation account	300,000	Balance c/f	700,000
	800,000		800,000

Buildings accumulated depreciation account

	FRw.		FRw.
Buildings account	100,000	Balance b/f	100,000

Revaluation reserve account

	FRw.		FRw.
Balance c/f	300,000	Buildings account	300,000

Using the second way of journal entries, The accounts will look as follows

	FRw	FRw
Dr Accumulated depreciation a/c	100,000	
Cr Revaluation increase a/c		100,000
Accumulated depreciation so far		
Dr Non-current asset a/c	200,000	
Cr Revaluation increase a/c		200,000
Revaluation increase from cost		

Buildings account

	FRw.		FRw.
Balance b/f	500,000		
Revaluation account	200,000	Balance c/f	700,000
	700,000		700,000

Buildings Accumulated depreciation account

	FRw.		FRw.
Revaluation account	100,000	Balance b/f	100,000

Revaluation account

	FRw.		FRw.
		Accumulated depreciation	100,000
Balance c/f	300,000	Buildings account	200,000
	300,000		300,000

Ex. 1.3. Kurusha's business has a building that cost FRw.500,000 of which depreciation of FRw.100,000 has been provided. We want to revalue it to FRw.460,000 as at the current balance sheet date.

Solution

- This time the cost goes down from FRw.500,000 to FRw.460,000, but there is an overall upward revaluation of FRw.60,000. Following the same steps as before, the following figures can be calculated:

	FRw.
Revalued amount	460,000
Carrying amount	400,000
Revaluation increase	60,000

Using the second method of journal entries, The accounts are as follows

	FRw	FRw
Dr Accumulated depreciation a/c	100,000	
Cr Revaluation increase a/c		100,000
Accumulated depreciation so far		
Dr Revaluation a/c	40,000	
Cr Non-current asset a/c		40,000
Revaluation decrease from cost		

Buildings account

	FRw.		FRw.
Balance b/f	500,000	Revaluation account	40,000
		Balance c/f	460,000
	500,000		500,000

Buildings accumulated depreciation account

	FRw.		FRw.
Revaluation account	100,000	Balance b/f	100,000

Revaluation account

	FRw.		FRw.
Buildings account	40,000	Accumulated depreciation	100,000
Balance c/f	60,000		
	100,000		100,000

Example 2

The accounting records of Riffon, a limited liability company included the following balances at 30 June 2008:

		FRw
Office buildings	– cost	1,600,000
Office buildings	– accumulated depreciation (10 years at 2% per year)	320,000
Plant and machinery –	cost (all purchased in 2000 or later)	840,000
and Plant machinery –	accumulated depreciation	306,000
Plant and machinery –	(straight line basis at 25% per year)	

During the year ended 30 June 2009 the following events occurred:

1 July 2008 , It was decided to revalue the office building to FRw2,000,000, with no change to the estimate of its remaining useful life.

1 October 2008, New plant costing FRw200,000 was purchased.

1 April 2009, Plant, which had cost FRw240,000 and with accumulated depreciation at 30 June 2008 of FRw180,000 was sold for FRw70,000.

It is the company's policy to charge a full year's depreciation on plant in the year of acquisition and none in the year of sale.

Required:

Prepare the following ledger accounts to record the above balances and events:

a) Office building: cost/valuation ; accumulated depreciation and revaluation reserve.

(b) Plant and machinery: cost; accumulated depreciation and disposal.

Solution

Office building – cost/valuation account

	FRw		FRw
Balance b/f	1,600,000		
Revaluation	400,000	Balance c/f	2,000,000
	2,000,000		2,000,000

Office building – accumulated depreciation account

	FRw		FRw
Revaluation reserve	320,000	Balance b/f	320,000
Balance c/f	50,000	Income statement (W1)	50,000
	370,000		370,000

Revaluation account

	FRw		FRw
		Offices building	400,000
Balance c/f	720,000	Accumulated depreciation	320,000
	720,000		720,000

Plant and machinery – cost

	FRw		FRw
Balance b/f	840,000	Disposal	240,000
Cash/bank	200,000	Balance c/f	800,000
	1,040,000		1,040,000

Plant and machinery accumulated depreciation account

	FRw		FRw
Disposal	180,000	Balance b/f	306,000
Balance c/f	326,000	Income statement (W2)	200,000
	506,000		506,000

Plant and machinery – disposal account

	FRw		FRw
Plant & machinery – cost	240,000	Accumulate depreciation	180,000
Income statement - profit	10,000	Cash/bank	70,000
	250,000		250,000

Workings

W1: Depreciation of office building

FRw2m/40 (remaining useful life) = FRw50,000

W2: Depreciation of plant and machinery

25% x (FRw840,000 – FRw240,000 + FRw200,000) = FRw200,000

QUESTION 63:

The plant and machinery at cost account of a business for the year ended 30 June 2009 was as follows

Plant and machinery – cost

2008	FRw	2008	FRw
1 July Balance	240,000	30 Sept. Disposal account	60,000
2009		2009	
1 Jan Cash – purchase of plant	160,000	30 Jun Balance	340,000
	400,000		400,000

The company’s policy is to charge depreciation at 20% per year on the straight-line basis, with proportionate depreciation in the years of purchase and disposal.

What should be the depreciation charge for the year ended 30 June 2009?

QUESTION 66

Cotraco had the following balances as at 01April 2009 the start of the year.

	Cost FRw	Accumulated depreciation FRw
Equipment	840,000	210,000
Motor vehicles	7,600,000	4,100,000

During the year the following transactions took place:

- Equipment was acquired during the year for FRw170,000 cash
- Motor vehicle that cost FRw3,600,000 with carrying amount of FRw500,000 was sold to Rwanda motors the supplier, for FRw450,000, and another new motor vehicle bought for FRw4,000,000 Cotraco paying the difference in cash.
- The depreciation policy is as follows: Equipment: 15% Reducing balance basis; Motor vehicles: 20% Reducing balance basis
- Full years depreciation is charged in the year of acquisition and none in the year of disposal

Required:

- Equipment and Motor vehicles at cost account ;
- Accumulated (provision for) depreciation – Equipment and Motor vehicles
- Disposal of motor vehicles account

EXERCISE : QUESTION 67

At 31 December 2008 Quantum, a business, owned land that cost FRw4,000,000 and a building that cost FRw8,000,000 on 1 January 1999.

The building was depreciated at 2% per year while the land was not depreciated.

On 1 January 2009 a revaluation to FRw10,000,000 was recognized for the building and to FRw5,000,000 for the land. At this date the building had a remaining useful life of 40 years.

Required:

- The revaluation reserve balance as at 1 January 2009?

-The depreciation charge for the year ended 31 December 2009.

QUESTION 69. TRIAL BALANCE AS AT 31st OCTOBER 2009

	RWF('000')	RWF('000')
Cash at Bank	600 000	
Cash at hand	500 000	
Capital		973 000
Drawings	200	
Loan to be repaid in 2012 – BK		100 000
Insurance expense	1 000	
Interest expense	500	
Debtors and Creditors	2 800	3 500
Office Equipment (cost) and accumulated depreciation	8 000	4 000
Motor van (cost) and accumulated depreciation	45 000	23 000
Stock (inventory), 01/11/2008	100	
Discount allowed and Discount received	30	20
Purchases and Sales	5 600	60 000
Sales returns and Purchases returns	50	60
Rent expense	200	
Carriage out	20	
Transport in	80	
TOTAL	**1 163 580**	**1 163 580**

Additional information:

- Inventory (Stock), 31/10/2009 FRw25,000
- Insurance is prepaid FRw 100,000
- Interest payable is FRw 200,000
- Accrued rental income of FRw 250,000
- Depreciation is 10% straight line for office equipment and 20% reducing balance method for motor vehicles

Required: Prepare for Karungu Ltd

- **A income statement (trading, profit and loss account) for year ended 31st October 2009**
- **A balance sheet as at 31st October 2009**

Capital		959,000
Drawings	22,000	
Loan from KCB (to repay 2015)		35,000
Accounts receivable and Accounts payable	60,000	8,000
Loan from Amasezerano (to repay Dec 2009)		15,000
Bank overdraft		3,000
Carriage out	16,000	
Carriage in	40,000	
Returns in	43,000	
Returns out		15,000
Discount allowed	10,000	
Discount received		6,000
Salaries and wages	245,300	
Advertising expense	14,000	
Maintenance and repairs	130,400	
Electricity and water	30,700	
Interest expenses	35,600	
Interest income		14,000
Rental income		80,000
Opening inventory	31,000	
Purchases and Sales	493,000	950,000
Cash	7,000	
Short term investment	43,000	
Bad debts	14,000	
Allowance for doubtful debt		35,000
Equipment (cost) and Accumulated depreciation	350,000	40, 000
Furniture and fittings (cost) and Accumulated depreciation	120,000	25,000
Land and buildings	480,000	
TOTAL	**2 185 000**	**2 185 000**

Additional information:

- The closing inventory was FRw23,000
- Interest income accrued amounted to FRw14,000
- Rental income received in advance FRw10,000
- Cash power (electricity) paid for in advance FRw5,000 and water bill unpaid FRw11,000
- Allowance for doubtful debt to be reduced to FRw30,000
- The depreciation for equipment is 5% reducing balance basis and for furniture and fittings is 5% straight line. No depreciation for land and buildings.

Required: In vertical format for Agnes:

- Income statement for the year ended 30 June 2009
- Balance sheet as at 30 June 2009

QUESTION 72 : SUSAN TRIAL BALANCE AS AT 31st JULY 2009

Capital	-	900 000
Buildings (cost) and Accumulated depreciation	850 000	50 000
Furniture (cost) and Accumulated depreciation	240 000	40 000
Equipment (cost) and Accumulated depreciation	163 000	13 000
Long term investment	160 000	-
Discount allowed and Discount received	4 600	6 500
Opening inventory	52 200	-
Cash	4 500	-
Accounts receivable and Accounts payable	60 000	70 000
Bank overdraft	-	14 500
Loan (repayable in 2011)	-	300 000
Purchases and Sales	560 000	1 050 000
Loan (repayable on 30 December 2009)	-	60 000
Salaries and Wages	180 000	-
Drawings	25 000	-
Interest income	-	11 500
Carriage out	3 500	-
Carriage in	5 600	-
Electricity and water	9 500	-
Insurance	44 000	-
Returns in and Returns out	7 000	4 000
Interest expense	36 800	-
Rent expense and Rent income	29 800	14 000
General expenses	76 000	-
Bad debts and Allowance for doubtful debt	30 000	8 000
TOTAL	**2 541 500**	**2 541 500**

The account balances extracted from the books of Susan as at 31 July 2009

Adjustment required:

Closing inventory at 31 July 2009 was FRw60,600

Water bill accrued amounted FRw1,400

Interest income accrued FRw 6,600

Electricity expense prepaid FRw1,500

Interest expense unpaid FRw10,000

Rent expense accrued FRw2,200

Depreciation:

Buildings: 5% Straight line basis;

Furniture: 10% Reducing balance basis;

Equipment: 20% Reducing balance basis

The allowance for doubtful debt is to be adjusted to Rwf10,000

You are required to prepare:

- Susan’s Income statement for the year ended 31 July 2009
- Susan’s Balance sheet as at 31 July 2009

CHAPTER SIX :

RECTIFICATION OF ERRORS AND SUSPENSE ACCOUNTS

6.1. RECTIFICATION OF ERRORS

- While recording transactions, posting to the various accounts and extraction of list of account balances, it is possible for errors to be committed.
- Such errors may or may not affect the totals of the list of account balances.
- It is possible for some errors to not affect the totals being equal for the list of account balances

There are two major types of errors in accounts:

- Errors that do not affect the List of account balances (trial balance)
- Errors that do affect the List of account balances (trial balance)

A. Errors that do not affect the Trial balance

The following errors will not affect the totals of list of account balances

i)Error of omission

- Here, a transaction is completely omitted from the accounts and therefore the double entry is not made. For example a sales invoice of FRw.400 is not posted in the sales journal therefore no entry is made in the debtor's account and the sales account.
- That is both debit of Frw.400 in debtor's account and Sales account of Frw. 400

The effect of the omission error of the sales invoice is that it understates both the debtors and the sales. To correct this error, the transaction is posted in the books by:

	FRw	FRw
Debit Account to be debited	XX	
Credit Account to be credited		XX
To correct error of omission		

	FRw	FRw
Debit Debtors account	400	
Credit Sales account		400
To correct error of omission		

(ii) Error of Commission

This error occurs when a transaction is posted to a wrong account but the account is of the correct class of account.

Example: a credit sale to T Thierry is posted to L Thierry's account for an amount of FRw. 200. Instead of a debit to T Thierry's account it is made to
L Thierry's account and the corresponding credit in the sales account is correct.

To correct this error

Although the debit entry is made into the wrong account, the two accounts are of the same class of Debtors.
To correct this error a transfer is made from L Thierry's account to T Thierry by:

	FRw	FRw
Debit Account to be debited	XX	
Credit Account to be credited		XX
To correct error of commission		

	FRw	FRw
Debit T Thierry account	200	
Credit L Thierry account		200
To correct error of commission		

(iii)Error of principle

This type of error occurs when a transaction is posted to the wrong class of account. For example, Furniture purchased for FRw. 4,000 cash is debited to the Furniture repairs account instead of debiting Furniture account, and the credit entry in the cashbook is correct.

The furniture is a non-current asset, and a furniture repair is an expense. Therefore a capital expenditure has been posted as revenue expenditure.

To correct such an error, the amount in the wrong class of account has to be removed and transferred to the right class of account.
For this example

	FRw	FRw
Debit Furniture account	4,000	
Credit Furniture repairs account		4,000
To correct error of principle		

(iv)Complete reversal of entries

A transaction is posted to the correct accounts but to the wrong sides of the accounts. That is a debit is posted as a credit and a credit is posted as a debit in the right accounts. For example, discount received of FRw.560 is debited in the Discount received account and credited in the Creditor's account.

To correct such an error, the entries have to be reversed first to cancel or correct the initial mistake then record the transaction rightly. As such the amounts will double.

For this example:

This involves the two steps as follows

	FRw	FRw
Debit Creditor's account	560	
Credit Discount received account		560
To cancel the wrong transaction		

	FRw	FRw
Debit Creditor's account	560	
Credit Discount received account		560
To record the correct transaction		

	FRw	FRw
Debit Creditor's account	1,120	
Credit Discount received account		1,120
To correct error of complete reversal of entries		

Notice the account to be debited is debited twice and account to be credited is credited twice too.

(v)Error of Original entry

Here a transaction is posted to the correct accounts but the amount posted is not correct. That is, it is either under/over stated. It is possible that the figure in the amount might be interchanged. Such is a transposition error.

For example, cash received from a debtor of FRw.980 is credited to the customer's account as FRw.890. The amounts were understated by FRw.90 (always a factor of 9)

To correct this error, the amount understated or overstated is posted to these accounts so as to increase or reduce the amounts in the accounts to get the right amount. For this example:

	FRw	FRw
Debit debtors account	90	
Credit Cash Account		90
To correct error of original entry		

(vi)Compensating Errors

These are errors that have the effect that tend to cancel out each other in amounts. That is, if the effect of one error is to understate the debits or credits then another error may take place to overstate the debits or credits by the same amount, hence canceling out each other. For example, if the balance c/d of the purchases a/c is FRw.3,980 but shown in the trial balance as FRw.3,890 and another error carried to the trial balance of fixture amounting to FRw.4,540 instead of FRw.4,450:

Purchases	FRw
Right amount	3,980
Wrong amount	3,890
Understatement	90
Fixtures	
Right amount	4,450
Wrong amount	4,540
Overstated	90

The overall effect is nil on the debit side. Notice that the two accounts involved have debit balances. It is possible to have canceling effect even accounts with credit balances or even a mixture. The main thing is that, the effect on totals is nil.

To correct such errors, the accounts involved have to be corrected to take care of the amounts overstated or understated. For this example

	FRw	FRw
Debit Purchases account	90	
Credit Fixtures account		90

To correct compensating error

Example

Give the journal entries needed to record the corrections of the following. Narratives are required.

1) Extra capital of FRw. 10,000 paid into the bank had been credited to Sales account.

2) Goods taken for own use FRw. 700 had been debited to General Expenses.

3) Private insurance FRw. 89 had been debited to Insurance account.

4) A purchase of goods from C Kelly FRw. 857 had been entered in the books as FRw. 587.

5) Cash banked FRw. 390 had been credited to the bank column and debited to the cash column in the cashbook.

6) Cash drawings of FRw. 400 had been credited to the bank column of the cashbook.

7) Returns inwards FRw. 168 from M McCarthy had been entered in error in J Charlton's account.

8) A sale of a motor van FRw. 1,000 had been credited to Motor Expenses.

Solution

	FRw	FRw
Debit Sales account	10,000	
Credit Capital account		10,000
To correct principle error		
Debit Drawings account	700	
Credit General expenses account		700
To correct principle error		
Debit Drawings account	89	
Credit Insurance account		89
To correct principle error		
Debit Purchases account	270	
Credit C Kelly account		270
To correct error of original entry		
Debit Bank account	780	
Credit Cash account		780
To correct error of complete reversal		
Debit Bank account	400	
Credit Cash account		400
To correct commission error		
Debit J Charlton account	168	
Credit M McCarthy account		168
To correct commission error		
Debit Motor expenses account	1,000	
Credit Motor disposal account		1,000
To correct principle error		

QUESTION 74: The following errors were discovered in the accounts for the year ended 31 December 2009

1. Vehicle repairs of Rwf240,000 were debited to the Motor vehicles a/c
2. Insurance expense of Rwf 60,000 was debited in the maintenance expense a/c
3. Purchase on credit from Samsung Rwf47,000 was credited in Purchases account and debited in Sumsung account
4. The debit side of Bank account was overcast by Rwf26,000 while the sales account had been overstated by the same amount.
5. Purchases invoice of Rwf23,000 from Rigotech was discovered under the office tray unrecorded
6. Purchase of Machinery for Rwf560,000 was debited in the fuel and electricity account
7. Payment by cheque for acquisition of furniture for Rwf352,000 was debited in the bank account and credited in the furniture account.
8. Cash sales of 142,000 was recorded in both accounts as FRw124,000

Required: Prepare journal entries to correct these errors

B. Errors that do affect the List of account balances (trial balance) and the suspense account

These errors will affect the totals of the list of account balances.. The totals of debit balances will not equal the totals of credit balances.

The likely causes may be as follows:

(i)Transaction amount is posted only on one side of the accounts. That is, only a debit entry or a credit entry.

Example cash received from a debtor is debited to the cashbook and not credited to the debtor’s account

(ii) A transaction is posted only on one side of both accounts. That is, two debits or two credits instead of following double entry.

Example, a payment to a creditor of FRw. 300 is credited in the cashbook and also credited in the creditor’s a/c

b) Errors that do affect the List of account balances (trial balance) and the suspense account(con't)

(iii)A transaction is posted correctly following double entry but different amounts. That is, debit amount is not the same as the credit amount.

Example, cash received from a debtor of Rwf. 450 is debited in the cashbook as Rwf. 450 and credited as Rwf. 540 in the debtor's a/c

(iv)Error on balances of accounts.

For example, understatement or overstatement of an account balances due to mathematical errors.

(v)Balance on an account is shown on the wrong side of the account when opening the ledger accounts or when taken up to the trial balance.

Example Bal c/d for cash at bank of Rwf. 2,000 is shown as a credit that is, an overdraft, instead of a debit in trial balance.

(vi)A balance is omitted from the trial balance.

To correct such errors, only one account will be needed. The other account to fulfill double entry will be the *suspense* account.

- Suspense account is a temporary account that is opened to take care of differences between the total in the list of account balances.
- The balance to be shown on the suspense accounts depends on which side of the list of account balances has the lower total.
- If the debits totals exceed total credits, then an amount is included on the credit side of the list of account balances so that the debits equal credits and is called Suspense account.
- If the credits totals exceed total debits, then an amount is included on the debit side of the list of account balances so that the debits equal credits

For example

	Debit FRw	Credit FRw
Totals	65,200	63,800
Suspense account		1,400
	65,200	65,200

Suspense account

	FRw.		FRw.
		Balance b/f	1,400

- **Example**

A bookkeeper extracted a list of account balances on 31 December 2009 that failed to agree by FRw.3,300, a shortage on the credit side of the list of account balances. A suspense account was opened for the difference.

- In January 2010 the following errors made in 2009 were found:

I. Sales daybook had been undercast by FRw.1,000.
II. Sales of FRw.2,500 to J Church had been debited in error to J Chane account.
III. Rent account had been undercast by FRw.700.
IV. Discounts received account had been under cast by FRw.3,000.
V. The sale of a motor vehicle at book value had been credited in error to Sales account FRw.3,600.

You are required to:

Show the journal entries necessary to correct the errors.

Draw up the suspense account after the errors described have been corrected.

Solution

	FRw	FRw
Debit Suspense account	1,000	
Credit Sales account		1,000
Sales undercast now corrected		
Debit J Church account	2,500	
Credit J Chane account		2,500
To correct commission error		
Debit Rent account	700	
Credit Suspense account		700
To correct undercast in rent account		
Debit Suspense account	3,000	
Credit Discount received account		3,000
To correct undercast in the account		
Debit Sales account	3,600	
Credit Disposal account		3,600
To correct principle error		

Suspense account

	FRw.		FRw.
Sales	1,000	Balance b/f	3,300
Discount received	3,000	Rent	700
	4,000		4,000

- **Statement of corrected profit and revised balance sheet**
- It is possible after preparation of financial statements, that errors are discovered and corrected. In there correction, profit originally calculated may be affected.

Furthermore the balances reported in the balance sheet may also change.

Continuing from previous example

- If the net profit had previously been calculated at FRw.79,000 for the year ended 31 December 2009, show the calculations of the corrected net profit
- The errors that will affect the net profit are those in (i), (iii) and (iv) only.
- Notice the error in note (ii) does not affect net profit since there is no income or expense item affected.
- Error (v) does not affect net profit since both items are incomes and increase in one decreases the other.

Statement of corrected net profit

	FRw.	FRw.
Net profit as per account		79,000
Add:		
Sales	1,000	
Discount received	3,000	4,000
		83,000
Less:		
Rent		700
Corrected net profit		82,300

Example2

The balance sheet of N Patel, a sole trader, as at 31 March 2010 was as follows:

	FRw000	FRw000		FRw000	FRw000
Capital 1 April 2009		1,890	Land and buildings (at valuation)		1,650
Profit for the year ended 31 March 2010	450		Machinery (at cost)	1,200	
Deduct: drawings	150	300	Deduct: depreciation	750	450
Creditors		630	Inventory at cost	570	
Bank overdraft		270	Debtors	420	990
		3,090			3,090

Further investigation reveals the following information:

- The closing inventory includes damaged goods, which, although they had cost FRw.10,000 have an estimated sale value of FRw.7,500.
- Debtors include FRw.20,000 in respect of a customer who has gone bankrupt. Allowance for doubtful debts of 2.5% is also required on the balance of the debtors.
- The machinery was acquired five years ago and is being depreciated to its scrap value on a straight-line basis over eight years. A more realistic estimate indicates that the life span will be 10 years.
- Wages owing at 31 March 2010 amounted to FRw.9,500 but this has not been reflected in the accounts.
- Charges for the bank overdraft, amounting FRw.8,000 have not been reflected in the accounts.
- In arriving at the profit for the period, a drawing of FRw.100,000 paid to Mr. Patel had been deducted as an expense.
- FRw.20,000 rent owing to Mr. Patel for the letting of part of his business premises to external party had not been received and no entry had been made in the books in respect of this item.
- **Required: 1) Journal entries to correct errors and omissions.**

2) A statement of revised profit and a revised balance sheet for the year ended 31 March 2010

Solution

Journal entries to correct errors and omissions.

	FRw	FRw
Debit Income statement	2,500	
Credit Inventory account		2,500
Write off of stock to net realizable value		
Debit Bad debts account	20,000	
Credit Debtors account		20,000
Write off of bad debt for a debtor gone bankrupt		
Debit Income statement	10,000	
Credit Allowance for bad debt account		10,000
Providing for doubtful debts (2½%x(420,000-20,000))		
Debit Wages expense account	9,500	
Credit Accrued wages expense account		9,500
To record wages owing		
Debit Bank charge account	8,000	
Credit Bank account		8,000
To record bank overdraft charge		
Debit Drawings account	100,000	
Credit Income statement account		100,000
To correct error of principle (drawings treated as an expense)		
Debit Accrued rent income account	20,000	
Credit Rent income account		20,000
To record rent income owing		

Statement of adjusted net profit

	FRw	FRw
Net profit as per the account		450,000
Add:		
Drawings	100,000	
Accrued rent income	20,000	120,000
		570,000
Less:		
Stock reduction	2,500	
Bad debts	20,000	
Allowance for doubtful debts	10,000	
Accrued wages	9,500	
Bank charges	8,000	(50,000)
Revised Net profit		520,000

To prepare the revised balance sheet, it necessary to find out the effects of each additional information and see the effect on the assets, liabilities and capital. From the journal entries, all the additional notes affect the balance sheet items.

Revised balance sheet as at 31 March 2010

Non-current assets	FRw	FRw	FRw
Land and buildings	1,650,000	-	1,650,000
Machinery	1,200,000	(750,000)	450,000
Current Assets			2,100,000
Inventory		567,500	
Debtors	400,000		
Allowance for doubtful debts	(10,000)	390,000	
Accrued rent income		20,000	
			977,500
			3,077,500
Capital			1,890,000
Net Profit			520,000
			2,410,000
Drawings			(250,000)
Current liabilities			2,160,000
Creditors		630,000	
Accrued wage expense		9,500	
Bank overdraft		278,000	
			917,500
			3,077,500

QUESTION 76

Uwamwiza had extracted the list of account balances which did not agree by a figure of FRw51,000, credit totals exceeding debit totals. She went ahead and prepared the income statement for the year ended 30 September 2009 which showed a profit of FRw1,030,000.

After going through the accounts, she discovered the following errors.

1. The discount allowed total for the month of June 2006 of FRw 47,500 was credited in the discount received account, otherwise the specific entries in the accounts receivable was right.
2. A sales invoice to Mucuruzi of FRw 52,000 was discovered under the office table unrecorded.
3. A credit note issued by the entity to Mujenzi of FRw4,700 was debited in Mujenzi's account and credited in the returns in account.
4. Purchases of FRw33,000 by cheque was debited in the equipment account.
5. Rent expense of FRw 77,000 was debited in the insurance expense account.
6. Payment by cheque of FRw21,000 for advertisement was debited in both accounts.
7. The returns in daybook was overcast by FRw 2,000

Required:

- **Prepare the journal entries with narratives to correct these errors**
- **Prepare the suspense account after correcting the errors**
- **Prepare a statement of corrected profit or loss for the period**