MGT101 PPT Slides (Module) 10 To 18 Complete

Chapter - 10

Fixed Assets and Depreciation Accounting

MGT 101
Financial Accounting

By
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Contents

Fixed Assets Accounting

Basic Definitions and Concepts

Property Plant and Equipment

- These are assets that will be used over a period of time (in excess of one year)
- These are not held for re-sale in the normal course of trading
- These may be held for:
  - Production of goods or services
  - Selling of goods or services
  - Administrative purposes
  - Rental to others

Recognition Criteria

- Cost can be measured reliably
- Probability of inflow of economic benefits in future

Measurement at Recognition

- Purchased, constructed or manufactured assets are initially measured at cost
- Exchanged assets are initially measured at fair value, unless:
- The exchange transaction lacks commercial substance or
- Fair value cannot be determined, in these circumstances; carrying amount of the asset given up will be the value of the asset taken in exchange.

Measurement after Recognition

After once recognized the items of property, plant and equipment are measured at either of the two models:

- Cost model
- Revaluation model **(not in syllabus)**

Cost Components

- Purchase price less trade discounts and rebates
- Import duties
- Non-refundable purchase taxes
- Directly attributable cost
- Estimated cost of dismantling, removal and site restoration

Depreciation & Depreciable Amount

- Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life

- Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value

Useful Life

- Period over which an asset is expected to be used; or
- Number of production units expected to be obtained from the asset

Depreciation rate is determined based on useful life and residual value of the asset.

Accounting for Fixed Assets

Depreciation Methods and Depreciation Rates

Depreciation Methods

- Straight line method
- Reducing balance method
- Sum of years digit method
- Number of units output method
- Number of service hours method

Practice 10.1

Machine bought on 1.1.20X9 for Rs.80,000. Its residual value is estimated Rs.2,000 with 4 years useful life. It can work for 12,000 hours in total and can produce 40,000 units in total (as per the estimate given by expert)

Following are its actual results in 20X9 and 20Y0

Year	Service Hours	Units Produced
20X9	2,000	7,000
20Y0	5,000	15,000

Calculate depreciation for two years using each of the following methods:

1. Straight line method
2. Reducing balance method
3. Service hour method
4. Units produced method
5. Sum of years' digit method

Answer – Practice 10.1

	Rs.
Cost of Machine	80,000
Less Residual value	(2,000)
Depreciable amount	**78,000**

1. **Straight Line Method**

$$\frac{\text{Depreciable Amount}}{\text{useful Life}} = \text{Depreciation}$$

$\frac{78{,}000}{4} = 19500$	Year 20X9	Rs. 19,500
78,000 x 25%	Year 20Y0	Rs. 19,500

Answer – Practice 10.1

2. **Reducing Balance Method**

$$\left(1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost}}}\right) \times 100 = \%$$

Where n = useful life

$$\left(1 - \sqrt[4]{\frac{2{,}000}{80{,}000}}\right) \text{x } 100 = 60\%$$

Year 20X9	80,000 x 60%	Rs. 48,000
Year 20Y0	32,000 x 60%	Rs. 19,200

Under reducing balance method first year's depreciation is calculated by applying depreciation rate on cost, whereas in subsequent years depreciation is calculated by applying depreciation rate on opening balance of Net Book Value (NBV).

Answer – Practice 10.1

3. Service Hours Method/Usage method

$$\frac{\text{Depreciable Amount}}{\text{Total Estimated Hours}} = \text{Depreciation Rate Per Hour}$$

$$\frac{78{,}000}{12{,}000} = Rs.6.50 PerHour$$

Year 20X9	2,000 x 6.50	Rs. 13,000
Year 20Y0	5,000 x 6.50	Rs. 32,500

4. Units Output/Production Method

$$\frac{\text{Depreciable Amount}}{\text{Total Estimated Output}} = \text{Depreciation Rate Per Unit}$$

$$\frac{78{,}000}{40{,}000} = Rs.1.95 PerUnit$$

Year 20X9	7,000 x 1.95	Rs. 13,650
Year 20Y0	15,000 x 1.95	Rs. 29,250

Answer – Practice 10.1

5. Sum of Years' Digit Method

Year				Rs.
20X9	1	78,000 x 4/10	=	31,200
20Y0	2	78,000 x 3/10	=	23,400
20Y1	3	78,000 x 2/10	=	15,600
20Y2	4	78,000 x 1/10	=	7,800

Sum of years 1 + 2 + 3 + 4 = 10. In the year 20X9 i.e. first year the Machine is expected to be used for 4 year, in second year the Machine is expected to be used for 3 years, in third year the Machine is expected to be used for next 2 years and in last year the Machine is expected to be used in the current year only.

Important Tips To Remember - ITTR

1. Selection of depreciation method depends upon the pattern of economic benefits associated to the asset
2. Except for reducing balance method; for all the other methods first calculate depreciable amount and then work out depreciation expense

Accounting for Fixed Assets

Basic Accounting for Depreciation

Depreciation – Accounting Entries

Fixed Asset
    Cash/Bank/Creditor
(Purchase of Fixed Asset)

Depreciation Expense
    Provision for Depreciation
(Depreciation expense FTY)

Profit & Loss
    Depreciation Expense
(Closing entry for expense)

Practice 10.2

20X9		*Rs.*
Jan 1,	Plant and Machinery b/f	25,000
Jan 1,	Accumulated Depreciation b/f	10,000
July 1,	Purchased New Plant	20,000

Prepare Plant and Machinery Account and Provision for Depreciation Account for the year ending on December 31, 20X9 assuming the following scenarios:

I

Depreciation method	Reducing Balance Method
Depreciation rate	10%
Depreciation basis	Full year depreciation in the year of purchase

Practice 10.2

II

Depreciation method	**Reducing Balance Method**
Depreciation rate	**10%**
Depreciation basis	**Time proportionate**

III

Depreciation method	**Straight Line Method**
Depreciation rate	**10%**
Depreciation basis	**Full year depreciation in the year of purchase**

IV

Depreciation method	**Straight Line Method**
Depreciation rate	**10%**
Depreciation basis	**Time proportionate**

Answer - Practice 10.2

I – Reducing Balance Method – Full Year Depreciation

Plant and Machinery account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	25,000	Dec 31 Balance c/f	45,000
July 1 Bank	20,000		
	45,000		**45,000**

Provision for Depreciation

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Dec 31 Balance c/f	13,500	Jan 1 Balance b/f	10,000
		Dec 31 Depreciation Expense	3,500
	13,500		**13,500**

Opening NBV x rate 25,000 – 10,000 = 15,000 x10%	**Rs. 1,500**
New Machine 20,000 X 10% Fully Year	**Rs. 2,000**
	3,500

Answer – Practice 10.2

II – Reducing Balance Method – Time Proportionate Depreciation

Plant and Machinery account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	25,000	Dec 31 Balance c/f	45,000
July 1 Bank	20,000		
	45,000		**45,000**

Provision for Depreciation

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Dec 31 Balance c/f	12,500	Jan 1 Balance b/f	10,000
		Dec 31 Depreciation Expense	2,500
	12,500		**12,500**

Opening NBV x rate 25,000 – 10,000 = 15,000 x10% Rs. 1,500
New Machine 20,000 X 10% x 6/12 Rs. 1,000
2,500

Answer – Practice 10.2

III – Straight Line Method – Full Year Depreciation

Plant and Machinery account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	25,000	Dec 31 Balance c/f	45,000
July 1 Bank	20,000		
	45,000		**45,000**

Provision for Depreciation

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Dec 31 Balance c/f	14,500	Jan 1 Balance b/f	10,000
		Dec 31 Depreciation Expense	4,500
	14,500		**14,500**

Closing Balance of Asset x rate = 45,000 x10% Rs. 4,500

Answer – Practice 10.2

IV – Straight Line Method – Time Proportionate Depreciation

Plant and Machinery account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	25,000	Dec 31 Balance c/f	45,000
July 1 Bank	20,000		
	45,000		**45,000**

Provision for Depreciation

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Dec 31 Balance c/f	13,500	Jan 1 Balance b/f	10,000
		Dec 31 Depreciation Expense	3,500
	13,500		**13,500**

Opening NBV x rate = 25,000 x10%	Rs. 2,500
New Machine = 20,000 X 10% x 6/12	Rs. 1,000
	3,500

Important Tips To Remember - ITTR

1. Provision for depreciation is contra to asset account
2. Depreciation is a charge against usage of fixed asset, if nothing is mentioned then calculate depreciation on time proportion basis

Accounting for Fixed Assets

Disposal of Fixed Assets
Accounting Entries

Depreciation – Accounting Entries

1. Asset Disposal
   Fixed Asset

(Asset transferred to asset disposal account, with the amount of gross carrying amount / cost of asset)

2. Provision for Depreciation
   Asset Disposal

(Accumulated depreciation balance till the date of disposal transferred to asset disposal account)

3. Bank
   Asset Disposal

(Disposal Consideration / sales proceeds received on disposal of the asset)

4. Gain/Loss – on Disposal

a) Asset Disposal
   Income Statement

(Profit/Gain on disposal of asset transferred to income statement for the period)

b) Income Statement
   Asset Disposal

(Loss on disposal of asset transferred to income statement for the period)

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Practice – Scenario I

Disposal of Fixed Assets at the start of the year – for loss

Practice 10.3

On Jan. 1 20X9 machine costing Rs.70,000 and accumulated depreciation being Rs.50,000 was sold for Rs.15,000 on Jan 1 20X9.

Depreciation – Accounting

Machine Account

Particulars	**Rs.**	**Particulars**	**Rs.**
20X9		**20X9**	
Jan 1 Balance b/f	70,000	Jan 1 Disposal a/c	70,000
		Balance c/f	Nil
	70,000		**70,000**

Provision for Depreciation Account

Particulars	**Rs.**	**Particulars**	**Rs.**
20X9		**20X9**	
Jan 1 Disposal a/c	50,000	Jan 1 Balance b/f	5,000
Balance c/f	Nil		
	50,000		**50,000**

Asset Disposal Account

Particulars	**Rs**	**Particulars**	**Rs**
20X9		**20X9**	
Jan 1 Machine a/c	70,000	Jan 1 Provision for depreciation	50,000
		Jan 1 Cash a/c	15,000
		Dec 31 Income Statement (Loss)	5,000
	70,000		**70,000**

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Practice – Scenario II

Disposal of Fixed Assets at the start of the year – for gain

Practice 10.3

On Jan. 1 20X9 machine costing Rs.70,000 and accumulated depreciation being Rs.50,000 was sold for Rs.22,000 on Jan 1 20X9.

Depreciation – Accounting

Machine Account

Particulars	Rs	Particulars	Rs
20X9		**20X9**	
Jan 1 Balance b/f	70,000	Jan 1 Disposal a/c	70,000
		Balance c/f	Nil
	70,000		**70,000**

Provision for Depreciation Account

Particulars	Rs.	Particulars	Rs.
2009		**20X9**	
Jan.1 Disposal a/c	50,000	Jan 1 Balance b/f	50,000
Balance c/f	Nil		
	50,000		**50,000**

Asset Disposal account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan. 1 Machine a/c	70,000	Jan 1 Provision for depreciation	50,000
Dec.31 Income Statement (Profit)	2,000	Jan 1 Cash a/c	22,000
	72,000		**72,000**

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Practice – Scenario III

Disposal of Fixed Assets during the year – for loss

Practice 10.3

On Jan. 1 20X9 machine costing Rs.70,000 and accumulated depreciation being Rs.50,000 was sold for Rs.15,000 on Jan 30 20X9.

The machine was depreciated at 10% on reducing balance method

Depreciation – Accounting

Machine Account

Particulars	**Rs.**	**Particulars**	**Rs.**
20X9		**20X9**	
Jan 1 Balance b/f	70,000	June 30 Disposal a/c.	70,000
		Balance c/f	Nil
	70,000		**70,000**

Provision for Depreciation Account

Particulars	**Rs.**	**Particulars**	**Rs.**
20X9		**20X9**	
June 30 Disposal a/c.	51,000	Jan 1 Balance b/f	50,000
Balance c/f	Nil	June 30 Depreciation expense	1,000
	51,000		**51,000**

Depreciation – Accounting

Asset Disposal Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Machine a/c.	70,000	June 30 Provision for depreciation	51,000
		June 30 Cash a/c.	15,000
		Dec 31 Income Statement (Loss)	4,000
	70,000		**70,000**

Depreciation Expense Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Provision for Dep.	1,000	Dec 31 Income Statement	1,000
	1,000		**1,000**

Cost	70,000	
Less Accumulated Depreciation	50,000	
NBV	20,000	$\times 10\% = 2{,}000 \times \frac{6}{12} = 1{,}000$

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Practice – Scenario IV

Disposal of Fixed Assets during the year – for gain

Practice 10.3

On Jan. 1 20X9 machine costing Rs.70,000 and accumulated depreciation being Rs.50,000 was sold for Rs.15,000 on Jan 30 20X9.

The machine was depreciated at 10% on straight line method

Depreciation – Accounting

Machine Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	70,000	June 30 Disposal a/c	70,000
		Balance c/f	NIL
	70,000		**70,000**

Provision for Depreciation Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Disposal	53,500	Jan 1 Balance b/f	50,000
Balance c/f	NIL	June 30 Depreciation Expense*	3,500
	53,500		**53,500**

*** Working:**

NBV 70,000 $\times 10\% = 7{,}000 \times \frac{6}{12} = 3{,}500$

Depreciation – Accounting

Asset Disposal Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Machine a/c	70,000	June 30 Provision for depreciation	53,500
Dec.31 Income Statement (Profit)	5,500	June 30 Cash A/c	22,000
	75,000		**75,500**

Depreciation Expense Account

Particulars	Rs	Particulars	Rs
20X9		**20X9**	
June 30 Provision for Dep	3,500	Dec 31 Income Statement	3,500
	3,500		**3,500**

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Practice – Scenario IV

Disposal of Fixed Assets during the year – for gain

Practice 10.3

On Jan. 1 20X9 machine costing Rs.70,000 and accumulated depreciation being Rs.50,000 was sold for Rs.15,000 on Jan 30 20X9.

The machine was depreciated at 10% on straight line method

Depreciation – Accounting

Machine Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
Jan 1 Balance b/f	70,000	June 30 Disposal a/c	70,000
		Balance c/f	NIL
	70,000		**70,000**

Provision for Depreciation Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Disposal	53,500	Jan 1 Balance b/f	50,000
Balance c/f	NIL	June 30 Depreciation Expense*	3,500
	53,500		**53,500**

*** Working:**

NBV $70{,}000 \times 10\% = 7{,}000 \times \frac{6}{12} = 3{,}500$

Depreciation – Accounting

Asset Disposal Account

Particulars	Rs.	Particulars	Rs.
20X9		**20X9**	
June 30 Machine a/c	70,000	June 30 Provision for depreciation	53,500
Dec.31 Income Statement (Profit)	5,500	June 30 Cash A/c	22,000
	75,000		**75,500**

Depreciation Expense Account

Particulars	Rs	Particulars	Rs
20X9		**20X9**	
June 30 Provision for Dep	3,500	Dec 31 Income Statement	3,500
	3,500		**3,500**

Important Tips To Remember - ITTR

1. Identify the amount of accumulated depreciation till the date of disposal in accordance with depreciation basis (full year or time basis)
2. Transfer accumulated depreciation into disposal account
3. Transfer cost of asset disposed of in asset disposal
4. Asset sold for cash, credit or claim against insurance, the amount will be considered as disposal proceeds

Accounting for Fixed Assets

Exchange of Asset

Exchange of Asset – Trade-in-Allowance

When an old asset is exchanged with a new asset the seller of new asset will offer an allowance while receiving payment for selling asset in consideration of the exchange of old asset. Such allowance is known as “trade in allowance”. The buyer will subtract “trade in allowance” from the cost of new asset while making payment to the seller.

Cost of new asset = Cash consideration + Trade in allowance.
Cost of new asset – trade in allowance = Cash consideration

Asset account will be debited with the cost of new asset i.e., cash paid plus trade in allowance.

Trade in allowance is considered as disposal proceeds of the old asset.

Exchange of Asset – Commercial Substance

When an asset is exchanged with another asset and commercial substance does not exist in such exchange, the cost of asset taken through exchange is carrying amount of asset given up.

But when the commercial substance does exist, then cost of asset taken through exchange would be fair value of asset given up.

When fair value of both assets is not determinable the carrying amount of asset given up would be considered as cost of asset taken through exchange.

Existence of commercial substance means; that the entity specific value (present value of future expected cash flows) of both assets are not equal.

Important Tips To Remember - ITTR

Single accounting entry for disposal of fixed asset

Provision for Depreciation	Dr.
Cash-Trade in Allowance-A/R-Insurance Claim	Dr.
Income Statement (for Loss - if any)	Dr.
Fixed Asset	Cr.
Income Statement (For Gain - if any)	Cr.

Important Tips To Remember - ITTR

Fair value is the price that <u>would be received to sell an asset</u> in an orderly transaction between market participants at the measurement date

Chapter - 11

Control Accounts

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Financial Accounting

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Contents

Control Accounts

Why Control Accounts are Maintained

Representative Account

Control Account is a simple ledger account that represents numerous ledger accounts of similar nature.

Examples include:

1. Trade receivables
2. Trade payables
3. Payroll
4. Inventories

Important Tips To Remember - ITTR

1. Control accounts are prepared in Main Ledger
2. Each control account is backed by a memorandum or subsidiary ledger

Control Account

Format
Debtors' Control Account

Debtors' Control Account

- Sales Ledger Control Account
- Total Debtors Control Account
- Sundry Debtors Control Account
- Trade Receivables Control Account

Format

Debtors' Control A/C
Trade Receivable Control A/C

Opening Dr. Balance b/f	*Opening Cr. Balance b/f*
Credit sales (Invoice issued)	Cash received from debtors
Refund to debtors	Cheques received from debtors
Cheques dishonoured	Bills receivable accepted by debtors
Bills receivable dishonoured	Discount allowed
Interest charged to debtors	Bad debts
	Sales return (Credit note issued)
	Contra / set off / balance transferred
Closing Cr. Balance c/f	*Closing Dr. balance c/f*

Debtors Control Account	
Opening Dr Balance	Opening Cr Balance (unusual)
Closing Cr Balance (unusual)	Closing Dr Balance

Cr balance in Debtors account might arise because of cash received in advance from customers

Important Tips To Remember - ITTR

1. Opening balances are placed at their side of nature
2. Closing balances are placed at the side opposite to their nature

Control Account

Format
Creditors Control Accounts

Creditors' Control Account

- Purchase Ledger Control Account
- Total Creditors Control Account
- Sundry Creditors Control Account
- Trade Payables Control Account

Format

Creditors Control A/C
Trade Payable Control A/C

Opening Dr. Balance b/f	*Opening Cr. Balance b/f*
Cash paid to creditors	Credit purchases (Invoice received)
Cheques paid to creditors	Bills payable dishonoured
Bills payable given to creditors	Interest payable
Discount received	
Purchases return (Credit note received)	
Contra / set off / balance transferred	
Closing Cr. Balance c/f	*Closing Dr. balance c/f*

Creditors Control Account	
Opening Dr Balance (unusual)	Opening Cr Balance
Closing Cr Balance	Closing Dr Balance (unusual)

Dr balance in Creditors account might arise because of cash paid in advance to suppliers

Important Tips To Remember - ITTR

1. Opening balances are placed at their side of nature
2. Closing balances are placed at the side opposite to their nature

Control Account

Contra Entries

Creditors' Control Account

- Contra entry appears in Debtors as well as in Creditors
- Contra entry behaves opposite to the nature of the account

Scenario – Contra Entry

There might be a situation that a person who is Debtor (Customer) for the entity is also a Creditor (Supplier) of the same entity with different outstanding amounts.
For example; Mohsin is Debtor with Rs.700 and Mohsin is also Creditor with Rs.500. In this case contra entry would be required to set-off these two balances. Contra entry is always recorded with lower balance of outstanding amount, in this case Rs. 500.
The contra entry would be:

Creditors Control A/c. (Mohsin) Dr. 500
Debtors Control A/c. (Mohsin) Cr 500

Scenario – Contra Entry

In case Mohsin is Debtor with Rs.700 and Mohsin is also a Creditor with Rs 1,000, the contra entry would remain the same but the amount would then be Rs. 700 the lower one:

Creditors Control (Mohsin) Dr. 700
Debtors Control (Mohsin) Cr 700

Important Tips To Remember - ITTR

1. Contra entry is passed in both accounts i.e., Debtors and Creditors
2. Contra entry is passed in side opposite to the nature of the account
3. Contra entry is passed with lower of the two outstanding amounts

Control Account

Posting from Journal to Individual Accounts maintained in Subsidiary Ledger

Practice 11.1

Books of Original Entries

Purchase Journal / Day book

DATE	PARTICULARS	Rs.
	A	2,000
	B	3,000
	C	1,000
	D	4,000
	A	2,500
	D	1,000
	B	3,000
		16,500

Purchases A/c. Dr
Creditors Control A/c. Cr

Sale Journal / Day book

DATE	PARTICULARS	Rs.
	O	5,000
	P	2,000
	Q	1,000
	O	2,000
	R	7,000
	Q	2,000
	P	3,000
	O	1,000
		23,000

Debtors Control A/c. Dr.
Sales A/c. Cr.

Practice 11.1

Books of Original Entries

Purchase Return Journal / Day book

DATE	PARTICULARS	Rs.
	A	1,500
	C	1,000
	D	2,000
		4,500

Creditors Control a/c Dr
Purchases Return a/c Cr

Sale Return Journal / Day book

DATE	PARTICULARS	Rs.
	P	500
	O	1,500
	Q	1,000
		3,000

Sales Return a/c Dr
Debtor Control a/c Cr

Practice 11.1

Books of Original Entries

General Journal / Transfer Journal

DATE	PARTICULARS	Dr.	Cr.
	Bad Debts A/c.	500	
	Debtor "O" A/c.		500

CASH BOOK

	DISC.	DEBTOR	TOTAL		DISC.	CREDITOR	Total
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
O		3,000		A	100	700	
P	100	150		B		2,000	
Q	50	700		D	200	1,500	
O		2,000		C		2,500	
R		5,000		B		1,000	
P		1,000		A		500	
	150	11,850			300	8,200	

Answer - Practice 11.1

Subsidiary Ledger
Debtors' Ledger / Sales Ledger

O account	Rs.		Rs.
Sales Journal	5,000	Sales Return	1,500
Sales Journal	2,000	Cash Received	3,000
Sales Journal	1,000	Cash Received	2,000
		Bad Debts	500
		Balance c/f	1,000
	8,000		8,000

Q account	Rs.		Rs.
Sales Journal	1,000	S.R.J.	1,000
Sales Journal	2,000	Cash Rec.	700
		Disc All.	50
		Balance c/f	1,250
			3,000

Answer - Practice 11.1

Subsidiary Ledger
Debtors' Ledger / Sales Ledger

P account	Rs.		Rs.
Sales Journal	2,000	Sales Return	500
Sales Journal	3,000	Cash Received	150
		Cash Received	1,000
		Disc. Allowed	100
		Balance c/f	3,250
	5,000		5,000

R account	Rs.		Rs.
Sales Journal	7,000	Cash Rec	5,000
		Balance c/f	2,000
	7,000		7,000

Answer - Practice 11.1

Subsidiary Ledger
Debtors' Ledger / Sales Ledger

LIST	Rs.
O	1,000
P	3,250
Q	1,250
R	2,000
Total	**7,500**

Answer - Practice 11.1

Subsidiary Ledger
Creditors' Ledger / Purchase Ledger

A account	Rs.		Rs.
Purchase return	1,500	Purchase Journal	2,000
Cash Paid	700	Purchase Journal	2,500
Cash Paid	500		
Disc Received	100		
Bal. c/f	1,700		
	4,500		4,500

C account	Rs.		Rs.
Purchase return	1,000	Purchase Journal	1,000
Cash Paid	2,500	Bal. c/f	2,500
	3,500		3,500

Answer - Practice 11.1

Subsidiary Ledger
Creditors' Ledger / Purchase Ledger

B account	Rs		Rs.
Cash Paid	2,000	Purchase Journal	3,000
Cash Paid	1,000	Purchase Journal	3,000
Balance c/f	3,000		
	6.000		6,000

D account	Rs.		Rs.
Purchase return	2,000	Purchase Journal	4,000
Cash Paid	1,500	Purchase Journal	1,000
Disc Received	200		
Balance c/f	1,300		
	5,000		5,000

Answer - Practice 11.1

Subsidiary Ledger
Creditors' Ledger / Purchase Ledger

LIST	Rs.
A	1,700
B	3,000
C	-2,500
D	1,300
Total	**3,500**

Important Tips To Remember - ITTR

1. Individual customers' or suppliers' accounts are maintained as memorandum
2. Subsidiary ledger balances are not taken to Trial Balance

Control Account

Posting from Journal to Control Accounts maintained in Main Ledger

Practice 11.1

Main Ledger

Debtors Control A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Opening balance b/f	0	Cash received	11,850
Sales	23,000	Sales return	3,000
		Bed debts	500
		Discount allowed	150
		Closing balance c/f	7,500
	23,000		**23,000**

Practice 11.1

Main Ledger

Sales A/c.

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Income statement	23,000	Sales Journal	23,000
	23,000		**23,000**

Sales Return A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Sales Journal	3,000	Income statement	3,000
	3,000		**3,000**

Practice 11.1

Main Ledger

Discount Allowed A/c.

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Debtors control A/c.	150	Income statement	150
	150		**150**

Bad Debts A/c.

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Debtors control A/c.	500	Income statement	500
	500		**500**

Practice 11.1

Main Ledger

Creditors Control A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Cash paid	8,200	Opening balance b/f	0
Purchase return	4,500	Purchases	16,500
Discount received	300		
Closing Balance c/f	3,500		
	16,500		**16,500**

Practice 11.1

Main Ledger

Purchases A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Purchases Journal	16,500	Income statement	16,500
	16,500		**16,500**

Purchases Return A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Income statement	4,500	Purchase Journal	4,500
	4,500		**4,500**

Practice 11.1

Main Ledger

Discount Received A/c

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		**20X9**	
Income statement	300	Creditors control a/c	300
	300		**300**

Important Tips To Remember - ITTR

1. Sum of the BOE are posted in the relevant ledger accounts in main ledger
2. C/F balance of control account should be equal to the total of the list as per relevant subsidiary ledger

Control Account

Names of Accounting Records that cause confusion

Names of Accounting Records

Sales journal/daybook	Book of original entry for credit sales
Sales ledger	Subsidiary ledger - a book for debtors
Sales ledger control a/c	Debtors control a/c in main ledger
Sales account	Sales income a/c in main ledger
Purchase journal/daybook	Book of original entry for credit purchases
Purchase ledger	Subsidiary ledger - a book for creditors
Purchase ledger control a/c	Creditor control a/c in main ledger
Purchase account	Purchase expense a/c in main ledger

Important Tips To Remember - ITTR

1. Don’t confuse with different names
2. Just concentrate on the concept for which the records are being kept

Control Account

Control Account Reconciliation

Control Account - Reconciliation

Any difference arising between the balance as per control account and total of the list must be investigated and correction made.

This may involve adjustments:

a) to the control account; and/or
b) to the list of balances as per subsidiary ledgers

Reasons and Amendments

	Reasons of difference	Amendments
I	Books of Original Entries a. Recording error b. Casting error	 Control a/c and List Control a/c only
II	Control Accounts – Main Ledger a. Posting error b. Casting error	 Control a/c only Control a/c only
III	Individual Accounts – Sub Ledger a. Posting error b. Casting error	 List only List only
IV	List of Balances a. Listing error b. Casting error	 List only List only

Important Tips To Remember - ITTR

	Reasons of difference	Amendments
I	Books of Original Entries	
	a. Recording error	Control a/c and List
	b. Casting error	Control a/c only
II	Control Accounts – Main Ledger	
	a. Posting error	Control a/c only
	b. Casting error	Control a/c only
III	Individual Accounts – Sub Ledger	
	a. Posting error	List only
	b. Casting error	List only
IV	List of Balances	
	a. Listing error	List only
	b. Casting error	List only

Control Account

Practice

Control Account Reconciliation

Practice 11.2

Waheed & Sons have an accounting year ended 30 June 20X9. At that date the balance on the receivables ledger control account was Rs.130,000, but the total of the individual accounts in the receivables ledger came to Rs.127,240.

Upon investigation the following facts were discovered:

1. The sales day book total for week 22 had been overcast by Rs.600.
2. A credit balance of Rs.420 on Oreem's account had been incorrectly treated as a debit entry when listing the receivables ledger.
3. A contra of Rs.3,000 has been entered in Bungish's account in the receivables ledger but no other entry had been made.

Practice 11.2

Particulars	Debit Rs.	Particulars	Credit Rs.
30 June 20X9		30 June 20X9	
Balance b/f (reopened)	130,000	Sales day book over cast by	600
		Contra entry in Bungish a/c	3,000
		Balance c/f	126,400
	130,000		130,000

The adjusted balance on the list of individual debtors is:

	Rs.
Balance as per list of individual balances 30 June 20X9 (Dr.)	127,240
Credit balance of Oreem account treated as debit balance (420 x 2) (Cr.)	-840
Adjusted Balance as per list of individual debtors on 30 June 20X9 (Dr.)	**126,400**

Important Tips To Remember - ITTR

	Reasons of difference	Amendments
I	Books of Original Entries	
	a. Recording error	Control a/c and List
	b. Casting error	Control a/c only
II	Control Accounts – Main Ledger	
	a. Posting error	Control a/c only
	b. Casting error	Control a/c only
III	Individual Accounts – Sub Ledger	
	a. Posting error	List only
	b. Casting error	List only
IV	List of Balances	
	a. Listing error	List only
	b. Casting error	List only

Control Account

Practice

Control Account Reconciliation

Practice 11.3

Babar Shafi prepared the following payables ledger reconciliation statement on 30th June 20X9:

		Rs.
Balance on purchase ledger control account	Cr.	46,865
Payment entered twice in purchase ledger control account	Cr.	573
	Cr.	47,438
Purchase daybook overcast	Dr.	900
Total of list of balances	Cr.	46,538

Which balance should be reported in the balance sheet as on 30th June 20X9?

Practice 11.3

Particulars	Debit Rs.	Particulars	Credit Rs.
30th June 20X9		30th June 20X9	
Purchase day book overcast	900	**Balance b/f**	**46,865**
		Payment posted twice in controla/c	**573**
Balance c/f (Liability)	46,538		
	47,438		**47,438**

Important Tips To Remember - ITTR

	Reasons of difference	Amendments
I	Books of Original Entries	
	a. Recording error	Control a/c and List
	b. Casting error	Control a/c only
II	Control Accounts – Main Ledger	
	a. Posting error	Control a/c only
	b. Casting error	Control a/c only
III	Individual Accounts – Sub Ledger	
	a. Posting error	List only
	b. Casting error	List only
IV	List of Balances	
	a. Listing error	List only
	b. Casting error	List only

Chapter - 12

Rectification of Errors

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Rectification of Errors

Types of Errors

Types of Errors

1. Those errors that do not cause a difference in trial balance agreement
2. Those errors that do cause a difference in trial balance agreement

Important Tips To Remember - ITTR

1. Trial balance agreement doesn't mean that the records are free from error
2. Difference in both sides of trial balance is temporarily transferred to "Suspense a/c"

Rectification of Errors

Errors that do not cause any difference in Trial Balance

Errors & Rectification

a)	Error of Omission

When financial information is completely omitted from recording in the books of original entry.
For example: sales invoice of Rs.1,000 issued before closing date but not recorded in the books of original entry.

<u>**Rectifying Entry**</u>

Debtors a/c Dr. 1,000
Sales a/c Cr. 1,000

Errors & Rectification

b) Error of Commission

When correct accounting effect (Dr/Cr) is given in the wrong accounting head but the main head remains correct
For example: Purchase of computer Rs.5,000 for office was wrongly debited to the furniture account. (both accounts belong to the same main head; Assets)
This error will have no effect (positive or negative) on financial position as well as financial performance.

Rectifying Entry

Computer a/c Dr	**5,000**
Furniture a/c Cr	**5,000**

Errors & Rectification

c) Error of Principle

When correct accounting effect (Dr/Cr) is given in the wrong accounting head as well as the wrong main head.
For example: Purchase of computer Rs.5,000 for office was wrongly debited to the stationery account.
This type of error will cause a difference in financial performance (net profit) and/or financial position (Asset = Owners' equity + Liability)
Error of principle occurs because of wrong decision about capital and revenue nature at the time of recognizing accounting heads.

Rectifying Entry

Computer a/c Dr.	**5,000**
Stationery a/c Cr.	**5,000**

Errors & Rectification

d) Error of Original Entry

When correct accounting entry is recorded in the books of accounts but the amount in both accounting effect (Dr & Cr) is wrong although the amount is same.
For example: Debtors to be written off for Rs. 250 as bad debts were recorded in the correct accounts but the amount was posted in both accounts was Rs. 520, causing a difference of Rs. 270 in both sides.
It is also known as transposition error.

<u>Rectifying Entry</u>

Debtors a/c Dr.	270
Bad Debts a/c Cr.	270

Errors & Rectification

e) Compensating Error

When the sum of more than one errors cancels the accounting effect of each other.
For example: Sales were less credited with Rs. 260 and at the same time opening balance of capital account was brought forward with an amount that is Rs. 200 more than the correct amount and Rent expense owing of Rs. 60 was although credited to rent payable account but was not debited to the rent expense.

<u>Rectifying Entry</u>

Capital a/c Dr	200
Rent expense a/c Dr	60
Sales a/c Cr	260

Important Tips To Remember - ITTR

Rectification of Errors

Errors that do cause a difference in Trial Balance

Suspense Account Error

Difference in both sides of trial balance is temporarily transferred to "Suspense a/c"

Difference in Trial Balance

Trial Balance

Particulars	Dr. (Rs)	Particulars	Cr. (Rs)
Assets	65,000	Capital	**40,000**
Expenses	13,000	Sales	**100,000**
Purchases	80,000	Liabilities	**25,000**
Drawings	2,500	Provisions	**3,000**
	160,500		**168,000**

Suspense Account

Trial Balance

Particulars	Dr. (Rs)	Particulars	Cr. (Rs)
Assets	65,000	Capital	40,000
Expenses	13,000	Sales	100,000
Purchases	80,000	Liabilities	25,000
Drawings	2,500	Provisions	3,000
Suspense	7,500		
	168,000		168,000

Reasons for Difference in Trial Balance

a)	Under or Over Casting of a Ledger Account
Sales account (income) was over-cast by Rs. 200	Sales a/c Dr 200 Suspense a/c Cr 200
Sales account (income) was under-cast by Rs. 500	Suspense a/c Dr 500 Sales a/c Cr 500

It will only affect the Trial Balance agreement

Reasons for Difference in Trial Balance

b)	Omission of a balance from Trial Balance
Balance of bad debts account Rs. 700 (already correctly accounted for) is not appearing in the trial balance.	Bad Debts a/c Dr 700 Suspense a/c Cr 700

It will only affect the Trial Balance agreement

Reasons for Difference in Trial Balance

c)	Balance representing an account appearing in trial balance with less or excess (wrong) amount.
Building a/c balance c/f was Rs. 700,000 but erroneously appearing in the Trial Balance as Rs. 70,000	Building a/c Dr 630,000 Suspense a/c Cr 630,000

It will only affect the Trial Balance agreement

Reasons for Difference in Trial Balance

d)	An account was given debit effect instead of credit effect
Sales of Rs. 800 on credit was correctly debited in Debtors a/c but was also debited to sales a/c mistakenly.	Suspense a/c Dr 1,600 Sales a/c Cr 1,600

Causing difference with double amount

Reasons for Difference in Trial Balance

e)	A ledger account was given credit effect instead of debit effect
Sales of Rs. 800 on credit was correctly credited in Sales a/c but was also credited in debtors' a/c mistakenly.	Debtors a/c Dr 1,600 Suspense a/c Cr 1,600

Causing difference with double amount

Reasons for Difference in Trial Balance

f)	Single accounting effect, either Dr or Cr was recorded/posted in the books of account

Sales of Rs. 800 on credit was posted in Sales a/c only	Debtors a/c Dr Suspense a/c Cr	800 800

Causing difference with single amount

Reasons for Difference in Trial Balance

g)	One of the accounting effects was recorded with wrong amount

Sales of Rs. 800 on credit was correctly credited in Sales a/c but was wrongly debited to debtors' a/c with Rs. 80 only	Debtors a/c Dr Suspense a/c Cr	720 720

Causing difference with single amount

Important Tips To Remember - ITTR

1. Single entry rectifies the error the second effect is recorded in suspense account.
2. Ultimately the suspense account should be NIL

Rectification of Errors

Practice Correction in Trial Balance

Scenario – Practice 12.1

Anjum has extracted following balances from her books of accounts.

She has forgotten to extract the balance for Discounts Allowed account.

Help her to find the balance?

Omission in Trial Balance

Accounting Heads	Rs.
Plant and machinery	95,000
Property	135,000
Inventory	6,400
Payables	3,600
Receivables	2,850
Bank overdraft	970
Loan	45,000
Capital	100,000
Drawings	32,000
Sales	362,000
Purchases	156,000
Purchase returns	2,200
Discounts allowed	?
Discounts received	3,500
Sundry expenses	82,500

Difference in Trial Balance

Accounting Heads	Debit – Rs.	Credit – Rs.
Plant and machinery	95,000	
Property	135,000	
Inventory	6,400	
Payables		3,600
Receivables	2,850	
Bank overdraft		970
Loan		45,000
Capital		100,000
Drawings	32,000	
Sales		362,000
Purchases	156,000	
Purchase returns		2,200
Discounts allowed	?	
Discounts received		3,500
Sundry expenses	82,500	
Total	509,750	
Difference (Discount allowed)	7,520	
Total	517,270	517270

Correct Trial Balance

Accounting Heads	Debit – Rs.	Credit – Rs.
Plant and machinery	95,000	
Property	135,000	
Inventory	6,400	
Payables		3,600
Receivables	2,850	
Bank overdraft		970
Loan		45,000
Capital		100,000
Drawings	32,000	
Sales		362,000
Purchases	156,000	
Purchase returns		2,200
Discounts allowed	7,520	
Discounts received		3,500
Sundry expenses	82,500	
Total	517,270	517270

Important Tips To Remember - ITTR

1. Assets and Expenses Heads appear in the Dr. side of TB
2. Capital, Liabilities and Incomes Heads appear in Cr. side of TB.
3. Contra accounting heads are the exceptions

Rectification of Errors

Practice
Suspense Account

Scenario – Practice 12.2

A trial balance has been extracted and a suspense account opened.

One error relates to the mis-posting of an amount of Rs.200, being discounts received from suppliers.

This was recorded on the wrong side of the discounts account.

Rectifying Entry

Suspense account Dr.	400	
Discount allowed Cr.		200
Discount received Cr.		200

Scenario – Practice 12.3

Mithu recorded a payment from the bank of Rs.880 for repairs of company van.

Correct entry was recorded in the bank account but no other effect was recorded.

Rectifying Entry

Van Repair Dr.	400	
Suspense Account Cr.		200

Scenario – Practice 12.4

Dazy recorded an amount of Rs.3,175 for rent.

Both the rent account and the bank account were debited.

Rectifying Entry

Suspense Account Dr.	6,000	
Bank Account Cr.		6,000

Scenario – Practice 12.5

Rosy paid Rs. 500 for office cleaning in cash.

She made the following accounting entry in her books:

Trade payables Dr. 500

Cleaning expenses Cr. 500

Rectifying Entry

Cleaning expense Dr.	1,000	
Trade payable Cr.		500
Cash account Cr.		500

Important Tips To Remember - ITTR

1. Step 1 – Pass the correct original entry
2. Step 2 – Pass the wrong entry that was made erroneously
3. Step 3 – Pass the rectifying entry by comparing wrong with the correct original entry

Rectification of Errors

Practice
Posting in Suspense Account

Scenario – Practice 12.6

Tipu's trial balance at 31 October 20X9 is out of agreement, with the credit side totaling Rs.1,610 lesser than the debit side. (Difference is appearing in the Dr. side of Trial Balance`)

Upon investigation, the following errors were discovered:

1. Debit side of the purchases account for October had been overcast by Rs.1,050.
2. Rent expense of Rs.240 had been debited to the rent income account.
3. The provision for doubtful debts, which was increased by Rs.280, had been recorded in the provision for doubtful debts account as a decrease.

Suspense Account

Particulars	Debit Rs.	Particulars	Credit Rs.
20X9		20X9	
Purchase account over-cast Provision for doubtful debts Balance	1,050 560 NIL	Difference b/f from TB	1,610
	1,610		1,610

Important Tips To Remember - ITTR

1. Amount of difference appearing in the Dr. side of TB should be placed in Dr. side of Suspense account and vice versa
2. Trial Balance is not a ledger account

Rectification of Errors

Calculation of Adjusted Profit

Nominal Accounts in Rectifying Entries

Nominal accounts relate to Income Statement (Expense and Income)
Dr. effect to Nominal Accounts causes a decrease in the net profit
Cr. effect to Nominal Accounts causes an increase in net profit

Scenario – Practice 12.7

Income statement of PASHA shows a net profit figure of Rs. 100,000 in the presence of following errors

1. Debit side of the purchases account had been overcast by Rs.1,050.
2. Rent expense of Rs.240 had been debited to the rent income account.
3. The provision for doubtful debts, which was increased by Rs.240, had been recorded in the provision for doubtful debts account as a decrease.
4. Credit note issued against sales returns Rs. 800 was completely omitted to record in journal

Adjusted Profit

Particulars	Rs.
Profit prior to rectification – Cr.	100,000
Purchase account overcast – Cr.	1,050
Rent expense – Dr. Rent income – Cr.	0
Provision for doubtful debts – Cr.	0
Sales return – Dr. Debtors – Cr.	0
Adjusted Profit – post rectification of errors	101,050

Important Tips To Remember - ITTR

1. Only nominal accounts affect net profit
2. Profit – Cr nature
3. Loss – Dr. nature

Rectification of Errors

Calculation of Adjusted Working Capital

Working Capital in Rectifying Entries

Current Assets and Current Liabilities are known as Working Capital Items
Dr. effect to working capital items causes increase in the working capital
Cr. effect to working capital items causes decrease in working capital

Scenario – Practice 12.8

Balance Sheet of Almas shows a Working Capital figure of Rs.100,000 in the presence of following errors (Current Assets Rs.170,000 and Current Liabilities Rs.70,000)

1. Debit side of the Debtors account had been overcast by Rs.1,000.
2. Accrued Rent (payable) of Rs.2,000 had been credited to the Rent Income.
3. Accumulated Depreciation had been overcast by Rs. 5,000.
4. Credit purchase of Rs. 8,000 was completely omitted to record in journal

Adjusted Profit

Particulars	Rs.
Working capital – (170,000 – 70,000) Dr.	100,000
Debtors overcast – Cr.	- 1,000
Rent Income – Dr. Accrued Rent – Cr.	- 2,000
Accumulated Depreciation overcast – Dr.	0
Purchases – Dr. Creditors – Cr.	- 8,000
Adjusted Working Capital	89,000

Important Tips To Remember - ITTR

1. Working capital is Net Current Assets
2. Working Capital is Dr. in nature

Rectification of Errors

Concept of Capital and Revenue Expenditure / Receipts

Concept of Capital and Revenue

Capital and Revenue Expenditure / Receipts should be correctly recognized in the appropriate accounting heads.

Concept of Capital and Revenue

Capital expenditure	– Asset
Revenue expenditure	– Expense
Capital receipt	– Liability or Owners' Equity
Revenue receipt	– Income

Practice – Capital & Revenue

	Expenditure		Receipts	
	Capital	Revenue	Capital	Revenue
Purchase of car	★			
Repair of car		★		
Purchase of computer	★			
Installation of software	★			
Purchase of USB for data transfer		★		
Receipt of Loan from bank			★	
Receipt of service fee				★
Construction of store room	★			
Rent of store room		★		
Wages for machine operator		★		

Important Tips To Remember - ITTR

1. Capital nature belongs to Balance Sheet
2. Revenue nature belongs to Income Statement

Chapter - 13

Final Accounts with Adjustments

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

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1	Preparation of Final Accounts
2	Practice - Adjustments for Fixed Assets – Rectification of Errors
3	How to Read Trial Balance Prior to Preparing Final Accounts
4	Adjusting Entries Prior to Preparing Final Accounts
5	Practice: BRS - Provision for Doubtful Debts - Claim against Loss
6	Important Tips to Remember

Final Accounts with Adjustments

Preparation of Final Accounts for Sole Proprietors

Final Accounts

1. Income statement (Statement of profit or loss and other comprehensive income)

Incomes – Expenses = Profit

2. Balance sheet (Statement of financial position)

Assets = Owners equity + Liabilities

Technique to Prepare Final Accounts

- Read trial balance very carefully
- Identify the nature of accounting head correctly and mark A-E-I-L-O
- Pass journal entries for adjustment.
- Place adjusted balances in the appropriate part of income statement and balance sheet

Important Tips To Remember - ITTR

1. Mark A-E-I-L-O
2. Dr. side of TB contains Assets and Expenses
3. Cr. side of TB contains Equity, Liability and Incomes
4. Take care of contra nature of accounting heads

Final Accounts with Adjustments

Practice
Adjustments for Fixed Assets
Rectification of Errors

Practice 13.1

Trial Balances as on 31.3.20X9 of Al-Fanar Stores

Particulars	Dr. (Rs)	Cr. (Rs)
Cash in hand	1,400	
Cash at bank	2,600	
Sundry debtors	86,000	
Stock on **1.4.20X8**	62,000	
Furniture & fixtures	25,000	
Depreciation (F&F)		3,600
Equipment (Depreciation 4,000)	16,000	
Buildings (cost)	60,000	
Motor car (Cost 30,000)	20,000	
Sundry creditors		43,000
12% Loan from Bhutta		30,000
Provision for bad debts		3,000
Purchases	140,000	
Purchase returns		2,600
Sales		230,000
Sales returns	4,200	
Salaries	11,000	
Rent for godown	5,500	

Practice 13.1

Trial Balances as on 31.3.20X9 of Al-Fanar Stores

Particulars	Dr. (Rs)	Cr. (Rs)
Interest on loan from Bhutta	2,700	
Rates & taxes	2,100	
Discount allowed to Debtors	2,400	
Discount received from creditors		1,600
Freight on purchases	400	
Carriage inwards	800	
Carriage outwards	2,000	
Drawings	12,000	
Printing and stationery	1,800	
Electricity charges	2,200	
Insurance premium	5,500	
General office expenses	3,000	
Bad debts	2,000	
Bank charges	1,600	
Motor car expenses	3,600	
Capital A/c		162,000
TOTAL	**475,800**	**475,800**

Practice 13.1 - Adjustments

1. Depreciate: (a) Building by 5% on reducing balance method; (b) Furniture and fixtures by 10% on reducing balance method; One steel table purchased during the year for Rs 1,400 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15% on straight line method; Purchase of a typewriter during the year for Rs 4,000 has been wrongly debited to purchase; and (d) Motor car by 20% on reducing balance method; A fully depreciated motor car, original cost Rs. 5,000 was sold during the year. The proceeds of Rs. 1,000 were credited to sales account, no other accounting entries for disposal were recorded. During the year a motor car was purchased for Rs. 10,000 on credit, this remained unrecorded.

Practice 13.1 - Adjustments

2. Value of stock on reporting date was Rs 44,000.
3. One month's rent for godown is outstanding,
4. One month's salary is outstanding.
5. Interest on loan from Bhutta is payable at 12 percent per annum, this loan was taken on 1.5.20X8.
6. Provision for bad debts is to be increased by Rs. 1,500
7. Insurance premium includes Rs 4,000 paid towards proprietor’s life insurance policy and the balance of the insurance charges cover the period from 1.4.20X8 to 30.6.20X9.
8. Building was bought during the reporting period, half of which is used for residential purpose by Sheikh.
9. Discount allowed to debtors Rs. 600 has been wrongly debited to discount allowed by the creditors.

Practice 13.1- Mark AEILO

Particulars	Dr. (Rs)	Cr. (Rs)
Cash in hand A	1,400	
Cash at bank A	2,600	
Sundry debtors A	86,000	
Stock on **1.4.20X8** E	62,000	
Furniture & fixtures A	25,000	
Depreciation (F&F) – A		3,600
Equipment (Depreciation 4,000) A, – A	16,000	
Buildings (cost) A	60,000	
Motor car (Cost 30,000) A, – A	20,000	
Sundry creditors. L		43,000
12% Loan from Bhutta L		30,000
Provision for bad debts – A		3,000
Purchases E	140,000	
Purchase returns – E		2,600
Sales I		230,000
Sales returns – I	4,200	
Salaries E	11,000	
Rent for godown E	5,500	

Practice 13.1- Mark AEILO

Particulars	Dr. (Rs)	Cr. (Rs)
Interest on loan from Bhutta E	2,700	
Rates & taxes E	2,100	
Discount allowed to Debtors E	2,400	
Discount received from creditors I		1,600
Freight on purchases E	400	
Carriage inwards E	800	
Carriage outwards E	2,000	
Drawings – O	12,000	
Printing and stationery E	1,800	
Electricity charges E	2,200	
Insurance premium E	5,500	
General office expenses E	3,000	
Bad debts E	2,000	
Bank charges E	1,600	
Motor car expenses E	3,600	
Capital account O		162,000
TOTAL	**475,800**	**475,800**

Adjusting Entries

1. Depreciation expense for the year

Name of Assets	Furniture & Fixture 10 % R B M	Equipment 15% Straight line	Building 5 % R B M	Motor car 20 % R B M
Cost Opening	25,000	20,000	30,000	30,000
Addition	-	4,000	-	10,000
Deletion /Disposal	(1,400)	-	-	(5,000)
Closing Balance	23,600	24,000	30,000	35,000
Acc. Dep. Opening	3,600	4,000	-	10,000
Disposal	-	-	-	(5,000)
For the year	2,000	3,600	1,500	6,000
Closing balance	(5,600)	(7,600)	(1,500)	(11,000)
Net Book Value	18,000	16,400	28,500	24,000

Adjusting Entries

1. Depreciation expense for the year

Depreciation expense E	Dr.		13,100	
Accumulated Depreciation – Furniture		Cr. – A		2,000
Accumulated Depreciation – Equipment		Cr. – A		3,600
Accumulated Depreciation – Building		Cr. – A		1,500
Accumulated Depreciation – Motor Car		Cr. – A		6,000
Sales account – I	Dr.		1,400	
Furniture & Fixture account		Cr. – A		1,400
Office equipment A	Dr.		4,000	
Purchases account		Cr. – E		4,000

Adjusting Entries

1. Depreciation expense for the year

Motor car	A	Dr.	10,000	
Creditors for motor car	L	Cr.		10,000
Accumulated depreciation motor car	A	Dr.	5,000	
Sales	– I	Dr.	1,000	
Motor car	– A	Cr.		5,000
Profit on disposal of motor car	I	Cr.		1,000

2. Closing Stock

Closing Stock	A	Dr.	44,000	
Cost of goods sold	– E	Cr.		44,000

Adjusting Entries

3. Outstanding rent for godown – one month = 500 (5,500 = 11 months)

Rent for godown	E	Dr.	500	
Rent payable / owing	L	Cr.		500

4. Outstanding salaries – one month = 1,000 (11,000 = 11 month)

Salaries	E	Dr.	1,000	
Salaries payable / owing	L	Cr.		1,000

Adjusting Entries

5. **Interest on loan @ 12% (30,000) = 3,600 x 11/12 = 3,300 – 2,700 = 600**

Interest on loan	E	Dr.	600	
Interest payable	L	Cr.		600

6. **Increase in provision for doubtful debts**

Bad debts	E	Dr.	1,500	
Provision for doubtful debts	– A	Cr.		1,500

Adjusting Entries

7. **Insurance premium includes insurance for proprietor**

Drawings	– O	Dr.	4,000	
Insurance premium	E	Cr.		4,000

Insurance prepaid for 3 months (1,500 x 3/15 = 300)

Prepaid Insurance	A	Dr.	300	
Insurance premium	E	Cr.		300

Adjusting Entries

8. Half of the building purchased during the year is being used by owner for personal use

Drawings account	– O	Dr.	30,000	
Building account	– A	Cr.		30,000

9. Discount allowed wrongly debited to discount received

Discount allowed	E	Dr.	600	
Discount received	I	Cr.		600

Income Statement

Al – Fanar Stores
Income Statement
For the Year Ended on 31 March 20X9

	Rs.	**Rs.**	**Rs.**
Sales (W-4)			223,400
Cost of Goods Sold			
Opening Stock		62,000	
Purchases (W-5)	133,400		
Freight	400		
Carriage inwards	800	134,600	
Closing Stock		(44,000)	(152,600)
Gross Profit			70,800

Income Statement

Gross Profit			70,800
Operating Expenses			
Salaries	(11,000 + 1,000)	12,000	
Rent for Godown	(5,500 + 500)	6,000	
Interest on Loan	(2,700 + 600)	3,300	
Rates and Taxes		2,100	
Discount to Debtors	(2,400 + 600)	3,000	
Carriage outwards		2,000	
Printing & Stationery		1,800	
Electricity charges		2,200	
Insurance premium (W-6)		1,200	
General office Expenses		3,000	
Bad debts (W-2)		1,500	
Bank charges		1,600	
Motorcar Expenses		3,600	
Depreciation		13,100	56,400
Operating Profit			14,400

Income Statement

Operating Profit			14,400
Other Income			
Discount Received	(1,600 + 600)	2,200	
Profit on Sale of Motor		1,000	3,200
Net Profit			17,600

Balance Sheet

Al – Fanar Stores
Statement of Financial Position
As At March 31, 20X9

		Rs.	Rs.
Assets			
Fixed Assets			
Furniture & Fixture	(W -1)	18,000	
Equipment	(W - 1)	16,400	
Building	(W - 1)	28,500	
Motor Car	(W - 1)	24,000	86,900
Current Assets			
Stock		44,000	
Trade Debtors	(W - 3)	83,500	
Prepaid Insurance	(W - 6)	300	
Cash in hand		1,400	
Cash at Bank		2,600	131,800
			218,700

Balance Sheet

Owners' Equity			
Capital		162,000	
Net profit		17,600	
Drawing	(W – 7)	(46,000)	133,600
Liabilities:			
Long Term			
Loan from Bhutta		30,000	
Current Liabilities			
Creditor for motor car		10,000	
Trade Creditors		43,000	
Outstanding Expense		1,500	
Interest on loan payable		600	85,100
			218,700

Working Notes

W – 1

Fixed Asset and Depreciation

Name of Assets	**Furniture & Fixture 10 % R B M**	**Equipment 15% Straight line**	**Building 5 % R B M**	**Motor car 20 % R B M**
Cost Opening	25,000	20,000	30,000	30,000
Addition	-	4,000	-	10,000
Deletion /Disposal	(1,400)	-	-	(5,000)
Closing Balance	23,600	24,000	30,000	35,000
Acc. Dep. Opening	3,600	4,000	-	10,000
Disposal	-	-	-	(5,000)
For the year	2,000	3,600	1,500	6,000
Closing balance	(5,600)	(7,600)	(1,500)	(11,000)
Net Book Value	18,000	16,400	28,500	24,000

Working Notes

W – 2

Provision for Doubtful Debts

	Rs.		**Rs.**
Bad debts transferred	2,000	Balance b/f	3,000
		Bad debts	1,500
Balance c/f	2,500		
	4,500		4,500

Bad debts

	Rs.		**Rs.**
Debtors	2,000	Provision for D Debts	2,000
		Income Statement	1,500
Provision increased by	1,500		
	3,500		3,500

Working Notes

W – 3 **Rs.**

Sundry Debtor	86,000
Provision for bad debts	(2,500)
	83,500

W – 4 Sales

Sale – Sale Return – Furniture – Profit & Loss A/c.

= 230,000 – 4,200 –1,400 –1,000

= 223,400

Working Notes

W – 5

Net Purchase

Purchase – Purchase return – office equipment

= 140,000 – 2,600 – 4,000

W – 6

Insurance prepaid

= 5,500 – 4,000

= 1,500 x 3/15 = 300

Insurance Premium

1,500 – 300 = 1,200

W – 7

Drawings 12,000 + 4,000 + 30,000 = 46,000

Important Tips To Remember - ITTR

1. Items appearing in TB have single effects in Final Accounts
2. Except for the following heads all other heads appearing in TB reveal closing balance:
   a) Owner's Capital
   b) Provision for Depreciation
   c) Provision for Doubtful Debts
   d) Opening Stock

Final Accounts with Adjustments

Practice

Bank Reconciliation
Provision for Doubtful Debts
Claim against Losses

Practice 13.2

Trial balance extracted from the books of Decent Traders as on December 31, 20X9

	Dr. Rs	Cr. Rs.
Capital account		1,318,000
Drawing account	129,000	
Building	500,000	
Showroom racks	285,400	
Furniture & fixture	25,000	
Staff advance	17,400	
Provision for doubtful debts		39,400
Export sales		100,000
Local sales		2,189,400
Administrative expenses	659,600	
Bank overdraft (HBL)		2,400
Marketing expenses	20,000	
Cost of goods sold	1,027,400	
Sundry debtors	744,000	
Sundry creditors		243,400
Stock	200,000	
Cash at bank (MCB)	260,000	
Cash in hand	24,800	
TOTAL	**3,892,600**	**3, 892,600**

Practice 13.2 – Adjustments Required

1. Charge depreciation at 10% on building, showroom racks and furniture & fixture
2. Sundry debtors include:
   a. A customer who is in default for Rs. 44,000 and expected recovery from him is not more than 75%;
   b. A customer owing Rs. 25,000 who is also a creditor for Rs. 30,000 (however setoff is not required)
   c. General provision for doubtful debts is to be calculated @ 5% of sundry debtors.
3. Provision for income tax is to be accounted for @ 40% of the net profit.
4. Balance as per bank statement received from MCB on 31 December 20X9 was different because of following reasons:

Un presented cheques	Rs. 8,000
Un collected cheques	Rs. 3,000
Un recorded standing orders (paid for trade subscription)	Rs. 2,000
Un recorded credit transfers (building rent realized)	Rs. 6,000

5. Goods valuing Rs. 10,000 were destroyed by fire and insurance company has admitted the claim for Rs. 7,500, no accounting entry has been passed for loss and claim.

Income Statement

Decent Trader
Income Statement
For the Year Ended December 31, 20X9

	Rs.	Rs.	Rs.
Sales			
Local sales		2,189,400	
Export sales		100,000	2,289,400
Cost of Goods Sold – (W - 5)			(1,017,400)
Gross Profit			1,272,000
Administrative Expenses	659,600		
Marketing expense	20,000		
Operating Expenses		679,600	
Deprecation – (W - 1)		81,040	
Bad debts – (W- 2)		5,350	
Loss of goods – (W - 5)		2,500	
Trade subscription (Order)		2,000	(770,490)
Operating Profit			501,510
Other Incomes			
Rent realized (credit transfer)			6,000
Net Profit before Tax			507,510
Income Tax Provision (W - 4)			(203,004)
Net Profit after Tax			304,506

Balance Sheet

Decent Trader
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

		Rs.	Rs.
Assets			
Fixed Asset			
Building	(W - 1)	450,000	
Showroom Stock	(W - 1)	256,860	
Furniture & Fixture	(W - 1)	22,500	729,360
Current Assets			
Closing Stock		200,000	
Insurance Claim	(W - 5)	7,500	
Staff Advance		17,400	
Debtors	(W - 2)	699,250	
Cash at Bank	(W - 4)	264,000	
Cash in hand		24,800	1,212,950
			1,942,310

Balance Sheet

Decent Trader
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

Owners' Equity		
Capital	1,318,000	
Net profit	304,506	
Drawing	(129,000)	1,493,506
Liabilities:		
Provision for Income Tax	203,004	
Bank Overdraft	2,400	
Sundry Creditors	243,400	448,804
		1,942,310

Working Notes

W – 1

Depreciation	Rate	Cost Rs.	Depreciation Rs.	N.B.V. Rs.
Building	@ 10 %	500,000	50,000	450,000
Show room Racks	@ 10 %	285,400	28,540	256,860
Furniture & Fixture	@ 10 %	25,000	2,500	22,500
		810,400	810,40	729,360

W – 2

		Rs.
Total Debtor		744,000
Provision for doubtful debts		
Goods debtors 25,000 x 0%	=	0
Specific debtors 44,000 x 25%	=	11,000
General debtors 675,000 x 5%	=	33,750
		44,750
Net Debtors = 744,000 – 44,750	=	699,250

Working Notes

W – 3

Cash Book (MCB)

	Rs.		Rs.
B/f	260,000	Standing order	2,000
Direct credit	6,000	C /f	264,000
	266,000		266,000

W – 4

Income Tax 474,110 x 40 % = Rs. 189,644

W – 5

	Rs.	Rs.
Loss by fire	2,500	
Insurance Claim	7,500	
Purchases		10,000
Cost of Goods Sold		1,027,400
Less: Loss of Goods by fire		(10,000)
		1,017,000

Important Tips To Remember - ITTR

- Concept of direct and indirect expense does not exist in financial accounting language.
- For classification purposes all expenses are categorized into five functions:

1. Cost of goods sold
2. Administrative
3. Selling & distribution
4. Financial
5. Income tax

Chapter - 14

Manufacturing Accounts

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Manufacturing Accounts

Reporting Requirements of Manufacturing Entity

Reporting Requirements

1. Manufacturing account
2. Trading account
3. Profit & Loss account
4. Cost per unit of production

Important Tips To Remember - ITTR

1. Accountants of manufacturing entities are required to prepare “Manufacturing Account” apart from the “Trading Account”

Manufacturing Accounts

Classification and Analysis of the Cost of Production

Cost Elements

1. Material
2. Labour
3. Factory Overhead

Cost Classification

Material cost	=	Direct material cost	+	Indirect material cost
+		+		+
Labour cost	=	Direct labour cost	+	Indirect labour cost
+		+		+
Other costs	=	other Direct costs	+	other Indirect cost
Total cost of production	=	**Prime cost**	+	**Factory overhead cost**

Variable

Fixed

Direct Material Cost + Direct Labour Cost + FOH Cost

Prime Cost

Conversion Cost

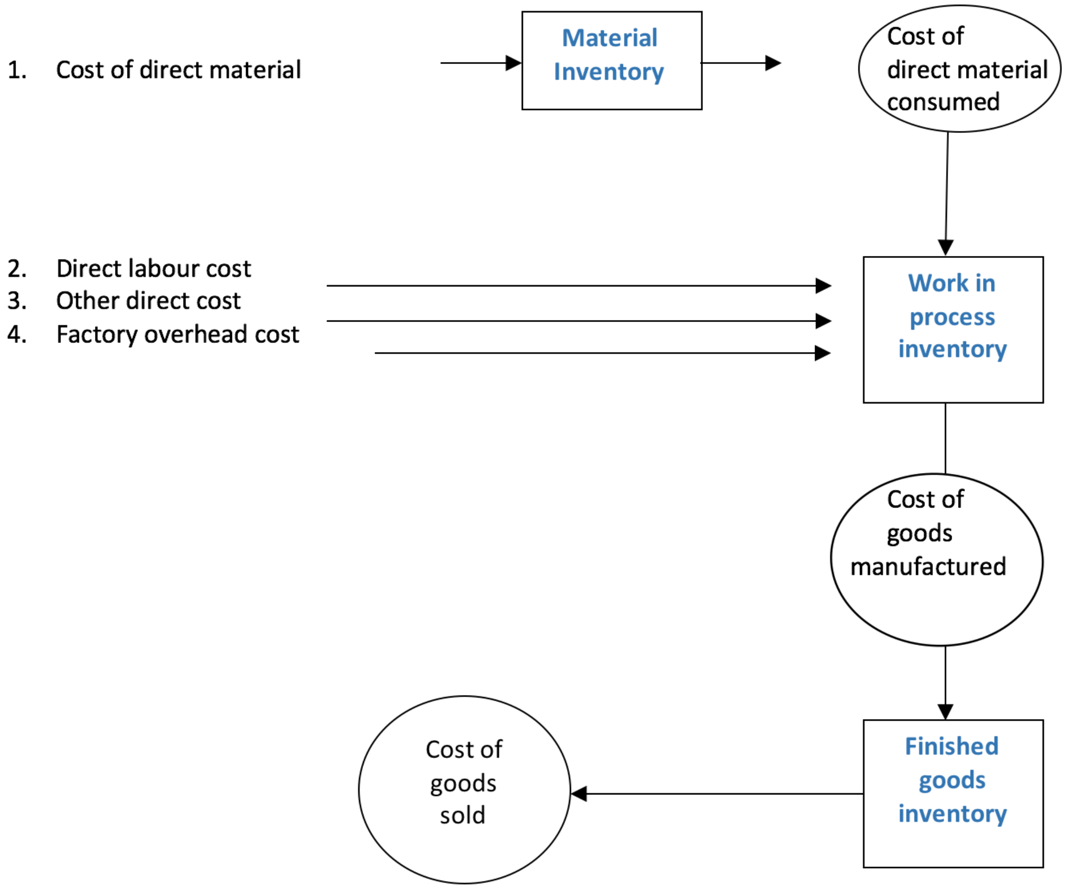
Important Tips To Remember - ITTR

1. Cost Vs Expense
2. Cost that expires is Expense
3. Cost of Goods Manufactured is Cost
4. Cost of Goods Sold is Expense

Manufacturing Accounts

Manufacturing Cycle

Manufacturing Cycle



Important Tips To Remember - ITTR

Types of Inventories

1. Material Inventory
2. Work in Process Inventory
3. Finished Goods Inventory

Manufacturing Accounts

Types of Inventories

Types of Inventories

1. Material and Supplies
   a) Direct Supplies (Raw Material)
   b) Indirect Supplies
   c) Office Supplies
   d) Shipping Supplies
2. Work in Process
3. Finished Goods

Important Tips To Remember - ITTR

1. Stores and spares are indirect material supplies
2. Cost of consumed supplies is included in FOH by adjusting opening and closing inventories

Manufacturing Accounts

Format of Financial Statements of Manufacturing Entities

Format – Manufacturing Account

Sample Company
Manufacturing Account
For the year ended 31st. December 20X9

	Rs.	Rs.	Rs.
Direct material consumed			
Opening inventory		***	
Purchases of raw material	***		
Returns outwards	(**)		
Carriage inwards	***		
Other receiving and handling cost of material	***	***	
Closing inventory		(**)	***
Direct labour			***
Other Direct cost			***
Prime cost			***

Format – Manufacturing Account

Sample Company
Manufacturing Account
For the year ended 31st. December 20X9

Prime cost		***
Factory overhead cost		
Indirect material	***	
Indirect labour	***	
Power & fuel	***	
Factory depreciation	***	
Other factory expenses	***	***
Total factory cost / manufacturing cost/production cost		***
Opening work in process inventory		***
Closing work in process inventory		(**)
Cost of goods manufactured		***

Format – Trading Account

Sample Company
Trading account
For the year ended 31^{st}. December 20X9

	Rs.	*Rs.*
Sales	***	
Returns inwards	(**)	***
Cost of goods sold		
Opening finished goods inventory	***	
Cost of goods manufactured	***	
Closing finished goods inventory	(**)	(**)
Gross profit		***

Important Tips To Remember - ITTR

1. Manufacturing account is integral part of income statement
2. Manufacturing account provides information for Trading account
3. Trading account provides information to P&L account

Manufacturing Accounts

Manufacturing Account without Work in Process Inventory

Practice 14.1

Prepare cost of goods manufactured of Sandhu Sports for the year ended 31st. March 20X9. **Opening and closing work in process inventories do not exist in this reporting period.**

	Rs.
Stock of raw material (opening)	1,500
Stock of raw material (closing)	2,100
Raw material purchases	24,000
Carriage inwards	1,000
Direct manufacturing wages	40,000
Royalty at production stage	5,000
Indirect manufacturing wages	12,000
Factory building rent	18,000
Depreciation of plant and machinery	2,000
Other indirect factory cost	10,500

Practice 14.1

Sandhu Sports
Manufacturing Account
For the year ended 31st. March 20X9

	Rs.	Rs.	Rs.
Direct material consumed cost			
Opening inventory		1,500	
Purchases of raw material	24,000		
Carriage inwards	1,000	25,000	
Closing inventory		(2,100)	24,400
Direct labour cost			40,000
Other direct cost (Royalty)			5,000
Prime cost			**69,400**

Practice 14.1

Sandhu Sports
Manufacturing Account
For the year ended 31st. March 20X9

Prime cost		**69,400**
Factory overhead cost		
Indirect labour	12,000	
Factory building rent	18,000	
Depreciation plant & machinery	2,000	
Other indirect factory cost	10,500	42,500
Total factory cost		**111,900**
Opening work in process inventory		0
Closing work in process inventory		(0)
Cost of goods manufactured		**111,900**

Important Tips To Remember - ITTR

1. Correctly identify the nature of the expense head based upon its function, like wages can be direct, indirect, administrative and selling.
2. Factory overhead should be worked out carefully e.g., Depreciation of production plant is FOH
3. Store rent is FOH, rent for finished goods warehouse is operating expense.

Manufacturing Accounts

Manufacturing Account with Work in Process Inventory

Practice 14.2

Prepare cost of goods manufactured of Sandhu Sports for the year ended 31st. March 20X9. Opening work in process inventory Rs.12,000 and closing work in process inventory is Rs.10,900.

	Rs.
Stock of raw material (opening)	1,500
Stock of raw material (closing)	2,100
Raw material purchases	24,000
Carriage inwards	1,000
Direct manufacturing wages	40,000
Royalty at production stage	5,000
Indirect manufacturing wages	12,000
Factory building rent	18,000
Depreciation of plant and machinery	2,000
Other indirect factory cost	10,500

Practice – 14.2

Sandhu Sports
Manufacturing Account
For the year ended 31st. March 20X9

	Rs.	Rs.	Rs.
Direct material consumed cost			
Opening inventory		1,500	
Purchases of raw material	24,000		
Carriage inwards	1,000	25,000	
Closing inventory		(2,100)	24,400
Direct labour cost			40,000
Other direct cost (Royalty)			5,000
Prime cost			**69,400**

Practice – 14.2

Sandhu Sports
Manufacturing Account
For the year ended 31st. March 20X9

Prime cost		**69,400**
Factory overhead cost		
Indirect labour	12,000	
Factory building rent	18,000	
Depreciation plant & machinery	2,000	
Other indirect factory cost	10,500	42,500
Total factory cost		**111,900**
Opening work in process inventory		12,000
Closing work in process inventory		(10.900)
Cost of goods manufactured		**113,000**

Important Tips To Remember - ITTR

1. Work in process inventory is also known as semi finished goods inventory
2. If closing inventories are appearing in the trial balance then don’t subtract closing inventories for calculating cost of consumption or cost of goods manufactured

Chapter - 15

Accounting for Inventories

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Accounting for Inventories

Important Definitions as per IAS 2

Definitions

Inventories are assets, held:

a) for sale in the ordinary course of business;
b) in the process of production for such sale; or
c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Definitions

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make such sale.

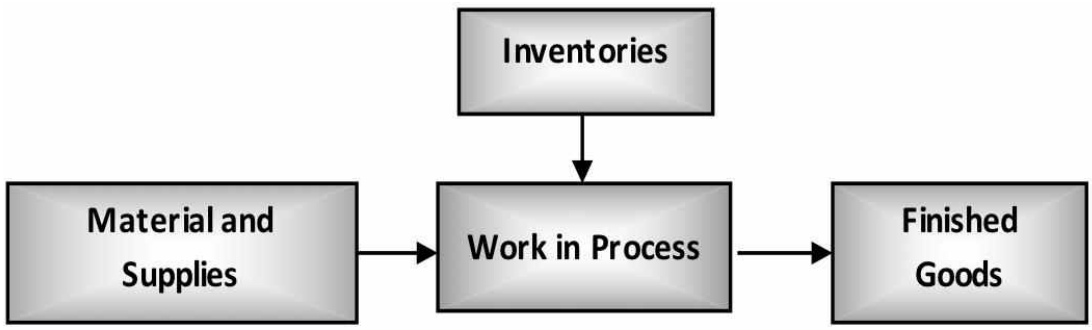
Important Tips To Remember - ITTR

1. Inventories are "Assets"
2. Material or Supplies include
   1. Production Supplies
   2. Office Supplies
   3. Shipping Supplies

Accounting for Inventories

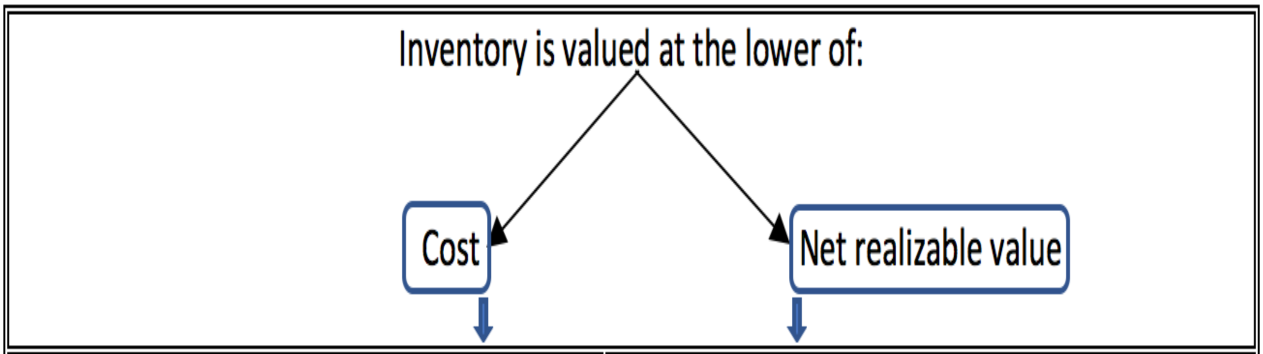
Classification and Valuation of Inventories

Classification of Inventories



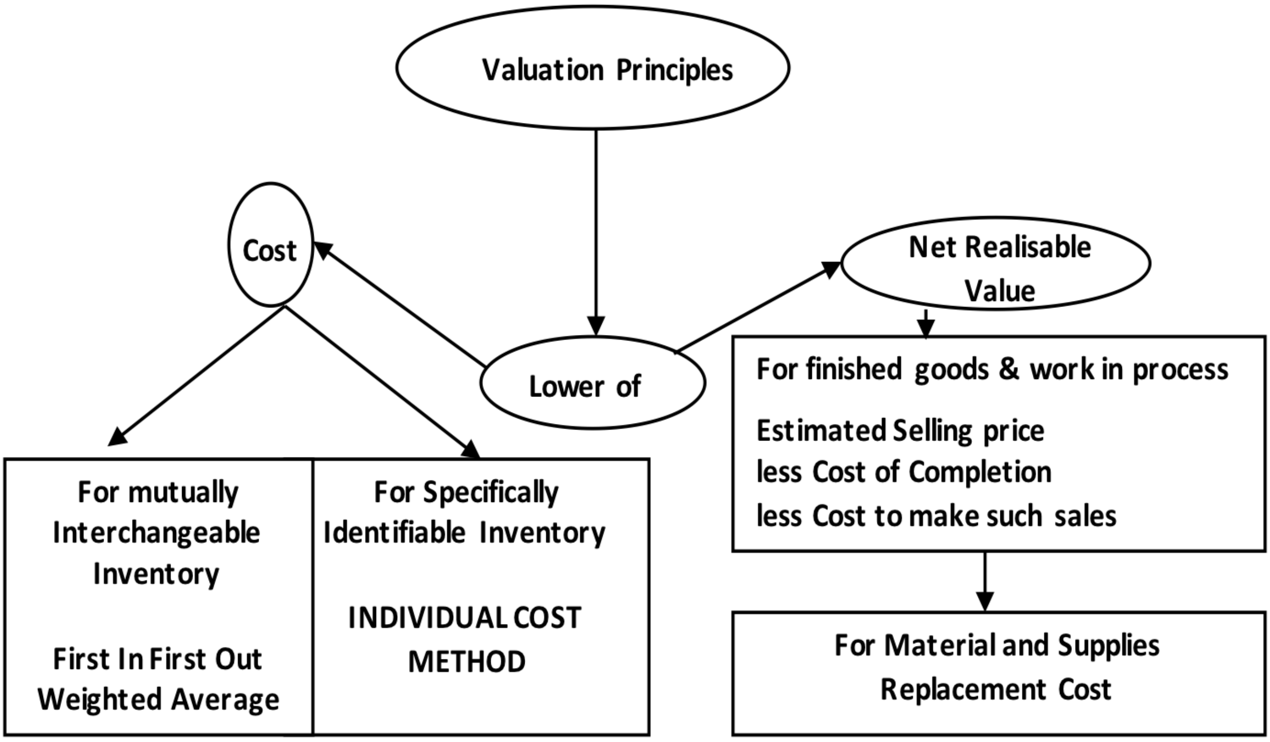
Valuation of Inventories

Inventories are valued at lower of cost and net realizable value, on item-by-item basis or group basis.



That was paid to acquire the inventory	That can be realized by selling the inventory
Cost of Purchases + Conversion Cost	Selling Price – Further Costs to Sell

Valuation of Inventories



Important Tips To Remember - ITTR

1. For Assets to be reliable, a prudent view must be taken where there is certainty to ensure that assets and gains are not overstated.

Accounting for Inventories

Net Realizable Value
Finished Goods, WIP, Raw Material

Practice 15.1 – NRV FG & WIP

Bataka Company. has stock of finished shoes on December 31, 20X9 costing Rs15,000. The company also has a work in process inventory, the estimated cost to complete this work-in-process is Rs.5,000 on which cost of Rs.10,000 has already been spent till December 31, 20X9.

The company pays 2% commission on sales to its distributors. Estimated selling price of finished goods and work in process (when this will be converted to finished goods) is Rs. 35,000.

Answer – Practice 15.1

Its NRV shall be calculated as under:

		Rs.
Estimated Sales price		35,000
Less:	Estimated cost of completion	5,000
	Estimated cost necessary to make such sales (Rs. 35,000 x 2%)	700
		(5,700)
Net Realizable Value		29,300
Cost of inventory		
	Finished Goods	15,000
	Work in Process	10,000
Total cost of inventory		25,000

Cost of inventory is lesser than its net realizable value. Recognized in the balance sheet at cost Rs. 25.000

Practice 15.2 – NRV Raw Material

Cotton Expert Ltd. is engaged in manufacturing of cloth.

Price of cotton acquired by Cotton Expert Ltd. has fallen from Rs.200 per lb. to Rs.180 per lb.

At the end of the month company had 3,000 units which it had purchased @ Rs.200 per unit. The cloth made from this cotton is sold for Rs.500 per meter. The cost of producing one-meter cloth is Rs.400. One lb. of cotton is converted into one-meter cloth.

Calculate the value of inventory of Raw material.

Answer – Practice 15.2

As the finished goods are sold above their cost, so inventory of such raw material is not written down to NRV

Thus, the value of inventory is

<u>**Rs.200 x 3,000 = Rs.600,000**</u>

Practice 15.3 – NRV Raw Material

Prince Limited is engaged in a manufacturing business. One unit of raw material is converted into one unit of finished goods.

The cost of raw material acquired by the company is Rs.300 per unit. On January 31, due to excess supply price has fallen from Rs.300 to Rs.200.

The cost of producing one unit of finished goods is Rs.500 while NRV of the product is Rs.400 per unit.

Calculate the value of inventory of Raw Material. The company has 75 units of raw material at month end.

Answer – Practice 15.3

The value of inventory of Raw material will be written down to NRV or replacement cost, as the finished goods would not be sold at or above the cost

Thus, the value of inventory of raw material is

Rs. 200 x 75 = Rs. 15,000

Important Tips To Remember - ITTR

1. If NRV of finished goods is lesser than its cost then its Raw material shall be measured at lower of its cost and Replacement Cost (NRV)
2. If NRV of finished goods is greater than its cost then its Raw material shall be measured at cost.

Accounting for Inventories

Components of the Cost of Inventory

Cost Components

Cost of inventories comprises of:

1. Costs of purchase
2. Cost of conversion and
3. Other costs incurred in bringing the inventories to their present location and condition

Cost of Purchase

Cost of purchase comprise of

1. Purchase price, less trade discount if any;
2. Import duties and other non-refundable taxes;
3. Transport and handling; and
4. Other cost directly attributable to acquisition of finished goods, materials and services

Practice 15.4

Haroon Textile Ltd. imported raw material for use in production of goods with following details:

	Rs. (000)
Invoice value	1,000
Custom duty	150
Central Excise Duty (C.E.D)	50
Non-adjustable income tax	225
Refundable sales tax	180
Carriage	40
Commission paid to agent for clearance of raw materials	100

Calculate the cost of purchase of inventories

Answer – Practice 15.4

Cost of purchase	Rs. (000)
Invoice value	1,000
Custom duty	150
C.E.D.	50
Non-adjustable income tax	225
Carriage	40
Commission to agent	100
Cost of purchase	1,565

Not included in the cost of inventories

1. abnormal production costs
2. storage costs, unless those costs are necessary in the production process
3. administrative overheads and selling costs

Allocation of Fixed and Variable Overhead

- Allocation of fixed production overheads to the costs of inventories is based on normal capacity of the production facilities.;
- The actual level of production may be used if it approximates normal capacity;
- In periods of abnormally high production, allocate fixed production overheads on actual level
- Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Practice 15.5

Jamil Bashir Limited is engaged in manufacturing of Surgical Instruments.
Following data relates to the reporting period ending on December 31, 20X9:

Fixed production overheads	Rs. 2,000,000
Variable production overheads	Rs. 200 per unit
Material cost per unit	Rs. 800 per unit
Labour cost per unit	Rs. 300 per unit

Normal production capacity of the company is 20,000 units per annum.
During the year, company manufactured 5,000 units. There was nil balance of inventory on opening date and the company sold 4,000 units in the year.

Answer – Practice 15.5

Production Cost Per Unit	Rs.
Material	800
Labor	300
Variable overheads	200
Fixed production overheads [(on the basis of actual capacity) (2,000,000/5,000)]	400
Per unit cost	1,700

Inventory Cost Per Unit	
Material	800
Labor	300
Variable overheads	200
Fixed production overheads [(on the basis of normal capacity) (2,000,000/20,000)]	100
Per unit cost	1,400

Value of inventory = 1,000 units @ Rs. 1,400 = Rs.1,400,000

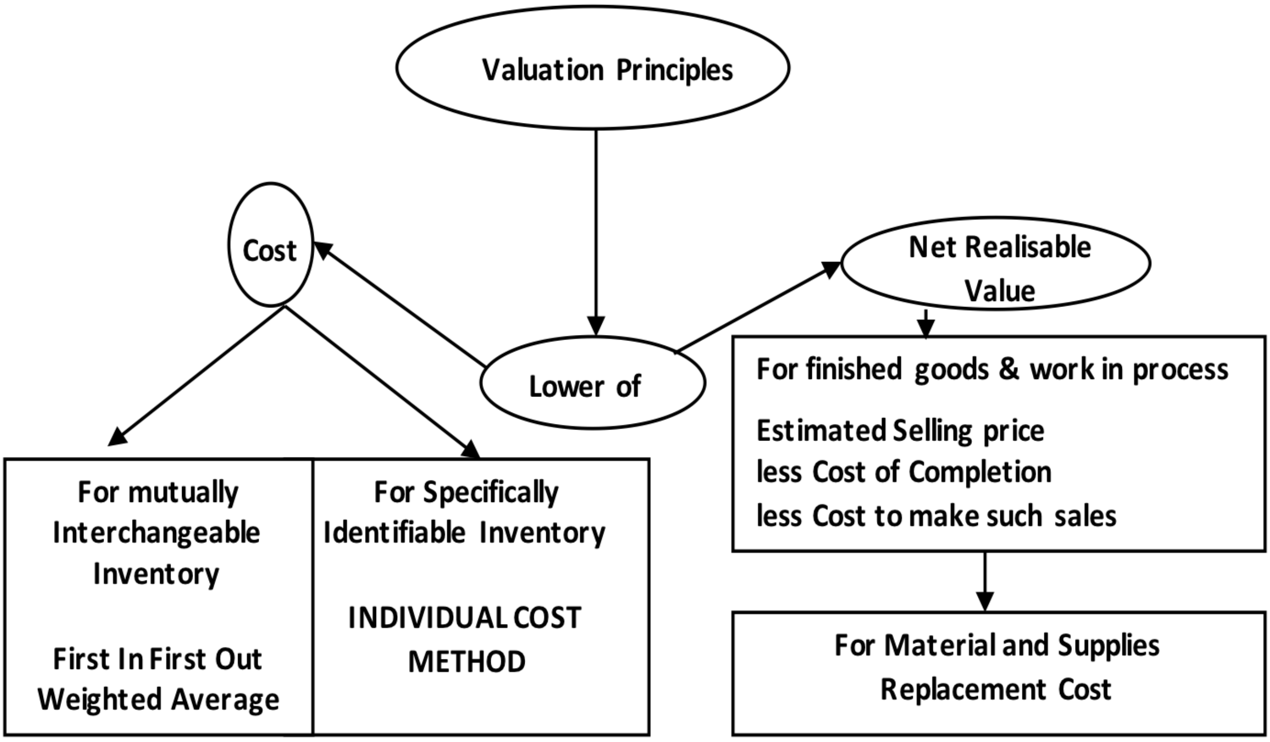
Important Tips To Remember - ITTR

Cost of inventory includes all the costs that are incurred to bring the inventory into its present location and condition

Accounting for Inventories

Inventory costing methods

Costing Methods



Practice 15.6

Purchases	5 units at Rs.4/unit
	5 units at Rs.5/unit
	5 units at Rs.5.50/unit
Closing inventory	8 units

First In, First Out (FIFO)

	Rs.
5 units @ Rs.5.50	27.50
3 units @ Rs.5.00	15.00
Cost of closing inventory	**42.50**

Weighted average (Average cost – WAVCO)

$$\frac{\text{Total cost of investory purchased}}{\text{No. of units purchased}} \text{ x no. of units in inventory}$$

$$\frac{(5\times Rs.4)+(5\times Rs.5)+(5\times Rs.5.50)}{15}\times 8 = Rs.38.67$$

Important Tips To Remember - ITTR

1. IAS 2 allows only two methods to work out cost of inventory:
   a) FiFo
   b) Weighted Average

Accounting for Inventories

Accounting systems to record inventories

Accounting Systems

1. Perpetual System
2. Periodic System

Perpetual System - Entries

<u>Purchase of inventory (Purchase is recognized as Asset)</u>

Inventory Purchase A/c	Dr	
Bank a/c or Creditors A/c		Cr

<u>Issue/Use/Sale of inventory</u>

Consumption Cost A/c	Dr	
Or		
Cost of Goods Sold A/c	Dr	
Inventory Purchases A/c		Cr

Periodic System - Entries

<u>Purchase of inventory (Purchase is recognized as Expense)</u>

Purchase A/c	Dr	
Bank a/c or Creditors A/c		Cr

<u>Issue/Use/Sale of inventory</u>

No accounting entry is passed to record such issue in the books of account

<u>Transfer entry for Purchases and Op Inventory</u>

Cost of Goods Sold A/c	Dr	
Opening Inventory A/c		Cr
Purchases A/c		Cr

<u>Adjusting entry for Closing Inventory</u>

Closing Inventory A/c	Dr	
Cost of Goods Sold A/c		Cr

Abnormal and normal loss of inventory

Loss	Perpetual System	Periodic System
Abnormal Loss	Abnormal Loss Inventory A/c.	Abnormal Loss Purchase A/c.
Normal Loss	Cost of goods sold Inventory A/c.	No accounting entry is required

Important Tips To Remember - ITTR

1. Perpetual system is followed in the entities where systematic accounting is adopted
2. Periodic system is easy and simple to follow.

Accounting for Inventories

Practice
Perpetual and
Periodic System

Practice 15.7

Jan. 20X9

01. Opening balance 400 units @ Rs. 4 each
02. Purchase 1000 units @ Rs. 5 each
03. Sales 700 units @ Rs. 12 each
04. Purchases 1200 units @ Rs. 6 each
05. Sales 1000 units @ Rs. 12 each
06. Purchase 800 units @ Rs. 7 each
07. Sale 500 units @ Rs. 12 each

a) Enter the above transactions in the books of accounts under periodic and perpetual system of accounting.
b) Calculate the cost of inventory under periodic and perpetual systems using FIFO, and weighted average methods.

Practice 15.7

	Units
Opening inventory	400
Purchases (1,000+1,200+800)	3,000
Unit available for sale	3,400
Units sold (700+1,000+500)	(2,200)
Closing inventory	1,200

	Amount of Sales Rs.
700 x 12 =	8,400
1000 x 12 =	12,000
500 X 12 =	6,000
	26,400

Accounting Entries

Jan.	Periodic System			Jan.	Perpetual Systems		
05	Purchases	5,000		05	Inventory purchase	5,000	
	Cash		5,000		Cash		5,000
10	Cash	8,400		10	Cash	8,400	
	Sales		8,400		Sales		8,400
					Cost of goods sold	3,100	
					Inventory Purchases		3,100
					(FIFO method)		
15	Purchases	7,200		15	Inventory purchase	7,200	
	Cash		7,200		Cash		7,200

Accounting Entries

Jan.	Periodic System			Jan.	Perpetual Systems		
20	Cash	12,000		20	Cash	12,000	
	Sales				Sales		12,000
					Cost of goods sold	5,300	
					Inventory purchases		5,300
					(FIFO method)		
25	Purchases	5,600		25	Inventory purchase	5,600	
	Cash		5,600		Cash		5,600
30	Cash	6,000		30	Cash	6,000	
	Sale		6,000		Sales		6,000
					Cost of goods sold	3,000	
					Inventory Purchases		3,000
					(FIFO method)		

Accounting Entries

Jan.	Periodic System			Jan.	Perpetual Systems		
31	Cost of goods sold	1,600		31	Income Statement	11,400	
	Opening stock		1,600		Cost of goods sold		11,400
31	Cost of goods sold	17,800					
	Purchases		17,800				
31	Closing stock			31	Sales	26,400	
	Cost of goods sold		8,000		Income statement		26,400
31.	Income statement	11,400					
	Cost of goods sold		11,400				
31	Sales	26,400					
	Income statement		26,400				

Ledger Accounts – Periodic System

Purchases (Exp)

Jan				
05	Cash	5,000		
15	Cash	7,200		
25	Cash	5,600	Cost of goods sold	17,800
		17,800		**17,800**

Sales

		10	Cash	8,400
		20	Cash	12,000
COGS	26,400	30	Cash	6,000
	26,400			**26,400**

Ledger Accounts – Periodic System

Stock (Asset)

Bal b/f	1,600	Cost of goods sold	1,600
Cost of goods sold	8,000	Bal c/f	8,000
	9,600		**9,600**

Cost of Goods Sold

Opening stock	1,600	Closing stock	8,000
Purchases	17,800	Income Statement	11,400
	19,400		19,400

Opening Stock	**1,600**
Add: Purchases	**17,800**
Less: Closing stock	**(8,000)**
	11,400

Ledger Accounts – Perpetual System

Inventory Purchases (Assets)

Jan			Jan		
01	Bal b/f	1,600	10	COGS	3,100
05	Cash	5,000	20	COGS	5,300
15	Cash	7,200	30	COGS	3,000
25	Cash	5,600	31	Bal c/f	8,000
		19,400			**19,400**

Cost of Goods Sold

10	Inventory purchase	3,100		
20	Inventory purchase	5,300		
30	Inventory purchase	3,000	Income Statement	11,400
		11,400		**11,400**

Ledger Accounts – Perpetual System

Sales

		10	Cash	8,400
		20	Cash	1,200
Inc. Statement	26,400	30	Cash	6,000
	26,400			**26,400**

Cost of Inventory – Periodic System

FIFO method

Closing inventory = 1200 units remained unsold

800 x Rs.7	=	Rs.5,600
400 x Rs.6	=	Rs.2,400
Cost of Closing inventory		Rs.8,000

Weighted average cost method

Total cost (Opening Inventory + Purchases)= cost per unit
Total unit (Opening Inventory + Purchases)

Rs.(1,600 + 17,800) = Rs.5.7058 per unit
(400 + 3,000) units

Cost of closing inventory = 1200 x Rs. 5.7058 =Rs. 6,847

Important Tips To Remember - ITTR

1. Perpetual system gives us balance of inventory after each information of movement in inventory
2. Periodic system tell us inventory balance after the end of reporting period only

Accounting for Inventories

Practice
FIFO and Weighted Average
under
Perpetual System

Practice 15.7

Jan. 20X9

01. Opening balance 400 units @ Rs. 4 each
02. Purchase 1000 units @ Rs. 5 each
03. Sales 700 units @ Rs. 12 each
04. Purchases 1200 units @ Rs. 6 each
05. Sales 1000 units @ Rs. 12 each
06. Purchase 800 units @ Rs. 7 each
07. Sale 500 units @ Rs. 12 each

a) Enter the above transactions in the books of accounts under periodic and perpetual system of accounting.
b) Calculate the cost of inventory under periodic and perpetual systems using FIFO, and weighted average methods.

Cost of Inventory – Periodic System

FIFO method

Closing inventory = 1200 units remained unsold

800 x Rs.7	=	Rs.5,600
400 x Rs.6	=	Rs.2,400
Cost of Closing inventory		Rs.8,000

Weighted average cost method

Total cost (Opening Inventory + Purchases)= cost per unit
Total unit (Opening Inventory + Purchases)

Rs.(1,600 + 17,800) = Rs.5.7058 per unit
(400 + 3,000) units

Cost of closing inventory = 1200 x Rs. 5.7058 =Rs. 6,847

Cost of Inventory – Perpetual System

FIFO Method

Date	Particulars	Received			Issues			Balance		
		Qty	Rate	Rs.	Qty	Rate	Rs.	Qty	Rate	Rs.
01	Op. Balance							400	4	1,600
05	Purchases	1000	5	5,000				400	4	1,600
10	Sales							1000	5	5,000
	(700 units)				400	4	1,600			
					300	5	1,500	700	5	3,500
15	Purchases	1200	6	7,200				700	5	3,500
								1200	6	7,200
20	Sales				700	5	3,500			
	(1000 units)				300	6	1,800	900	6	5,400
25	Purchases	800	7	5,600				900	6	5,400
								800	7	5,600
30	Sales				500	6	3,000	400	6	2,400
	(500 units)							800	7	5,600
								1200		8,000

Cost of Inventory – Perpetual System

Weighted Average Cost Method

Date	Particulars	Received			Issues			Balance		
		Qty	Rate	Rs.	Qty	Rate	Rs.	Qty	Rate	Rs.
01	Op. Balance							400	4	1,600
05	Purchases	1000	5	5,000				1400	(w-1) 4.7142	6,600
10	Sales				700	4.7142	3,300	700	4.7142	3,300
15	Purchases	1200	6	7,200				1900	(w-2) 5.526	10,500
20	Sales				1000	5.526	5,526	900	5.526	4,974
25	Purchases	800	7	5,600				1700	(w-3) 6.22	10,594
30	Sales				500	6.22	3,110	1200	6.22	7,464

(W-1)

Rs.6,600 /1400 = 4.7142

(W-2)

(3,300+7,200)/(700+1,200) = 5.526

(W-3)

(4,974+5,600)/(900+800) = 6.22

Important Tips To Remember - ITTR

1. FIFO – Balance column will contain inventory count in chronological order
2. W Avg. – Balance column will contain total number of inventory in hand on that date with its total cost

Accounting for Inventories

Problem of Stock Taking under Periodic System

Problem of Stock Taking

1. Stock count takes place on a later date
2. Stock count takes place on an earlier date

Stock Count on Later Date

Start with the value of inventory on that later date

Add: Sales (at cost) between the two dates
Add: Purchase returns between the two dates
Add: Inventory lost because of any reason between the two dates

Less: Purchases between the two dates
Less: Sales returns (at cost price) between the two dates

Do nothing:
Inventory bought before closing date but still in transit (not yet received)

Stock Count on Earlier Date

Start with the value of inventory on that earlier date

Less: Sales (at cost) between the two dates
Less: Purchase returns between the two dates
Less: Inventory lost because of any reason between the two dates

Add: Purchases between the two dates
Add: Sales returns (at cost price) between the two dates

Practice 15.10

"Stock Taking Team" could not count inventory on reporting date that was 31.12.20X9.
Cost of inventory as per the physical count on 05.01.20Y0 was Rs.150,000.
Following information was provided to you regarding the movement in inventory after the reporting date till the date of physical count:

a) Sales totaled Rs.120,000, which include profit margin of Rs.20,000
b) Sales returned were Rs.12,000, cost of these goods was Rs.10,000
c) Purchase of goods totaled Rs.50,000
d) Purchases retuned were Rs.5,000
e) Goods costing Rs.15,000 were lost by theft

Answer – Practice 15.10

	Rs.
Cost of inventory as per physical count	150,000
a) Cost of sold goods during the period	100,000
b) Cost of sales return during the period	(10,000)
c) Cost of purchases during the period	(50,000)
d) Cost of purchase return during the period	5,000
e) Cost of goods lost during the period	15,000
Cost of inventory at 31st December 20X9	210,000

Important Tips To Remember - ITTR

1. Work out inventory movement at cost
2. NRV is calculated once the cost has been ascertained

Accounting for Inventories

Recognition of Inventory as Expense

Inventory as an Expense

1. The inventories have been sold to customers
2. The amount of any write-down of inventories to net realizable value
3. All losses of inventories due to theft or fire etc.

Practice 15.8

Sumaiya is engaged in production of surgical items. Following data is available for the month of March.

Opening stock	3,000 unit @ Rs. 100 per unit
Production	30,000 unit @ Rs. 100 per unit
Closing stock	2,000 unit @ Rs. 100 per unit

Expense charged to Income Statement is the cost that has been expired:

Unit sold = opening units + units produced - closing units
= 3,000 + 30,000 – 2,000
= 31,000 units

Cost of goods sold = 31,000 x Rs.100 = Rs.3,100,000

Practice 15.9

Hamza has following data for the month of March:

Opening stock	300 units @ Rs. 100
Purchases	1,000 units @ Rs. 100
Closing stock	200 units

At 31 March, NRV of the product comes down to Rs.95

		Closing Stock At NRV Rs.		Closing Stock At Cost Rs.
Opening stock		30,000		30,000
Purchases		100,000		100,000
		130,000		130,000
Closing stock	200 x Rs.95	(19,000)	200 x Rs.100	(20,000)
Cost of goods sold		$\boxed{111,000}$		110,000

Thus, reducing the value of closing stock to NRV would cause increase in cost of goods sold.

Important Tips To Remember - ITTR

1. Cost that expires is Expense

Chapter - 16

Partnership Accounting

Topic Videos 138-157 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

Accounting for Partnership Firms

Reporting Difference between Sole Proprietorship and Partnership Entities

The only Difference

Profit Distribution Statement

Or

Profit and Loss Appropriation Account

Profit Distribution Basis

Basis for distribution	Facts and Reasons
Interest on Capital	Difference in amount of contributed capital
Partner's Salary	Difference in services performed
Profit sharing ratio	Difference in experience and personal contacts

Interest on drawings
Before applying profit sharing ratio, adjustment for interest on drawings is made based on the reason that; had the drawings not been made by the partners the firm would have earned more profits.

Important Tips To Remember - ITTR

1. The only difference is that there are partners now who need profit to be distributed
2. Solution is Profit Distribution Statement

Accounting for Partnership Firms

Profit Distribution Statement

Practice 16.1

X, Y and Z set up a partnership firm on 1-1-20X9. They contributed Rs.150,000, Rs.120,000 and Rs.90,000 respectively as their Capitals and decided to share Profit & Loss in the ratio of 3: 2: 1.
The Net amount of profit as per Income Statement for the year 20X9 was Rs.106,980.
The partnership deed provides that X is to be paid a salary of Rs.3,000 per month and Y Rs.15,000 per annum. It also provides that interest on Capital be allowed at 6% per annum. The drawings and Interest on drawings for the year were as follows:

Partners	Drawings Rs.	Interest on drawings Rs.
X	40,000	810
Y	20,000	540
Z	10,000	270

Prepare profit distribution statement

Profit Distribution Statement

	X Rs.	Y Rs.	Z Rs.	Total Rs.
Net profit				106,980
Interest on drawings	(810)	(540)	(270)	1,620
Partners salaries	36,000	15,000	-	(51,000)
Interest on Capital				
X 150,000 x 6%	9,000			
Y 120,000 x 6%		7,200		
X 90,000 x 6%			5,400	(21,600)
Profit ratio				
X 36,000 x 3/6	18,000			
Y 36,000 x 2/6		12,000		
Z 36,000 x 1/6			6,000	(36,000)
	62,190	33,660	11,130	Nil

Partners' Current Account

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
Drawings	40,000	20,000	10,000	Balance b/f	0	0	0
				Profit share	62,190	33,660	11,130
Balance c/f	22,190	13,660	1,130				
	22,190	13,660	11,130		62,190	33,660	11,130

Partners' Current Account

Abridged

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
Drawings	40,000	20,000	10,000	Bal b/f	0	0	0
				Profit	62,190	33,660	11,130
Bal c/f	22,190	13,660	1,130	Share			
	62,190	33,660	11,130		62,190	33,660	11,130

Detailed

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
Drawings	40,000	20,000	10,000	Bal b/f	0	0	0
Interest Drawings	810	540	270	Salary	36,000	15,000	
				Interest	9,000	7,200	5,400
Bal c/f	22,190	13,660	1,130	Profit	18,000	12,000	6,000
	22,190	13,660	11,130		62,190	33,660	11,130

Partners' Capital Account

	X Rs.000	Y Rs.000	Z Rs.000		X Rs.000	Y Rs.000	Z Rs.000
				Bal b/f	150	120	90
Bal c/f	150	120	90				
	150	120	90		150	120	90

Important Tips To Remember - ITTR

1. There are three reasons for difference of share in profit:
   a) Amount of capital invested
   b) Performance of service
   c) Experience

Accounting for Partnership Firms

Calculation of Interest on Capital

Interest on Capital

Interest on capital is calculated on the effective capital balances at an agreed rate of interest

Practice 16.2

January 1, 20X8	Capital Balances	Rs.
	A	50,000
	B	75,000
June 30, 20X8	Fresh Capital introduced by A	20,000
August 31, 20X8	Fresh Capital introduced by B	45,000

Calculate Interest on Capital at 10%, accounting year ends on December 31, 20X8.

Effective Capital Balances		Rs.	Rs.
A	Opening	50,000	
	Fresh 20,000 x 6/12	10,000	60,000
B	Opening	75,000	
	Fresh 45,000 x 4/12	15,000	90,000
Interest on Capital			
A	60,000 x 10%	6,000	
B	90,000 x 10%	9,000	

Important Tips To Remember - ITTR

1. Calculate effective capital balance
2. Apply interest rate on effective capital balance

Accounting for Partnership Firms

Calculation of Interest on Drawings

Interest on Capital

Interest on drawings is calculated on the effective drawings balances at an agreed rate of interest

Practice 16.2

Drawings made by partners during the year ending on December 31:

Interest on drawings @ 6% pa Dates of drawings	Partner A Rs.	Partner B Rs.
March 31, 2008	4,000	6,000
June 30, 2008	3,000	2,000
September 30, 2008	6,000	4,800
December 31, 2008	4,000	6,000

Practice 16.2

Effective Drawings Balances – Partner A

		Rs.
Mar 31	4,000 x 9/12 =	3,000
Jun 30	3,000 x 6/12 =	1,500
Sep 30	6,000 x 3/12 =	1,500
Dec 31	4,000 x 0/12 =	0
		6,000
Interest on drawings	6,000 x 6%	360

Effective Drawings Balances – Partner B

		Rs.
Mar 31	6,000 x 9/12 =	4,500
Jun 30	2,000 x 6/12 =	1,000
Sep 30	6,000 x 3/12 =	1,500
Dec 31	6,000 x 0/12 =	0
		7,000
Interest on drawings	7,000 x 6%	420

Important Tips To Remember - ITTR

1. Calculate effective drawings balance
2. Apply interest rate on effective drawings balance

Accounting for Partnership Firms

Change in Constitution of Partnership Firm

Reasons of changes in Constitution

Partnership Constitution is also known as Partnership Deed

Following changes can happen:

1. Admission of a new partner
2. Retirement of an existing partner
3. Death of a partner

Important Tips To Remember - ITTR

1. A different accounting treatment is required whenever these changes occur

Accounting for Partnership Firms

Admission of a new Partner

Adjustments Required

1. Calculation of new profit sharing ratio
2. Calculation and accounting treatment of goodwill
3. Revaluation of net assets

Important Tips To Remember - ITTR

Admission of a new partner will bring changes in:

1. Profit distribution
2. Partners' Current Account
3. Partners' Capital Account

Calculation of New Profit Sharing Ratio

New Profit Sharing Ratio

Basic Data:

Old Ratio A : B
3 : 2

C is admitted for $1/6^{th}$ share in profits

Scenario I

A and B will continue sharing in old ratio

Scenario II

A and B will share equally after C's admission

Scenario III

C will buy his share half from A and half from B

Scenario I

A and B will continue sharing in old ratio (mutual ratio would no change)

A and B's Share = $1 - \frac{1}{6}$ = 5/6

A = $\frac{5}{6} \times \frac{3}{5}$ = $\frac{3}{6}$

B = $\frac{5}{6} \times \frac{2}{5}$ = $\frac{2}{6}$

C = $\frac{1}{6}$ = $\frac{1}{6}$

New Ratio of A, B and C = 3 : 2 : 1

Scenario II

A and B will share equally after C's admission

A = $\frac{5}{6} \times \frac{1}{2}$ = $\frac{5}{12}$

B = $\frac{5}{6} \times \frac{1}{2}$ = $\frac{5}{12}$

C = $\frac{1}{6} \times \frac{2}{2}$ = $\frac{2}{12}$

New ratio of A, B and C = 5 : 5 : 2

Scenario III

C will buy his share half from A and half from B

Profit of C's Share	=	$\frac{1}{6} \text{x} \frac{1}{2}$	=	$\frac{1}{12}$
A	=	$\frac{3}{5} - \frac{1}{12}$	=	$\frac{31}{60}$ (through LCM)
B	=	$\frac{2}{5} - \frac{1}{12}$	=	$\frac{19}{60}$ (through LCM)
C	=	$\frac{1}{12} + \frac{1}{12}$	=	$\frac{2}{12} \text{x} \frac{5}{5} = \frac{10}{60}$
New ratio of A, B and C	=	31 : 19 : 10		

Important Tips To Remember - ITTR

1. Its simple mathematics
2. Total share will remain = 1

Accounting for Partnership Firms

Readjustment of Capital Balances of Partners in New Profit Sharing Ratio

Readjustment of Capital Balances

Partners' capital balances are readjusted in their new profit sharing ratio.

Bases:

1. Capital balances of the old partners
2. Capital introduced by the new partner
3. Total capital balance of the firm after admission of new partner

Practice 16.9

Old partners' capital balances

A	Rs.1,212,500
B	Rs.950,000

New partner introduces capital

C	Rs. 400,000

A and B were sharing profits in 3:2, C was admitted for 1/5 share in profit. After C's admission, the profit sharing ratio is 12:8:5 for A, B and C respectively.

Readjust the capital balances of A, B & C in new profit sharing ratio on the following bases:

1. Capital balances of the old partners
2. Capital introduced by the new partner
3. Total capital balance of the firm after admission of new partner

Answer - Practice 16.9

			Rs.
	A & B's Capital	12/25	A = 1,297,500
Base 1.	$2,162,500 \times \frac{5}{4} = 2,703,125$	8/25	B = 865,000
		5/25	C = 540,625
			2,703,125
	C's Capital	12/25	A = 960,000
Base 2.	$400,000 \times \frac{5}{1} = 2,000,000$	8/25	B = 640,000
		5/25	C = 400,000
			2,000,000
	Combined Capital (A, B & C)	12/25	A = 1,230,000
Base 3.	$2,562,500 \times \frac{1}{1} = 2,562,500$	8/25	B = 820,000
		5/25	C = 512,500
			2,562,500

Important Tips To Remember - ITTR

1. Grossing up total capital
2. Divide in new profit sharing ratio

Accounting for Partnership Firms

Calculation of Sacrificing and Gaining Ratio

Calculation - Sacrificing Ratio

Basic Data:

Old Ratio	A : B
	3 : 2
New Ratio	A : B : C
	5 : 5 : 2

Sacrificing and Gaining Ration = (New – Old)

A = 5/12 – 3/5 : $\boxed{-11}$ A is sacrificing 11 times

B = 5/12 – 2/5 : $\boxed{+01}$ B is gaining 1 time

Sum of these = -10

Sacrificing and Gaining Ration A : B

-11/10 : 1/10

Important Tips To Remember - ITTR

1. Sacrificing Ratio is New - Old
2. -ve means sacrificing
3. +ve means gaining

Accounting for Partnership Firms

Valuation of Goodwill

Goodwill

1. Goodwill is aggregate of those intangible attributes of a business that contribute to the superior earning capacity of the business.
2. Goodwill is the outcome of an impression created in the mind of each customer and related persons.

Goodwill – Calculation Methods

1. Average profit
2. Super profit
3. Market capitalization

Practice 16.3 – Average Profit

Years	Profit Rs.
1st year	20,000
2nd year	40,000
3rd year	50,000
4th year	70,000
Total	180,000

Goodwill of the firm is equal to three years purchase of the last four years average profits:

Average profit = 180,000 / 4 = Rs. 45,000

Goodwill = 45,000 x 3 = 135,000

Practice 16.4 – Supper Profit

<u>Steps to calculate Goodwill</u>

1. Calculate normal profit by multiplying firm's capital with normal rate of return
2. Calculate average profit of the firm
3. Calculate super profit by subtracting normal profit from the average profit
4. Multiply the super profit by the number of years' purchase

Considering the information given in Practice 16.3

Owners' Equity	= Rs.200,000
Normal profit	= Rs.200,000 x 18% = Rs.36,000
Super profit	= Average profit – Normal profit
	= 45,000 – 36,000 = 9,000
Goodwill	= 9,000 x 3 = 27,000

Practice 16.5 - Market Capitalization

<u>Steps to calculate Goodwill</u>

1. Calculate firm's market capitalization based on average profit divided by market rate of return
2. Subtract book value of net assets from the market capitalization

Considering the information given in Practice 16.3 and 16.4

Market Capitalization	$\frac{45,000}{18} \times 100$	= 250,000
Firm's Net Assets		= 200,000
Goodwill		= 50,000

Important Tips To Remember - ITTR

1. No of years' purchase means; this much times (a multiplying number)
2. It is mutually agreed among the partners to decide the formula and basis of calculating goodwill

Accounting for Partnership Firms

Accounting Treatment for Goodwill

Goodwill Premium

Goodwill Premium is the amount contributed by new coming partner in addition to the amount invested as capital

Goodwill Premium is treated in the books of accounts in different ways

Goodwill – Scenarios

1. Goodwill Raised and Retained as Asset
2. Goodwill Raised and Written-off
3. Cash Brought-in for Goodwill Premium
4. Cash Brought-in for Goodwill Premium and then Withdrawn

Important Tips To Remember - ITTR

1. The amount that incoming partner pays for goodwill is known as premium for goodwill
2. It is incoming partner's share in Firm's Goodwill

Accounting for Partnership Firms

Scenario I
Goodwill raised and retained as Asset

Goodwill Raised as Asset

- The new partner does not bring cash for goodwill premium
- Goodwill is raised in the books of accounts at its full value
- **Goodwill calculated = Rs.135,000**
- **Profit sharing ratio of partners A & B = 3 : 2**

Journal Entry

	Rs.	Rs.
Goodwill A/c	135,000	
A's capital A/c		81,000
B's capital A/c		54,000

Working

A's share = 135,000 x 3/5 = 81,000

B's share = 135,000 x 2/5 = 54,000

Important Tips To Remember - ITTR

1. Raise the Goodwill with incremental amount, if the amount of Goodwill is already appearing in the Balance Sheet is lesser than the value of goodwill.

Goodwill A/c	Dr
Old Partners' Capital A/c	Cr

2. Write down the excess amount of Goodwill if the amount of Goodwill already appearing in the Balance Sheet is greater than the value of goodwill.

Old partners' capital accounts	Dr
Goodwill accounts	Cr

Important Tips To Remember - ITTR

Revaluation of Goodwill shall be adjusted in old profit sharing ratio

Accounting for Partnership Firms

Scenario II
Goodwill raised and Written Off

Goodwill Raised as Asset

- The new partner does not bring cash for goodwill premium
- Partners decide that Goodwill should not appear as Asset
- Goodwill calculated = Rs.135,000
- Profit sharing ratio A & B = 3 : 2 (New ratio A:B:C = 3:2:1)

Journal Entry

	Rs.	Rs.
Goodwill A/c	135,000	
A's capital A/c		81,000
B's capital A/c		54,000

Working

A's share = 135,000 x 3/5 = 81,000

B's share = 135,000 x 2/5 = 54,000

Goodwill Written Off

Journal Entry

	Rs.	Rs.
A's capital A/c	67,500	
B's capital A/c	45,000	
C's capital A/c	22,500	
Goodwill A/c		135,000

(New profit sharing ratio A:B:C = 3:2:1)

A's benefit		Rs.	**B's benefit**		Rs.
Old ratio	(Cr)	81,000	Old ratio	(Cr)	54,000
New ratio	(Dr)	67,500	New ratio	(Dr)	45,000
	(Cr)	13,500		(Cr)	9,000

A's benefit + B's benefit

13,500 + 9,000 = 22,500

C's share = 22,500

C's share = 135,000 x 1/6 = 22,500

Important Tips To Remember - ITTR

Use new profit sharing ration whenever all the partner (old + new) are being Dr. or Cr.

Accounting for Partnership Firms

Scenario III
Cash brought in for Goodwill Premium

Distribution of Goodwill Premium

1. All the old partners sacrifice their profit sharing
2. Few partners do sacrifice but few partners gain profit sharing

All partners are sacrificing

- The new partner brings cash for goodwill premium
- Goodwill calculated = Rs.135,000
- Old profit sharing ratio A:B = 3:2
- New profit sharing ratio A:B:C = 3:2:1
- Goodwill Premium = 135,000 x 1/6 = 22,500
- Sacrificing and Gaining Ration = (New – Old)

A = 3/6 – 3/5 = -3 A is sacrificing 3 times

B = 2/6 – 2/5 = -2 B is sacrificing 2 times

Sum of these = -5

Sacrificing and Gaining Ration A : B

-3/5 : -2/5

Accounting Treatment

Journal Entries	Rs.	Rs.
Bank A/c.	22,500	
Goodwill premium A/c.		22,500

Goodwill premium A/c.	22,500	
A's Capital A/c.		13,500
B's Capital A/c.		9,500

Goodwill premium of Rs. 22,500 will be distributed as:

A = 22,500 x -3/5	13,500
B = 22,500 x -2/5	9,500
	22,500

One Partner Sacrifices Other Gains

- The new partner brings cash for goodwill premium
- Goodwill calculated = Rs.135,000
- Old profit sharing ratio A:B = 3:2
- New profit sharing ratio A:B:C = 5:5:2
- Goodwill Premium = 135,000 x 1/6 = 22,500
- Sacrificing and Gaining Ration = (New – Old)

A = 5/12 – 3/5 = -11 A is sacrificing 11 times

B = 5/12 – 2/5 = +01 B is gaining 1 time

Sum of these = -10

Sacrificing and Gaining Ration A : B

-11/10 : 1/10

Accounting Treatment

Journal Entries	Rs.	Rs.
Bank A/c.	22,500	
Goodwill premium A/c.		22,500
Goodwill premium A/c.	22,500	
B's Capital A/c.	2,250	
A's Capital A/c.		24,750

Goodwill premium of Rs. 22,500 will be distributed as:

A = 22,500 x -11/10	24,750
B = 22,500 x 1/10	-2,250
	22,500

Important Tips To Remember - ITTR

1. Sacrificing partner should be Cr.
2. Gaining partner should be Dr.

Accounting for Partnership Firms

Scenario IV
Cash brought in for Goodwill Premium and Withdrawn

Drawing of Goodwill Premium

1. New Partner brings in cash for Goodwill Premium
2. Old Partners withdraw cash equal to their share in Goodwill Premium

Accounting Treatment

Journal Entries	Rs.	Rs.
Cash brought in the business for Goodwill Premium		
Bank A/c.	22,500	
Goodwill premium A/c.		22,500
Distribution of Goodwill Premium in Sacrificing Ratio		
Goodwill premium A/c.	22,500	
A's Capital A/c.		13,500
B's Capital A/c.		9,500
Drawing of Goodwill Premium by the old partners		
A's capital A/c	13,500	
B's capital A/c	9,000	
Bank A/c		22,500

Important Tips To Remember - ITTR

1. Amount of Drawings may vary from the distributed amount
2. Drawings are not necessarily to be made in proportion to any profit sharing ratio

Accounting for Partnership Firms

Revaluation of Assets and Liabilities

When to Revalue Net Assets?

At the time of admission of a new partner or retirement of existing partner, net assets of the firm are revalued to their fair value.

Accounting Treatment - Revaluation

1. For increase in assets value

Specific asset a/c	Dr
Revaluation a/c	Cr

2. For decrease in assets value

Revaluation a/c	Dr
Specific asset a/c	Cr

3. For increase in Liabilities value

Revaluation a/c	Dr
Specific liabilities a/c	Cr

4. For decrease in Liabilities value

Specific liabilities a/c	Dr
Revaluation a/c	Cr

Gain / Loss on Revaluation

5. For gain on revaluation

Revaluation a/c	Dr
Old partners Capital A/c	Cr(Old ratio)

OR

6. For loss on revaluation

Old Partners Capital A/c.	Dr(Old ratio)
Revaluation A/c.	Cr

Important Tips To Remember - ITTR

Any gain or loss because of change in fair value of net assets should be adjusted immediately so that such gain or loss does not positively or negatively affect the new coming partner or old partners as the case may be.

Accounting for Partnership Firms

Retirement of a Partner

Retiring Partner's Capital Balance

Make adjustments in Capital Balance or Retiring Partner for:

1. Share in goodwill of the firm
2. Gain or loss on revaluation of net assets

Transfer capital balance of retiring partner to Loan (Liability) A/c.

Important Tips To Remember - ITTR

Retiring Partners Capital Dr.

Personal Loan Cr

Accounting for Partnership Firms

Death of a Partner

Deceased Partner's Capital Balance

Deceased partner's capital balance is transferred to Executor's Account along with the following balances:

1. Share in profit/loss till the date of death
2. Share in goodwill of the firm
3. Interest on capital
4. Drawings
5. Interest on drawings
6. Any other time to be specified; like "loan to or from the firm"

Important Tips To Remember - ITTR

1. Any balance appearing as un-appropriated profits, or Reserves Account will be transferred to those partners' capital accounts who were partners prior to such change, in their respective profit sharing ratio (old ratio).
2. Cr. Balance of Deceased Partner's Executor A/c is Liability
3. Dr. Balance of Deceased Partner's Executor A/c is Asset

Accounting for Partnership Firms

Final Accounts of Partnership Firm

Final Accounts – Partnership Firm

1. Income Statement
2. Profit Distribution Statement
3. Balance Sheet

Practice 16.9

Shezra and Sumaiya are partners in a trading business, sharing profit and losses in the ratio 3:2. Trial Balance on 31st March, 20Y0:

Debit Balances	(Rs.)	Credit Balances	(Rs.)
Opening stock	2,000	Capital account – Shezra	10,000
Purchases	148,000	Capital account – Sumaiya	10,000
Trade Debtors	12,000	Sales	220,000
Wages sales staff	5,000	Trade Creditors	21,000
Salaries administrative staff	10,000	Bills payable	20,000
Building	30,000	Discount	6,500
Machinery	25,000		
Furniture	16,000		
Advertisement (for 2 years)	6,000		
Bills Receivable	8,000		
Insurance premium	2,000		
Drawings – Shezra	2,000		
Drawings – Sumaiya	3,000		
Cash in hand	5,500		
Repair and maintenance	10,000		
Utility bills	3,000		
	287,500		287,500

Practice 16.9

Adjustments:

1. Stock on hand on 31st March, 20Y0 was at Rs.5,000.
2. Write off Rs.2,000 for further Bad debts and maintain provision for doubtful debts at 5% on debtors.
3. Depreciate Building at 5%, Machinery at 10% and furniture at 10%
4. Outstanding expenses were; wages Rs.2,000 and salary Rs.1,000.
5. Prepaid repair Rs.1,600
6. Credit purchases amounted to Rs.4,000 were not recorded in the books of account.
7. It was decided that there will be no interest on capital and drawings.
8. Both partners are entitled to annual salary; Shezra Rs.15,000, Sumaiya Rs.10,000.

From the above Trial Balance and adjustments prepare Income Statement for the year ended 31st March, 20Y2 and Balance Sheet as on that date.

Answer – Practice 16.9

Shezra and Sumaiya
Income Statement
for the year ended 31st March, 20Y2

	Rs.	Rs.	Rs.
Sales			220,000
Cost of goods sold			
Opening stock		2,000	
Purchases	148,000		
Un recorded credit purchases	4,000	152,000	
Closing stock		-5,000	149,000
Gross profit			**71,000**

Answer – Practice 16.9

Gross profit			**71,000**
Other income – Discount received			6,500
Operating expenses			
Wages – sales staff	5,000		
Outstanding wages	2,000	7,000	
Salaries – administrative staff	10,000		
Outstanding salaries	1,000	11,000	
Advertisement	6,000		
Prepaid advertisement	-3,000	3,000	
Insurance		2,000	
Repair and maintenance	10,000		
Prepaid repair	-1,600	8,400	
Utility bills		3,000	
Depreciation			
Building	1,500		
Machinery	2,500		
Furniture	1,600	5,600	
Bad debts	2,000		
Increase in provision for doubtful debts	500	2,500	42,500
Net profit before distribution to partners			35,000

Answer – Practice 16.9

Profit Distribution Statement
For the year ended 31st March 20Y2

		Shezra Rs.	Sumaiya Rs.	Total Rs.
Net profit				35,000
Partners salaries		15,000	10,000	-25,000
				10,000
Profit ratio				
Shezra	10,000 x 3/5	6,000		
Sumaiya	10,000 x 2/5		4,000	-10,000
		21,000	**14,000**	**Nil**

Answer – Practice 16.9

Shezra and Sumaiya
Balance Sheet
As at 31st March 20Y2

	Rs.	Rs.	Rs.
Non-Current Assets			
Building	30,000		
Depreciation	1,500	28,500	
Machinery	25,000		
Depreciation	2,500	22,500	
Furniture	16,000		
Depreciation	1,600	14,400	65,400
Current Assets			
Closing stock		5,000	
Trade Debtors	12,000		
Further bad debts	-2,000		
Provision for doubtful debts	-500	9,500	
Prepaid advertisement		3,000	
Prepaid repair		1,600	
Bills receivable		8,000	
Cash in hand		5,500	32,600
			98,000

Answer – Practice 16.9

Shezra and Sumaiya
Balance Sheet
As at 31st March 20Y2

	Rs.	Rs.	Rs.
Owners' Equity			
Shezra's Capital	10,000		
Shezra's Profit share	21,000		
Shezra's Drawings	-2,000	29,000	
Sumaiya's Capital	10,000		
Sumaiya's Profit share	14,000		
Sumaiya's Drawings	-3,000	21,000	50,000
Liabilities			
Trade creditors	21,000		
Un-recorded purchases	4,000	25,000	
Bills payable		20,000	
Outstanding wages		2,000	
Outstanding salaries		1,000	48,000
			98,000

Important Tips To Remember - ITTR

1. Practice few more questions

Chapter - 17

Company Financial Statements
(Final Accounts)
Topic Videos 158-163 are mandatory part of this module

MGT 101
Financial Accounting

By
Mian Ahmad Farhan, FCA

Contents

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Company Financial Statements

Components of Financial Statements

Components of Financial Statements

Companies are governed by a law prevailing in the country.

Most of the countries have adopted IFRS, which requires companies to prepare following set of reports as final account:

1. Statement of Financial Position (Balance Sheet)
2. Statement of Profit or Loss and Other Comprehensive Income (Income Statement)
3. Statement of Changes in Equity
4. Statement of Cash Flows
5. Notes (Accounting Policies and Disclosures of Explanatory Working)

Important Tips To Remember - ITTR

1. Final account is the last step involved in accounting cycle.
2. Operational results are presented in SOPL&OCI
3. Financial position is presented in SOFP
4. Cash flows are presented in SOCF

Company Financial Statements

Statement of Financial Position

Components of SOFP

Assets
- Non Current Assets
- Current Assets

Liabilities
- Non Current Liabilities
- Current Liabilities

Owners' Equity

Current and Non Current Assets

<u>Current Asset</u>
- Held for trading
- Consumable in normal operating Cycle
- Recoverable in 12 months
- Cash & Cash Equivalents

<u>Non-Current Asset</u>
- Which are not current

Current and Non Current Liabilities

Current Liability

- Held for trading
- Expected to be settled in normal operating cycle
- Payable in 12 months

Non-Current Liability

- Which are not current

Owners' Equity

Residual interest in assets of the entity after deducting its liabilities

It includes share capital and reserves

Format - SOFP

Company's Name
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

	Rs.	*Rs.*
RESOURCES		
Non-Current Assets		
Fixed Assets		
Tangible Assets – (IAS 16)	***	
Intangible Assets – (IAS 38)	***	***
Investment Properties – (IAS 40)		***
Long Term Financial Assets – (IFRS 9)		***
(Investments in Equity/Debt, Deposits, Prepayments, Loans & Receivables)		
Total Non-Current Assets		***
Current Assets		
Inventories – (IAS 2)	***	
Accounts Receivables & Accruals – (IFRS 9)	***	
Short Term Investments & Prepayments – (IFRS 9)	***	
Cash and Bank Balances – (IFRS 9)	***	***
Current Liabilities		
Accounts Payable & Accruals – (IAS 39)	***	
Short Term Loans – (IAS 39)	***	
Current portion of lease liability – (IAS 17)	***	
Current portion of long term loans – (IFRS 9)	***	
Provisions against expected losses – (IAS 37)	***	
Provisions for current tax – (IAS 12)	***	
Bank Overdraft – (IFRS 9)	***	(***)
Working Capital		***
Capital Employed (Non-Current Assets + Working Capital)		***

Format - SOFP

Company's Name
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

	Rs.	*Rs.*
FINANCED BY – SOURCES/CLAIMS		
Owners' Equity (Owned source)		
Ordinary Share Capital/Common Stocks – (IAS 32)	***	
Other Components of Equity – (IAS 32)	***	
Share Premium – (IAS 32)	***	
Revaluation Reserve – (IAS 16)	***	
Plant Replacement Reserve – (IAS 32)	***	
Dividend Equalization Reserve – (IAS 32)	***	
Any other named Reserve – (IAS 32)	***	
General Reserves – (IAS 32)	***	
Retained Earnings – (IAS 32)	***	***
Non-Current Liabilities		
Loan Stocks/Bonds/Preferred Shares – (IAS 39)	***	
Loan from financial institutions – (IAS 39)	***	
Lease liability – (IFRS 16)	***	
Defined Benefit Plan Obligation *Less* Plan Asset – (IAS 19)	***	
Deferred Tax Liability – (IAS 12)	***	***
Capital Employed (Owners' Equity + Non-Current Liabilities)		***

Important Tips To Remember - ITTR

1. Classification should be followed consistently over the years

Company Financial Statements

Statement of Profit or Loss and Other Comprehensive Income

Components of SOPL

<u>Incomes</u>

1. Sales revenue (operating income)
2. Other incomes (non-operating incomes)

<u>Expenses</u>

1. Cost of sales
2. Administrative
3. Selling and marketing
4. Financial
5. Income Tax

Statement of OCI

OCI presents unrealized gains and losses during the year. These are further categorized into two:

1. Items that will not be reclassified to SOPL
2. Items that may be reclassified subsequently to SOPL

Format - SOPL

Company's Name

Statement of Profit or Loss and Other Comprehensive Income (Income Statement)

For the Year ended December 31, 20X9

	Rs.	Rs.
Sales revenue – (IFRS 15)		***
Cost of goods sold – (IAS 2)		(***)
Gross profit		***
Operating expenses – (IAS 1, 16, 36, 38, 37, 40, IFRS 2)		
Administrative expense	***	
Selling & Marketing expenses	***	(***)
Profit from operations		***
Other income – (IAS 11, 16, 20, 40, IFRS 9, 15)		***
Financial expenses – (IAS 23, IFRS 9, 16)		(***)
Profit before tax		***
Income tax expense – (IAS 12)		(***)
Profit after tax		***

Format - OCI

Statement of Other Comprehensive Income

For the Year ended December 31, 20X9

Profit after tax		***
Items that will not be reclassified to Income Statement (Profit or Loss)		
Gain on Revaluation of Property Plant & Equipment – (IAS 16)	***	
Re-measurement of Investments in Equity – (IFRS 9)	***	
Actuarial gain/loss on defined benefit plan – (IAS 19)	***	***
Items that may be reclassified subsequently to Income Statement (Profit or Loss)		
Foreign exchange gain/loss on translating foreign operations – (IAS 21)	***	
Cash flow Hedges – effective part – (IFRS 9)	***	***
Total Comprehensive Income		***

Important Tips To Remember - ITTR

1. Realized gains or losses are presented in SOPL
2. Unrealized gains or losses are presented in OCI

Company Financial Statements

Statement of Changes in Equity

Components of SOCE

It presents reconciliation between the carrying amount at the beginning and end of the period.

It separately discloses changes in:

1. Profit or loss
2. Items of OCI
3. Transactions with owners

Format - SOCE

Company's Name
Statement of changes in equity
For the year ended December 31, 20X9

	Share Capital	Share Premium	Revaluation Reserve	Accumulated OCI*	Retained Profits	Total
Opening Balance	***	***	***	***	***	***
Fresh issue of shares	***	***				***
Revaluation of assets			***			***
Transferred upon disposal			(***)		***	
For the year (after tax)				***	***	***
Dividend paid during the year					(***)	(***)
Bonus Share	***	(***)			(***)	-
Totals	***	***	***	***	***	***

***It is used to accumulate unrealized losses and unrealized gains with the exception of revaluation reserve under IAS 16**

Important Tips To Remember - ITTR

1. SOCE gives full year movement and final balances of Owners' Equity items

Company Financial Statements

Practice Company Financial Statements

Statement of Profit or Loss and Other Comprehensive Income

Practice 17.1

Trial Balance of Pestle Cement Company on 31 Dec 20X9

Accounting Heads	Rupees	Rupees
Share capital		550
Share premium		100
Revaluation reserve		125
Retained earnings		563
Land and buildings (carrying value)	678	
Plant and machinery (carrying value)	585	
Inventory 1 Jan 20X9	120	
Sales revenue		925
Purchases	512	
Administration expenses	102	
Marketing expenses	165	
Financial expenses	42	
Trade receivables	300	
Cash balance	45	
Trade payables		286
Total	2,549	2,549

Practice 17.1

Further information:

1. Inventory at 31 December 20X9 amounted to Rs.235,000
2. Create provision for tax expense for the year Rs.62,000
3. The revaluation reserve relates to land that was revalued during the year.

Prepare for the year ended 31 December 20X9:

1. Statement of Profit or Loss
2. Other Comprehensive Income

Answer – Practice 17.1

Pestle Cement Company
Statement of Profit or Loss and Other Comprehensive Income (Income Statement)
For the Year ended December 31, 20X9

	Rs.	Rs.
Sales revenue		925
Cost of goods sold		
Opening inventory	120	
Purchase	512	
Closing inventory	(235)	(397)
Gross profit		528
Operating expenses		
Administrative expense	102	
Selling & Marketing expenses	165	(267)
Profit from operations		261
Other income		0
Financial expenses		(42)
Profit before tax		219
Income tax expense		(62)
Profit after tax		**157**

Answer – Practice 17.1

Statement of Other Comprehensive Income
For the Year ended December 31, 20X9

Profit after tax		157
Items that will not be reclassified to Income Statement (Profit or Loss)		
Gain on Revaluation of Property Plant & Equipment	125	
Re-measurement of Investments in Equity	0	125
Items that may be reclassified subsequently to Income Statement (Profit or Loss)		
Foreign exchange gain/loss on translating foreign operations	0	
Cash flow Hedges – effective part	0	0
Total Comprehensive Income		**283**

Important Tips To Remember - ITTR

1. Presentation and classification should be properly taken care

Company Financial Statements

Practice
Company Financial Statements

Statement of Changes in Equity
and
Statement of Financial Position

Practice 17.2

Trial Balance of Pestle Cement Company on 31 Dec 20X9

Accounting Heads	Rupees	Rupees
Share capital		550
Share premium		100
Revaluation reserve		125
Retained earnings		563
Land and buildings (carrying value)	678	
Plant and machinery (carrying value)	585	
Inventory 1 Jan 20X9	120	
Sales revenue		925
Purchases	512	
Administration expenses	102	
Marketing expenses	165	
Financial expenses	42	
Trade receivables	300	
Cash balance	45	
Trade payables		286
Total	2,549	2,549

Practice 17.2

Further information:

1. Inventory at 31 December 20X9 amounted to Rs.235,000
2. Create provision for tax expense for the year Rs.62,000
3. The revaluation reserve relates to land that was revalued during the year.

Prepare for the year ended 31 December 20X9:

1. Statement of Changes in Equity
2. Statement of Financial Position as on that date

Answer – Practice 17.2

Pestle Cement Company
Statement of changes in equity
For the year ended December 31, 20X9

	Share Capital	Share Premium	Revaluation Reserve	Accumulated OCI	Retained Profits	Total
Opening Balance	550	100	0	0	563	1,231
Fresh issue of shares	0	0				0
Revaluation of assets			125			125
For the year (after tax)				0	157	157
Dividend paid during the year					(0)	(0)
Total	**550**	**100**	**125**	**0**	**720**	**1,495**

Answer – Practice 17.2

Pestle Cement Company
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

	Rs.	Rs.
RESOURCES		
Non-Current Assets		
Fixed Assets		
Land & Building	678	
Plant & Machinery	585	1,263
Total Non-Current Assets		1,263
Current Assets		
Inventories	235	
Trade Receivables	300	
Cash and Bank Balances	45	580
Current Liabilities		
Accounts Payable	286	
Provisions for current tax	62	(348)
Working Capital		232
Capital Employed (Non-Current Assets + Working Capital)		**1,495**

Answer – Practice 17.2

Pestle Cement Company
Statement of Financial Position (Balance Sheet)
As at December 31, 20X9

	Rs.	Rs.
FINANCED BY – SOURCES/CLAIMS		
Owners' Equity		
Ordinary Share Capital/Common Stocks	550	
Share Premium	100	
Revaluation Reserve	125	
Retained Earnings	720	1,495
Non-Current Liabilities		
Loan Stocks/Bonds/Preferred Shares	0	
Deferred Tax Liability	0	0
Capital Employed (Owners' Equity + Non-Current Liabilities)		**1,495**

Important Tips To Remember - ITTR

1. Movement in Revaluation Reserves should be presented separately in the SOCE

Chapter - 18

Statement of Cash Flows

Topic Videos 164-169 are mandatory part of this module

MGT 101
Financial Accounting

By
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Statement of Cash Flows

Purpose of Preparing Statement of Cash Flows

Analytical Statement

Cash Receipts

→ Cash Inflows

Cash Payments

→ Cash Inflows

Cash Book Vs SOCF

<u>Cash Book</u>
is maintained chronologically for all receipts and payments

<u>Receipt & Payment</u>
is a report that is prepared at the end of a reporting period

<u>Statement of Cash Flows</u>
is an analysis of all receipts and payments into; Operating Activity, Investing Activity, Financing Activity

Important Tips To Remember - ITTR

1. Although the SOCF is one of the five components of financial statements, it is also plays vital role in analyzing cash flows of an entity

Statement of Cash Flows

Format
Statement of Cash Flows

Format - SOFP

Company Name
Statement of Cash Flows
For the year ended, 30th June 20X9

Operating Activity:	**Rs.**	**Rs.**
Cash generated from operations **(W-1)**	***	
Cash received from Interest/Dividends **(W-2)**	***	
Cash paid for interest/financial charges **(W-3)**	(**)	
Cash paid for Income Tax **(W-4)**	(**)	***
Investing Activity:		
Cash paid for purchasing non-current assets **(W-5)**	(**)	
Cash from disposal of non-current assets **(W-5)**	***	***
Financing Activity:		
Cash received from owners as capital	***	
Cash paid to owners as distribution of profits	(**)	
Cash received as loan (short/long term)	***	
Cash paid for repayment of loan (short/long term)	(**)	
Cash paid for redemption of debt certificates	(**)	***
Net cash In-flow / Out-flow during the year		***
+ Opening Cash and Cash Equivalents **(W-6)**		***
Closing Cash and Cash Equivalents **(W-6)**		***

Important Tips To Remember - ITTR

1. Operating
2. Investing
3. Financing
4. Cash & Cash Equivalent

Statement of Cash Flows

Working Notes

Cash Generated from Operations

Format - SOFP

Company Name
Statement of Cash Flows
For the year ended, 30th June 20X9

	Rs.	Rs.
Operating Activity:		
Cash generated from operations **(W-1)**	***	
Cash received from Interest/Dividends **(W-2)**	***	
Cash paid for interest/financial charges **(W-3)**	(**)	
Cash paid for Income Tax **(W-4)**	(**)	***
Investing Activity:		
Cash paid for purchasing non-current assets **(W-5)**	(**)	
Cash from disposal of non-current assets **(W-5)**	***	***
Financing Activity:		
Cash received from owners as capital	***	
Cash paid to owners as distribution of profits	(**)	
Cash received as loan (short/long term)	***	
Cash paid for repayment of loan (short/long term)	(**)	
Cash paid for redemption of debt certificates	(**)	***
Net cash In-flow / Out-flow during the year		***
+ Opening Cash and Cash Equivalents **(W-6)**		***
Closing Cash and Cash Equivalents **(W-6)**		***

Cash Generated from Operations

W-1 (Direct Method)

Cash generated from operations:

Cash collected from Customers (W-1a)	***
Cash paid to suppliers (W-1b)	(**)
Cash paid to and on behalf of employees	(**)
Cash paid for other operating Expenses (W-1c)	(**)
	***

W-1a

Customers' (Debtors) A/c.

	Rs.		Rs.
Opening Debtors	**	**Cash from customers**	?
Total Sales (Cash+ Credit)	**	Bad Debts	**
		Discount Allowed	**
		Closing Debtors	**
	**		**

Cash Generated from Operations

W-1b **Suppliers' (Creditors) A/c.**

	Rs.		Rs.
Cash Paid to suppliers	**?**	Opening Creditors	**
Discount Received	**	Total Purchases w-1(b-i)	**
Closing Creditors	**		
	**		**

W-1(b-i)

Total Purchases	**Rs.**
Cost of Goods Sold	***
+ Closing Stock	***
- Opening Stock	***
Total Purchases	*******

Cash Generated from Operations

W-1(c)	**Rs.**	**Rs.**
All operating Expenses	***	
Less:		
Salaries & Wages	***	
Depreciation	***	
Amortization	***	
Loss on Disposal of Asset	***	
Bad Debts	***	
Discount Allowed	***	(**)
Cash paid for Operating Expenses		***
+Opening Due		***
-Closing Due		(**)
-Opening Advance		(**)
+Closing Advance		***
Cash paid for Operating Expenses		*******

Cash Generated from Operations

W-1 (Indirect Method)	Rs.	Rs.
Profit after tax		***
+ Income Tax Expense		***
Profit before Tax		***
+ Financial Changes (Interest Expense)		***
Other incomes:		
- Profit on disposal and Interest Income etc.		(**)
Profit from Operations		***
+ Non-Cash Operating Expenses (Non-Current Assets)		
Depreciation/Amortization	***	
Impairment	***	
Loss on disposal	***	***
± Adjustment for non-cash Working capital items		
Stock	***	
Debtors	***	
Prepaid Operating Expenses	***	
Creditors	***	
Accrued operating Expenses	***	***
Cash Generated from operations		*****

Important Tips To Remember - ITTR

1. Direct method focuses on receipt and payment items only
2. Indirect method works back to shunt out non-cash items that were considered while calculating profit for the year

Statement of Cash Flows

Working Notes

Statement of Cash Flows

Format - SOFP

Company Name
Statement of Cash Flows
For the year ended, 30th June 20X9

	Rs.	Rs.
<u>Operating Activity:</u>		
Cash generated from operations **(W-1)**	***	
Cash received from Interest/Dividends **(W-2)**	***	
Cash paid for interest/financial charges **(W-3)**	(**)	
Cash paid for Income Tax **(W-4)**	(**)	***
<u>Investing Activity:</u>		
Cash paid for purchasing non-current assets **(W-5)**	(**)	
Cash from disposal of non-current assets **(W-5)**	***	***
<u>Financing Activity:</u>		
Cash received from owners as capital	***	
Cash paid to owners as distribution of profits	(**)	
Cash received as loan (short/long term)	***	
Cash paid for repayment of loan (short/long term)	(**)	
Cash paid for redemption of debt certificates	(**)	***
Net cash In-flow / Out-flow during the year		***
+ Opening Cash and Cash Equivalents **(W-6)**		***
Closing Cash and Cash Equivalents **(W-6)**		***

Interest Income & Interest Expense

W-2	Rs.
Interest Income (from I/S)	***
+ Opening Interest Due (Assets in previous B/S)	***
- Closing Interest Due (Assets in current B/S)	(**)
Cash Received for Interest	***

W-3	Rs.
Interest Expense (from I/S)	***
+ opening interest Due (Liabilities in Previous B/S)	***
- Closing interest Due (Liabilities in Current B/S)	(**)
Cash Paid for Interest	***

Income Tax Expense

W-4	Rs.
Income Tax Expense (from I/S)	***
+ Opening Tax Provision (Liabilities in Previous B/S)	***
- Closing Tax Provision (Liabilities in Current B/S)	(**)
Cash Paid for Income Tax	***

Fixed Asset

W-5

Fixed Asset (cost) A/c.

Opening Balance	**	Disposal	**
New Purchases	**	Closing Balance	**
	**		**

Provision for Depreciation A/c.

Disposal	**	Opening Balance	**
Closing Balance	**	Depreciation F.T.Y.	**
	**		**

Asset Disposal A/c.

Fixed Asset Cost	**	Provision for Dep.	**
Profit/Gain	**	**Cash (Sales proceed)**	**
	**	**Loss**	**

Cash and Cash Equivalent

W-6

	Opening Balance	**Closing Balance**
Cash in hand	**	**
Cash at Bank	**	**
Very short-term Investments	**	**
Bank Overdraft	(**)	(**)
Cash and Cash Equivalents	**	**

Important Tips To Remember - ITTR

1. Do reverse calculation to ascertain cashed based information from the accrual based information
2. Demand deposit bank accounts and very short term investments and deposits are Cash Equivalents

Statement of Cash Flows

Practice

Statement of Cash Flows
<u>from</u>
Receipt and Payment Account

Practice 18.1

Cash Receipt and Payment Account
For the year ended December 31, 20X9

Receipt	Rs.	Payments	Rs.
Opening Balance	5,650	Purchase of Machinery	146,750
Interest on Investment	800	Drawing	8,000
Loan from Babar	100,000	Interest on loan	500
Fresh Capital	74,000	Income tax paid	3,000
Cash from Debtors	60,000	Salaries	5,000
Sales	5,000	Wages	3,000
Bad Debts Recovered	1,350	Electricity Bill	1,000
Sale of Machine	9,200	Rent	500
		Creditors paid	25,000
		Purchases	8,000
		Loan repaid	50,000
		Closing Balance	5,250
Total	**256,000**	**Total**	**256,000**

Prepare Statement of Cash Flows for the year ended December 31, 20X9

Answer – Practice 18.1

Business Name
Statement of Cash Flows
For the year ended 31.12.2008

<u>**Operating Activity**</u>	**Rs.**	**Rs.**
Cash received from customers		
Debtors	60,000	
Sales	5,000	
Bad debts received	<u>1,350</u>	66,350
Cash paid to suppliers		
Creditors	25,000	
Purchases	<u>8,000</u>	(33,000)
Cash paid to employees		
Salaries	5,000	
Wages	<u>3,000</u>	(8,000)
Cash payment for other operating expenses		
Electricity	1,000	
Rent	<u>500</u>	<u>(1,500)</u>
Cash generated from operations		**23,850**

Answer – Practice 18.1

Business Name
Statement of Cash Flows
For the year ended 31.12.2008

	Rs.	Rs.
Cash generated from operations		**23,850**
Interest and dividend received	800	
Interest on loan paid	(500)	
Income tax paid	(3,000)	**21,150**
Investing Activity		
Sales of machine	9,200	
Purchase of machine	(146,750)	**(137,550)**
Financing Activity		
Fresh capital	74,000	
Drawings	(8,000)	
Loan taken from B	100,000	
Loan repaid	(50,000)	**116,000**
Net cash out flow during the year		(400)
Opening cash and cash equivalent		5,650
Closing cash and cash equivalent		5,250

Important Tips To Remember - ITTR

1. Mark carefully O-I-F

Statement of Cash Flows

Practice

Statement of Cash Flows
<u>from</u>
Balance Sheet
<u>of</u>
Current & Previous Years

Practice 18.2

Balance Sheet	**20X9** **Rs.**	**20X8** **Rs.**
Fixed Assets		
Cost	25,000	15,000
Provision for depreciation	(5,000)	(2,000)
Net Book Value – Fixed Assets	20,000	13,000
5% Investments	10,000	0
Current Assets		
Stocks	3,000	3,500
Debtors	1,200	1,000
Prepaid expenses	200	300
Bank and Cash balances	4,000	2,000
	38,400	**19,800**
Owners' Equity	30,000	18,000
Liabilities		
8% Bank loan	7,000	0
Creditors	1,000	1,500
Accrued Expenses	400	300
	38,400	**19,800**

Practice 18.2

Other Information	Rs.
Drawings During the year	8,000
Fresh Capital Introduced	15,000

Machine cost Rs.6,000 NBV Rs.4,800 sold for a loss of Rs.1,200

Prepare statement of cash flows for the year ending 31-12-20X9

Answer – Practice 18.2

Statement of Cash Flows
For the year ended 31. 12. 2009

	Rs.	Rs.	Rs.
Operating activity			
Net profit (W-4)		5,000	
Financial charges (Interest on loan)		560	
Other income (Interest on investment)		(500)	
Profit from operations		5,060	
Add back			
Non-cash operating expense (non-current asset)			
Depreciation (W-2)	4,200		
Loss on disposal	1,200	5,400	
Adjustments for working capital items			
Debtors increased by	(200)		
Stock decreased by	500		
Prepaid expenses decreased by	100		
Creditors decreased by	(500)		
Accrued expense increased by	100	0	
Cash generated from operations		10,460	

Answer – Practice 18.2

Statement of Cash Flows
For the year ended 31. 12. 2009

	Rs.	Rs.	Rs.
Cash generated from operations		10,460	
Interest received		500	
Interest paid		(560)	10,400
Investing Activity			
Sale proceeds of machine (W-3)		3,600	
Fixed asset purchased (W-1)		(16,000)	
Investments purchased		(10,000)	(22,400)
Financing Activity			
Fresh capital		15,000	
Drawings		(8,000)	
Loan taken		7,000	14,000
Net cash inflow during the year			2,000
Opening cash and cash equivalent			2,000
Closing cash and cash equivalent			4,000

Working – Practice 18.2

W-1

Fixed Asset A/c.

	Rs.		Rs.
Opening balance b/f	15,000	Disposal	6,000
Additions (Bal. figure)	16,000	Closing balance c/f	25,000
	31,000		31,000

W-2

Accumulated Depreciation A/c.

	Rs.		Rs.
Disposal	1,200	Opening balance b/f	2,000
Closing balance c/f	5,000	Depreciation expense	4,200
	6,200		6,200

W-3

Asset Disposal A/c.

	Rs.		Rs.
Fixed asset	6,000	Acc. depreciation	1,200
		Loss on disposal	1,200
		Cash received (Bal figure)	3,600
	6,000		6,000

Working – Practice 18.2

W-4 **Net profit**

	Rs.
Closing capital	30,000
Drawings	8,000
Fresh capital	(15,000)
Opening capital	(18,000)
Net profit	5,000

Important Tips To Remember - ITTR

1. Take Care of non-cash movement in accounting heads
   - Issue of bonus shares
   - Revaluation of fixed assets
2. Interest and Dividend received can be Operating as well as Investing Activity
3. Interest and Dividend paid can be Operating as well as Financing Activity

Important Tips To Remember - ITTR

4. Operating activity belongs to Income Statement
5. Investing activity belongs to Non-Current Assets
6. Financial activity belongs to Non-Current Liabilities and Owners' Equity

Important Tips To Remember - ITTR

7. Change in all Current Assets and Current Liabilities should not be taken to Operating Activity
   - Cash & Cash Equivalent
   - Loan receivable
   - Loan payable
   - Creditor against purchase of non-current assets
   - Current portion of lease liability