

Module 10:- Accounting For Fixed Assets and Depreciation:-

• Basic of Depreciation:-

These are assets that are used over a period of time.

- Depreciation is a systematic allocation of the cost of depreciable assets to expense over its useful life.

• Recognition Criteria:-

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

• Measurements:-

At Recognition:-

- Purchased assets are initially measured at cost.
- Exchanged assets are initially measured at fair value.

- The exchanged transaction lacks commercial substance.

- Fair value cannot be determined in these circumstances, carrying amount of given assets given up will be the value of the asset taken in exchange.

• After Recognition-

After Recognition the items of Property Plant and equipment are measured at either of two models-

• ~~Cost~~ ^{Cost} models-

cost of less asset accumulated depreciation less accumulated impairment loss.

• Revaluation models-

Revalued amount less accumulated depreciation subsequent to revaluation and accumulated impairment loss subsequent to revaluation

• impairment loss-

when carrying amount of assets is greater than its recoverable amount the difference is impairment loss.

• Depreciable amounts-

cost of an asset, or other amount for cost, less its residual value.

• Useful life:-

It is life for which an assets is estimated to provide benefits.

• Notes:-

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

Depreciation Methods:-

There are Five depreciation Methods:-

1. Straight line Method
2. Reducing balance method
3. Sum of years digit Method
4. Number of units output method
5. Number of service hours Method.

1. Straight Line Method:-

• Formula:-

$$\text{Annual depreciation} = \frac{\text{Cost} - \text{Residual value}}{\text{Useful life}}$$

• Practice:-

$$\text{Cost} = \text{Rs. } 150,000$$

$$\text{D. cost} = \text{Rs. } 30,000$$

$$\text{Useful life} = 10 \text{ years}$$

Value put in Formula:-

$$= \frac{150,000 - 30,000}{10 \text{ years}}$$

$$= \frac{120,000}{10}$$

$$\text{Annual Depreciation} = 12,000 \text{ Rs}$$

• Note:-

In straight line Method, the depreciable cost has same in 10 years.

2. Reducing Balance Method:-

- Formula:-

$$= \frac{1}{\text{Estimated working life}} \times 2 \times \text{Balance}$$

- Practice:-

$$\text{Cost} = 100,000 \text{ Rs}$$

$$\text{Salvage value / Depreciable cost} = 10,000 \text{ Rs}$$

$$\text{Useful life} = 3 \text{ year}$$

Put value in formula:-

$$\text{Year 1} = \frac{1}{10} \times 2 \times 100,000$$

$$= 20,000 \text{ Rs}$$

$$\text{Year 2} = \frac{1}{10} \times 2 \times 80,000$$

$$= 16,000 \text{ Rs}$$

$$\text{Year 3} = \frac{1}{10} \times 2 \times 64,000$$

$$= 12,800 \text{ Rs}$$

3. Sum of year digit Methods-

- Formulas-

= Depreciable Cost $\times$ Year fraction

= Cost - Residual Value $\times$ Year fraction

we can calculate sum of years by this formula-

$$= \frac{n(n+1)}{2}$$

Then we can find fraction we divide

max value over sum of year.

If we can calculate 5 years the

sum of depreciations:

$$= \frac{5(5+1)}{2} = \frac{30}{2} = 15$$

Year fraction = $\frac{5}{15}, \frac{4}{15}, \frac{3}{15}, \frac{2}{15}, \frac{1}{15}$

- Practice:-

Jan 1, 2016 Cost = 170,000 Rs

Useful life year = 5 year

Salvage value = 20,000

Dec 31, 2016 Depreciable cost = $150,000 \times \frac{5}{15}$

$$= 50,000$$

Dec 31, 2017 = $150,000 \times \frac{4}{15}$

$$= 40,000$$

- Notes:-

In this method, the depreciation charge remain constant.

4. Number of units output Methods- Life is units.

- Formula:-

$$= \frac{\text{Cost} - \text{Residual value}}{\text{Useful life (units)}}$$

- Practices-

$$\text{Cost} = 150,000 \text{ Rs}$$

$$\text{Salvage cost} = 30,000$$

$$\text{Useful life (units)} = 10,000 \text{ units}$$

Put value in Formula:-

$$= \frac{150,000 - 30,000}{10,000 \text{ units}}$$

$$\text{Depreciable cost per units} = 12 \text{ per unit}$$

If we can calculate depreciation in 4000 unit
Then,

$$= 4000 \text{ unit} \times 12 \text{ unit}$$

$$= 48,000 \text{ units}$$

5. Service Method^{Hours}:-

life is in hours.

Formulas:-

$$= \frac{\text{Cost} - \text{Residual value}}{\text{Useful life}}$$

$$\text{Cost} = 150,000 \text{ Rs}$$

$$\text{Salvage value} = 30,000 \text{ Rs}$$

$$\text{Useful life} = 10,000 \text{ hours}$$

Put value in formulas-

$$= \frac{150,000 - 30,000}{10,000 \text{ hours}}$$

$$\text{Depreciation per hour} = \text{Rs. } 12 \text{ Per hour}$$

If we calculate depreciation 4000 hours then

$$= 4000 \text{ hours} \times 12 = 48,000 \text{ hours}$$

We can calculate this depreciation per hour.

• Base of Accounting for Depreciations:-

1. Purchase of fixed asset upon payment or on credit.

1. Fixed assets accounts:-

Cash/Bank/creditor accounts.

2. Depreciation Expense accounts:-

Provision for depreciation account

1. Provision against depreciation expense for the year.

3. Profit and loss account:-

Depreciation Expense account

(Depreciation Expense closed to income statement.)

• Accounting Entries For Disposal of Fixed Assets:-

1. Asset Disposal Accounts:-

Fixed asset account

Calculate Depreciation till due date of sale.

2. Provision for Depreciation Accounts:-

Asset Disposal accounts:-

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

3. Bank Accounts:-

Asset Disposal account

Disposal consideration/sales proceeds, received on disposal of the asset.

Book value = cost - Accumulated Depreciation

4.

a) Asset Disposal accounts:-

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

b) Income statements:-

Asset Disposal account
Loss on disposal of asset transferred to income
statement for the period.

• Formulas:-

Gain/Loss = Selling - Book Value

- Selling Price is increase we gain.
- Selling Price is decrease we loss.

• Exchange of Assets:-

In 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.

- **Formulas-**

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.

- **Commercial Substances-**

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 commercial substance does exist, then cost of asset taken through exchange would be **Fair value of asset given up**
- When both fair value of asset 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 of both asset are not equal.

Module 11+

• Control Accounts-

control account is simple ledger account that represents numerous ledgers account of similar nature.

Examples-

- ✓ Trade Receivable
- ✓ Trade Payable
- ✓ Payroll
- ✓ Inventory

• Creditors Control accounts-

In this account we purchase some things from the seller.

• Names of Creditors control accounts-

- Purchase ledger control account.
- Total creditors control account.
- Sundry creditors control account
- Trade Payable control account

Debtors control account

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	contra / set off / balance transferred
closing Cr. Balance c/f	closing Dr. Balance c/f

Creditors Control account

Trade Payable control A/c

opening Balance b/f Dr	opening Balance b/f Cr
cash paid to creditors	credit purchases (invoice issued)
Bills Payable given to creditors	Bills Payable dishonoured
Discount received	Interest Payable
Purchased return credit note received	
contra / set off / Balance transferred	
closing Cr. Balance c/f	closing Dr. Balance c/f

IIRS:-

- Contra Entry:-

- It appears in debtors ledger as well as in creditors ledger.
- It behaves opposite to the nature of account.

- Posting:-

- In this process, we enter ledger accordingly entries into journal account.

- Control Account Reconciliations:-

closing balance of control account may not agree with total of the list of individual balances extracted from the subsidiary ledgers.

a) Any difference must be investigated and corrections made;

b) This may involve adjustments:

- To control account and/or.
- To the list of balance as per subsidiary ledger.

• Reasons of difference:-

1. Books of original Entries-	Amendments
a). Recording error	control A/c and list
b). Casting error	control A/c only

a). Recording error:-

In this error, we mistake in the Record of accounting entries.

b). Casting error:-

In this error, we mistake in the total of accounting entries when we neglect one of an entry.

2. Main ledger - Control Accounts-

a). Posting error	control A/c only
b). Casting error	control A/c only

a). Posting error

In this error, we mistake when we posting total entries into main ledger.

3. Subsidiary ledger - Individual Accounts:-

a). Posting error	List only
b). Casting error	List only

4. List of Balance:-

a). Listing error

Lat only

b). Casting error

Lat only

Listing errors:-

In this error, we mistake in list of subsidiary ledger.

- Cr balance in Debtors account might arise because of cash received in advance.
- Dr Balance in Creditors account might arise because of cash paid in advance.
- Closing balance always appears on opposite side:-
 - 1). Closing Dr. Balance will appear in credit.
 - 2). closing Cr. Balance will appear in debit side.
- Regard less of nature of ledger accounts:-
 - a). Opening Dr. Balance will appear in debit side.
 - b). Opening Cr. Balance will appear in credit side.

• Names of Accounting Records:-

That are often confused by the students.

- a). Sales journal/day book is a Book of original entry (For credit sales)
- b). Sales ledger is a Subsidiary ledger (a book for sales)
- c). Sales ledger account is a Debtors control a/c in main ledger
- d). Sales account is a Sales income in main ledger.

- a). Purchase journal is a Book of original entry (credit purchase)
- b). Purchase ledger is a Subsidiary ledger (Book for creditors)
- c). Purchase ledger a/c is a Creditors control a/c in main ledger
- d). Purchase account is a Purchase expense in main ledger

Module 12:-

Types of Errors

These are split into two

categories:-

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.

Errors that do not cause any difference
Initial Balance:-

Reasons of Error

Rectifying Error Entry

a) Error of Omission:-

When financial information is completely omitted for recording in the book of original entry.

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

• Own word:-

When we cannot record one entry in the book of original entry.

• Examples:-

Sales invoice of Rs. 1000 issued before closing date but not recorded in book of original entry.

Reasons of Error

Rectifying Entry Error

b) Error of Commission:-

when correct accounting head (Dr/cr) is given in the wrong accounting head but the main head remains constant / correct.

• Own words:-

when we enter accounting effect in original book but we can change accounting head.

If we purchase a computer Rs. 5000. But in accounting book we ~~entire~~ enter debited to Furniture account. (Both account belong same main head. Asset).

Computer a/c Dr. 5000
Furniture a/c Cr. 5,000

This error have no effect on the main head of financial position. It mean that we cannot loss / gain.

c) Error of R Principle

Reversing Entry

when accounting effect (Dr/Cr) is given in the wrong accounting head as well as main head.

- Own words:-

If we enter some entry in Asset but we enter the entry in Expense / for owner equity. So, this error occur.

- Example:-

If we purchase a computer 5000 for office use wrongly debited in Stationary account. Stationary account belongs to Expense but computer belongs to Asset.

Computer % Dr- 5000
Stationary % Cr- 5000

This type of error effect on Financial Performance (net Profit) and Financial Position ($\text{Asset} = \text{Liability} + \text{owner equity}$).

- Causes-

Error occurs because of wrong decision about Capital nature.

Error of Original Entry

When an correct accounting entry is recorded in the both of account but the amount in both accounting effect is wrong although the amount is same.

- Own words:-

If we enter into the entry in debit side but the entry are in credit side, so this error occur.

- Examples:-

Debtors is to be written off for Rs. 250 as bad debts were recorded in the correct accounts but the amount was posted in both account was Rs. 270 causing a difference of Rs. 270 in both side.

It is also known as transposition error.

Rectifying Entry

Debtor 9/c Dr. 270
Bad debts 9/c cr. 270

Compensating Error

When sum of more errors than one errors are to counter the accounting effect each other.

• 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 Rs 200 more than the correct amount and Rent expense ending of Rs 60 was although credited to rent expense account but was not debited to rent expense.

Rectifying Error

Capital $\frac{1}{2}$ Dr. 200
Rent Expense $\frac{1}{2}$ Dr. 60
Sales $\frac{1}{2}$ Cr. 260

• Possible reasons for difference in the trial Balances-

Reason of Error	Rectifying Error
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- Under/over casting of a ledger account maintained in main ledger:-

- Under-casting-

When we can calculate trial Balance. Then we mistake in total Balance. For examples- we can calculate 100. But we can enter 110 in trial Balance.

- Sales income account was undercast by Rs. 500.

Suppose a/c Dr. 500
Sales a/c Cr. 500

- Over-casting-

When we can calculate trial Balance. Then we enter one entry increasing from its original balance. For examples- we can enter one entry 20Rs. But its original entry is 10Rs.

- Sales income account was over-cast by Rs. 500.

Sale a/c Dr. 200
Expense a/c Cr. 200

- It will be affect in trial Balances-

- Omission of Balance From trial Balance.

Balance of but debts account (Rs. 700 already correctly accounted for) is not appearing in the trial Balance.

End debts $\frac{1}{2}$ Dr. 700
Surplus $\frac{1}{2}$ Cr. 700

- It will be affect trial balance only.

- Balance representing an account appearing in trial Balance with less or excess amounts-

Building account Balance $\frac{1}{2}$ Rs. 700 was erroneously was appearing in the trial balance with Rs. 7000.

Building $\frac{1}{2}$ Dr. 63000
Surplus $\frac{1}{2}$ Cr. 63000

It will be affect trial Balance only.

- An account was given debit affect instead of credit side effects-

Sales of Rs. 1000 on credit was correctly debited in debtors account but was also debit^{ed} sales account mistakenly.

Surplus $\frac{1}{2}$ Dr. 1000
Sales $\frac{1}{2}$ Cr. 1000

Causing difference with double amount.

- A ledger account was given credit effect instead of debit side:-

Sales of Rs. 100 on credit was correctly credited in sales account but was also credited in debtor's account mistakenly, causing difference with double amounts.

Debtor's a/c Dr. 1000
Suspense a/c Cr. 1000

- Single accounting effect either Dr or Cr was recorded/pasted in the bank of account:-

Sales of Rs. 100 on credit was pasted in sales a/c only:-

Debtor's a/c Dr. 100
Suspense a/c Cr. 100

- One of the accounting effects was recorded with wrong a/c:-

Sales of Rs. 100 on credit was correctly credited in sales account but was wrongly debited to debtor's a/c with Rs. 100 only.

Debtor's a/c Dr. 700
Suspense a/c Cr. 700

- Nominal Accounts in Rectifying Entries-

1). in a rectifying entry, any nominal accounting head related to income statement (Expense and income) is given debit effects, it would cause a decrease in the net profit. And if, credit effect is given, then there would be an increase in net profit.

- Debit effects-

when debit side is increase, and credit side is decrease, so this is called debit effect.

- Concept of Capital and Revenue Expenditure Receipts:-

Capital and Revenue, Expenditure / Receipts should be taken care while recognizing accounting heads as Dr. or Cr.

- Capital expenditure — Asset
- Revenue expenditure — Expense
- Capital receipt — Liability or owner's equity
- Revenue receipt — Income

- Error of Principles-

Error that takes place because of wrong decision about the nature of accounting head, Capital or Revenue is

known as error of Principle.

Module - 13

• Final Account and adjustments

• Final accounts:-

Usually the sole Proprietors prepare following two financial statements as final account.

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

$$\text{Income} - \text{Expense} = \text{Profit}$$

2. Balance sheet (Statement of financial position).

$$\text{Assets} = \text{Owner's equity} + \text{Liabilities.}$$

- Income statement is prepared to know the financial performance an entity.
- Balance sheet (Statement of financial position) is prepared to know the financial position of an entity.

• Reporting Period:-

Income statement is prepared for a specific period for which starting and end dates are defined, normally a year or 12 months, also known as reporting period.

- **Financial Performances-**

It refers to the Profitability (Profit or Loss) of entity during an accounting Period.

- **Reporting dates-**

Financial Position refers to the financial strength of entity on a specific date. Normally, it is prepared at the end of reporting period which is known as reporting date or balance sheet date.

- **Technique to Prepare final accounts-**

1. Read trial balance very carefully.
2. Identify the nature of accounting head correctly.
3. Pass journal entries for adjustment.
4. Place adjusted balance in the appropriate
- ✓ Part of income statement and balance sheet.

- Important tip to follow is to mark A/E/I/L/O while reading trial balance and then pass journal entries for adjustment.

• Notes-

Fixed asset appearing in the Trial Balance may have contra account for accumulated depreciation within Trial Balance or may have information outside of Trial Balance.

$$\therefore \text{Net Book Value} = \text{Original asset cost} + \text{Accumulated depreciation.}$$

Module - 14

Reporting Requirements of Manufacturing Entities:-

Business entity is of two types:-

1. Service-oriented
2. Goods-oriented (deal with manufacturing and trading)

1. Goods-oriented:-

Raw material into finished goods,
sell them to their customers.

Type s:-

1. Trading entity
2. Manufacturing entity

1 Trading entity:-

Trading entities Purchase
good in finished form, make those goods
available in the showroom, do marketing
& sell those goods to the
customers.

• Examples-

importers, exporters, wholesalers and
retailers.

• Note-

They do not enter in any process
of defining the finished goods.

Manufacturing entity:-

Manufacturing entity refers to a process through which a material is converted into a product in a workshop where certain other cost are incurred to convert that raw material into finished product.

- **Examples-**

Furniture manufacturers, jewelry maker, textile confectioners and construction contractors.

- **Notes-**

They also include the entity which do not convert raw-material into a finished good but they modify or improve the form of a product to be suitable for a potential customer.

- **Examples-**

Rice mills, electrical fittings, canned food activities and embrodders.

- **Trading entity:-**

Accounts of trading entity split income statement into two main heads:-

1. Trading account

2. Profit and loss account

- **Manufacturing entity:-**

Accountants of manufacturing entity prepares:-

1. Manufacturing entity account
2. Trading account
3. Profit/Loss account

Manufacturing account consolidates all production cost that are incurred to bring a product to saleable condition. These costs are categorized as:-

1. direct cost
2. indirect cost

- **Direct costs:-**

Direct material, Direct labor and direct cost that can be independently traced as product cost.

- **Indirect costs**

Factor overhead cost also known as product overhead cost.

It is also a product cost but cannot be independently traced in the cost of products.

- **Example:-**

electricity bills of workshop, rent of factory

building.

• Types of inventories-

There are three types of inventories.

1. Material inventory
2. work in process inventory
3. Finished goods inventory

• Cost Elements:-

1. Material
2. Labor
3. factory overhead

• Classification and analysis of Cost of Products-

$$\text{Material cost} = \text{Direct material cost} + \text{indirect material cost}$$
$$+ \quad + \quad +$$

$$\text{Labor cost} = \text{Direct labor cost} + \text{indirect material cost}$$
$$+ \quad + \quad +$$

$$\text{other cost} = \text{other direct cost} + \text{other indirect cost}$$

$$\text{Total cost of Production} = \text{Prime cost} + \text{Factory overhead cost}$$

• Difference b/w cost and expenses-

• Costs:-

Direct material consumed, direct labour, factory overheads, total manufacturing, etc. are treated as cost.

• Expenses:-

- Cost is that which is expense.
- The cost that is incurred and has expired during the accounting period is expense.

• Classification and Analysis of cost of Production:-

- The cost of goods manufactured is transferred to finished goods inventory, when it is sold to various other categories of cost.
- The same these finished goods are sold these become expense and the unsold finished goods are assets. This is because the selling activity is conversion brought from category of the cost of production goods by selling these to the customers.

- That's why only components of the cost of production are not termed as expenses. Because "cost of good sold" is expense to business but not that cost "cost" is used in life.

• Manufacturing cycles-

1. Cost of direct material

Material
Inventory

Cost of
direct material
incurred

2. Direct labour cost

3. Other direct cost

4. Factory overhead cost

Work in process inventory

Cost of good
Manufactured

Cost of good
sold

Finished goods inventory

• Types of inventories -

There are three types of inventories that can be identified in a manufacturing enterprise.

1. Material and supplies inventory -

- This is the inventory for raw material, spare items, spare parts and indirect material that are used in production.

- It is the cost that represents un-consumed materials and supplies lying in the stores at the end of the reporting period.

• Categories -

Direct supplies (Raw material), Indirect supplies, office supplies, shipping supplies.

2. Work in Process inventory -

- This is the inventory of semi-finished goods.

- It is the cost that represent work in process, which remained semi-finished at the end of the reporting period; a further cost of it is still required to be incurred on this type of inventory in order to convert it into finished goods.

3. Finished goods inventory:-

- This is the inventory of completed products which are ready for sale.
- ~~Prime~~ Finished goods inventory is the value of those fully manufactured product which remained unsold at the end of the reporting period.

• Formulas:-

• Prime cost:-

Direct material cost + Direct cost + other Direct cost

• Total factory cost / Production cost:-

Prime cost + factory overhead cost

• Cost of good manufactured:-

Prime cost + factory cost / Production cost + opening work in Process inventory - close work in process inventory

• Gross profit:-

Returns inward / Net Sales - cost of goods sold