CAT

Certified Accounting Technicians Examination

Stage: Level L1.1

Subject Title: Introduction to Financial Accounting

Study Manual

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INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA
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INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS
OF
RWANDA

Level 1

L1.1 INTRODUCTION TO FINANCIAL ACCOUNTING

First Edition 2012

This study manual has been fully revised and updated
in accordance with the current syllabus.
It has been developed in consultation with experienced lecturers.

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Contents

INTRODUCTION TO THE COURSE

Stage: Level 1
Subject Title: L1.1 Introduction to Financial Accounting

Aim
The aim of this subject is to ensure that students acquire and understand the basic accounting fundamentals, knowledge of double-entry bookkeeping, accounting systems and accounts preparation.

Learning Outcomes

On successful completion of this subject students should be able to:

- An understanding of the different types of business entity and the accountant's role in an organisation
- The ability to identify the various user groups which need accounting information
- An understanding of accounting terminology, basic accounting concepts and principles
- An ability to record financial transactions in the books of original entry
- An understanding of and use of double entry system of bookkeeping to prepare a trial balance
- An ability to understand, explain and use control accounts, bank reconciliation statements and suspense accounts
- An understanding of the key features of financial statements
- An ability to prepare financial statements for sole traders and "not for profit" organisations

Syllabus:

ACCOUNTING FUNDAMENTALS

1. Types of Business Entity

- Sole Traders
- Partnerships
- Limited Companies

2. Function of financial accounting and management accounting

- Financial Accounting
- Management Accounting
- Nature, principles and scope of accounting

3. The Accountant's role in an organisation

- Accountant's role and function in an organisation

4. Accounting terminology

- Assets, liabilities, income, expenses
- Drawings
- Trade receivables (debtors) and Trade Payables (creditors)
- Introduction to financial statements

5. Basic accounting concepts and principles

- The business entity
- The accounting equation
- Underlying assumptions, accruals basis, going concern

6. Users of accounting information and their information needs

- The objectives of financial statements
- Users of accounting information and their information needs
- The qualitative characteristics of accounting information

7. Ethical issues and responsibilities accruing

- Ethical issues for the Accounting Technician
- Ethical issues for managers, accountants and historical experience

DOUBLE ENTRY BOOK-KEEPING & ACCOUNTING SYSTEMS

8. Form and content of accounting records

- Business transactions and the purpose of accounting records
- Source documentation

9. Books of original entry

- Books of original (prime) entry
- Sales day book
- Purchases day book
- Sales returns day book

- Purchase returns day book

10. Ledger accounting and double entry

- Nominal Ledger
- Double entry bookkeeping
- The Journal
- Posting from day books to nominal ledger
- Sales & Purchases Ledger
- Accounting for Vat
- Irrecoverable VAT
- Accounting for wages,
- Salaries/wages control accounts
- Extraction of the trial balance

11. Distinction between capital and revenue expenditure

- Explanation of capital and revenue expenditure
- Impact of incorrect treatment

12. Control Accounts

- Understanding the purpose of control accounts
- Receivables control accounts
- Payables control accounts
- Contra entries
- Debit and credit balances at the beginning and end of an accounting period
- Incomplete records

13. Bank Reconciliation statements

- Bank statements and the banking system
- Identification of errors and omissions
- Updating the bank account in the ledger
- Preparation of bank reconciliation statements

14. Accounting for errors and suspense accounts

- Correction of errors
- Types of errors and their impact on the trial balance
- Correction of errors and journal entries
- Use of suspense accounts

15. Accounting for depreciation and disposal of assets

- Non- current assets register
- Definition of depreciation
- Calculation of depreciation using the straight line and reducing balance methods
- Ledger accounting entries for depreciation
- Accounting for the disposal of non- current assets

ACCOUNTS PREPARATION

16. Key features of financial statements

- Cost of goods sold
- Accruals
- Prepayments
- Discounts
- Irrecoverable debts and allowances for receivables
- Non- Current Assets
- Depreciation using straight line method and reducing balance method
- Disposal of non- current assets
- Accounting for inventory
- Different valuation methods and their impact on reported profits

17. Preparation of financial statements for sole traders

- From the trial balance to financial statements
- The Statement of Comprehensive Income as part of the double entry system
- Layout of financial statements

18. Preparation of accounts for "not for profit" organisations

- Financial statements for clubs and societies
- Receipts and payments accounts
- Income & expenditure accounts

Study Unit 1

The General Framework of Accounting

Contents

A. INTRODUCTION

Financial accounting is a branch of economics. It involves gathering, recording, summarising and presenting information to the various users of financial information.

B. THE OBJECTIVE OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

Financial position reveals information about the economic resources that an entity controls, its financial structure, its liquidity and solvency and its ability to change. This information is contained in the Statement of Financial Position. Changes in financial position are revealed in a Cash Flow Statement.

Financial Performance means the return obtained on the resources which the entity controls. This information can be extracted from the profit and loss account. In International Accounting the profit and loss account is referred to as the Statement of Comprehensive Income.

The Reporting Entity
Financial Statements report on all of the activities and resources under the control of the entity that has prepared them whether it is a sole trader, a club or society or a limited company.

C. USERS OF FINANCIAL STATEMENTS

Users of financial statements include the following:

(a) **Existing and potential shareholders**
Information is required in relation to profit, dividends, trends and prospects in connection with share price.

(b) **Loan Creditors**
Information is required in relation to liquidity and to highlight the risk of non-payment.

(c) **Business Contact Group** i.e. suppliers, customers, competitors and merger/acquisition situations. Information is required to ensure ability to pay debts, continuity of supply and trade information.

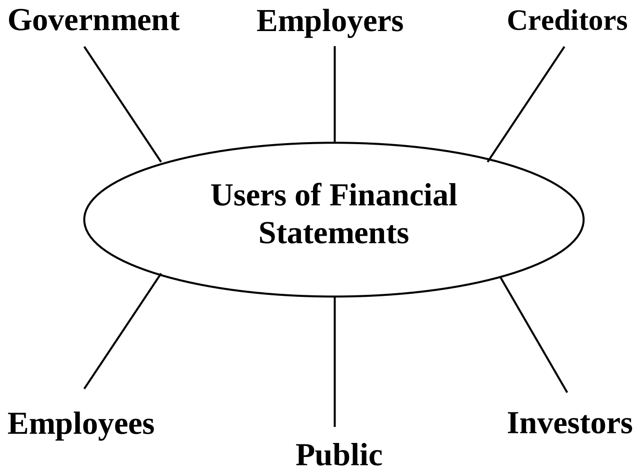
(d) **Analysts and investors**
Information on performance, trends and prospects is required for clients

(e) **Government**
Information is required as a base for taxation and to ensure compliance with company law

(f) **Employees**
Information about employment security and to assist with collective pay bargaining

(g) **Public**

Any member of the public may require details of the contribution to the local and national economy made by the company and the environmental impact.



The objective of accounting is to provide sufficient information to meet the needs of the various users at the lowest possible cost. There are two branches of accounting, that reflect the internal and external users of accounting information. Management accounting is concerned with the provision of information to people within the organisation to help them make better decisions and improve the efficiency and effectiveness of existing operations, whereas financial accounting is concerned with the provision of information to external parties outside the organisation. As such, management accounting could be called internal accounting and financial accounting could be called external accounting.

Differences between management accounting and financial accounting

The major differences between these two branches of accounting are:

- *Legal requirements.* There is a statutory requirement for public limited companies to produce annual financial accounts regardless of whether or not management regards this information as useful. Management accounting is entirely optional and information should only be produced if it is considered that the benefits from the use of the information by management exceed the cost of collecting it.
- *Focus on individual parts or segments of the business*. Financial accounting reports describe the whole of the business whereas management accounting focuses on small parts of the organisation i.e. profitability of products, services etc. Management accounting information measures the economic performance of decentralised operating units, such as divisions and departments
- *Generally accepted accounting principles*. Financial accounting statements must be prepared to conform with the legal requirements and the generally accepted accounting principles established by the regulatory bodies. These requirements are essential to ensure the uniformity and consistency that is needed for external financial statements. Outside users need assurance that external statements are prepared in accordance with generally accepted accounting principles so that the inter-company and historical comparisons are possible. In contrast, management accountants are not

required to adhere to generally accepted accounting principles when providing managerial information for internal purposes. Instead, the focus is on the serving management's needs and providing information that is useful to managers relating to their decision-making, planning and control functions.

- *Time dimension*. Financial accounting reports what has happened in the past in an organisation, whereas management accounting is concerned with future information as well as past information. Decisions are concerned with future events and management therefore requires details of expected future costs and revenues.
- *Report frequency*. A detailed set of financial accounts is published annually and less detailed accounts are published semi-annually. Management requires information quickly. Consequently, management accounting reports on various activities may be prepared at daily, weekly or monthly intervals.

D. STEWARDSHIP AND ECONOMIC DECISIONS

Stewardship entails the safekeeping and proper use of an entity's resources and their efficient and profitable use. Existing investors assess management's stewardship in order to decide whether to seek a change in management or to change the level of their shareholding in the entity.

Ethical Issues for Management

Ethical behaviour is an important element of stewardship. Increased accountability and legal frameworks across the globe now require that businesses take stock of their actions. Ethical debates in business are not new, however, and the area is large and often hard to quantify.

Business ethics are moral principles that guide how a business behaves and they are the foundation of lasting business success. When a business practices ethical decision-making they are practising the values of a democratic society within the workplace. Therefore a business that places emphasis on ethics provides an environment that promotes honest working practices. This is especially important in a world that has recently witnessed mass corporate failures and questionable accounting practices. It is therefore important that businesses apply appropriate values, ethics and attitudes.

Businesses or other corporate structures will usually have their own statement of business principles or a code, which sets out their core values and standards. This statement of principle or code enables the application of a common code of basic values that all persons within the organisation can agree on. It forces employers and companies to adhere to high standards of performance by not only following company law legislation but also by "doing the right thing." A business ethical code emphasises the importance of applying moral values to company decisions. It is also important to realise that a code will apply to all members of the organisation regardless of their position in the company. However, a higher expectation is placed on qualified professionals such as accountants, who are held in a position of trust which is damaged by unscrupulous behaviour or poor practice.

The advantages of ethical behaviour include:

Higher revenues – demand from positive consumer support

- Improved brand and business awareness and recognition
- Better employee motivation and recruitment
- New sources of finance – e.g. from ethical investors

The disadvantages claimed for ethical business include:

- Higher costs – e.g. sourcing from Fairtrade suppliers rather than lowest price
- Higher overheads – e.g. training & communication of ethical policy
- A danger of building up false expectations

E. THE QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION

In deciding what information should be included in financial statements, when it should be included and how it should be presented, the aim is to ensure that financial statements yield useful information. Financial information is useful if it is:

Relevant - If it has the ability to influence the economic decisions of users and is provided in time to influence those decisions

Reliable - Reliability is characterised by:

- Faithful representation
- Substance over form recognition of the economic substance of a transaction over its legal form
- Neutrality - free from bias
- Prudence - a degree of caution in making estimates in conditions of uncertainty
- Completeness - an omission can cause information to be false or misleading

Comparable - It enables users to discern and evaluate similarities in, and differences between, the nature and effects of transactions and other events over time and across different reporting entities.

Understandable - Its significance can be perceived by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study with reasonable diligence the information provided.

If a conflict arises between these characteristics, a trade-off needs to be found that still enables the objective of financial statements to be met. For example, if the information that is the most relevant is not the most reliable and vice versa, it will usually be appropriate to use the item of information that is the most relevant of those that are reliable.

Financial information with the above characteristics will be most useful to the users of financial statements. In deciding whether to present financial information separately in the financial statements the accountant must assess the information's ability to influence economic decisions it is considered to be material and should be presented separately in the financial statements.

F. COMPONENTS OF FINANCIAL STATEMENTS

The primary financial statements are currently:

(a) Trading Profit and Loss Account/the Statement of Comprehensive Income

(b) A Statement of Changes in Equity

(c) The Statement of Financial Position

(d) The Cash Flow Statement

Notes to these primary financial statements are used to amplify and explain the primary statements. The notes on primary financial statements form an integral part of the financial statements.

G. THE STATEMENT OF FINANCIAL POSITION

This is a financial statement of the assets, liabilities and ownership interests drawn up at a particular point in time. This point in time for the annual financial statement is referred to as the entity's year end.

H. THE STATEMENT OF COMPREHENSIVE INCOME (PROFIT & LOSS)

The Statement of Comprehensive Income details the trading results for the period. It details the Revenue earned and the expenses incurred.

I. THE STATEMENT OF CHANGES IN EQUITY

A statement of changes in equity shows the following items:

- Net profit/loss for the period
- Gains/losses recognised directly in equity e.g. surplus on revaluation of land and buildings
- Cumulative effect of changes in accounting policy and the correction of fundamental errors (per IAS 8, which will be dealt with in a later chapter)
- Capital transactions with owners, for example, dividend payments share issue.
- Accumulated profit/loss
  - At start of the year
  - Movement for year
  - At end of year

- Reconciliation between carrying amount at the start and end of the year for:
  - Each class of equity
  - Share premium
  - Each reserve

J. THE CASH FLOW STATEMENT

This statement shows the increase or decrease in the amount of cash/cash equivalents the entity has generated since the previous year end.

K. ELEMENTS OF FINANCIAL STATEMENTS

Financial statements need to reflect the effects of transactions and other events on the reporting entity's financial performance and financial position. This involves a high degree of classification and aggregation. Order is imposed on this process by specifying and defining the classes of items – the elements – that encapsulate the key aspects of the effects of those transactions and other events. The main elements and their definitions are as follows:

- **Assets –** a resource controlled by an entity as a result of past events from which future economic benefits are expected to flow. Assets are broken down between current assets and non-current assets (formerly known as fixed assets).
- **Liabilities –** present obligations of the entity arising from past events, settlement of which is expected to result in an outflow of resources embodying economic benefits. Liabilities are broken down between current liabilities and non-current liabilities.
- **Equity –** the residual interest in the assets of the entity after deducting all its liabilities.
- **Income –** increases in economic benefits in the form of inflows of assets or decreases of liabilities that result in increases in equity.
- **Expenses –** decreases in economic benefits in the form of outflows of assets or incurrence of liabilities that result in decreases in equity.

➢ **Assets**

Future Economic Benefits **–** If an item does not generate future economic benefits it is not an asset. There must be evidence that cash will be received in the future.

Controlled by an Entity – Though ownership is not essential control is a vital element. Control means the ability to restrict use.

Past Transactions or Events **–** The transaction or event must be in the past before an asset can arise. Access to economic benefits obtained after the Statement of Financial Position date cannot constitute an asset.

➢ **Liabilities**

Obligations – These may be legal or constructive. A legal obligation derives from a contract, legislation or other operation of law. A constructive obligation derives from the entity's actions e.g. refunds to dis-satisfied customers.

Transfer of Economic Benefits – This normally represents a transfer of cash but could involve the exchange of an asset e.g. trade in of a motor vehicle.

Obligations that are not expected to result in a transfer of economic benefits e.g. the guarantee of a loan, are referred to as contingent liabilities

Past Transactions or Events – The transaction or event must be in the past.

L. RECOGNITION IN FINANCIAL STATEMENTS

The objective of financial statements is achieved to a large extent by showing in the primary financial statements, in words and by a monetary amount, the effects that transactions and other events have on the elements. This process is known as recognition.

For example, if the effect of a transaction is to create a new asset or liability or to add to an existing asset or liability, that new asset or liability or addition will be recognised in the Statement of Financial Position if there is sufficient evidence that it exists and it can be measured reliably enough as a monetary amount. A gain or loss will be recognised at the same time, unless there has been no change in the total net assets or the whole of the change is the result of capital contributions or distributions.

M. MEASUREMENT IN FINANCIAL STATEMENTS

In order that an asset or liability can be recognised, it needs to be assigned a monetary carrying amount. Two measurement bases could be used for this purpose:

- Historical Cost – which is the lower of cost and recoverable amount (as defined below)

  Or

- Current Value – which is the lower amount of replacement cost and recoverable amount.

Most assets and liabilities arise from arm's length transactions. In such circumstances and regardless of the measurement basis used, the carrying amount assigned on initial recognition will be the transaction cost.

The carrying amounts derived from the two bases will usually change after initial recognition, making it necessary to decide which basis to use. The approach adopted by many entities involves measuring some Statement of Financial Position categories at historical cost and some at current value. Although this is often referred to as the modified historical cost basis, it is more accurately referred to as the mixed measurement system.

It is envisaged that the measurement basis used for a category of assets or liabilities will be determined by reference to factors such as the objective of financial statements, the nature of the assets or liabilities concerned and the particular circumstances involved. It is also envisaged that a separate decision as to the appropriate measurement basis will be taken for each Statement of Financial Position category. That decision will need to be kept under review as accounting thought, access to markets, and circumstances change.

Whatever the measurement base chosen, the carrying amount may need to be changed from time to time. This process is known as re-measurement.

- When historical cost measure is used, re-measurements are necessary to ensure that items are stated at the lower of cost and recoverable amount.
- When a current value is used, re-measurements are necessary to ensure that items are stated at up to date current value.

Re-measurements will be recognised only if there is sufficient evidence that the monetary amount has changed and the new amount can be measured with sufficient reliability.

Recoverable amount is the higher of realisable value and value in use. Realisable value is the amount that could be obtained by selling the asset in an orderly disposal. Value in use is the present discounted value of the future cash flows obtainable as a result of an asset's continued use, including those resulting from its ultimate disposal.

N. THE HISTORICAL CONVENTION/SYSTEM

Conventionally, financial accounts are based on historical cost – which is assets/liabilities recorded in the Statement of Financial Position at their cost of acquisition. Expenses are charged against revenues in determining profit based upon historic cost of assets used in generation of the revenues.

Advantages of Historical Cost Accounting:

(a) Consistent with fundamental accounting concepts

(b) Objective and the information it produces is easily verified.

(c) Simple and inexpensive to record the information.

(d) Easily understood by the users of financial statements.

Disadvantages of Historical Cost Accounting:

(a) Assets values unrealistic, in particular land and buildings.

(b) Comparisons over time meaningless.

(c) Maintenance of the physical substance of business ignored.

O. THE ACCOUNTING PROFESSION AND THE ROLE OF THE ACCOUNTANT

Professional independence is a concept fundamental to the accountancy profession. It is essentially an attitude of mind characterised by **integrity** and an objective approach to professional work. A practising member should both be and appear to be, in each professional assignment he undertakes, free of any interest, which might be regarded, whatever its actual effect, as being incompatible with objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work. Accountants cannot avoid external pressures on their integrity and objectivity in the course of their professional work, but they are expected to resist these pressures. They must, in fact, retain their integrity and objectivity in all phases of their practice and, when expressing "opinions" on financial statements avoid involvement in situations that would impair the credibility of their independence in the minds of reasonable people familiar with the facts.

The accountancy profession exists to ensure that all interested parties entitled to knowledge of certain facts have those facts presented objectively. That is the essence of high professional standards and is as appropriate to the accountant in commerce and industry as to the accountant in public practice. Anything, which tends to impair or might appear to impair objectivity, in relation to any particular assignment or client must cast grave doubt on the propriety of the accountant acting in the assignment for the client in question. Examples of undesirable financial involvement are

- An accountant should not make a loan to a client or guarantee a client's overdraft
- A loan should not be accepted from a client
- An accountant should not give advice to a client, where such advice, if acted upon would result in receipt of commission by the accountant, unless the client is made aware of the receipt of such commission

It is undesirable that a practice should derive too great a part of its professional income from one client or group of connected clients. A practice, therefore, should endeavour to ensure that the recurring fees paid by one client or group of connected clients do not exceed 10% of the gross fees of the practice or, in the case of a member practising part-time, 10% of his gross earned income. It is recognised that a new practice seeking to establish itself or an old practice running itself down may well not, in the short term, be able to comply with this criterion. If a member is dependent for his income on the profits of any one office within a practice and the gross income of that office is regularly dependent on one client or a group of connected clients for more than 10% of its gross fees, a partner from another office of the practice should take final responsibility for any report made by the practice on the affairs of that client.

The conduct towards which an accountant should strive is embodied in six broad principles stated as affirmative *Ethical Principles*:-

1. **Independence, Integrity and Objectivity**
   An accountant should maintain his/her integrity and objectivity and, when engaged in the practice of public accounting, be independent of those he/she serves
2. **Competence and Technical Standards**
   An accountant should observe the profession's technical standards and strive continually to improve this competence and the quality of his/her services
3. **Responsibilities to Clients**
   An accountant should be fair and candid with his/her clients and serve them to the best of his/her ability, with professional concern for their best interests, consistent with his/her responsibilities to the public

4. **Responsibilities to Colleagues**
   An accountant should conduct himself/herself in a manner, which will promote co-operation and good relations among members of the profession

5. **Other Responsibilities and Practice**
   An accountant should conduct himself/herself in a manner, which will enhance the stature of the profession and its ability to serve the public

6. **Responsibility of Members Not In Practice**
   An accountant not in practice must uphold the standards and etiquette of the profession

The foregoing Ethical Principles are intended as a broad guideline. They constitute the philosophical foundation upon which the professional conduct of accountants is based.

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Study Unit 2

Regulatory & Non-Regulatory Framework

Contents

A. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

The phrase Generally Accepted Accounting Principles is a technical accounting term that encompasses the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. These conventions, rules and procedures provide a standard by which to measure financial presentations.

GAAP includes the requirements of the Companies Acts and accounting standards. It also includes acceptable accounting treatments whether or not they are set out in law and accounting standards.

Sources of GAAP

The main sources of GAAP are:

(a) Company Law

(b) International and Local Accounting Standards

(c) Stock Exchange Requirements

(d) The International Framework for the preparation and presentation of financial statements.

(e) Any other generally accepted concepts and principles e.g. the money measurement concept.

B. THE REGULATORY FRAMEWORK – NON STATUTORY

Accounting rules and regulations in certain jurisdictions for example (Ireland, UK) are governed by a Financial Reporting Council (FRC). The FRC (UK & Ireland) has two divisions – the Accounting Standards Board (ASB) and the Review Panel. There are 25 members on the council plus some observers, comprising a chairman and three deputy chairmen. Member representation is from both users and preparers and from auditors and drawn from three broad establishments – the accountancy profession, the financial community and the world of business and administration at large. The council meets approximately three times a year.

The main functions of a Financial Reporting Council (FRC) are to:

- Provide funding for its two divisions – the ASB and the Review Panel.
- Enforce compliance with standards currently in issue and in particular to the Review Panel – it is the FRC which takes companies to court to enforce changes to accounts where a company has refused to make changes recommended by the review panel.
- Set a general work programme for the ASB.
- Give guidance to the ASB and the Review Panel to ensure their work is carried out efficiently and economically.
- Provide a forum for public debate and support of accounting standards.

Prior to the creation of the FRC (UK & Ireland) accounting rules and regulations were governed by the Accounting Standards Committee (ASC). In total the ASC issued 25

Statements of Standard Accounting Practice (SSAP) covering such areas as stocks and long term contracts research and development and post reporting period events.

In Rwanda: The Companies Act, Law No 7/2009 of 27/4/2009 Relating to Companies (Article 254 and others) mandates the application of International Accounting Standards with regard to financial reporting by the registered companies. At present, the banks and other financial institutions are required by the National Bank of Rwanda to follow IFRS. The newly established **ICPAR** has been legally mandated to prepare accounting and auditing standards consistent with IFRS and ISA respectively.

International Accounting Standards Board (IASB): In April 2001 the International Accounting Standards Board was formed to take over the work of the International Accounting Standards Committee (IASC).

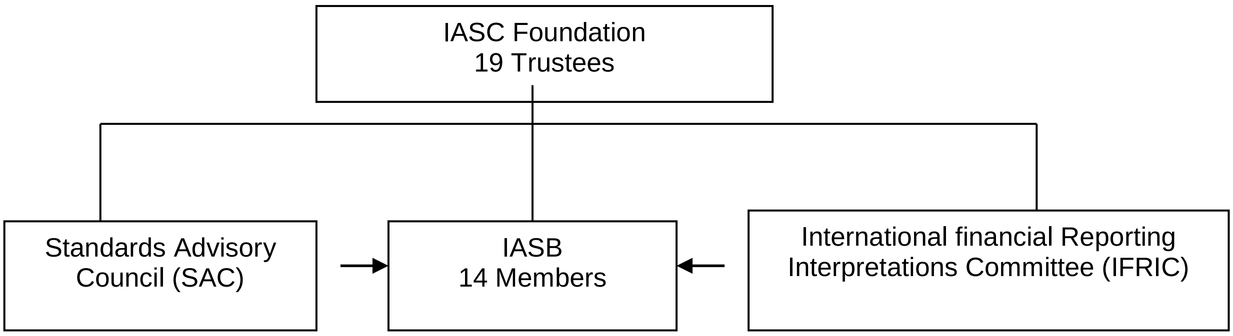
The International Accounting Standards Committee was set up in 1973. The role of this body was to formulate and publish accounting standards to be observed in the presentation of financial statements and to promote their world-wide acceptance and observance and to work for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial reporting.

Objectives of the IASB

The objectives of the IASB are set out in its mission statement:

- "To develop, in the public interest a single set of high quality, understandable and enforceable global accounting standards that require high quality transparent and comparable information in financial statements."
- To promote the use of rigorous application of these standards.
- To work actively with actual standard-setters to achieve conveyance of accounting standards around the world.

Structure



Foundation Trustees

These are 19 individuals from different geographical and functional backgrounds.

Among their functions are the appointment of the Council, The Board and The Interpretation Committee. Also they monitor the effectiveness of the IASB, secure funding and approve budgets and have responsibility for constitutional change.

IASB
This comprises 14 members (12 full time) who are appointed by the trustees for an initial term of three to five years. The Board's responsibilities include:

- Develop and publish discussion documents for public comment
- Prepare and issue exposure drafts
- Setting up procedures for reviewing comments received on documents published for comment
- Preparation and issue of International Accounting Standards

Standards Advisory Council (SAC)
About 45 members make up the Standards Advisory Council. It meets in public at least three times a year with the Board. It advises the Board on agenda decisions and priorities.

International Financial Reporting Interpretations Committee (IFRIC)
The committee is made up of accounting experts from different countries. The objective of IFRIC is to develop conceptually sound and practicable interpretations of International Accounting Standards to be applied on a global basis.

These interpretations are developed for financial reporting issues not specifically addressed by the International Accounting Standard and where unsatisfactory conflicting interpretations of a standard have developed. These pronouncements have the same force as an International Accounting Standard.

<u>Discussion Documents</u>
The IASB develops and publishes discussion documents. These represent a study of a financial reporting issue. They present alternative solutions to the issue under consideration and set out arrangements and implications relative to each. Following the receipt of comments IASB develops and publishes on Exposure Draft.

<u>Exposure Draft</u>
An exposure draft is a proposed accounting standard. The IASB invites comments thereon. After a reasonable time period, normally 120 days, an accounting standard is produced.

International Accounting Standards/International Financial Reporting Standards
The International Accounting Standards Committee (IASC) produced accounting standards called International Accounting Standards (IAS). It has published 41 International Accounting Standards some of which are no longer in force.

The International Accounting Standards Board, which took over from the IASC produces accounting standards called International Financial Reporting Standards IFRS. To date it has produced five of these.

Rwandan Stock Exchange
Public limited companies (Ltd) are required to observe requirements as set by the Rwandan Stock Exchange. Most of its requirements are covered by compliance with company law.

Statements of Recommended Practice (SORPs)
Statements of Recommended Practice are developed in the public interest and set out current best accounting practice. The primary aims in issuing SORPs are to narrow the areas of

difference and variety in the accounting treatment of the matters with which they deal and to enhance the usefulness of published accounting information. SORPs are issued on subjects on which it is not considered appropriate to issue an accounting standard at the time.

SORPs may be developed and issued by the Accounting Standards Board or they may be developed and issued by an "industry" group which is representative of the industry concerned for the purpose of the developing SORPs specific to that industry and is recognised as such by the ASR. Such SORPs are sent for approval and franking by the ASB and are referred to as "franked SORPs". Before approving and franking a franked SORP, the ASB will review the proposed statement and the procedures involved in its development.

Although SORPs are not mandatory, entities falling within their scope are encouraged to follow them and to state in their accounts that they have done so. They are also encouraged to disclose any departure from the recommendations and the reasons for it. The provisions need not be applied to immaterial items.

Advantages of Standards

(a) Provide the accounting profession with a manual of useful working rules

(b) Forces improvements in the quality of the work of the accountant

(c) Strengthen the accountant's resistance against pressure from directors to use an accounting policy which may be suspect

(d) Ensure that the users of financial statements get more complete and clearer information on a consistent basis from period to period

(e) Help in the comparison users may make between the financial statements of one organisation and another

(f) Direct financial statements towards establishing the economic truth of the entity's performance

Disadvantages of Standards

(a) The working rules are bureaucratic and lead to rigidity

(b) The quality of the work is restricted because firms and industries differ and change, as do the environments within which they operate. Standards, which are based on averages, lead to rigidity and reduce the scope for professional judgements.

(c) Official acceptance reduces the accountant's strength to resist the application of an inappropriate standard when the directors wish to follow it

(d) Users are likely to think that the financial statements produced using accounting standards are infallible

(e) Although providing formulae, standards are still low for the figures used as inputs are selected with some subjectivity, which reduces the possible benefits of comparison between firms, when the input base may not be known

(f) They have been derived through social or political pressures which may reduce the freedom and lead to manipulation of the profession

(g) They impair the development of critical thought

(h) The more standards there are the more costly the financial statements are to produce

True and Fair
True relates to the correctness of an item in the financial statements. Fair is a judgmental characteristic relating to the description and measurement of an item in the financial statements. Consider the following sentence: A motor vehicle cost RWF15,000,000 and its expected useful life is five years, the cost of RWF15,000,000 can be verified, it is true, however the useful life of five years is an estimate which can be regarded as fair. If the expected life was stated as 50 years this would not be regarded as fair.

Compliance with accounting standards is taken as the best indication that the financial statements show a true and fair view.

Framework for the Presentation and Preparation of Financial Statements

An accounting standard-setter's conceptual framework or statement of principles describes the accounting model that it uses as the conceptual underpinning for its work. The Statement describes the standard-setter's views on:

- The activities that should be reported on in financial statements
- The aspects of those activities that should be highlighted
- The attributes that information needs to have if it is to be included in the financial statements
- How information should be presented in those financial statements

The Purpose of the Framework
The framework documents can have a variety of roles. The main role of the Framework is to provide conceptual input into the IASB's work on the preparation and appraisal of accounting standards. The Framework is not, therefore, an accounting standard, nor does it contain any requirements on how financial statements are to be prepared.

A number of the principles in the Framework play fundamental roles in existing accounting standards, for example, several draw on the statement's definitions of assets and liabilities; IAS 37: Provisions, Contingent Liabilities and Contingent Assets.

The Framework therefore plays a very important role in the standard-setting process, although it is only one of the factors that the ASB takes into account when setting standards. Other factors include legal requirements, cost-benefit considerations, industry-specific issues, and the desirability of evolutionary change and implementation issues.

C. THE REGULATORY FRAMEWORK – STATUTORY

Company Law
The main law governing financial statements is the Companies Act Law no. 7/2009 of 27/4/2009 relating to companies.

1. It applies to companies both private and public.
2. All companies should file accounts with the Office of Registrar General.
3. All accounts must show a true and fair view.
4. IFRS and IASB standards must be adhered to.

CONCEPTS

Prior to the introduction of the Framework the following accounting concepts were used:

Going Concern	Continuity of the entity in its present form for the foreseeable future/there is no intention to put the company into liquidation or to drastically cut back the scale of operations
Prudence	Cautious presentation of the entity's financial position. Profits are recognised only when realised while losses are provided for as soon as they are foreseen
Accruals	Revenue earned in the period matched with costs incurred in earning it, not as money is received or paid
Consistency	There is similar accounting treatment of like items within each accounting period and from one period to the next
Entity	That the accounts recognise the business as a distinct separate entity from its owners
Money Measurement	Accounts only deal with those items to which a monetary value can be attributed
Materiality	If omission, misstatement or non-disclosure affects the view given, the item is material and disclosure is required
Substance over Legal Form	Recognises economic substance from legal form e.g. assets acquired on hire purchase
Stable Monetary Unit	That the value of the monetary unit used is consistent over time
Accounting Periods	Accounts are prepared for discrete time periods

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Study Unit 3

Double Entry, Trial Balance, Statement of Financial Position

Contents

A. BOOKS OF ORIGINAL ENTRY/BOOKS OF PRIME ENTRY/BOOKS OF FIRST ENTRY

In order to extract a trial balance, a Statement of Comprehensive Income and Statement of Financial Position, the information must be posted to the accounting books. These accounting books are known by a number of names - the books of original entry, the books of prime entry or the books of first entry. The books of original entry comprise the following books:

- Sales Book
- Sales Return Book
- Cash Receipts Book
- Debtors (Trade Receivables)Ledger
- Purchases Book
- Purchases Return Book
- Cheque Payment Book
- Creditors (Trade Payables) Ledger
- Petty Cash Book

SALES BOOK: Written from Sales Invoice

Each sales invoice should be entered in the sales book as follows:

(a) Date of invoice

(b) Customers name

(c) Invoice number - all sales invoices should be sequentially numbered at the printers

(d) Total amount of invoice

(e) Trade Receivables ledger account

(f) Cash sale amount - if not a credit sale

(g) Analysis columns appropriate to the various different types of sales including VAT analysis columns - showing net goods and VAT for the respective rates and then the analysis excluding VAT. Analysis columns can be specifically tailored to the nature of the entity's business and transactions type. Analysis headings should only be set up for items, which are expected to recur regularly. All other items should be analysed under a sundry column with a brief narrative as to their nature beside that item.

The sales book should be totalled and ruled off monthly. The total should agree with the cross tot of the analysis columns. Each month should be commenced on a new page.

A separate section should be opened in the sales book for all sales credit notes issued and these should be dealt with in the same fashion as above in relation to recording sales invoices. This can be a separate book, if required, known as the sales returns book.

A sales summary may be prepared at the back of the sales book by entering the totals of both invoices and credit notes for each month.

Example Layout of Sales Day Book:

Sales Day Book					
Date	**Details**	**Folio No.**	**Total**	**VAT**	**NET**

CASH RECEIPTS BOOK

This book should record all monies received and lodged to the bank accounts. Each receipt will be entered into the cash receipt book as follows:

(a) Date received

(b) Details of receipt i.e. from whom received

(c) The amount of the receipt

(d) Analysis of receipts i.e. debtors receipt, cash sales receipt and miscellaneous receipts. Miscellaneous receipts should have a written narrative beside such receipts for identification purposes e.g. VAT refunds etc. These miscellaneous receipts will have no corresponding entry in the debtors' ledger. Cash sales will be analysed in the sales book both for the type of transaction and VAT analysis

(e) Lodgement column - This should be the last column and should record all lodgements made to the bank

The total of all the analysis columns at the end of each month should be equal to the total column - excluding the lodgement column. The total column ought to agree with the total of the lodgement column, provided daily lodgements are being made. The cash receipts book should be totalled and ruled off monthly and each month should be commenced on a new page.

Bank stamped lodgement slips should be retained and kept on a special file.

Example Layout of Cash Receipt Book:

Cash Receipt Book						
Date	**Details Sundry Receipts**	**Total**	**Receipts A/C Ref From DRS**	**VAT**	**Analysis of Col.**	

PURCHASES BOOK
On receipt of a purchase invoice, the invoice should be assigned an internal sequential number. This number has no relevance to the supplier but it is a method of filing and retrieving it, if required. All calculations, additions and extensions on the purchase invoice should be checked. It is also a means to check that all invoices are entered into the "books". I.e. numbers should be sequential and it is easier to check if any are missing from the relevant books and analysis sheets.

Each invoice should be entered in the purchase book detailing the following:

(a) Date of invoice - i.e. date received and entered

(b) Supplier's name

(c) Internal sequential number of invoice

(d) Total amount

(e) Creditor's ledger amount - if applicable

(f) Analysis columns for purchase of materials by category e.g. capital expenditure, sub-contract work, travel, entertainment, sundry, etc. including VAT analysis columns. The analysis columns should show net goods and VAT at the respective rates and the analysis excluding VAT. The VAT analysis columns will be split between items for re-sale and non-re-sale items and any further analysis required for the annual VAT returns. Analysis columns will be specifically tailored to the nature of the entity's business and the transactions type. Analysis headings should only be set up for items which are expected to recur regularly. All other items should be analysed under a sundry column and a brief narrative as to their nature beside that item.

The purchase book should be totalled and ruled off monthly. The total column must agree with the cross total of the analysis columns plus the VAT column. Each month should be commenced on a new page.
A separate section should be opened in the purchases book for all purchases credit notes received and these should be dealt with in the same fashion as noted above related to recording purchase invoices. This can be kept as a separate book, if necessary and called the purchase returns book.

A purchase summary should be prepared at the back of the purchases book by entering the total of the invoices and credit notes for each month.

Example Layout of Purchases Day Book:

Purchases Day Book

Date	**Details**	**No.**	**Total**	**VAT**	**NET**

CHEQUE PAYMENTS BOOK

This records all payments made through the bank accounts. Each payment amount will be entered into the cheque payments book as follows:

(a) Date of cheque

(b) Details of payment i.e. to whom payable and for what

(c) Cheque number

(d) Cheque total

(e) Analysis of payment i.e. creditors payments, salaries, wages, motor expenses, etc. Apart from payment to creditors, other payments will be made directly by cheque i.e. no corresponding entry will exist in the purchase book or creditors ledger. The exact analysis of items other than payments processed through the payments relating to purchases book and the creditors' ledger will be dependent on the nature of the company's business and transactions. Analysis headings should only be set up for items, which are expected to recur regularly. All other times should be analysed under a sundry column with a brief narrative as to their nature beside that item.

It is essential that when cheques are being presented for signature that they must be accompanied by the supporting documentation i.e. invoice, goods received note and/or supplier's statement. On payment, the supporting documentation should be stamped "Paid" and initialled by the cheque signatory in order to prevent re-payment. All cheques should be crossed "Account Payee only - non-negotiable". Suppliers' statements should be agreed with invoices to hand and if applicable, the creditors' ledger balances.

The total of all the analysis columns at the end of the month should be equal to the total column. The cheque payments should be totalled and ruled off monthly and each month should be commenced on a new page.

Example Layout of Cheque Payments Book:

Cheque Payments Book

Date	Ch. No.	Payee	Total Payments	Payments to Creditors	A/C Ref	Wages	Bank Interest Charges	Other Analysis Columns

DEBTORS (Trade Receivables) LEDGER/SALES LEDGER

A debtors' (trade receivables) ledger is used to keep a record of all amounts due to the company in respect of sales made. A loose-leaf type ledger would be the appropriate form to operate. An account should be maintained for each debtor (trade receivables) - including debtors (trade receivables) in foreign currencies, if any. An index at the front of the ledger can record the debtors' name.

All sales to customers should be posted from the sales book to the DEBIT side of the individual accounts involved. Each entry should show the date, the description i.e. goods or services, the invoice number, the sales book reference and the amount - including VAT.

All returns from customers should be posted from the sales return book on the CREDIT side of the individual accounts involved. Each entry should show the date, the description, the credit note number, the sales returns book reference and the amount, including VAT.

Any receipts from debtors (trade receivables) should be posted from the debtors' (trade receivables) columns in the cash receipts book on the CREDIT side of the individual accounts involved. Each entry should show the date received, description i.e. cash or cheque, the cash receipts book reference and the amount received.

A list of balances should be maintained periodically and this list should show the amount due by debtors (trade receivables) to the company at that date.

*A **control account** should be maintained at the front of the ledger to which the total sales, total credits and total receipts for each month should be posted. The balance on this control account at the end of every month should agree with the total of the debtors'(trade receivables) balances at that date.*

CREDITORS (Trade Payables) LEDGER/PURCHASES LEDGER

A creditors' (trade payables) ledger is used to keep a record of all amounts due by the company in respect of purchases made. Initially, a creditor's ledger account should only be opened where the amounts involved are relatively large or for a supplier where transactions are expected to recur on a regular basis. At a later date, when the overall volume of transactions increases, to maintain a control, all purchases may be processed through the creditors' (trade payables) ledger whether for cash/cheque or credit. A Creditor's Ledger is useful to analyse from whom purchase are made, how often and how much

A loose-leaf type ledger would be the appropriate form to operate. An account should be maintained for each creditor - including foreign currency creditors. An index at the front of the ledger can record the creditors' (trade payables) name.

All purchases from suppliers should be posted from the purchase book to the CREDIT side of the individual account involved. Each entry should show the date of the purchase, the description i.e. goods or services, the internal reference number, the purchase book reference and the amount, including VAT.

All returns to customers should be posted from the purchases returns book on the DEBIT side of the individual accounts involved. Each entry should show the date, the description, the credit note number, the purchases returns book reference and the amount, including VAT.

Any payments to creditors (trade payables) should be posted from the creditor columns in the cheque payments book on the DEBIT side of the individual accounts involved. Each entry should show the date paid, description i.e. cash or cheque, the cheque number, the cheque payments book reference and the amount paid.

A list of balances should be maintained periodically and this list should show the amount due to creditors by the company at that date.

*A **control account** should be maintained at the front of the ledger to which the total purchases, total credits and total payments for each month should be posted. The balance on* *this control account at the end of every month should agree with the total of the creditors* (trade payables) *balance at that date.*

PETTY CASH BOOK or PETTY CASH ACCOUNT
This should record all cheques drawn to fund petty cash. These should be recorded as receipts in the petty cash book. Furthermore, a full record should be kept, with supporting documentation, of all disbursements made out of petty cash. These disbursements should be analysed under appropriate columns as follows:

(a) Date

(b) Narrative

(c) Petty cash docket reference number

(d) Total amount

(e) VAT analysis split between items for re-sale and non-re-sale items recording the net goods and VAT amount for each rate of VAT

(f) The analysis of the nature of the disbursements will be the amount exclusive of VAT and all probably cover headings such as postage, entertainment, travel, publications, office requisitions, etc. and a sundry column. The sundry column is for items, which are not expected to recur regularly and each entry in this column should have a brief narrative as to the nature of transaction.

It is preferable that an imprest petty cash system be operated whereby a pre-set amount of cash be introduced into petty cash, i.e. RWF100,000 and this would be topped up to the pre-set amount at the end of each week, or when required. The exact amount to be put into petty cash will be determined by the volume of transaction processed through petty cash and the amount of the individual transactions. It would be preferable to establish a maximum amount that may be processed for any transaction through petty cash i.e. RWF10,000. Thereafter, any amounts in excess of that amount are paid by cheque.

B. NOMINAL LEDGER

The information to prepare a Statement of Comprehensive Income and Statement of Financial Position is extracted from the NOMINAL LEDGER.

The NOMINAL LEDGER is a book/record containing what are referred to as LEDGER ACCOUNTS.

An individual LEDGER ACCOUNT shows details of transactions in relation to the various ASSETS, LIABILITIES, EXPENSES and REVENUE.

Each account is given a separate page. The page is divided into two halves. The left-hand side of the page is called the debit side while the right hand side of the page is called the credit side. The title of the account is shown across the top of the account at the centre.

EXAMPLE Capital of RWF10,000 introduced into business and lodged to the Bank Account

BANK ACCOUNT

Debit Side			Credit Side		
		RWF			RWF
1 Jan	Capital Account	10,000			

CAPITAL ACCOUNT

Debit Side			Credit Side		
		RWF			RWF
			1 Jan	Bank Account	10,000

DOUBLE ENTRY
The method of bookkeeping in use is called the double entry method. It was invented in the 15^{th} century by Luca Pacioli

1. For every debit entry, there is an equal and corresponding credit entry.
2. For every credit entry, there is an equal and corresponding debit entry.

TRIAL BALANCE
All the items recorded in all the accounts on the debit side should equal in total all the items recorded on the credit side.

In accounting terminology to see if the two sides of the NOMINAL LEDGER agree, a TRIAL BALANCE is drawn up.

EXAMPLE
Trial Balance

	Debit	**Credit**
	RWF	RWF
Bank	5,800	
Premises	5,000	
Furniture	400	
Van	500	
Inventory	5,500	
Trade Receivables	1,000	
Capital		10,000
Loan		4,000
Trade Payables		3,250
Profit & Loss		950
	18,200	18,200

C. DOUBLE ENTRY

Accounting involves the systematic interpretation of economic transactions and activities and the communication of the results to the decision-makers.

The two basic rules relating to double entry bookkeeping are:

(a) Debits are to the LEFT while credits are to the RIGHT in a standard ledger account.

(b) Every DEBIT must have a CREDIT – or more specifically, the value of entries posted to the DEBIT side must equal the value of entries posted to the CREDIT side i.e. both sides should be equal and balance at all times.

Ledger Account

Debit Side	Credit Side

Following these rules, as the value of the total debits must be equal to the value of the credit, then

Assets = Liabilities and Capital

D. THE ACCOUNTING EQUATION

The resources of a firm are known as ASSETS. Someone must have supplied these resources. The total amount supplied by the owner of the business is known as CAPITAL.

Therefore, if all the resources of the business are supplied by the owner, the following must be true:

ASSETS = CAPITAL

However, some of the assets normally have been provided by some other person than the owner. This indebtedness of a firm is referred to as LIABILITIES. Therefore, the equation is now referred to as

ASSETS = CAPITAL + LIABILITIES

or

ASSETS - LIABILITIES = CAPITAL

This equality of assets with the total of capital and liabilities will always hold true.

ASSETS are made up of items such as PREMISES, PLANT and MACHINERY, MOTOR VEHICLES, FIXTURES and FITTINGS, etc.

LIABILITIES are made up of money owing for goods purchased, for expenses incurred and loans received by the firm, etc.

CAPITAL refers to the owners' EQUITY or NET WORTH.

EXERCISE

T. Chahine. starts a business. Before he actually starts to sell anything he has bought the following:

Fixtures RWF2,000, Motor Vehicle RWF5,000 and stock of RWF3,500. Although he has paid in full for the fixtures and motor vehicle, he still owes RWF1,400 for some of the goods. J. Ayim. has lent him RWF3,000, which is payable within 1 year. T. Chahine., after the above, has RWF2,800 in the business bank account and RWF100 cash in hand.

You are required to prepare a Statement of Financial Position of the business.

T. Chahine.
Statement of Financial Position As At …

	RWF	RWF
Non-current Assets		
Fixtures	2,000	
Motor Vehicle	5,000	
		7,000
Current Assets		
Stock	3,500	
Bank	2,800	
Cash	100	
		6,400
		13,400
Capital (Balancing Figure)		9,000
Current Liabilities		
Trade Payables	1,400	
Loan	3,000	
		4,400
		13,400

E. THE STATEMENT OF COMPREHENSIVE INCOME

The Statement of Comprehensive Income shows details how the PROFIT or LOSS of a period has been made.

THERE ARE TWO COMPONENTS PARTS:

- **THE TRADING ACCOUNT:**
  This shows the GROSS PROFIT for the account period.
  The GROSS PROFIT is the difference between:
  SALES and COST OF GOODS SOLD

- **THE PROFIT AND LOSS ACCOUNT:**
  This shows the NET PROFIT for the period.
  NET PROFIT = GROSS PROFIT plus INCOME FROM OTHER SOURCES less EXPENSES

EXAMPLE

HORIZONTAL FORMAT
Statement of Comprehensive Income for year ended 31st December 20X0

	RWF		RWF
Opening Inventory	11,300	Sales	50,000
Purchases	29,100	Closing Inventory	10,700
Gross Profit	20,300		
	60,700		60,700

Statement of Comprehensive Income for year ended 31st December, 20X0

	RWF	RWF		RWF
Administration Expenses:			Gross Profit	20,300
Salaries/Wages	8,300			
Rent and Rates	3,200			
Depreciation	1,100	12,600		
Financial Expenses:				
Bad Debts		200		
Selling & Distribution Expenses:				
Travelling	210			
Advertising	1,000	1,210		
NET PROFIT		6,290		
		20,300		20,300

EXAMPLE

VERTICAL FORMAT
Statement of Comprehensive Income for year ended 31st December, 20X0

	RWF	RWF	RWF
Sales			50,000
Opening Inventory		11,300	
Purchases		29,100	
		40,400	
Closing Inventory		(10,700)	
Cost of Sales			(29,700)
Gross Profit			20,300
Expenses:			
Administration Expenses:			
Salaries and Wages	8,300		
Rent and Rates	3,200		
Depreciation	1,100	12,600	

Financial Expenses:			
Bad Debts	200	200	
Selling & Distribution Expenses:			
Travelling Expenses	210		
Advertising	1,000	1,210	
			(14,010)
Net Profit			6,290

EXERCISE: PLB LIMITED

Statement of Comprehensive Income: Basic
The following list of balances has been extracted from the ledger of PLB Ltd as at 31st December 20X2

	RWF
Sales	32,279
Bank Interest paid	1,978
Rent and Rates	3,271
Postage and Stationery	242
Advertising	785
Salaries and Wages	8,437
Repairs and Renewals	125
Cost of Sales	16,346

Required:
Prepare the Statement of Comprehensive Income for the year ended 31st December, 20X2

PLB Limited
Statement of Comprehensive Income for the Year Ended 31st December 20X2

	RWF	RWF
Sales		32,279
Cost of Sales		(16,346)
Gross Profit		15,933
Expenses:		
Rent and Rates	3,271	
Bank Interest	1,978	
Postage and Stationery	242	
Advertising	785	
Salaries	8,437	
Repairs	125	
		14,838
Net Profit		1,095

F. THE STATEMENT OF FINANCIAL POSITION

This is simply a list of all the ASSETS CONTROLLED and all LIABILITIES OWED by the business at a particular date. It is a snapshot of the financial position of the business at a given moment in time. In the Statement of Financial Position, assets and liabilities are sub-divided into:

Non-current Assets
An asset with a LONG LIFE acquired FOR USE IN THE BUSINESS and NOT PURCHASED FOR RESALE

(i) INTANGIBLE e.g. Goodwill

(ii) TANGIBLE e.g. Plant and machinery

(iii) FINANCIAL e.g. Investments

Current Assets
An asset owned by the business with the INTENTION OF CONVERSION INTO CASH within ONE YEAR. These are shown in order of LIQUIDITY – Inventory (stock, finished and unfinished goods), Trade Receivables, Prepaid Expenses, Bank and Cash (the more liquid, the lower down the list).

Current Liabilities
Amounts PAYABLE WITHIN ONE YEAR - Examples: Trade Payables, Accrued Expenses

Long-Term Liabilities
Amounts PAYABLE AFTER MORE THAN ONE YEAR - Examples: Debentures, Loans

Capital
This is a special type of LIABILITY, representing what is owed by THE BUSINESS to ITS OWNERS i.e. the proprietors claim against the business. In non-commercial entities, this is often referred to as an accumulated fund.

G. THE EFFECT OF TRANSACTIONS ON A STATEMENT OF FINANCIAL POSITION

Any transaction completed by the owner/employees of the business will affect the business Statement of Financial Position. The reason for this is because at all times, the golden rule is being applied i.e. every DEBIT has a CREDIT or more precisely, the value of the DEBITS is equal to the value of the CREDITS. For example, if the owner buys an asset with cash, the cash balance decreases (Credit) while the non-current assets increase (Debit).

The Statement of Financial Position may be presented in one of two ways:

Horizontal Format

Example Limited
Statement of Financial Position as at 31 December 20XX

		RWF			RWF
Non-current Assets		8,800	**Capital:**		
Current Assets:			Share Capital		3,500
Inventory	1,400		Reserves		3,000
Trade Receivables	4,800	6,200	Shareholders' Funds		6,500
			Loan Capital		3,000
			Current Liabilities		
			Trade Payables	3,500	
			Taxation	2,000	5,500

	15,000		15,000

Vertical Format

Example Limited
Statement of Financial Position as at 31 December 20XX

	RWF	RWF	RWF
Non-current Assets		8,800	
Current Assets			
Inventory	1,400		
Trade Receivables	4,800		
		6,200	
			15,000
Share Capital			3,500
Reserves			3,000
Shareholders			6,500
Non-current Liabilities			3,000
Current Liabilities			
Trade Payables		3,500	
Tax Payable		2,000	5,500
			15,000

Complete the following business transactions in the pro forma Statement of Financial Position set out below: (The solutions are set out further in this unit)

1. **The Introduction of Capital**:
   G. Sarr. sets himself up in business on 1 January by paying RWF10,000 into a business bank account

Statement of Financial Position of G. Sarr. as at 1 January

	ASSETS	LIABILITIES
	RWF	RWF

2. **The Purchase of an Asset by Cheque and the Incurring of a Liability**:
   January 2 - Purchase of premises for RWF5,000 satisfied by cheque RWF1,000 and mortgage RWF4,000

Statement of Financial Position of G. Sarr. as at 2 January

	ASSETS	LIABILITIES
	RWF	RWF

3. **Purchase of Assets for Credit and for Cash:**
January 3 - Purchase of van RWF500, on credit and office furniture RWF400 for cash

Statement of Financial Position of G. Sarr. as at 3 January

	ASSETS	**LIABILITIES**
	RWF	RWF

4. **Purchase of asset for cash:**
January 4 - Purchase of Inventory for cash RWF4,000

Statement of Financial Position of G, Sarr, as at 4 January

	ASSETS	**LIABILITIES**
	RWF	RWF

5. **Sale of an Asset on Credit at a Profit**:
January 5 - Sale of Inventory, which cost RWF1,500, for RWF2,500 on credit

Statement of Financial Position of G. Sarr. as at 5 January

	ASSETS	**LIABILITIES**
	RWF	RWF

6. **The Payment of a Liability by Cheque:**
January 6 - RWF250, being half the cost of the van, is paid by cheque

Statement of Financial Position of G. Sarr. as at 6 January

	ASSETS	**LIABILITIES**
	RWF	RWF

7. **The Payment of an Expense by Cheque:**
January 7 - Electricity bill paid, RWF50

Statement of Financial Position of G. Sarr. as at 7 January

	ASSETS	**LIABILITIES**
	RWF	RWF

8. **Purchase of an Asset on Credit:**
January 8 - Further Inventory purchased on credit at a cost of RWF3,000

Statement of Financial Position of G. Sarr. as at 8 January

	ASSETS RWF		LIABILITIES RWF

9. **Collection of an Asset:**
January 9 - RWF1,500 is received in part settlement of the original debt for RWF2,500

Statement of Financial Position of G. Sarr. as at 9 January

	ASSETS RWF		LIABILITIES RWF

Solutions

1. **The Statement of Financial Position of G Sarr**

Statement of Financial Position of G. S.arr as at 1 January

	ASSETS RWF		LIABILITIES RWF
Cash at Bank	10,000	Capital	10,000
	10,000		10,000

The business is separate from G. arr. as an individual. Therefore, the business has an asset of RWF10,000 and a liability, i.e. an amount owing to a person, of RWF10,000. In this case, the amount is owing to the proprietor, G. Sarr., and by convention is called Capital, i.e. the amount the individual has invested in the business.

2. **Statement of Financial Position as at 2 January**

Statement of Financial Position of G. Sarr. as at 2 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Current Assets:		**Non-current Liabilities**	
Cash at Bank	9,000	Mortgage	4,000
	14,000		14,000

The business has acquired an additional source of finance - a mortgage loan. There are now two types of asset, fixed and current and it is important to distinguish between them. Note that fixed or non-current assets are recorded first.

3. **Statement of Financial Position as at 3 January**

Statement of Financial Position of G. Sarr. as at 3 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	**Non-current Liabilities**	
Van	500	Mortgage	4,000
	5,900	**Current Liability:**	
Current Assets:		Trade Payables	500
Cash at Bank	8,600		
	14,500		14,500

A further source of finance has arisen – Creditors (Trade Payables). As it is of a short-term nature, it is classified separately from the other sources of finance. The assets acquired are non-current assets and are listed in order of permanence under the heading. A sub-total of non-current assets is always made.

4. **Statement of Financial Position as at 4 January**

Statement of Financial Position of G. Sarr. as at 4 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	**Non-current Liabilities**	
Van	500	Mortgage	4,000
	5,900	**Current Liability:**	
Current Assets:		Trade Payables	500
Inventory	4,000		
Cash at Bank	4,600		
	14,500		14,500

There is no change in the sources of finance; only the assets have been deployed differently. In the current assets, there are now two categories. (Note that the two items are listed in reverse order for ease of convertibility to cash). The grand totals of the Statement of Financial Position are shown on the same line.

5. **Statement of Financial Position as at 5 January**

Statement of Financial Position of G. Sarr. as at 5 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	Profit to date	1,000
Van	500		11,000
	5,900	**Non-current Liabilities**	
Current Assets:		Mortgage	4,000
Inventory	2,500	**Current Liability:**	
Trade Receivables	2,500	Trade Payables	500

Cash at Bank	4,600		
	15,500		15,500

An additional source of finance has been found. The profit on the transaction has been in the business. It belongs to the proprietor and is added to his Capital Account. The inventory has cost RWF1,500 so Inventory Account is reduced by that amount. A credit sale means that payment will be received later. The business is owed money for the Inventory by a debtor (trade receivables) and the amount owing, RWF2,500, is shown as a Current Asset in Trade Receivables.

6. **Statement of Financial Position as at 6 January**

Statement of Financial Position of G. Sarr. as at 6 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	Profit to date	1,000
Van	500		11,000
	5,900	**Non-current Liabilities**	
Current Assets:		Mortgage	4,000
Inventory	2,500	**Current Liability:**	
Trade Receivables	2,500	Trade Payables	250
Cash at Bank	4,350		
	15,250		15,250

The liability is met by issuing a cheque. Both the cash at bank and the creditor balance are reduced by RWF250.

7. **Statement of Financial Position as at 7 January**

Statement of Financial Position of G. Sarr. as at 7 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	Profit to date	950
Van	500		10,950
	5,900	**Non-current Liabilities**	
Current Assets:		Mortgage	4,000
Inventory	2,500	**Current Liability:**	
Trade Receivables	2,500	Trade Payables	250
Cash at Bank	4,300		
	15,200		15,200

The expense paid out of the bank reduces the value of the business; in this case, the profit of the period to date is reduced by the expense disbursed.

8. **Statement of Financial Position as at 8 January**

Statement of Financial Position of G. Sarr. as at 8 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	Profit to date	950
Van	500		10,950
	5,900	**Non-current Liabilities**	
Current Assets:		Mortgage	4,000
Inventory	5,500	**Current Liability:**	
Trade Receivables	2,500	Trade Payables	3,250
Cash at Bank	4,300		
	18,200		18,200

The creation of the additional asset, Inventory, is matched by a corresponding increase in trade payables, as the whole of the additional Inventory was purchased on credit.

9. **Statement of Financial Position as at 9 January**

Statement of Financial Position of G. Sarr.as at 9 January

	RWF		RWF
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	Profit to date	950
Van	500		10,950
	5,900	**Non-current Liabilities**	
Current Assets:		Mortgage	4,000
Inventory	5,500	**Current Liability:**	
Trade Receivables	1,000	Trade Payables	3,250
Cash at Bank	5,800		
	18,200		18,200

The effect of the collection of the debt is to reduce one asset, the Trade Receivables, and to increase another, cash.

From the examples given, it can be seen that even the simplest transactions effected by daily business are reflected in the Statement of Financial Position

The above mentioned transactions can also be recorded in the nominal ledger as follows:

Note the details show where the other entry or entries can be found

BANK A/C

DR					CR
		RWF			RWF
1 Jan	Capital	10,000	2 Jan	Premises	5,000
2 Jan	Mortgage Loan	4,000	3 Jan	Furniture	400
9 Jan	Trade Receivables	1,500	4 Jan	Inventory	4,000
			6 Jan	Trade Pay	250
			7 Jan	Electricity	50
			9 Jan	Balance c/d	5,800
		15,500			15,500
9 Jan	Balance b/d	5,800			

PREMISES A/C

DR					CR
		RWF			RWF
2 Jan	Bank	5,000			

FURNITURE A/C

DR					CR
		RWF			RWF
2 Jan	Bank	400			

VAN A/C

DR					CR
		RWF			RWF
3 Jan	Creditor	500			

INVENTORY A/C

DR					CR
		RWF			RWF
4 Jan	Bank	4,000		Statement of Comprehensive Income	1,500
8 Jan	Creditor	3,000	9 Jan	Balance c/d	5,500
		7,000			7,000

TRADE RECEIVABLES A/C

DR					CR
		RWF			RWF
5 Jan	Sales	2,500	9 Jan	Bank	1,500
			9 Jan	Balance c/d	1,000

		2,500			2,500

ELECTRICITY EXPENSE A/C

DR					CR
		RWF			RWF
9 Jan	Bank	50		Statement of Comprehensive Income	50
		50			50

CAPITAL A/C

DR					CR
		RWF			RWF
			1 Jan	Bank	10,000

MORTGAGE LOAN A/C

DR					CR
		RWF			RWF
			2 Jan	Bank	4,000

TRADE PAYABLE A/C

DR					CR
		RWF			RWF
6 Jan	Bank	250	3 Jan	Van	500
9 Jan	Balance c/d	3,250	8 Jan	Inventory	3,000
		3,500			3,500
			9 Jan	Balance b/d	3,250

SALES A/C

DR					CR
		RWF			RWF
	Statement of Comprehensive Income	2,500	5 Jan	Trade Receivables	2,500
		2,500			2,500

STATEMENT OF COMPREHENSIVE INCOME A/C

DR					CR
		RWF			RWF
	Inventory	1,500		Sales	2,500
	Profit c/d	1,000			
		2,500			2,500
				Profit b/d	1,000
	Electricity	50			

Profit c/d	950		
	1,000		1,000

The trial balance is extracted before final adjustments are made to ensure that the double entry has so far been correctly dealt with.

G.Sarr.

Trial Balance as at 9th January

	Debit	**Credit**
	RWF	RWF
Bank	5,800	
Premises	5,000	
Furniture	400	
Van	500	
Inventory	5,500	
Trade Receivables	1,000	
Capital		10,000
Loan		4,000
Trade Payables		3,250
Statement of Comprehensive Income		950
	18,200	18,200

H. CAPITAL EXPENDITURE AND REVENUE EXPENDITURE

CAPITAL EXPENDITURE is expenditure, which results in the ACQUISITION OF NON-CURRENT ASSETS or an IMPROVEMENT in their EARNINGS CAPACITY

⇒ NOT CHARGED AS AN EXPENSE in the PROFIT AND LOSS ACCOUNT

⇒ APPEARS UNDER "NON-CURRENT ASSETS" in the STATEMENT OF FINANCIAL POSITION

REVENUE EXPENDITURE is expenditure for the purpose of either:

⇒ TRADE OR BUSINESS e.g. administration, distribution

⇒ MAINTAINING the EXISTING EARNINGS CAPACITY OF NON-CURRENT ASSETS e.g. repairs

⇒ CHARGED to the STATEMENT OF COMPREHENSIVE INCOME IN THE PERIOD TO WHICH IT RELATES

Effects of incorrect treatment

- Amount of Expense
- Amount of Asset
- Amount of Profit (Net/Gross)

The following table shows the effect of incorrect treatment of revenue and capital expenditure:

Incorrect Classification	Effect on Accounts	Effect on Net Profit	Effect on Statement of Financial Position
Purchase of fixed asset treated as revenue expenditure	Expense overstated Fixed asset account understated	Understated	Capital understated Fixed asset understated
Revenue expenditure treated as a capital item	Expense understated Fixed asset account overstated	Overstated	Capital overstated Fixed asset overstated

EXAMPLE
State whether each of the following items should be classified as "capital" or "revenue" expenditure for the purpose of a trading, profit and loss account and Statement of Financial Position:

1. Purchase of leasehold premises
2. Lawyers' fees in connection with the purchase of leasehold premises
3. Annual depreciation charge for the use of leasehold premises
4. Annual ground rent of lease
5. Cost of new machinery
6. Customs duty charged on new machinery from supplier to factory
7. Carriage on new machinery from supplier to factory
8. Cost of installing new machinery
9. Removal expenses
10. Annual patent renewal fees

SOLUTION:
1. Capital
2. Capital
3. Revenue
4. Revenue
5. Capital
6. Capital
7. Capital
8. Capital
9. Revenue
10. Revenue

I. QUESTIONS/SOLUTIONS

Question: MR. Balewa.

Mr. Balewa. commenced business on 1 January 20X2. All expenses were paid by cheque and any cash received was banked daily. The following is a summary of the transactions, which took place during the first year of trading:

(a) On 1 January 20X2, Mr. Balewa. commenced business with RWF5,000 which he lodged to the business bank account

(b) During the period, total purchases amounted to RWF4,000 and payments made to suppliers were RWF3,550. On 31 December, 20X2, RWF450 was still due to suppliers in respect of these purchases

(c) Sales for the year totalled RWF9,000 all on credit. Amounts received from customers during the year were RWF8,100. On 31 December, 20X2, RWF900 was still owing from customers

(d) Mr B. purchased a van in December costing RWF2,500

(e) Administration Expenses were RWF2,300 for the year

Required:

1. Write up the ledger accounts for Mr Balewa,
2. Extract the Trial Balance
3. Prepare the Statement of Comprehensive Income for the year ended 31 December, 20X2 given that the value of Inventory at 31 December 20X2 was RWF500
4. Prepare the Statement of Financial Position as at 31 December, 20X2

Question: MR A. Igwe.

Mr A. Igwe. commenced business as a retail butcher on 1 January 20X9. All expenses were paid by cheque and any cash received was banked daily. The following is a summary of the transactions, which took place during the first year of trading:

(a) On 1 January, 20X9 Mr A. Igwe. paid RWF4,000 into the business bank account

(b) Credit sales totalled RWF8,000 - RWF6,500 was received and RWF1,500 was outstanding at the end of the year

(c) Cash sales amounted to RWF15,000

(d) A delivery van was purchased on 1 January 20X9 at a cost of RWF3,900

(e) During the period, purchases amounted to RWF7,800,. Suppliers had been paid RWF7,200 for meat and invoices totalling RWF600 remained unpaid at 31 December 20X9

(f) Sundry expense (all paid during the period and relating to it) amounted to RWF2,200. During the year, Mr A. Igwe. drew RWF2,000 from the business

(g) The annual rent of the shop was RWF1,200 and Mr A. Igwe. paid this amount on 1 January 20X9

(h) Mr A. Igwe. paid his assistant RWF1,900 during the year

Required:

1. Write up the ledger accounts and cash book of Mr A. Igwe. to 31 December, 20X9
2. Extract a Trial Balance

3. Prepare the Statement of Comprehensive Income for the year ended 31 December 20X9 - closing Inventory at 31 December was RWF850
4. Prepare the Statement of Financial Position as at 31 December 20X9

Question: BSB Ltd

The following balances have been extracted from the books of BSB Limited as at the 31st December, 20X3

	RWF
Trade Receivables	2,340
Trade Creditors	2,678
Inventory	2,431
Equipment	5,720
Premises	10,410
Cash in hand	348
Bank Overdraft	1,279
Capital	6,000
Statement of Comprehensive Income	11,292

Required:

1. Prepare a Statement of Financial Position as at 31 December 20X3

EXERCISE 1

Q.1 Which of the following is not an asset?

(a) Buildings

(b) Cash Balance

(c) Trade Receivables

(d) Loan from Mrs K. Diop.

Q.2 Which one of the following is a liability?

(a) Machinery

(b) Trade Payables for goods

(c) Motor Vehicles

(d) Cash at Bank

Q.3 Gross Profit is:

(a) Excess of sales over cost of goods sold

(b) Sales less purchases

(c) Cost of goods sold plus Opening Inventory

(d) Net profit less expenses of the period

Q.4 The descending order in which current assets should be shown in the Statement of Financial Position are:

(a) Inventory, Trade Receivables, Bank, Cash

(b) Cash, Bank, Trade Receivables, Inventory

(c) Trade Receivables, Inventory, Bank, Cash

(d) Inventory, Trade Receivables, Cash, Bank

Q.6 Capital expenditure is:

(a) The extra capital paid in by the proprietor

(b) The cost of running the business on a day-to-day basis

(c) Money spent on buying Non-current assets or adding value to them

(d) Money spent on selling Non-current assets

Q.7 Working capital is:

(a) The Trade Receivables of a business

(b) The balance at bank of a business

(c) The current assets less long-term liabilities of a business

(d) The excess of current assets over current liabilities of a business

Q.8 Which of the following items are shown under the wrong headings:

Assets	**Liabilities**
Cash at bank	Loan from J. Gowon
Fixtures	Machinery
Creditors	Motor Vehicles
Buildings	Inventory of Goods
Trade Receivables	
Capital	

PTT LIMITED

The following are details of the assets, liabilities at 31st December 20X0 and revenue and expenses for the year ended 31st December 20X0 of PTT Limited which commenced business on 1st January 20X0. The figures are presented in the form of a list of balances:-

	RWF
Share Capital	3,500
Non-current Assets	8,800
Inventory	400
Sales	30,000
Trade Receivables	800
Cost of Sales	20,000
Trade Payables	500
Administration Expenses	3,000
Selling and Distribution Expenses	4,000
Loan Capital	3,000

PREPARE:

1. Statement of Comprehensive Income for year ended 31st December, 20X0

2. The Statement of Financial Position as at 31st December, 20X0

EXERCISE 2

Q.1 Which of the following is incorrect?

(a) Assets - Capital = Liabilities

(b) Liabilities + Capital = Assets

(c) Liabilities + Assets = Capital

(d) Assets - Liabilities = Capital

Q.2 Which of the following is incorrect?

	Assets	**Liabilities**	**Capital**
	RWF	RWF	RWF
(a)	7,850	1,250	6,600
(b)	8,200	2,800	5,400
(c)	9,550	1,150	8,200
(d)	6,540	1,120	5,420

Q.3 You are to complete the gaps on the following table?

	Assets	**Liabilities**	**Capital**
	RWF	RWF	RWF
(a)	55,000	16,900	?
(b)	?	17,200	34,400
(c)	36,100	?	28,500
(d)	119,500	15,400	?
(e)	88,000	?	62,000
(f)	?	49,000	110,000

Mr Balewa.: Pro Forma Solution

(a)

Capital

RWF	RWF

Purchases

RWF	RWF

Sales

RWF	RWF

Non-current Asset - Vehicle

	RWF		RWF

Administration Expenses

	RWF		RWF

Bank

	RWF		RWF

Trade Payables

	RWF		RWF

Trade Receivables

	RWF		RWF

(b)

Trial Balance

	Debit	**Credit**
	RWF	RWF
Capital		
Van at Cost		
Trade Receivables		
Trade Payables		
Bank		
Sales		
Purchases		
Administration Expenses		

(c)

Statement of Comprehensive Income for the Year ended 31st December 20X2

	RWF	RWF

Sales		
Purchases		
Less Closing Inventory		
Cost of Goods Sold		
Gross Profit		
Less Expenses		
Administration Expenses		
Net Profit		

(d)

Statement of Financial Position as at 31st December 20X2

	RWF	RWF
Non-current Assets		
Van		
Current Assets		
Inventory		
Trade Receivables		
Bank		
Financed By:		
Capital		
Add: Net Profit		
Current Liabilities		
Trade Payables		

Mr Balewa.: Solution

(a)

Capital

	RWF		RWF
		Bank	5,000

Purchases

	RWF		RWF
Creditors	4,000		

Sales

	RWF		RWF
		Trade Receivables	9,000

Non-current Asset - Vehicle

	RWF		RWF
Bank	2,500		

Administration Expenses

	RWF		RWF
Bank	2,300		

Bank

	RWF		RWF
Capital	5,000	Trade Payables	3,550
Trade Receivables	8,100	Van	2,500
		Administration	2,300
		Balance c/d	4,750
	13,100		13,100

Trade Payables

	RWF		RWF
Bank	3,550	Purchases	4,000
Balance c/d	450		
	4,000		4,000

Trade Receivables

	RWF		RWF
Sales	9,000	Bank	8,100
		Balance c/d	900
	9,000		9,000

(b)

Trial Balance

	Debit	**Credit**
	RWF	RWF
Capital		5,000
Van at Cost	2,500	
Trade Receivables	900	
Trade Payables		450
Bank	4,750	
Sales		9,000
Purchases	4,000	
Administration Expenses	2,300	
	14,450	14,450

(c)

Statement of Comprehensive Income for the Year ended 31st December 20X2

	RWF	RWF
Sales		9,000
Purchases	4,000	
Less Closing Inventory	(500)	

Cost of Goods Sold		3,500
Gross Profit		5,500
Less Expenses		
Administration Expenses		(2,300)
Net Profit		3,200

(d)

Statement of Financial Position as at 31st December 20X2

	RWF	RWF
Non-current Assets		
Van		2,500
Current Assets		
Inventory	500	
Trade Receivables	900	
Bank	4,750	6,150
		8,650
Financed By:		
Capital		5,000
Add: Net Profit		3,200
		8,200
Current Liabilities		
Trade Payables		(450)
		8,650

Mr A. Igwe. : Pro Forma Solution

Trade Receivables

	RWF		RWF
Sales		Bank	
		31 December 20X9	
		Balance c/d	
31 December 20X9			
Balance b/d			

Capital Account

	RWF		RWF
		1 Jan 20X9 Bank	

Delivery Van

	RWF		RWF
1 Jan 20X9 Bank			

Trade Payables

	RWF		RWF
Bank		Purchases	
31 December 20X9			

Balance c/d			
		31 December 20X9 Balance b/d	

Purchases

	RWF		RWF
Suppliers			

Sundry Expenses

	RWF		RWF
Bank			

Drawings

	RWF		RWF
Bank			

Rent

	RWF		RWF
Bank			

(b)

Trial Balance as at December 20X9

	RWF	RWF
Bank		
Trade Receivables		
Capital		
Delivery Van		
Trade Payables		
Drawings		
Sales		
Purchases		
Sundry Expenses		
Rent		
Assistant's Wages		

The trial balance is extracted before final adjustments are made to ensure that the double entry has so far been correctly dealt with. Drawings are amounts taken out of the business by the owner; therefore these are deducted from capital.

(c)

Statement of Comprehensive Income for the Year ended 31st December 20X9

		RWF	RWF
Sales			
Less:	Cost of goods sold		
	Purchases		
	Closing Inventory on 31 December 20X9		
Gross Profit			
Less:	Expenses		
	Sundry		
	Rent		
	Assistant's Wages		
Net Profit			

(d)

Statement of Financial Position as at 31st December 20X9

	RWF	RWF
Non-current Assets		
Delivery Van		
Current Assets		
Inventory		
Trade Receivables		
Cash at Bank		
Financed By:		
Proprietor's interest		
Capital at 1 January		
Profit for year		
Less: Drawings		
Current Liabilities		
Trade Payables		

Mr A. Igwe : Solution

Bank

	RWF		RWF
Capital	4,000	Delivery Van	3,900
Sales – Cash	15,000	Trade Payables	7,200

Trade Receivables	6,500	Sundry Expenses	2,200
		Drawings	2,000
		Rent	1,200
		Assistant's Wages	1,900
		31 December 20X9	
		Balance c/d	7,100
	25,500		25,500
Balance b/d	7,100		

Sales Account

	RWF		RWF
		Cash Sales	15,000
		Trade Receivables	8,000
			23,000

Assistant's Wages

	RWF		RWF
Bank	1,900		

Trade Receivables

	RWF		RWF
Sales	8,000	Bank	6,500
		31 December 20X9	
		Balance c/d	1,500
	8,000		8,000
31 December 20X9			
Balance b/d	1,500		

Capital Account

	RWF		RWF
		1 Jan 20X9 Bank	4,000

Delivery Van

	RWF		RWF
1 Jan 20X9 Bank	3,900		

Trade Payables

	RWF		RWF
Bank	7,200	Purchases	7,800
31 December 20X9			

Balance c/d	600		
	7,800		7,800
		31 December 20X9	
		Balance b/d	600

Purchases

	RWF		RWF
Suppliers	7,800		

Sundry Expenses

	RWF		RWF
Bank	2,200		

Drawings

	RWF		RWF
Bank	2,000		

Rent

	RWF		RWF
Bank	1,200		

(b)

Trial Balance as at December 20X9

	RWF	RWF
Bank	7,100	
Trade Receivables	1,500	
Capital		4,000
Delivery Van	3,900	
Trade Payables		600
Drawings	2,000	
Sales		23,000
Purchases	7,800	
Sundry Expenses	2,200	
Rent	1,200	
Assistant’s Wages	1,900	
	27,600	27,600

The trial balance is extracted before final adjustments are made to ensure that the double entry has so far been correctly dealt with. Drawings are amounts taken out of the business by the owner; therefore these are deducted from the capital.

(c)

Statement of Comprehensive Income for the Year ended 31st December 20X9

		RWF	RWF
Sales			23,300
Less:	Cost of goods sold		
	Purchases	7,800	
	Closing Inventory on 31 December 20X9	850	6,950
			16,050
Gross Profit			
Less:	Expenses		
	Sundry	2,200	
	Rent	1,200	
	Assistant's Wages	1,900	5,300
Net Profit			10,750

(d)

Statement of Financial Position as at 31st December 20X9

	RWF	RWF
Non-current Assets		
Delivery Van		3,900
Current Assets		
Inventory	850	
Trade Receivables	1,500	
Cash at Bank	7,100	9,450
		13,350
Financed By:		
Proprietor's interest		
Capital at 1 January		4,000
Profit for year		10,750
		14,750
Less: Drawings		2,000
Current Liabilities		
Trade Payables		600
		13,350

BSB Ltd: Pro Forma Solution

Statement of Financial Position of BSB Ltd. as at 31st December 20X3

	RWF	RWF
Non-current Assets		
Premises		
Equipment		
Current Assets		
Inventory		
Trade Receivables		
Cash in Hand		
Financed By:		
Capital		

Statement of Comprehensive Income		
Current Liabilities:		
Creditors		
Bank Overdraft		

BSB Ltd: Solution

Statement of Financial Position As at 31st December 20X3

	RWF	RWF
Non-current Assets		
Premises	10,410	
Equipment	5,720	16,130
Current Assets		
Inventory	2,431	
Trade Receivables	2,340	
Cash in Hand	348	5,119
		21,249
Financed By:		
Capital		6,000
Statement of Comprehensive Income		11,292
		17,292
Current Liabilities:		
Creditors	2,678	
Bank Overdraft	1,279	3,957
		21,249

Exercise 1: Solution

1. (d)
2. (b)
3. (a)
4. (b)
5. (a)
6. (c)
7. (d)
8. Assets: Creditors and Capital
   Liabilities: Machinery, motor vehicles and Inventory

PTT LIMITED: Pro Forma Solution

Statement of Comprehensive Income for the year ended 31st December 20X0

	RWF	RWF
Sales		
Less: Cost of Sales		
Gross Profit		
Less: Administration Expenses		

Selling and Distribution Expenses	________	________
Net Profit		========

PTT Limited

Statement of Financial Position as at 31st December 20X0
(Horizontal Layout)

	RWF		RWF
Assets		**Liabilities**	
Non-current Assets		Share Capital	
		Reserves (Profit for Year)	________
		Shareholders Funds	
Current Assets			
Inventory		Non-current Liabilities	
Trade Receivables		Current Liabilities	
	________		________
	========		========

PTT LIMITED

Statement of Financial Position as at 31st December 20X0
(Vertical Layout)

	RWF	RWF
Employment of Capital		
Non-current Assets		
Current Assets		
Inventory		
Trade Receivables	________	________
		========
Capital Employment		
Share Capital		
Reserves (Revenue)		________
Shareholders Funds		
Non-current Liabilities		
Current Liabilities		________
		========

PTT LIMITED: Solution

Statement of Comprehensive Income for the year ended 31st December 20X0

		RWF	RWF
Sales			30,000
Less:	Cost of Sales		20,000
Gross Profit			10,000
Less:	Administration Expenses	(3,000)	
	Selling and Distribution Expenses	(4,000)	(7,000)
Net Profit			3,000

PTT Limited

Statement of Financial Position as at 31st December 20X0

(Horizontal Layout)

	RWF		RWF
Assets		**Liabilities**	
Non-current Assets	8,800	Share Capital	3,500
		Reserves (Profit for Year)	3,000
		Shareholders Funds	6,500
Current Assets			
Inventory	400	Non-current Liabilities	3,000
Trade Receivables	800	Current Liabilities	500
	10,000		10,000

PTT LIMITED

Statement of Financial Position as at 31st December 20X0

(Vertical Layout)

	RWF	RWF
Employment of Capital		8,800
Non-current Assets		
Current Assets		
Inventory	400	
Trade Receivables	800	1,200
		10,000
Capital Employment		
Share Capital		3,500
Reserves (Revenue)		3,000
Shareholders' Funds		6,500
Non-current Liabilities		3,000
Current Liabilities		500
		10,000

Exercise 2: Solution

1. (c)

2. (c)

3.

	RWF
(a)	38,100
(b)	51,600
(c)	7,600
(d)	104,100
(e)	26,00
(f)	159,000

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Study Unit 4

Accruals and Prepayments

Contents

A. **ACCRUALS AND PREPAYMENTS**

The overriding criteria when preparing accounts, is that the Statement of Comprehensive Income must give a true and fair view of the profit or loss earned for the period and that the Statement of Financial Position must give a true and fair view of the position of the entity at a specified date. In order to achieve this true and fair view, a number of concepts were introduced and are followed. These are:

Going Concern	Continuity of the entity in its present form for the foreseeable future - there is no intention to put the company into liquidation or drastically to cut back the scale of operations
Prudence	Cautious presentation of the entity's financial position. Profits are recognised only when realised while losses are provided for as soon as they are foreseen
Accruals	Revenue earned in the period matched with costs incurred in earning it, not as money is received or paid
Consistency	There is similar accounting treatment of like items within each accounting period and from one period to the next
Entity	The accounts recognise the business as a distinct separate entity from its owners
Money Measurement	Accounts only deal with those items to which a monetary value can be attributed
Materiality	If omission, misstatement or non-disclosure affects the view given, item is material and disclosure is required
Substance over Legal Form	Recognises economic substance from legal form e.g. assets acquired on hire purchase
Stable Monetary Unit	The value of the monetary unit used is consistent over time
Accounting Periods	Accounts are prepared for discrete time periods

On examination of the definition of the "Accruals" concept - revenue earned in the period matched with costs incurred in earning it, and not as money is received or paid - the entire concept of accruals and prepayments is born. In other words, the profit as reported for a period will include some invoices/expenses not yet received but the costs of which relate to the period - accrued expenses - while some invoices cover a period of time beyond the time frame of the present accounts – pre-payments or payments in advance.

EXAMPLE 1

ACC LTD commenced business on 1 Jan 20X4. During the first year of trading, the following telephone invoices were received.

TELEPHONE ACCOUNT

DR					**CR**
		RWF			RWF
Feb	Invoice – Jan	600	31 Dec	Statement of Comprehensive Income	
Mar	Invoice – Feb	600			
Apr	Invoice – Mar	600			
May	Invoice – Apr	600			
Jun	Invoice – May	600			
Jul	Invoice – Jun	600			
Aug	Invoice – Jul	600			
Sep	Invoice – Aug	600			
Oct	Invoice – Sep	600			
Nov	Invoice – Oct	600			
Dec	Invoice – Nov	600			

If the account was closed now, the figure transferred to the Statement of Comprehensive Income would be RWF6,600. However, the invoice for December has not been received. In order to give the correct charge for telephone in the period, a journal must be posted:

DR	Telephone	600	
	CR Accruals		600

Now, the telephone account can be closed off and the figure of RWF7,200 transferred to the Statement of Comprehensive Income. The figure of RWF600 will appear in the Statement of Financial Position under current liabilities. In Jan, the accrual of RWF600 is reversed -

DR	Accruals	600	
	CR Telephone		600

On receipt of the invoice in January, the invoice is processed as normal.

TELEPHONE ACCOUNT

DR					**CR**
		RWF			RWF
Feb	Invoice – Jan	600	31 Dec	Statement of Comprehensive Income	7,200
Mar	Invoice – Feb	600			
Apr	Invoice – Mar	600			
May	Invoice – Apr	600			
Jun	Invoice – May	600			
Jul	Invoice – Jun	600			
Aug	Invoice – Jul	600			
Sep	Invoice – Aug	600			
Oct	Invoice – Sep	600			
Nov	Invoice – Oct	600			
Dec	Invoice – Nov	600			
Dec	Accrual – Dec	600			
		7,200			7,200

Jan	Invoice – Dec	600	Jan	Accrual – Dec	600

EXAMPLE 2

ACC LTD paid an insurance bill in January 20X4, for RWF3,000, which covered assets on a temporary basis. During the next six months, a number of other assets were included and on 30th June 20X4, the finance director negotiated the insurance premium for the following 12 months. The premium agreed was RWF7,000 for the year, which was paid immediately.

INSURANCE ACCOUNT

DR					**CR**
		RWF			RWF
Jan	Invoice	3,000	31 Dec	Statement of Comprehensive Income	
June	Invoice	7,000			

If this account is closed now, with the costs transferred to the Statement of Comprehensive Income, the profit or loss would be distorted by RWF3,500. To prevent this, a journal entry is posted:

DR	Prepayments	3,500	
CR	Insurance		3,500

The account can now be closed and the costs of RWF6,500 transferred to the Statement of Comprehensive Income. The figure of RWF3,500 will appear in the Statement of Financial Position under current assets. In January 20X5, the journal is reversed to ensure the cost transferred from 20X4 is correctly accounted for in 2005.

DR	Insurance	3,500	
CR	Prepayments		3,500

INSURANCE ACCOUNT

DR					**CR**
		RWF			RWF
Jan	Invoice	3,000	31 Dec	Statement of Comprehensive Income	6,500
June	Invoice	7,000		Prepayments	3,500
		10,000			10,000
Jan	Prepayment	3,500			

Accruals and Prepayments – Alternative Approach

The alternative approach to accruals and prepayments is to enter these as balancing figures in the respective ledger accounts. These balances are then brought down in the next accounting period.

EXAMPLE 1

TELEPHONE ACCOUNT

DR					**CR**
		RWF			RWF
Feb	Etc… Invoices	6,600	Dec	Statement of Comprehensive Income	7,200
Dec	Balance c/d	600			
		7,200			7,200
			Jan	Balance b/d	600

EXAMPLE 2

INSURANCE ACCOUNT

DR					**CR**
		RWF			RWF
Jan	Invoice/Bank	3,000	Dec	Balance c/d	3,500
June	Invoice/Bank	7,000	Dec	Statement of Comprehensive Income	6,500
		10,000			10,000
Jan	Balance b/d	3,500			

B. QUESTIONS/SOLUTIONS

Questions

1. Mr T. Jalloh.

On 1 January 20X4 the following balances, among others, stood in the books of Mr T. Jalloh.:

(a) Lighting, (Dr) RWF277.

(b) Insurance, (Dr) RWF307.

During the year ended 31 December 20X4 the information related to these two accounts is as follows:

(i) Fire insurance, RWF960, covering the year ended 30 April was paid.

(ii) General insurance, RWF630, covering the year ended 31 August 20X5 was paid.

(iii) An insurance rebate of RWF55 was received on 30 June 20X4.

(iv) Electricity bills of RWF874 were paid.

(v) An electricity bill of RWF83 for December 20X4 was unpaid as on 31 December 20X4.

(vi) Fuel bills of RWF1,260 were paid.

(vii) Stock of oil as on 31 December was RWF92.

2. Mr J. Osie.
Mr J. Osie.'s year ended on 30 June 20X4. Write up the ledger accounts, showing the transfers to the final accounts and the balances carried down to the next year for the following:

(a) Stationery: Paid for the year to 30 June 20X4 RWF855; Stocks of stationery at 30 June 20X3 RWF290; at 30 June 20X4 RWF345.

(b) General expenses: Paid for the year to 30 June 20X4 RWF590; Owing at 30 June 20X3 RWF64; Owing at 30 June 20X4 RWF90.

(c) Rent and Rates (combined account): Paid in the year to 30 June 20X4 RWF3,890; Rent owing at 30 June 20X3 RWF160; Rent paid in advance at 30 June 20X4 RWF250; Rates owing at 30 June 20X3 RWF205; Rates owing 30 June 20X4 RWF360.

(d) Motor Expenses: Paid in the year to 30 June 20X4 RWF4,750; Owing as at 30 June 20X3 RWF180; Owing as at 30 June 20X4 RWF375.

(e) Commission Receivable: Received during the year to 30 June 20X4 RWF850; owing at 30 June 20X3 RWF80; owing as at 30 June 20X4 RWF145.

Solutions

1. Mr T. Jalloh.

LIGHTING & FUEL

		RWF			RWF
Jan 1	Balance b/d	277	Dec 31	Statement of Comprehensive Income	2,402
Dec 31	Bank (Electric)	874	Dec 31	Stock c/d	92
Dec 31	Bank (Fuel)	1,260			
Dec 31	Owing c/d	83			
		2,494			2,494

INSURANCE

		RWF			RWF
Jan 1	Balance b/d	307	Jun 30	Bank	55
Dec 31	Bank (Fire)	960	Dec 31	Statement of Comprehensive Income	1,102

Dec 31	Bank (General)	630	Dec 31	Prepaid c/d*	740
		1,897			1,897

*Prepaid calculated:	Fire 4 months 960 x 4/12	=	320
	General 8 months x 8/12	=	420
			740

2. Mr J. Osie.

(a)

STATIONERY

20X3			**20X4**		
Jul 1	Stock b/f	290	Jun 30	Statement of Comprehensive Income	800
20X4					
Jun 30	Cash & Bank	855	Jun 30	Stock c/d	345
		1,145			1,145

(b)

GENERAL EXPENSES

20X4			**20X3**		
Jun 30	Cash & Bank	590	Jul 1	Owing b/f	64
Jun 30	Owing c/d	90	**20X4**		
			Jun 30	Statement of Comprehensive Income	616
		680			680

(c)

RENT & RATES

20X4			**20X3**		
Jun 30	Cash & Bank	3,890	Jul 1	Owing b/f	
Jun 30	Rates Owing c/d	360		Rent	160
				Rates	205
			20X4		
			Jun 30	Statement of Comprehensive Income	3,635
			Jun 20	Rent prepaid c/d	250
		4,250			4,250

(d)

MOTOR EXPENSES

20X4			**20X3**		
Jun 30	Cash & Bank	4,750	Jul 1	Owing b/f	180
Jun 30	Owing c/d	375	**20X4**		
			Jun 30	Statement of Comprehensive Income	4,945
		5,125			5,125

(e)

COMMISSION RECEIVABLE

20X3			**20X4**		
Jul 1	Owing b/f	80	Jun 30	Cash & Bank	850
20X4			Jun 30	Owing c/d	145
Jun 30	Statement of Comprehensive Income	915			
		995			995

Study Unit 5

Trade Receivables, Bad Debts and Provisions

Contents

A. PROVISIONS

Leading on from accruals and prepayments, in order to insure the accounts give a true and fair view, certain provisions may have to be created. Examples could include:

- Bad debts,
- Provision for bad debts,
- Bad debts recovered and
- Provisions for discounts - both discount allowed and received.

B. TRADE RECEIVABLES, BAD DEBTS RECOVERED AND PROVISION FOR BAD DEBTS

The overriding criterion is the prudence concept - provide for all bad debts. Such bad debts are written off as an expense in the Statement of Comprehensive Income. A provision for bad debts is an estimate of the expense for bad debts. The amount of the initial provision is charged to the Statement of Comprehensive Income. When a provision exists but is subsequently increased, the amount of the increase is a charge in the Statement of Comprehensive Income. When a provision exists and is reduced, the decrease is recorded in Statement of Comprehensive Income as income or as a reduction in the bad debt expense. The Statement of Financial Position must also be adjusted. The value of Trade Receivables should be shown in the Statement of Financial Position after deducting the bad debt provision (in full not just the change in the provision).

BAD DEBTS
When a company sells goods/services, the effect of which is to

DR Trade Receivables

CR Sales

When the cash/cheque has been received, the effect is
DR Bank
CR Trade Receivables

The company who has purchased the goods/services records these transactions as follows:

DR Purchases

CR Trade Payables

When the company makes payment to the creditor

DR Trade Payables

CR Bank

With each sale, there is a risk associated with it - that is the risk that the money may not be received i.e. that the debtor may not pay. From time to time, entities within an industry go bankrupt or are put into liquidation. The result of which is that the payables may get not paid at all or get x Rwandan Francs for every RWF1,000 due. From the suppliers' view, some entries must be posted in the accounts to adjust for this.

EXAMPLE

BAD LTD sold goods on credit for RWF1,000 to DE Ltd. DE Ltd. subsequently went into liquidation and BAD Ltd does not expect to receive any money. Record the transactions in the books of BAD Ltd.

Journal Entries
On selling the goods

		RWF	RWF
DR	Trade Receivables – DE Ltd	1,000	
	CR Sales		1,000

On receipt of notice of Liquidation

		RWF	RWF
DR	Bad Debts A/C	1,000	
	CR Trade Receivables – DE Ltd		1,000

At the end of the period, close the Bad Debts account and transfer the expense to the Statement of Comprehensive Income.

The net effect of this is that the asset is not being recognised and the benefit of the sale is not recognised in the profit and loss for the period.

BAD DEBTS RECOVERED
Where the liquidator states that x Rwandan Francs in the RWF1 will be paid, *prudence* prevails - profits are recognised only when realised while losses are provided for as soon as they are foreseen - and the above journal should still be posted. On receipt of the x Rwandan Francs, the amount can be dealt as a bad debt recovered. The journal entry is:

DR Trade Receivables - with the amount received
CR Bad Debts recovered

DR Bank - with the amount received
CR Trade Receivables

The amount received is posted to the trade receivables individual account twice. Once when notification is received from the liquidator stating the amount and date when it will be paid to acknowledge monies due and on the second time, then the actual amount is received. This is to ensure maximum information in relation to the trade receivables is available on the Trade Receivables' individual account. It also complies with the *prudence* concept.

At the end of the period, the balance on the bad debt recovered is transferred to the Statement of Comprehensive Income as revenue.

DOUBTFUL DEBTS

From time to time, the management of the company will review outstanding Trade Receivables to assess their collectability. Any known bad debts are written off as described above. Management may concede that while all known bad debts are written off, there may be other Trade Receivables who will not pay the full debt. In these instances, a provision for bad debts is created. There are two types of provisions:

(a) Specific provision

(b) General provision

A specific provision is created where individual accounts throughout the Trade Receivables' ledger are identified where invoices are under dispute and either the full amount of the invoice or part of the invoice will remain unpaid. A list of Trade Receivables' names, together with the amount, is compiled and totalled. The total amount is the amount to be provided by way of specific provision.

A general provision is created where no one individual account can be identified where invoices are subject to dispute. The provision is created on a generalisation that x% of Trade Receivable will not pay.

Irrespective of whether the provision is a specific or a general provision, the journal entries are still the same. To create an opening provision, the journal entries are:

DR Statement of Comprehensive Income – Provision for Bad Debts

CR Provision for Bad Debts Account

BAD DEBT PROVISION A/C

DR					**CR**
		RWF			RWF
Yr 1	Balance c/d	7,000	Yr 1	Bad Debts	7,000
		7,000			7,000
			Yr 2	Balance b/d	7,000

The balance in the Bad Debt Provision A/c is shown in the Statement of Financial Position, under Current Assets, deducted from the Trade Receivables figure. The provision has the effect of reducing the asset, while the amount written off to the Statement of Comprehensive Income ensures that the benefit of the sale is not recognised in the Statement of Comprehensive Income for the period. This again agrees with the requirements of the *prudence* concept.

In the second and subsequent years, the closing balance from the previous year becomes the opening balance for the next year. Management must review Trade Receivables' accounts on a yearly basis using the same criteria as described. After the review is carried out and a figure for the final provision for bad debts is agreed, the Provision for Bad Debts Account may comply with one of these three situations:

1. The amount for the provision for this year *agrees exactly* with the provision for last year.
2. The amount for the provision for this year is *higher* than the provision for last year.
3. The amount for the provision for this year is *lower* than the provision for last year.

If the amount for this year's provision for this year agrees exactly with the provision for last year, there is no change in the provision for bad debts account.

BAD DEBT PROVISION A/C

DR			**CR**		
		RWF			RWF
Yr 1	Balance c/d	7,000	Yr 1	Bad Debts	7,000
		7,000			7,000
Yr 2	Balance c/d	7,000	Yr 2	Balance b/d	7,000
		7,000			7,000
			Yr 3	Balance b/d	7,000

Where the amount for the provision for this year is <u>higher</u> than the provision for last year.
Journal entry is:

DR Provision for Bad Debts – Statement of Comprehensive Income

CR Provision for Bad Debts Account

BAD DEBT PROVISION A/C

DR			**CR**		
		RWF			RWF
Yr 1	Balance c/d	7,000	Yr 1	Bad Debts	7,000
		7,000			7,000
			Yr 2	Statement of Comprehensive Income	1,000
Yr 2	Balance c/d	8,000	Yr 2	Balance b/d	7,000
		8,000			8,000
			Yr 3	Balance b/d	8,000

Where the amount for the provision for this year is lower than the provision for last year. The journal entry is:

DR Provision for Bad Debts Account

CR Provision for Bad Debts – Statement of Comprehensive Income

BAD DEBT PROVISION A/C

DR					**CR**
		RWF			RWF
Yr 1	Balance c/d	7,000	Yr 1	Bad Debts	7,000
		7,000			7,000
Yr 2	Statement of Comprehensive Income	1,000			
Yr 2	Balance c/d	6,000	Yr 2	Balance b/d	7,000
		7,000			7,000
			Yr 3	Balance b/d	6,000

The full amount of the bad debt provision is deducted from the trade receivables in the Statement of Financial Position.

Statement of Financial Position Extract:

	RWF
Current Assets	
Trade Receivables	100,000
Less Bad Debt Provision	6,000
	94,000

C. OTHER PROVISIONS

A company' management may provide for other costs and revenues, by way of provisions. The most common are discount allowed and discount received but there may be others. However, the accounting treatment will be similar throughout.

There are two types of discounts - trade discounts and cash discounts. A trade discount is a discount which is given when the sale transaction is being completed between two parties of the same or linked trades. A cash discount is given on settlement of the debt if settlement is within a specified period of time. For example, two people go into a timber merchant's yard. One person works in the trade, the other not. The trade discount would normally be given to the person who works in the trade while the one not working in the trade must pay the full price. Both agree to pay immediately. Both may now get the cash discount. So, in hindsight, the person who works in the industry gets both the trade discount and the cash discount while the person who works outside the trade only gets the cash discount.

Irrespective of whether the discount is a trade discount or a cash discount, a company may give a discount to their trade receivables - discount allowed - or receive a discount from their trade payables - discount received. At period end the management must review both the

Trade Receivables accounts and the Trade Payables accounts to estimate the amount of discounts involved. Once agreed upon, the necessary journal entries must be made.

D. PROVISIONS FOR DISCOUNTS ALLOWED

Where a discount is being established for the first year, the journal entry is:

DR Provision for Discount Allowed – Statement of Comprehensive Income

CR Provision for Discount Allowed Account

PROVISION FOR DISCOUNT ALLOWED A/C

DR					**CR**
		RWF			RWF
Yr 1	Balance c/d	1,000	Yr 1	Discount Allowed	1,000
		1,000			1,000
			Yr 2	Balance b/d	1,000

In the second and subsequent years, the closing balance from the previous year becomes the opening balance for the next year. Management must review Trade Receivables accounts on a yearly basis using the same criteria as described. After the review is carried out and a figure of a final provision for discounts allowed is agreed, the Provision for Discounts Allowed Account may comply with one of these three situations:

1. The amount for the provision for this year *agrees exactly* with the provision for last year.
2. The amount for the provision for this year is *higher* than the provision for last year.
3. The amount for the provision for this year is *lower* than the provision for last year.

The necessary adjustments apply here as with the provision for bad debts.

The full amount of the provision for discount allowed account is deducted from Trade Receivables in the Statement of Financial Position. The provision has the effect of reducing the Trade Receivables shown in the Statement of Financial Position.

The discount allowed provision is usually calculated as a percentage of Trade Receivables after deducting the year end bad debt provision.

Example

The year end Trade Receivables figure for ALL Ltd was RWF20,400. You are supplied with the following information:

(a) A customer has been declared bankrupt owing RWF400. This is to be written off.

(b) It has been decided that a 1% provision for discounts allowed should be made.

(c) The provision for doubtful debts should be 3% of Trade Receivables.

(d) The bad debts provision was RWF360.

Solution

1. Bad Debt Expense ... RWF400
2. Bad Debt Provision (RWF20,400 – 400) x 3% = RWF600.
3. The increase in the bad debt provision is RWF600 – 360 i.e. RWF240.
4. The discount allowed provision is calculated as follows:

   (RWF20,400 – 400 – 600) x 1% ... RWF194.

Statement of Comprehensive Income Entries

	RWF
Bad Debt Expense (W1)	400
Increase in Bad Debt Provision (W3)	240
Increase in Discount Allowed Provision (W4)	194

Statement of Financial Position

	RWF	RWF
Trade Receivables	20,000	
Less: Bad Debt Provision	(600)	
Provision for Discounts Allowed	(194)	
		19,206

E. PROVISIONS FOR DISCOUNTS RECEIVED

Where a discount provision is being set up and received for the first year, the journal entry is:

DR Provision for Discount Received Account

CR Provision for Discount Received – Statement of Comprehensive Income

PROVISION FOR DISCOUNT RECEIVED A/C

DR			CR		
		RWF			RWF
Yr 1	Statement of Comprehensive Income	1,500	Yr 1	Balance c/d	1,500
		1,500			1,500
Yr 2	Balance b/d	1,500			

In the second and subsequent years, the closing balance from the previous year becomes the opening balance for the next year. Management must review Trade Payables accounts on a yearly basis using the same criteria as described. After the review is carried out and a figure of a final provision for discounts received is agreed, the Provision for Discounts Received Account may comply with, again, one of these three situations:

1. The amount for the provision for this year *agrees exactly* with the provision for last year.
2. The amount for the provision for this year is *higher* than the provision for last year.
3. The amount for the provision for this year is *lower* than the provision for last year.

If the amount for this year's provision for this year agrees exactly with the provision for last year, there is no change in the provision for discount received account.

PROVISION FOR DISCOUNT RECEIVED A/C

DR			**CR**		
		RWF			RWF
Yr 1	Income Received	1,500	Yr 1	Balance c/d	1,500
		1,500			1,500
Yr 2	Balance b/d	1,500	Yr 2	Balance c/d	1,500
		1,500			1,500
Yr 3	Balance c/d	1,500			

Where the amount for the provision for this year is higher than the provision for last year. Journal entry is:

DR Provision for Discount Received Account – with the increase

CR Provision for Discount Received – Statement of Comprehensive Income

PROVISION FOR DISCOUNT RECEIVED A/C

DR			**CR**		
		RWF			RWF
Yr 1	Statement of Comprehensive Income	1,500	Yr 1	Balance c/d	1,500
		1,500			1,500
Yr 2	Balance b/d	1,500	Yr 2	Balance c/d	2,000
Yr 2	Statement of Comprehensive Income	500			
		2,000			2,000
Yr 3	Balance c/d	2,000			

Where the amount for the provision for this year is lower than the provision for last year. The journal entry is:

DR Provision for Discount Received Account – Statement of Comprehensive Income

CR Provision for Discount Received Account

PROVISION FOR DISCOUNT RECEIVED A/C

DR			**CR**		
		RWF			RWF
Yr 1	Discount Received	1,500	Yr 1	Balance c/d	1,500
		1,500			1,500
Yr 2	Balance b/d	1,500	Yr 2	Discount Received	500
			Yr 2	Balance c/d	1,000
		1,500			1,500
Yr 3	Balance c/d	1,000			

The provision for discount received account is shown in the Statement of Financial Position, under Current Liabilities, relating to Trade Payables. The provision has the effect of reducing the total liability due to Trade Payables.

Example of an Aged Trade Receivables Listing:

	Total Outstanding	**Dec**	**Nov**	**Oct**	**Over 3 Mths**	**Over 6 Mths**
	RWF	RWF	RWF	RWF	RWF	RWF
P. Red	2,000	1,000	1,000	-	-	-
B. Brown	10,000	10,000	-	-	-	-
G. Green	5,000	1,000	1,500	-	1,500	-
N. Blue	4,000	500	500	1,500	750	750
L. Yellow	1,500	500	-	-	-	1,000
	22,500	13,000	3,000	1,500	2,250	1,750

Management may use an aged Trade Receivables Listing to assess likelihood of the debt not being paid. A higher provision is set against long outstanding sums.

F. QUESTION/SOLUTION

Question

1. Mr N. Keita.

The books of Mr N. Keita. showed a Provision for Bad Debts amounting to RWF1,400 on 1st February 20X4. The total debts, at that date, amounted to RWF36,000 of which it was known that RWF1,000 would not be received. It was decided to make the Provision for Bad Debts to an amount equal to 5% of the Trade Receivables.

You are required to show:

(a) The Provision for Bad Debts Account after implementing the foregoing transactions.

(b) How the Trade Receivables will appear on the Statement of Financial Position.

Solution - Mr N. Keita.

PROVISION FOR BAD DEBTS

DR		**CR**	
	RWF		RWF
Balance c/d (W1)	1,750	1 Feb X4 Balance b/d	1,400
		Statement of Comprehensive Income	350
	1,750		1,750

BAD DEBTS A/C

DR		**CR**	
	RWF		RWF
Trade Receivables	1,000	Statement of Comprehensive Income	1,000

W1 Provision for Bad Debts

Trade Receivables	36,000
Less Bad Debts written off	(1,000)
	35,000
Provision required @ 5%	1,750
Provision at 1st Feb 20X4	(1,400)
Increase required in provision	350

Statement of Comprehensive Income Entries

	RWF
Bad Debt Expense	1,000
Increase in Bad Debt Provision (W1)	350

Statement of Financial Position Extract

	RWF
Trade Receivables	35,000
Less: Provision for Bad Debts 5%	1,750
	33,250

Statement of Comprehensive Income – Take the increase/decrease in provision to Statement of Comprehensive Income and deduct the full amount of the provision from Trade Receivables in Statement of Financial Position.

2. A Business

A Business started trading on 1st January 20X6. During the two years ended at 31st December 20X6 and 20X7 the following debts were written off to bad debts account on the dates stated.

31	August	20X6	MR W Balewa	RWF85
30	September	20X6	MR S Ayim	RWF140
28	February	20X7	MR LJ Fofana	RWF180
31	August	20X7	MR N Muller	RWF60
30	November	20X7	MR A Orji	RWF250

On 31st December 20X6 there had been a total of trade receivables remaining of RWF40,500. It was decided to make a provision for doubtful debts of RWF550.

On 31st December 20X7 there had been a total of trade receivables remaining of RWF47,300. It was decided to make a provision for doubtful debts of RWF600.

You are required to show:

(a) The Bad Debts Account for each of the two years, with the provisions included in this account.

(b) The charges to the Statement of Comprehensive Income for each of the two years.

(c) The relevant extracts from the Statement of Financial Position as at 31st December 20X6 and 31st December 20X7.

Solution – A Business

(a)

BAD DEBTS A/C

		RWF			RWF
20X6			20X6		
Aug 31	MR WBalewa	85	Dec 31	Statement of Comprehensive Income	775
Sep 30	MR SAyim	140			
Dec 31	Provision c/d	550			
		775			775
20X7			20X7		
Feb 28	MR LJ Fofana	180	Jan 1	Provision b/d	550
Aug 31	MR NMuller	60	Dec 31	Statement of Comprehensive	540

				Income	
Nov 30	MR AOrji	250			
Dec 31	Provision c/d	600			
		1,090			1,090

(b)

Statement of Comprehensive Income (Extracts)

		RWF
20X6	Bad Debts	775
20X7	Bad Debts	540

(c)

Statement of Financial Position (Extracts)

20X6	RWF
Trade Receivables	40,500
Less Provision for Bad Debts	(550)
	39,950
20X7	
Trade Receivables	47,300
Less Provision for Bad Debts	(600)
	46,700

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Study Unit 6

Control Accounts

Contents

A. CONTROL ACCOUNTS

The two most common examples of control accounts are the sales ledger control account and purchases ledger control account. These are sometimes known respectively as the trade receivables ledger and the trade payables ledger control accounts.

A control account (or total account) is debited and credited with the total amounts of all transactions which have been debited and credited in detail to individual ledger accounts. For example, a company has 100 credit sales transactions with its Trade Receivables in a particular period, the total of these transactions is debited to the Trade Receivables Control account and each individual transaction is debited to the individual debtor account. The Trade Receivables control in this instance acts as a control on the Sales ledger, since the balance on the Trade Receivables control account at any time should equal the sum of the balances of all individual Trade Receivables' accounts within that ledger, and provides a check on the accuracy of such balance. The Trade Payables Control account and the Purchases Ledger operate in the same way.

The principle on which the control account is based is known, together with information of the additions and deductions entered in the account, the closing balance can be calculated. Applying this to a complete personal ledger the total of opening balance together with the additions and deductions during the period should give the total of closing balances.

Format of Control Accounts
Sometimes considerable confusion arises over which side of the Control Accounts (i.e. Debit or Credit) should the different aspects of the transaction be included. So it is important to emphasise at this point that control accounts are <u>not</u> necessarily a part of the double entry system. They are merely <u>*arithmetical proofs*</u> performing the same function as a trial balance to a particular ledger.

(a) **Memorandum Accounts**
It is usual to find the control accounts in the same form as an account, with the totals of the debit entries in the ledger on the left hand side of the control account, and the totals of the various credit entries in the ledger on the right hand side of the control account. Therefore, the control accounts are treated as an integral part of the double entry system, the balances of the control accounts being taken for the purpose of extracting a trial balance. In this case the personal accounts are being used as memorandum records only, i.e. they do not form part of the double entry system.

(b) **Self-Balancing Ledger**
A self-balancing ledger is one whose balances, when extracted, form a complete trial balance. It is obvious that the Trade Receivables and Trade Payables ledgers will not balance, because the balances they contain will be one sided. Thus the creditor's ledger will comprise all credit balances, the debtors' ledger all debit balances. The ledgers could be made self-balancing by means of a control or total account, which would be an extra account inserted at the back of the ledger to make it self-balancing.

Items are posted to the individual ledger accounts in the usual way, but when the postings are complete, the total is posted to the opposite side of the control account. Therefore, at the end of a period the balances on the control account will be equal and opposite to the sum of balances on the ledger accounts thus proving the ledger and allowing a trial balance to be extracted for each ledger. The principle of check underlying the total account is that "the whole must be equal to the sum of all its parts".

The remainder of this note is based on the assumption that the control accounts form an integral part of the double entry system while the individual balances on personal ledger accounts are being used for memorandum purposes only.

B. THE TRADE RECEIVABLES CONTROL ACCOUNT

This account is debited with the total of Trade Receivables brought forward from the previous period. For the period in question the account is then debited with the total of all the items which have been debited in detail to individual personal accounts in the sales ledger, and credited with the total of all the items which have been credited to such accounts. The balance of the Trade Receivables control account should therefore be equal to the total of all individual balances appearing in the sales ledgers at the end of the period.
It must be remembered that the sales ledger may contain a few accounts showing credit balances, and the balance of the Trade Receivables control account will only represent the differences between the total of the debit balances and the total of the credit balances (if any) in the sales ledger. Therefore, an adjustment should be made to bring down balances on both sides of the Trade Receivables control account.

The following is an illustration showing some of the items which will appear in the Trade Receivables control account:

Trade Receivables Control Account

	RWF		RWF
Opening Balance	i	Opening Credit Balance	i
Sales made during the period	ii	Cash received from Trade Receivables	iv
Dishonoured bills and cheques	iii	Discounted allowed	vii
Cash refunded to Trade Receivables	ix	Returns inwards	viii
Transfers and other items	RWF	Bills receivable	v
Bad Debts Recovered	x	Bad debts written off	vi
Closing Credit Balances	xi	Bad debts recovered	x
		Transfers and other items	RWF
		Closing debit balance	xii
	RWF		RWF

Notes to Illustration

(i) The opening balances will be brought down from the previous period, and will agree with the total of the last list of individual Trade Receivables balances.

(ii) The total amount of credit sales for the period will be obtained from the sales day book, the totals of which should be posted monthly or at other regular intervals to the Trade Receivables control account.

(iii) Dishonoured bills and cheques will be detailed in the bills receivable book, and bank statements respectively.

(iv) The total amount of cash received from Trade Receivables which has been posted to the sales ledgers during the period will be obtained from the sales ledger column in the cash book and posted to the control account at monthly or other regular intervals.

(v) Bills receivable will be total of the bills receivable book.

(vi) Bad debts written off will be obtained from an analysis from the journal.

(vii) Discounts are totals of the discount column of the debit side of the cash book.

(viii) Returns inwards will be obtained from the totals of the returns inwards day book.

(ix) Cash refunded to Trade Receivables will be obtained from the credit side of the cash book.

(x) When a Bad debt is written off the balance on the receivable account is cleared to zero, the accounting entry are:

Dr Bad Debts

Cr Trade Receivables

To record the write off of the Bad debt.

If a trade receivable subsequently repays the bad debt we need to re-instate the debt and then record the subsequent repayment:

Dr Trade Receivable

Cr Bad Debts Recovered

To record amount to be received from debtor previously written of

Then
Dr Bank / Cash
Cr Trade Receivable
To record the receipt of payment.

(xi) Closing credit balance appears on left hand side of ledger account (debit side) and is brought down as an opening credit balance on the right hand side of the account.

(xii) Closing debit balance appears on right hand side of ledger account (credit side) and is brought down as an opening debit balance on the left hand side of the account.

C. THE TRADE PAYABLES CONTROL ACCOUNT

This account operates as a control account of the purchase ledgers and should disclose a balance equal to the total of all the individual balances in the creditor's ledgers.

Trade Payables Ledger Control Account

	RWF		RWF
Opening debit balances	i	Opening Credit Balances	i
Cash paid to Trade Payables	iii	Purchases during the period	ii
Discounts received	iv	Transfers and other items	vii
Bill payable accepted	v	Closing debit balances	xii
Returns Outwards	vi		
Transfers and other items	viii		
Closing credit balances	xii		
	RWF		RWF

Notes to Illustration

(i) The opening balances will be brought down from the previous period, and will agree with the total of the last schedule of individual Trade Payables balances.

(ii) The total amount of goods purchased during the period will be obtained from the payables ledger column in the cash book.

(iii) The total amount of cash paid to Trade Payables during the period will be obtained from the payables ledger column in the cash book.

(iv) Discounts received will be obtained from the totals of the Discount column on the credit side of the cash book, and from the cash discount column (if any) in the bills payable book. If no such column is provided in the bills payable book, and the items have not been passed through the discount column in the cash book, the total will be obtained from analysis of the journal.

(v) Bills payable will be obtainable from the totals of the bills payable book.

(vi) Returns outwards will be obtained from the totals of the purchases returns book.

Advantages of Control Accounts

The advantages of control accounts are as follows:

(a) For management purposes the balances on the control account can always be taken to equal Trade Receivables and Trade Payables without waiting for an extraction of individual balances. Management control is thereby aided, for the speed at which information is obtained is one of the pre-requisites of efficient control.

(b) If kept under the control of a responsible official, and not made accessible to the ledger clerks whose duty it is to post to the Trade Receivables and Trade Payables ledgers, the control accounts operate as a control over those ledgers, and constitute a valuable feature of the system of internal check.

(c) Key control accounts such as Trade Receivables, Trade Payables, bank and stock can be agreed as an intermediate step before the extraction of a trial balance. As a result of this the time spent in agreeing the trial balance itself should be considerably reduced.

D. QUESTIONS/SOLUTIONS

DB Limited

The following information relates to transactions with the Trade Receivables of DB Limited for the year-ended 31st December 20X1.

Customer	**Cash/ Credit**	**Balance at 1st Jan**	**Sales**	**Sales Return**	**Cash Received**	**Discount Allowed**
		RWF	RWF	RWF	RWF	RWF
LK & Co.	Credit	20,000	116,000	8,000	109,000	3,000
Mr. Bekker	Credit	16,000	24,000	2,000	32,000	-
SM Ltd.	Credit	14,000	160,000	-	125,000	1,000
BS Ltd.	Cash		20,000		20,000	
Total		50,000	320,000	10,000	286,000	4,000

The balance on Mr. Bekker account proved irrecoverable during the year and was written off.

You are asked to:

(a) Write up the Trade Receivables ledger as at 31st December 20X1.

(b) Prepare the Trade Receivables control account as at 31st December 20X1.

Solution DB Limited

LK & Co. Trade Receivables Account

		RWF			RWF
1 Jan X1	Balance b/d	20,000	During X1	Sales Returns	8,000
During X1	Sales	116,000	During X1	Cash Received	109,000
			During X1	Discount Allowed	3,000
			31 Dec X1	Balance c/d	16,000
		136,000			136,000
1 Jan X2	Balance b/d	16,000			

Mr. Bekker Trade Receivables Account

		RWF			RWF
1 Jan X1	Balance b/d	16,000	During X1	Sales Returns	2,000
During X1	Sales	24,000	During X1	Cash Received	32,000
			During X1	Bad Debts	6,000
		40,000			40,000

SM Ltd. Trade Receivables

		RWF			RWF
1 Jan X1	Balance b/d	14,000	During X1	Cash Received	125,000
During X1	Sales	160,000	During X1	Discount Allowed	1,000
			31 Dec X1	Balance c/d	48,000
		174,000			174,000
1 Jan X2	Balance b/d	48,000			

Trade Receivables Control Account

	RWF		RWF
Balance b/d	50,000	Sales Returns	10,000
Sales on Credit (Note 1)	300,000	Discount Allowed	4,000
		Bank/Cash	266,000
		Bad Debt	6,000
		Balance c/d	64,000
	350,000		350,000
Balance b/d	64,000		

List of Trade Receivables:

	RWF
LK & Company	6,000
SM Limited	48,000
	64,000

Note 1: ***BS Ltd is a cash customer, therefore no Trade Receivables ledger account opened and not included in the Trade Receivables control.***

CC Limited

The following information relates to transactions with the Trade Payables by CC Limited for the year-ended 31st December 20X1.

Supplier	**Cash/ Credit**	**Balance at 1st Jan**	**Purchases**	**Purchases Return**	**Cash Paid**	**Discount Received**
		RWF	RWF	RWF	RWF	RWF
Mr Marx	Credit	8,000	40,000	2,000	34,000	2,000
CLO Ltd.	Credit	-	20,000	-	12,000	-
NAV Ltd.	Credit	28,000	140,000	4,000	130,000	2,000
JZR Ltd.	Cash		40,000		40,000	
		36,000	240,000	6,000	216,000	4,000

You are asked to:

(a) Write up the Trade Payables ledger as at 31st December 20X1.

(b) Prepare the Trade Payables control account as at 31st December 20X1.

CC Limited

Mr. Marx – Trade Payables Account

		RWF			RWF
During X1	Bank	34,000	1 Jan X1	Balance b/d	8,000
During X1	Discount Received	2,000	During X1	Purchases	40,000
During X1	Purchases Returns	2,000			
31 Dec X1	Balance c/d	10,000			
		48,000			48,000
			1 Jan X2	Balance b/d	10,000

CLO Limited – Trade Payables Account

		RWF			RWF
During X1	Bank	12,000	During X1	Purchases	20,000
During X1	Balance c/d	8,000			
		20,000			20,000
			1 Jan X2	Balance b/d	8,000

NAV Limited – Trade Payables Account

		RWF			RWF
During X1	Bank	130,000	1 Jan X1	Balance b/d	28,000
During X1	Discount Received	2,000	During X1	Purchases	140,000
During X1	Purchases Returns	4,000			
31 Dec X1	Balance c/d	32,000			
		168,000			168,000
			1 Jan X2	Balance b/d	32,000

Trade Payables Control Account

	RWF		RWF
Purchases Returns	6,000	Balance b/d	36,000
Bank/Cash	176,000	Non-cash Purchases	200,000
Discount Received	4,000		
Balance c/d	50,000		
	236,000		236,000
		Balance b/d	50,000

List of Trade Payables:

	RWF
Mr Marx	10,000
CLO Limited	8,000
NAV Limited	32,000
	50,000

Control Accounts
Example 1
From the following details you are required to write up the debtors' (trade receivables) ledger and creditors' (trade payables) ledger control accounts for the month of January.

	RWF
Trade Receivables at January 1	9,753
Trade Payables at January 1	3,456
Credit Sales for month	19,506
Credit Purchases for month	6,912
Returns Outward for month	115
Returns Inward for month	97
Cash Received from Customers	18,912
Customers Cheques Dishonoured	100
Cash Paid to Suppliers	5,814
Discount Allowed	178
Discount Received	117
Interest Charged to Customers on Overdue Accounts	5
Bad Debts Written Off	76
Accounts Settled by "Contra"	345
DR Balances in Trade Payables Ledger at January 31	28
CR Balances in Trade Receivables Ledger at January 31	49

Solution 1

Trade Receivables Control Account

		RWF			RWF
1 Jan	Balance b/d	9,753	1 Jan	Sales Returns	97
	Sales	19,506		Cash	18,912
	Cheques Dishonoured	100		Discount Allowed	178
	Interest Charged	5		Bad Debts	76
	Balance c/d	49		Contra	345
				Balance	9,805
		29,413			29,413
31 Jan	Balance b/d	9,805	31 Jan	Balance b/d	49

Trade Payables Control Account

		RWF			RWF
1 Jan	Returns Outwards	115	1 Jan	Balance b/d	3,456
	Cash	5,814		Purchases	6,912
	Discount Received	117		Balance c/d	28
	Contra	345			
	Balance	4,005			
		10,396			10,396
31 Jan	Balance b/d	28	31 Jan	Balance b/d	4,005

Example 2

You are given the following information extracted from the books of the company.

On 1 July, 2001, trade receivables ledger balances were RWF7,560 debit and RWF32 credit, and the trade payables ledger balances RWF4,250 credit and RWF59 debit.

During the year-ended 30th June, 20X2, sales amounted to RWF52,130; purchases to RWF42,173; discount allowable RWF1,825; discount receivable RWF1,524; returns inwards RWF725; returns outwards RWF520; bad debts written off RWF220; a debit balance RWF25 in Trade Payables ledger was transferred to the Trade Receivables ledger; a contra entry of RWF1,000 was made between the ledgers in respect of T. Webb, who was a debtor of the firm for this amount but who was also a creditor of the firm for a much larger sum, cash received from Trade Receivables RWF48,270; cash paid to Trade Payables RWF40,250.

On 30th June, 20X2, Trade Receivables ledger balances were RWF7,643 debit, RWF nil credit and the Trade Payables ledger balances were RWF3,126 credit, RWF34 debit.

You are required to prepare:

(a) A Trade Payables control account for the year-ended 30th June, 20X2, and

(b) A Trade Receivables control account for the year-ended 30th June, 20X2.

Solution 2
Trade Receivables Control Account 30 June 20X2

	RWF		RWF
Balance b/d	7,560	Balance b/d	32
Sales	52,130	Discount Allowed	1,825
Contra	25	Returns Inwards	725
		Bad Debts	220
		Contra (T Webb)	1,000
		Bank	48,270
		Balance	7,643
	59,715		59,715
Balance b/d	7,643		

Trade Payables Control Account 30 June 20X2

	RWF		RWF
Balance b/d	59	Balance b/d	4,250
Discount	1,524	Purchases	42,170
Returns Outwards	520	Contra	25
Contra (T Webb)	1,000	Balance c/d	34
Bank	40,250		
Balance c/d	3,126		
	46,479		46,479
Balance b/d	34	Balance b/d	3,126

Example 3

TRADE RECEIVABLES CONTROL ACCOUNT

B. Chahine maintains the control account in the nominal ledger in respect of the Trade Receivables ledger. The net total of the balances extracted from the Trade Receivables ledger as on 31 December 20X9 amounted to RWF12,876, which did not agree with the balance on the Trade Receivables ledger control account. On checking the following errors were discovered, after the adjustment of which the books balanced and the corrected net total of the sales ledger balances agreed with the amended balance of the control account:

1. The sales return day book had been overcast by RWF200.
2. A balance owing by A.Debt of RWF478 had been written off as irrecoverable on 31 December 20X9 and debited to bad debts but no entry had been made on the control account.
3. No entries had been made in the control accounts in respect of a transfer of RWF360 standing to the credit of C. Sekibo's account in the Trade Payables ledger to his account in the Trade Receivables ledger.
4. A debit balance of RWF1,470 and credit balances amounting to RWF46 had been omitted from the list of balances.

5. A cheque for RWF254 received from D.I.S. had been dishonoured but the entry recording this fact in the cash book had not been posted to D.I.S. account.

You are required (where applicable):

(a) To amend the list of balances extracted from the personal ledger.

(b) To set out the Trade Receivables ledger control account showing the balance before and after the correction of the errors.

Trade Receivables Control Accounts

(a) **Calculation of Personal Ledger Balance**

	RWF
Original List Total	12,876
Plus debit balances omitted (4)	1,470
	14,346
Less credit balances omitted (4)	46
	14,300
Plus dishonoured cheque not posted (5)	254
Amended Total	14,554

(b)

Trade Receivables Ledger Control Account

		RWF			RWF
31 Dec	Balance (balancing fig)	15,192	31 Dec	Bad debt (D Debt)	478
31 Dec	Sales Returns DB	200	31 Dec	C Sekibo (Contra)	360
				Net Balances c/d (as per (a) calculation)	14,554
		15,392			15,392
1 Jan	Balance b/d	14,554			

E. Accounting for VAT

Scope of VAT

Other than exempt goods and services, Value Added Tax (VAT) is charged on the following:

- every taxable supply in Rwanda; and
- every taxable import of goods or services.

A person is required to register by law if he or she carries on a business in Rwanda whose turnover exceeds or is likely to exceed RWF 20 million (approximately US $34,000) in any relevant year or RWF 5 million (approximately US $8,500) in a calendar quarter.

The tax is paid:

- in the case of taxable supply by the taxable person making the supply
- in the case of imported goods, by the importer
- in the case of imported services, by the receiver of the service.

Goods will be deemed to be supplied outside Rwanda if their supply involves delivery to a place outside Rwanda for the purpose of installation, processing assembly or any other purposes whatsoever.

Services are regarded as supplied in Rwanda if the supplier of the services:

- has a place of business in Rwanda and no place of business elsewhere
- has no place of business in Rwanda or elsewhere but his usual place of residence is in Rwanda
- has places of business in Rwanda and elsewhere but the place of business most directly concerned with the supply of the services in question is the one in Rwanda
- has no place of business in Rwanda, has place of business elsewhere but the recipient of the service uses or obtains the benefit of the services in Rwanda.

Where a taxable supplier does not have a business establishment or a usual place of residence in Rwanda, the Commissioner General may require the taxable supplier to appoint a “tax agent’’ to act on his or her behalf in matters relating to tax.

Where a supplier is deemed to have a place of supply in Rwanda and makes supplies in the course of his business in Rwanda, then he will be liable to register and account for VAT in Rwanda.

VAT rates

Once it is established that a supplier falls within the scope of VAT in Rwanda, it is necessary to determine whether he or she makes taxable or non-taxable (exempt) supplies. Taxable supplies are supplies which are subject to VAT at a rate of 0% (zero-rated) or 18% (standard rated).

The VAT Act specifies those supplies that are classified as exempt or zero- rated supplies. Exempt supplies are not subject to output VAT.

In the case of zero rated supplies, VAT is chargeable but at 0%. Suppliers who provide services or goods which are zero rated are entitled to recover the input VAT they have incurred. This is unlike exempt supplies where input VAT recovery is restricted.

Any supplies which are not specifically included in the exempt and zero rated schedules under the VAT Act will be subject to VAT at the standard rate of 18%.

In addition to charging VAT on the sale and supply of taxable goods and services, VAT is also payable on the importation of goods and services into Rwanda. VAT paid on the importation of goods is treated in the same way as input VAT on local supplies i.e. can be recovered unless restricted as set out above. On the other hand, VAT reverse charge payable on importation of services cannot be automatically reclaimed.

VAT reverse charge

A local recipient of services from a foreign supplier will be required to account for VAT reverse charge at 18% of the value of the services procured. The Act further provides that the recipient may not reclaim the corresponding input VAT unless the services so procured are not available in the local market. This means that the cost of any services procured from outside Rwanda will increase by 18% where the reverse charge VAT is not recoverable. The RRA may deem services to be available in Rwanda even when the actual services procured are of a different specification/quality standard to those available locally.

However, in respect of imported transport services, consumers of such services are allowed a deduction of VAT reverse charge even if the services are available in Rwanda.

Time of supply

VAT on the supply of goods and services must be accounted for by reference to the tax point rules.

The tax point for any supply will be the earliest of:

- date of supply
- date of invoice
- date of payment.

Compliance obligations

When a supplier makes a taxable supply or where he procures services from abroad for the purposes of his business, he must charge VAT (output VAT for supplies or VAT reverse charge for imported services) at the appropriate rate (0% to 18%) and account for it to RRA.

A supplier who is registered for VAT and incurs input VAT on business purchases is entitled (subject to specific statutory exclusions) to reclaim the input VAT by offsetting it against the output VAT liability.

The net liability to VAT, including VAT reverse charge must be accounted for to RRA in the prescribed VAT declaration and relevant supporting schedules. The VAT return together with any payment due has to be filed/ made to the RRA within 15 days following the end of the month for which the VAT is accounted for.

From July 2010, VAT taxpayers with annual turnover of RWF 200 million (US $340,000) or below may elect to make declarations or payments on a quarterly or monthly basis.

Failure to register as a taxable supplier, to submit the VAT return on a timely basis or submission of an incorrect return, or failure to pay VAT due on time will render the taxpayer liable to interest and penalties.

Input tax not deductible (Blocked VAT supplies)

Input tax is not deductible on the following supplies:

Supply	Description
Supply of motor cars	VAT charged on the supply or importation of a motor car unless the supply of the motor car is: • by way of hire or rental • for purposes of resale, by a car dealer, or for use in the course of a car hire or driving instruction business.
Business entertainment	VAT charged on services used or to be used for the purpose of business entertainment of a third party.
Telephone, fuel and power services.	VAT paid on business overheads (e.g. electricity and fuel) whose use cannot be practically separable from private or non-business is restricted to a claim of 40% of the input tax.
Exports and reverse charge	VAT paid on exported goods or services whose proceeds are not repatriated into Rwanda. The VAT on reverse charge applying on imported services is not automatically deductible as input tax unless similar services are not available in Rwanda.

Time limit for claiming input tax

Input tax may not be deducted or credited after a period of three years from the date of the relevant tax invoice.

Tax paid prior to registration

On registration as a taxable supplier, one may claim input tax paid in respect of goods received up to six months prior to the date of registration.

Requirements of a valid tax invoice

All VAT registered suppliers must raise a tax invoice which includes the following:

• the word "tax invoice'' in a prominent place
• the address and VAT registration number of the supplier
• the name, address and VAT registration number of the supplier
• the serial number of the invoice and date of issue
• the quantity or volume of the goods or services supplied
• a description of the goods or services supplied
• the selling price excluding VAT
• the total amount of VAT charged
• the selling price including VAT

Invoices that do not include the last three items may be admissible if they contain:

• the selling price including VAT; and
• a statement that the price includes VAT, with the rate of VAT.

Simplified tax invoice

The law provides for the issue of a simplified tax invoices by a taxable supplier who makes taxable supplies of less than RWF1,000 (US $1.7) per supply.

Exempt supplies

Supplies that are specifically exempt are as listed below:

Item	**Description**
Water supply service	• The main supply of clean water. • Sewerage treatment services to protect the environment for a non-profit motive.
Goods and services for health purposes	• The supply of health and medical services. • Articles designed for a person with disability. • The supply of equipment and drugs to hospitals and health centres. • Supply or importation of drugs and medical equipment made by authorised persons for medical use, to patients and persons with disability.
Education materials and services	• Education services provided to pre-primary, primary and secondary students. • Educational services provided by social organisations to students and other youth, meant for promoting the social intellectual and spiritual development of the members other than for profit. • Education services provided to vocational and other high learning institutions. • Education material supplied directly to learning institutions.
Books, newspapers, journals and other electronic equipment used as educational materials	Certain books and newspapers are exempted from VAT. However commercial services, such as advertisement provided through newspapers and electronic media are not exempted.
Transport services	• Transportation of persons by road in licensed buses and coaches with a seating capacity of 14 persons or more. • Transportation of persons by air. • Transportation of persons by railway. • Transportation of persons or goods by boat. • Transportation of goods by road.
Lending leasing and sale	• The sale or lease of an interest in land. • Sale of a building or part of a building, flat

	or tenement meant for residential purposes. • The renting of, or other grant of the right to use accommodation in a building used predominantly as a place of residence of any person and his family, if the period of accommodation for a continuous term exceeds 90 days.
Financial and insurance services	• The premium charged on the provision of life and medical insurance services. • Fees charged on the operation of current account. • Transfer of shares. • Capital market transactions for listed securities. • Exchange operations carried out by recognised financial institutions. • Interest chargeable on credit and deposits. • Operations of the National Bank of Rwanda. • Fees charged on vouchers and bank instruments.
Precious metals	• The supply of gold bullion to a Bank .The supply must conform to the specification of No 71.08.2000 of the Customs Harmonised Systems Code.
Funeral services	• The supply of any goods or services in the course of a person's burial or cremation.
Energy supplies	• Energy saving lamps. • Solar water-heaters. • Wind energy systems. • Liquefied petroleum gas, cylinders and invertors. • Equipment used in the supply of biogas energy. • Kerosene intended for domestic use premium and gasoil.
Trade union subscriptions	
Leasing of exempt goods	
All unprocessed agricultural and livestock products	
Agricultural inputs and equipment	
Certain goods and services imported by persons with investment certificates	
Equipment for information communication and technology	
Mobile handsets and subscriber identification module (SIM) cards	

Zero rated supplies

Item	**Description**
Exports	• Export of goods from Rwanda by or on behalf of a taxable supplier. • The supply of services, including transport and ancillary services which are directly linked to the export of goods under the point above. • The supply of freight transport services from or to Rwanda, including transhipment and ancillary services that are directly linked to the transit of goods through Rwanda to destinations outside Rwanda. • The supply of goods by a duty free shop. • The supply of goods for use in aircraft stores on flights to destinations outside Rwanda. • The supply of aviation fuel. • The supply of services which are physically rendered outside Rwanda. • The supply, by a tour operator or travel agent, licensed as such, to a tourist of an inclusive tour, subject to such conditions as the Commissioner General may require.
Supplies to Privileged Persons	• Goods imported for the official purposes of a diplomatic mission accredited by the Republic of Rwanda. • Supplies made under special agreements between the Government of Rwanda and donor(s). • Supplies made to a Donor in Rwanda, in the course of implementing donor funded projects. • Supplies or importation made under special technical aid agreements, which are exempted under other laws of the country. Persons entitled to zero rating of goods imported by them or supplies otherwise received by them are required to pay VAT at the time of importation or receiving the supply and then apply for a refund of the VAT paid.

Study Unit 7

Bank Reconciliation Statements

Contents

A. THE CASH BOOK AND BANK RECONCILIATION STATEMENTS

The Cash Book - Introduction
Cash transactions are the simplest and most universal form of business transaction.

For example:

A sells B some goods for RWF150.

From A's point of view, he has gained RWF150 in cash but sold the goods.

This, in book-keeping terms, is the double aspect of every transaction.

A debits "cash a/c" with RWF150 and credits "sales a/c" with RWF150.

From B's point of view, he has decreased cash by RWF150 but has gained the goods.

In book-keeping terms, B debits "purchase account" with RWF150 and credits his "cash account" with RWF150.

To record cash transactions, a cash book is used. By convention receipts (debits) are on the left hand side and payments (credits) are on the right hand side.

Cash may be kept in hand or at the bank. Separate books can be kept, but usually one Cash Book is kept for both cash and bank. It is important to differentiate between cash and bank. Separate columns are used so that the balance of cash in hand and cash at bank can be found as required.

Use of Cash Book

Payments:
Payments by cash are entered in the cash column on the credit side

Payments by cheque are entered in the bank column on the credit side in date and cheque number order.

Receipts:
Receipts are normally all entered in the cash column on the debit side, then when paid into the bank the amount banked is credited to the cash (i.e. a payment out of cash) and debited to bank (i.e. a receipt by bank). The entries are referenced to one another in the folio column with a "C" meaning Contra.

In some cases where bankings are made daily, the receipts can be debited straight into the bank column.

Discount:
When payment is made within a period of credit, a cash discount is sometimes allowed. This means, for example, that a credit of RWF100 may be settled for RWF95 if payment is made within seven days (a 5% cash discount).

The Book-Keeping Entry is:
Enter the amount of the cheque in the bank column (RWF95),the discount in the discount column (RWF5), both on the credit side.

General

Balances
Cash is a material object. It is therefore a debit balance (i.e. one has some of the asset cash) or it is a nil balance (i.e. one has none). The bank is different because one can (with the bank's approval) overdraw an account and thus owe the bank. The bank overdraft is shown as a credit balance (i.e. a liability to the bank).

Autonomous Items
In the bank transactions arise which are at the instigation of persons other than the operator of the account.

(i) Bank Charges and Commission

(ii) Bank Interest

(iii) Standing Orders

(iv) Credit Transfers (Bank Giro)

(v) Returned Cheques

(vi) Direct Debits

Entries of these items must be made when notified by the bank.

Bank Reconciliation Statements – Introduction
The bank statement shows all the transactions of which the bank has knowledge, and should normally show the same entries as the customer's cash book. Therefore, it would be reasonable to assume that the balance shown on the bank statement should be the same as the bank balance in the cash book at any given date. In practice, you will find that they seldom agree.

The main reason (apart from errors) for the difference is that either the bank statement or the cash book is not up to date. The purpose of a bank reconciliation statement is to reconcile differences due to this cause. It can then be seen whether or not there are any errors.

Differences
There are two types of differences:

Items in Cash Book Not on Bank Statement
Items on Bank Statement Not in Cash Book

Items that are in the cash book but have not yet reached the bank's records: These items are either cheques drawn but not yet presented for payment by the payee (un-presented cheques), or cash and cheques paid into the bank but not yet recorded on the bank statement (lodgements not credited). To find these items, all entries in the cash book (bank) are ticked to the items of the bank statement, any entries left in the cash book are either errors or the items mentioned above. Errors in the cash book must first be corrected by entries in the cash book. The un-presented cheques and the lodgements not credited will appear in the reconciliation.

Autonomous Items

These items were mentioned in the cash book note. They will appear on the bank statements, but not all of them will appear in the cash book. After the cash book and statement have been ticked, these items will appear as unchecked on the bank statement. After their authenticity has been checked, they must be put into the cash book by suitable entries.

Examples of these items would be:

(i) Bank Interest
(ii) Bank Charges
(iii) Standing Orders
(iv) Direct debits
(v) Giro Credits

Procedure

Check that all bank statements are there.

On the bank statement, underline the last entry of the date on which the reconciliation is to be made.

Taking the debit side of the cash book, tick all the items to the credit side of the bank statements. By observation of dates and adding items together as necessary, it can be ensured that the items ticked are the same items.

Taking the credit side of the cash book, tick all the items to the debit side of the bank statement. By observation of dates and cheque numbers it is usually possible to ensure that the items ticked are the same items.

Any errors and/or omissions must be written in to the cash book.

The reconciliation can now be written out. It starts with the balance per the bank statement and ends with the balance in the cash book (bank).

Lodgements not credited are added to the balance at bank as if they have been credited by the bank. Conversely, lodgements not credited are deducted from a bank overdraft as, if they had been credited by the bank and as if the bank overdraft had fallen.

Un-presented cheques are deducted from a balance at bank, but added to a bank overdraft.

B. BANK RECONCILIATIONS STATEMENTS QUESTIONS/SOLUTIONS

B Bank

The bank columns in B Bank's cash book for the month of September were as follows:

		RWF			RWF
Sept 1	Balance b/d	420	Sept 5	L Laas	80
Sept 9	G Cawood	50	Sept 10	Wages	130
Sept 15	B Clase	220	Sept 17	G Malan	40
Sept 29	G Grayling	80	Sept 28	G Wilson	120
Sept 30	H Hall	45	Sept 28	A White	80
			Sept 30	Petty Cash	40
			Sept 30	Balance c/d	325
		815			815
Oct 1	Balance b/d	325			

The bank statements showed B Bank's account was as follows:

		Dr	**Cr**	**Balance**
Sept 1				420.00
Sept 8	843	80.00		340.00
Sept 10	SNDS		50.00	390.00
Sept 10	844	130.00		260.00
Sept 17	SNDS		220.00	480.00
Sept 19	845	40.00		440.00
Sept 30	848	40.00		400.00

You are required to prepare a statement reconciling the balance as 30th September.

Bank Reconciliations

B BANK

Bank Reconciliation Statement as at 30th September

			RWF	RWF
Balance per Bank Statement				400
Add:	Lodgements not credited:			
	Sept 29	G Grayling	80	
	Sept 30	H Hall	45	
				125
Less:	Cheques drawn but not presented			
	Sept 28	G Wilson	120	
	Sept 28	A White	80	
				200
Balance per Cash Book at 30th September			RWF325	

C Count

The Bank columns in C Count's cash book for the month of June were as follows:

			RWF				RWF
June	1	Balance b/d	240	June	3	Wages	137
	3	D Brink	320		4	S Nell	62
	5	T Geyer	64		8	W Wiese	55
	7	W Dafel	27		9	B Jacob	325
	11	Z Mann	169		14	Petty Cash	20
	13	S Shaw	82		17	Wages	145
	20	V Jones	79		29	J T Ltd	167
	22	NCA Ltd	300		30	C Cleef	47
	29	S X Ltd	210		30	N Mouy	84
	29	B Buys	450		30	Balance c/d	899
July	1	Balance b/d	899				

The statement received from the bank for the month of June showed the following entries:

		Dr	**Cr**	**Balance**
		RWF	RWF	RWF
June 1	Brought Forward			240.00
June 3	094	137.00		103.00
June 6	SNDS		384.00	487.00
June 10	097	325.00		
June 10	095	62.00		100.00
June 10	SNDS		27.00	127.00
June 11	096	55.00		72.00
June 12	SNDS		169.00	241.00
June 14	098	20.00		221.00
June 15	SNDS		82.00	303.00
June 17	099	145.00		158.00
June 24	SNDS		379.00	537.00
June 28	CHGS	22.00		515.00

STEP 1

C Count
Cash Book

		RWF			RWF
June 30	Balance b/f	899.00	June 28	Charges	22.00
			June 30	Balance c/d	877.00
		899.00			899.00
July 1	Balance b/d	877.00			

Step 2

Bank Reconciliation at 30th June 20X1

			RWF	RWF
Balance per Bank Statement				515
Add:	Lodgements not credited:			
	June 29	S X Ltd	210	
	June 29	B Buys	450	
				660
				1,175
Less:	Cheques drawn but not presented			
	June 29	J T Ltd	167	
	June 30	C Cleef	47	
	June 30	N Mouy	84	
				298
Balance as per Cash Book				877

C. QUESTIONS/SOLUTIONS

Questions

1. A Mostert

You are given the following information extracted from the records of A Mostert.

Cash Book Details: Bank

		Dr			**Cheque No**	**Cr**
		RWF				**RWF**
1 Dec	Total b/f	16,491	1 Dec	Alice	782	857
2 Dec	ABE Ltd	962	6 Dec	David	783	221
2 Dec	BKR Ltd	1,103	14 Dec	Pascal	784	511
10 Dec	CHR Ltd	2,312	17 Dec	Chantal	785	97
14 Dec	Delta & Co	419	24 Dec	Joseph	786	343
21 Dec	EHO Ltd	327	29 Dec	Rent	787	260
23 Dec	Cash Sales to Bank	529	31 Dec	Balance c/d		19,973

30 Dec	George	119		
		22,262		22,262

P B Ltd.
Bank Statement
A Mostert

Detail	**Payments**	**Lodgements**	**Date**	**Balance**
Balance Forward			1 Dec	17,478
836780	426		2 Dec	17,052
Remittance		176	2 Dec	17,228
836782	857		5 Dec	16,371
Charges	47		5 Dec	16,334
836781	737		6 Dec	15,587
Counter Credit		2,065	6 Dec	17,652
Standing Order	137		10 Dec	17,515
836783	212		11 Dec	17,303
Remittance		2,312	13 Dec	19,615
836784	511		17 Dec	19,104
Counter Credit		419	17 Dec	19,523
Remittance		327	23 Dec	19,850
Counter Credit		528	24 Dec	20,378
836786	343		28 Dec	20,035
310923	297		30 Dec	19,738

You are required to:

(a) From the above data, correct the cash book and prepare a bank reconciliation as at 31st December.

(b) List the reasons for preparing such a statement.

(c) Comment briefly upon any aspects of your reconciliation which might require further investigation.

2. Mr Rabe

On 15th May 20X8, Mr Rabe received his monthly bank statement for the month ended 30 April 20X8. The bank Statement contained the following details.

Statement of Account with Money Limited

All values are in thousands

Date	**Particulars**	**Payments** RWF	**Receipts** RWF	**Balance** RWF
1 April	Balance			1,053.29
2 April	236127	210.70		842.59
3 April	Bank Giro Credit		192.35	1,034.94
6 April	236126	15.21		1,019.73
6 April	Charges	12.80		1,006.93
9 April	236129	43.82		963.11
10 April	427519 DD ESB	19.47		943.64
12 April	236128	111.70		831.94
17 April	Standing Order	32.52		799.42
20 April	Sundry Credit		249.50	1,048.92
23 April	236130	77.87		971.05
23 April	236132	59.09		911.96
25 April	Bank Giro Credit		21.47	933.43
27 April	Sundry Credit		304.20	1,237.63
30 April	236133	71.18		1,166.45

For the corresponding period, Mr Rabe's own records contained the following bank account details:

Date	**Detail**	RWF	**Date**	**Detail**	**Cheque No.**	RWF
1 April	Balance	827.38	5 April	Purchases	128	111.70
2 April	Sales	192,35	10 April	Electricity	129	43.82
18	Sales	249.50	16 April	Purchases	130	87.77
April	Sales	304.20	18 April	Rent	131	30.00
24	Sales	192.80	20 April	Purchases	132	59.09
April			25 April	Purchases	133	71.18
30			30 April	Wages	134	52.27
April			30 April	Balance	c/d	1,310.40
		1,766.23				1,766.23

Required:

(a) From the above data correct the cash book and prepare a bank reconciliation statement.

(b) Explain briefly which items in your bank reconciliation statement would require further investigation.

Solutions

1. A Mostert

The opening balance in the bank statement and Cash book records do not agree:

	RWF
Bank Statement	17,478
Cash Book	16,491
Difference	987

In practice you would have in addition to the Bank Statements and the Cash Book records, a copy of the last Bank Reconciliation Statement. How do we explain the above difference?

Looking at the Cash Book Records for the period we can see that the first cheque issued in the period was number 782 but in the Bank Statement there are a number of cheques that were issued before this number (in a previous period):

Cheque Number	**Amount**
836780	426
836781	737
	1,163

This doesn't fully explain the difference but if we look again at the Bank Statement and the Cash Book Records we can see that in the Bank Statement on 2nd December there is a lodgement of RWF176 that does not appear in the cash book records. Given that this lodgement is at the start of the period we can assume that it was part of the difference between the opening balances. (If you look at the other lodgements credited to the Bank over the period you will note that the date on the Bank Statement is generally 2 to 6 days after the date in the cash book records.)

Cheque Number	**Amount**
836780	426
836781	737
	1,163
Lodgement	(176)
	987

None of these items will appear in the reconciliation for the period because they relate to items outstanding at the end of the previous period.

CASH BOOK ACCOUNT

	RWF		RWF
Balance b/d	19,973	Bank Charges	47
Cheque Overstated (No. 783)	9	Standing Order	137
		Payment no in cash book (923)	297
		Error in Lodgement	1
		Balance c/d	19,500
	19,982		19,982

Bank Reconciliation as at 31st December

(a)

	RWF	RWF
Balance as per Bank Statement		19,738
Less: Payments not presented	97	
	260	357
Add: Lodgement not yet on Statement		119
Balance per Cash Book		19,500

(b) A bank reconciliation is prepared:

(i) To provide an independent check on the legitimacy of the entries in the cash book.

(ii) To provide an independent check on the accuracy of cash book entries.

(c) Aspects requiring further investigation are:

(i) Correct amount of payment to David

(ii) Validity of standing order – is it A Mostert?

(iii) Payment of RWF297 – Cheques are not in 'sequence' number.

(iv) The nature of the bank charges – why are there any at all with a current account balance of almost RWF20,000?

2. Mr Rabe

The opening balance in the bank statement and Cash book records do not agree:

		RWF
Bank Statement		1,053.29
Cash Book		827.38
Difference		225.91
Cheque No 236127	210.70	
Cheque No 236126	15.21	225.91

These cheques will not form part of the reconciliation.

CASH BOOK ACCOUNT

	RWF		RWF
Balance b/d	1,310.40	Bank Charges	12.80
Bank Giro Credit	21.47	Cheque (No 519)	19.47
Cheque (No 130) Overstated	9.90	Standing Order	32.52
		Balance c/d	1,276.98
	1,341.77		1,341.77

(a)

	RWF	RWF
Balance as per Bank Statement		1,166.45
Add: Outstanding Lodgements		192.80
Less: Outstanding Cheques		
236131 Rent	30.00	
236134 Wages	52.27	82.27
Balance per Bank Account		1,276.98

(b) Items which require further investigation are:

(i) Authority for and nature of standing order for RWF32.52.

(ii) Authenticity of the cheque for RWF19.47 – the cheque number would indicate that it may have been wrongly charged by the bank.

(iii) Correct amount for cheque 236130 – is it RWF87.77 or RWF77.87?

(iv) Authenticity and nature of the bank giro credit for RWF21.47.

Study Unit 8

Suspense Account and Journal Entries

Contents

A. SUSPENSE ACCOUNTS

A suspense account is a nominal ledger account which is created in two main situations:

(a) If the trial balance does not balance the difference is placed in a suspense account; and

(b) If the bookkeeper is unsure of the posting of one side of the double entry he may post the debit/credit to the suspense account.

The suspense account is a **temporary account**. Once errors are located or the correct double entry has been ascertained the suspense account is cleared out.

B. EXAMPLE

After the preparation of a trial balance, an unexplained difference of DR RWF406 remains; a Suspense Account is opened for that amount. Subsequent investigations reveal:

(i) RWF35 received from A. Jalloh and credited to his account has not been entered in the bank account.

(ii) A payment of RWF47 to M. Strauss has been credited to that account.

(iii) Discounts allowed (RWF198) and discounts received (RWF213) have been posted to the discount accounts as credits and debits respectively.

(iv) Bank interest received of RWF111 has not been entered in the bank account.

(v) The carriage outwards (RWF98) has been treated as a revenue item.

Required:
Prepare the Suspense Account making the entries necessary to eliminate the debit balance there is.

SUSPENSE ACCOUNT

		RWF			RWF
Balance per Trial Balance		406	(i)	Bank Account	35
(iii)	Discounts received	426	(ii)	M Strauss	94
			(iv)	Discount Allowed	396
			(v)	Bank Account	111
			(vi)	Carriage Outward	196
		832			832

(i) The double entry is not complete. It is necessary to debit bank and credit suspense account.

(ii) A payment to a supplier should be debited to that account but in this instance it has been credited, it is necessary to debit the account twice or with double the amount and credit suspense account to correct the error.

(iii) Discount allowed should be debited to the discounts account; discount received should be credited to that account.

To correct the error it is necessary to debit the discount account with double the amount of the discount allowed and double the amount of the discount received, the corresponding entries will be in the suspense account.

(iv) The double entry is not complete it is necessary to debit the bank account and credit the suspense account.

(v) Carriage outwards is an expense and therefore should be debited to the carriage outwards account, to correct the error it is necessary to debit the carriage outwards account with double the amount and credit the suspense account.

C. ERRORS NOT AFFECTING THE TRIAL BALANCE

There are **six types** of errors which will not affect the trial balance. These are as follows:

1. The complete omission of a transaction.
2. Posting to the correct side of the ledger but to the wrong account.
3. Compensating errors e.g. if the sales account was added up to by RWF20 too much and the purchases account was also added up to by RWF20 too much, then these two errors would cancel out in the trial balance.
4. Error of principle – where an item is entered in the wrong class of account e.g. if a fixed asset such as a motor van is debited to an expenses account such as the motor expenses account.
5. Errors of original entry – where the original figure is incorrect yet double entry is observed using this incorrect figure.
6. Complete reversal of entries – where the correct accounts are used but each item is shown on the wrong side of the account. Suppose we received a cheque of RWF200 from D. Mare the double entry would be debit bank and credit D.Mare. In error it is entered as debit D. Mare and credit bank.

D. QUESTION/SOLUTION

Question - Sam Horak

You act as accountant to Sam Horak. Mr Horak has requested you draw up the Statement of Comprehensive Income for previous year's trading together with Statement of Financial Position. To this end he supplied you with a trial balance as at 31st December 20X3. He pointed out, however, that the debit side of said trial balance exceeded the credit side by RWF3,769.48. To balance the Trial Balance he opened a suspense account on the credit side.

His bookkeeper further investigated and discovered the following discrepancies:

(i) Sale of goods to J G Ltd. was posted to sales a/c as RWF990 and not RWF99 as originally recorded in sales day book.

(ii) A machine was sold on 28th October to Michael Quint. The proceeds were RWF3,700. The book value of the machine at 28th October was RWF3,970. Unfortunately when posting the entry to machinery account the proceeds were entered as RWF4,470 and the profit/loss computed accordingly.

(iii) Purchase of motor vehicle costing RWF3,750 was posted to purchases account.

(iv) Purchases returns in the sum of RWF350 were posted to the debit side of purchases returns account.

(v) RWF760 discounts allowed posted to the credit side of the discounts received account.

(vi) Bank overdraft in the sum of RWF3,000 was entered on the incorrect side of the trial balance.

(vii) A trade payable account in the sum of RWF1,765 entered in the incorrect side of the trial balance.

(viii) Sale of goods in the sum of RWF78,52 was posted in error to the account of John Hugo instead of Ernest Hugo.

(ix) Goods taken from stock in the sum of RWF1,900 were credited to the sales account only.

(x) Purchase of wrapping paper in the sum of RWF210.10 was included in the purchases day book but was not posted to the relevant account in the nominal ledger.

(xi) Carriage inwards in the sum of RWF584.71 was entered on the incorrect side of the trial balance.

You are required to draw up the suspense ledger account incorporating the relevant adjustments.

Solution - Sam Horak

SUSPENSE ACCOUNT

	RWF		RWF
Machinery Sales	3,700.00	Balance	3,769.48
Purchase Returns	700.00	Sales Account	891.00
Bank Account	6,000.00	Sale of Machinery	4,470.00
Trade Creditors	3,530.00	Discounts Received	1,520.00
		Drawings	1,900.00
		Carriage Inwards	1,169.42
		Wrapping Paper	210.10
	13,930.00		13,930.00

Notes

1. **The posting of the motor vehicle to the purchases account is an error of principle, if it does not affect the trial balance.**
2. **The posting of the sale of goods to John Hugo's account instead of Ernest Hugo's account will not affect the trial balance.**

E. THE JOURNAL

Introduction

A Journal, like other books of prime entry, is used to record a transaction prior to its entry in the ledger. Since the vast majority of transactions are capable of being assigned to one or the other of the day books, the use of the Journal is confined to items such as:

(a) Opening and closing entries of the business.

(b) Correcting and adjusting entries.

(c) The purchase and sale of non-current assets.

(d) Transfers from one account to another.

Method of Writing up the Journal

In the Journal, a memorandum is made, in the simplest possible terms, of entries to be made in the ledger. The essential information consists of:

(a) The date

(b) The name of the account to be debited.

(c) The name of the account to be credited.

(d) The amount of money.

(e) A brief description of the transaction.

(f) The ruling of the Journal and the method of entry are as follows:

Journal

Date		Folio	DR	CR
			RWF	RWF
(Date)	(A/C to be debited) Dr	Fol	Amount	
	(A/c to be credited) Cr	Fol		Amount
	Brief description of transactions			

Notes

(a) The amount to be debited appears first in the Journal by convention. Note the use of the word "Dr".

(b) Each entry must be accompanied by an explanation called the "narrative". The narrative should contain full information as to the nature of the transaction and the dates of contracts, minutes, resolutions, etc. giving rise to it, so that the authority for the transaction as well as the origin of the entry will be shown.

(c) The folio column should be entered when the transaction is posted to the ledger.

(d) Always total up the debit and credit columns, making sure they balance.

Advantages of a Journal

The main advantages to be gained from the use of journals are:

- The risk of omission of one or both of the entries required for each transaction is reduced. This is particularly important where more than one ledger is kept.

- More information on the nature of the transaction can be recorded than is possible in the ledger.
- The journal affords a permanent record of the nature of important transactions which can be referred to in future.

Important
Remember to journalise all important and unusual items. It is essential that journal entries be written neatly and completely.

Use of Journals
Opening Entries:
When either a new set of books is opened or a new business is started, the opening entries in the books are frequently journalised.

Example
A. Limited commenced trading on 1st April 20X4, with capital introduced of RWF5,000. He acquired the following:

	RWF
Lease of a Shop	1,000
Motor Car	500
Inventory	2,000
Furniture and Fixtures	200

Write up the opening journal entry.

Solution
JOURNAL

Date		Folio	Dr	Cr
20X4				
April 1	Leasehold	L1	1,000	
	Motor Vehicles	M1	500	
	Furniture & Fixtures	F1	200	
	Inventory	S1	2,000	
	Cash	CB	1,300	
	Capital			5,000
			RWF5,000	RWF5,000
	Being capital introduced and assets acquired on commencement of trading.			

Note
The balancing figure of RWF1,300 represents the cash remaining in the business.

Correction of Errors
If an error is made in the books, it is important to remember that the wrong entries should not be deleted from the books, but instead new entries, correcting or cancelling the old, are made.

A journal is usefully employed to achieve this end.

Example

On 10th March 20X4, it was discovered that a cheque for RWF30, paid to M. Jalloh on 1st March, was posted in error to the account of T. Everts.

This cheque would have been wrongly debited in T. Everts' account. To correct this, a credit entry in his account is required, and a debit entry is required to the account of M. Jalloh, thus:

JOURNAL

Date		**Folio**	**Dr.**	**Cr.**
20X4			RWF	RWF
March 10	M. Jalloh Dr.	J5	30	
	T. Everts	E3		30
	Cheque No. ... paid to M. Jalloh on March 1st posted in error to T. Everts, C.B. Folio ...			

Purchase/Sale of Property, Plant and Equipment

A journal is commonly used to enter the purchases of capital items so that a permanent record of important purchases can be maintained. This record comes in useful when calculating depreciation and computing tax.

The most common entries are:

(i) Purchase of property, plant and equipment on credit/cash.

(ii) Disposal of property, plant and equipment.

(iii) Scrapping of property, plant and equipment.

Transferring Items Incorrectly Posted.

The principle here is similar to the correction of errors.

F. QUESTIONS/SOLUTIONS

Question - E. Truter

Record the following transactions as journal entries.

(a) Sale of a machine used by the business for RWF5,000 cash, this being the book value.

(b) Purchase of RWF10,000 of goods on credit.

(c) Withdrawal of RWF1,000 cash by the proprietor for his personal use.

(d) Collection of RWF1,000 from E. Jalloh who has an account receivable with the firm.

(e) Return of RWF2,000 of goods to a supplier because it is faulty. The supplier has granted the firm credit for the original goods.

(f) Payment of RWF15,000 by the business to a supplier on account of an account payable.

(g) Purchase for machinery for RWF3,000 on credit.

(h) Additional cash of RWF10,000 invested in the business by the proprietor.

(i) Sale of machine for RWF2,000 on credit (at book value).

Solution - E. Truter

Journal Entries

(a)	Dr	Cash	RWF5,000	
	Cr	Non Current Assets		RWF5,000
	To record the sale of a printing machine at book value			
(b)	Dr	Purchases	RWF10,000	
	Cr	Trade Payables		RWF10,000
	To record the purchase of goods on credit			
(c)	Dr	Drawings	RWF1,000	
	Cr	Cash		RWF1,000
	To record the withdrawal of cash by the proprietor			
(d)	Dr	Cash	RWF1,000	
	Cr	Trade Receivables (E Jones)		RWF1,000
	To record the collection of cash from E Jones			
(e)	Dr	Trade Payables	RWF2,000	
	Cr	Purchase Returns		RWF2,000
	To record the return of goods			
(f)	Dr	Trade Payables	RWF15,000	
	Cr	Cash		RWF15,000
	To record a payment made to a supplier			
(g)	Dr	Non-Current Assets	RWF3,000	
	Cr	Trade Payables		RWF3,000
	To record the purchase of machinery on credit			
(h)	Dr	Cash	RWF10,000	
	Cr	Capital		RWF10,000
	To record additional cash invested in the business by the proprietor			
(j)	Dr	Trade Receivables	RWF2,000	
	Cr	Non-Current Assets – Net Book Value		RWF2,000
	To record the sale of a machine at book value on credit			

Question - Jean Claude

Jean Claude's trial balance failed to agree on 31/12/20X4 and he entered the difference in a suspense account. On examination of the books the following errors were revealed.

(i) Interest paid by Jean Claude RWF100 had been entered on the incorrect side of the interest account.

(ii) Bank charges RWF15 entered correctly in the cash book had not been posted to the ledger.

(iii) A payment of RWF140 for repairs to motor vehicles had been debited to the motor vehicles account.

(iv) A cheque for RWF96 received from a debtor M. Otto, had been entered correctly in the cash book but credited to the trade receivables account as RWF69.

(v) Goods sold on credit for RWF180 had not been entered in the books.

(vi) The purchases day book had been over-cast by RWF25.

You are required to:

(a) Journalise the necessary corrections.

(b) Show the Suspense Account.

(c) Calculate the correct net profit if the original figure was RWF9,800.

Solution - Jean Claude

Journal

			DR	CR
(a)	(i)	Interest Account	200	
		Suspense Account		200
		To reverse posting to incorrect side of interest account		
	(ii)	Bank Charges Account	15	
		Suspense Account		15
		To post amount omitted		
	(iii)	Motor Repairs Account	140	
		Motor Vehicles Account		140
		To correct error of posting to incorrect Account		
	(iv)	Suspense Account	27	
		M Otto (debtor)		27
		To correct error of crediting trade payables with RWF69 instead of RWF96		
	(v)	Trade Receivable Account	180	
		Sales Account		180
		Correction of omission of sale		

(vi)	Suspense Account	25	
	Purchases Account		25
	Correction of error whereby purchases were overstated		

(b)

JEAN CLAUDE – SUSPENSE ACCOUNT

		RWF			RWF
Difference in Trial Balance		163	Interest	(i)	200
M Otto (debtor)	(iv)	27	Bank Charges	(ii)	15
Purchases	(iv)	25			
		215			215

(c)

Statement of Corrected Net Profit

				RWF
Net Profit as originally calculated				9,800
Add:	Sales understated	(v)	180	
	Purchases overstated	(vi)	25	205
				10,005
Less:	Interest understated	(i)	200	
	Bank charges understated	(ii)	15	
	Motor repairs understated	(iii)	140	(355)
Corrected Net Profit for Year				9,650

Question - J. Kemp

Having prepared the Trial Balance of J. Kemp for year-ended 31st January 20X4 you discover that it does not balance and, pending later investigation, you place the difference in a suspense account. You prepare Final Accounts, which show a net profit of RWF8,735. Your investigations reveal the following:

(i) A refund of rates RWF150 had been debited to the rates account.

(ii) A payment of RWF750 for motor expenses had been debited to motor vehicles account.

(iii) A payment of RWF538 for cash purchases had been credited to the purchase account as RWF358.

(iv) The sales book had been under-cast by RWF1,000.

(v) Discounts received RWF750 had been debited to discounts allowed account.

(vi) A payment to trade payable P. Henning of RWF690 had been debited to the purchases account.

(vii) An invoice for stationery RWF365 had been debited to purchases account.

Required:

(a) The journal entries for the above.

(b) Show entries in the suspense account.

(c) Show your calculation of the corrected net profit.

Solution - J. Kemp

Journal Entries

			DR	CR
(a)	(i)	Suspense	300	
		Rates 2 x 150		300
		Being correction of error; rates refund debited to rates account		
	(ii)	Motor Expenses	750	
		Motor Vehicles		750
		Being correction of error; payment for motor expenses posted to motor vehicles		
	(iii)	Purchases	896	
		Suspense		896
		Being correction of error; payment of RWF538 for purchases posted to credit side as RWF358		
	(iv)	Suspense	1,000	
		Sales		1,000
		Being correction of error; the sales book had been under cast by RWF1,000		

		DR	CR
(v)	Suspense	1,500	
	Discounts Allowed		750
	Discounts Received		750
	Being correction of error; discounts received RWF750 debited to discounts allowed		
(vi)	Trade Payables (P Henning)	690	
	Purchases		690
	Being correction of error; a payment to a creditor debited to purchases		
(vii)	Stationery	365	
	Purchases		365
	Being correction of error; an invoice for stationery posted to purchases		

(b)

SUSPENSE ACCOUNT

		RWF			RWF
20X4 Jan 31			20X4 Jan 31		
Rates	(i)	300	Trial Balance difference		1,904
Sales	(iv)	1,000	Purchases	(iii)	896
Discounts Received	(v)	750			
Discounts Allowed	(v)	750			
		2,800			2,800

(c)

Calculation of Corrected Net Profit Year-ended 31/1/20X4

			RWF
Original Net Profit			8,735
Add Back			
	(i)	Rates	300
	(iv)	Sales	1,000
	(v)	Discounts	1,500
	(vi)	Purchases	690
			12,225
Less:			
	(ii)	Motor Expenses	(750)
	(iii)	Purchases	(896)
Current Net Profit			10,579

Note: **Item vii does not alter the profit.**

Study Unit 9

IAS 1 – Presentation of Financial Statements

Contents

Contents (continued)		**Continued Page**

A. OBJECTIVE

The objectives of IAS 1 are to:

1. Provide the formats for the presentation of Financial Statements, such as Statement of Comprehensive Income and Statement of Financial Position.
2. Ensure that the Financial Statements are comparable year on year for the entity and comparable to competitors.
3. Set out the disclosure required by management relating to the judgements they have made in selecting the entity's accounting policies.
4. Set out the disclosure to be made in relation to estimating uncertainty at the Statement of Financial Position date, in particular where there is a significant risk of causing a material adjustment to the carrying amounts at which assets and liabilities will be presented in the next financial year.

B. PURPOSE OF FINANCIAL STATEMENTS

The objective of general purpose financial statements is to provide information about the financial position of an entity. Financial statements also show the results of management's stewardship of the entity's resources.

C. COMPONENTS OF FINANCIAL STATEMENTS

A complete set of financial statements comprises a:

(a) Statement of Financial Position

(b) Statement of Comprehensive Income

(c) A statement showing either:

  (i) All changes in equity or

  (ii) Changes in equity other than capital transactions/distributions to owners

(d) Cash (or Funds) Flow Statement

(e) Notes to the accounts comprising a summary of significant accounting policies and explanatory notes.

D. FINANCIAL REVIEW BY MANAGEMENT

In addition to the Financial Statements identified in Section C above, management may present a Financial Review outside the Financial Statements. The Financial Review explains the main features of the entities financial performance and financial position as well as the main areas of uncertainty. This Financial Review typically includes:

(a) An outline of the main factors affecting performance including changes in the business environment in which the entity operates. How the entity has reacted to those changes and the effect.

(b) Entity's policy for investment and its dividend policy.

(c) How the entity is financed.

(d) Any resources that the entity uses that are not disclosed on the Statement of Financial Position in accordance with IFRSs.

Other reports which may be included are:

(a) Environmental Reports – Particularly in industries where environmental issues are of significance.

(b) Value Added Statements.

Any reports provided in addition to the Financial Statements are **<u>outside</u>** the scope of the IASs.

E. STRUCTURE, CONTENT AND REPORTING

- The financial statements shall be identified clearly and distinguished from other information.
- The financial statements should show:
  - The name of the reporting entity
  - The Statement of Financial Position date or the period covered by the Statement of Comprehensive Income
- The currency in which the financial statements are presented
- The level of rounding used in presenting amounts e.g. RWF'000, RWFm or the like.
- The financial statements shall be presented at least annually.

F. DEFINITIONS

Material **–** "Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the Financial Statements. Materiality depends in the size and nature of the omission or misstatement judged in the circumstances. The size or nature of the item, or a combination of both, could be the determining factor."

G. STATEMENT OF FINANCIAL POSITION FORMAT

It is important before attempting a Statement of Financial Position clearly to understand the split between current and non-current assets and liabilities

Current Assets
An asset shall be classified as current when it satisfies <u>any</u> of the following criteria:

(a) It is expected to be realised or is intended for sale or use in the entity's normal operating cycle;

(b) It is held primarily for the purpose of being traded;

(c) It is expected to be realised within 12 months after the Statement of Financial Position date, or

(d) It is cash or a cash equivalent (as defined by IAS 7 Cash Flow Statements)

All other assets shall be classified as non-current.

Current Liabilities

A liability shall be classified as current when it satisfies any of the following criteria:

(a) It is expected to be settled in the entity's normal operating cycle;

(b) It is held primarily for the purpose of being traded;

(c) It is due to be settled within 12 months after the Statement of Financial Position date.

All other liabilities shall be classified as non-current liabilities.

ABC LTD
STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 20X4

	RWFm	RWFm
Assets		
Non-Current Assets		
Property	150	
Plant and Equipment	78	
Intangible Assets	22	
Investments	30	
		280
Current Assets		
Inventories (raw materials, work in progress, finished goods etc.)	81	
Trade Receivables	76	
Prepayments	4	
Cash and Cash Equivalents	22	
		183
Total Assets		463
Equity and Liabilities		
Shareholders' Equity		
Share Capital	100	
Share Premium	20	
Revaluation Reserve	35	
Retained Earnings	97	
Total Equity		252
Non-Current Liabilities		
Long-Term Borrowings	150	
Long-Term Provisions	10	
Total Non-Current Liabilities		160
Current Liabilities		
Trade Payables	35	
Accruals	4	
Income Tax Payable	12	
Total Current Liabilities		51

Total Equity and Liabilities	463

H. EXAMPLE 1 – STATEMENT OF FINANCIAL POSITION

The following information is available about the balances of ALP, a limited liability company.

Balances at 31st May 20X4		RWF
Non-Current Assets	- Cost	500,000
	- Accumulated Depreciation	100,000
Cash at Bank		95,000
Issued Share Capital – Ordinary Shares of RWF1 each		200,000
Inventory (raw mats., wip, finished goods)		125,000
Trade Payables		82,000
Retained Earnings		292,500
10% Loan Notes		150,000
Trade Receivables		112,000
Loan Note Interest Owing		7,500

REQUIREMENT:
Prepare the Statement of Financial Position of ALP as at 31st May 20X4 using the format IAS 1 – Presentation of Financial Statements.

ALP Limited
Statement of Financial Position as at 31st May 20X4

Assets	RWF		RWF
Non-Current Assets:			
Cost	500,000		
Less Accumulated Depreciation	(100,000)		
			400,000
Current Assets			
Inventory	125,000		
Trade Receivables	112,000		
Cash at Bank	95,000		
			332,000
Total Assets			732,000
Equity and Liabilities			
Shareholders' Equity			
Share Capital	200,000		
Retained Earnings	292,500		
			492,500
Non-Current Liabilities			
10% Loan Notes		150,000	
Current Liabilities			
Trade Payables	82,000		
Accruals	7,500	89,500	
Total Current Liabilities			239,500
Total Liabilities			
Total Equity and Liabilities			732,000

I. THE STATEMENT OF COMPREHENSIVE INCOME

There are two different layouts for the Statement of Comprehensive Income. One format presents an analysis of expenses based on their function within the entity, the other format uses a classification based on the nature of expenses.

J. FUNCTION OF EXPENDITURE METHOD

This form of analysis classifies expenses according to their function as part of cost of sales or for example the costs of distribution or administrative activities. This method can provide more relevant information to users than the classification of expenses by nature but the allocation of costs to functions may require arbitrary allocations and involve considerable judgement.

Example

	RWF
Sales Revenue	10,500
Cost of Sales	(4,100)
Gross Profit	6,400
Other Operating Income	300
Distribution Costs	(2,200)
Administrative Expenses	(1,800)
Profit from Operations	2,700
Finance Cost (Interest)	(300)
Profit Before Tax	2,400
Income Tax Expense	(380)
Net Profit for the Period	2,020

K. NATURE OF EXPENDITURE METHOD

Expenses are combined in the Statement of Comprehensive Income according to their nature, for example depreciation, purchase of materials, employee benefits and advertising costs. The method is simple to apply because no allocations of expenses to functions are required.

Example

		RWF
Sales Revenue		10,500
Other Income		300
Changes in Inventories of Finished Goods and Work-In-Progress	200	
Raw Materials and Consumables Used	3,900	
Employee Benefits Cost	2,500	
Depreciation Expense	600	
Other Expenses	900	
Total Expenses		(8,100)
Profit from Operations		2,700
Finance Cost (Interest)		(300)
Profit Before Tax		2,400
Income Tax Expense		380
Net Profit for the Period		2,020

The choice between the two methods depends on historical and industry factors and the nature of the entity. Management is required to select the most relevant and reliable presentation.

However, because information on the nature of expenses is useful in predicting future cash flows additional disclosure is required when the function of expense classification is used.

L. CHANGES IN INVENTORIES OF FINISHED GOODS AND WORK-IN-PROGRESS

This represents the difference between the opening and closing inventories of finished goods and work-in-progress. If Closing Stock (in total for both Finished Goods and Work in Progress) is lower in value than opening stock then you add this figure to the other expenses being deducted from Sales Revenue to give you Profit from operations. If Closing Stock (in total for both Finished Goods and Work in Progress) is higher in value than opening stock then you deduct this figure from the total expenses being deducted from Sales Revenue to give you Profit from operations.

M. RAW MATERIALS AND CONSUMABLES USED

This represents opening inventories of raw materials and consumables plus purchases of these minus closing inventories of raw materials and consumables.

Example
PLO Limited's directors have supplied you with the following information in respect of their Statement of Comprehensive Income.

Opening Inventories:	RWFm
Raw Materials	120
Work-In-Progress	300
Finished Goods	180
Purchases of Raw Materials	500
Closing Inventories:	
Raw Materials	160
Work-In-Progress	280
Finished Goods	170

REQUIREMENT:
Calculate the required amounts for the headings:

(a) "Changes in inventories of finished goods and work-in-progress" ,

(b) "Raw materials and consumables used" and

(c) Cost of Sales

SOLUTION:

(a)	Changes in inventories of finished goods and work-in-progress	
	(180 – 170) + (300 – 280)	(30)
(b)	Raw materials and consumables used	
	(120 + 500 – 160)	(460)
(c)	Cost of Sales	
	Opening Stock (120 + 300 + 180)	600
	Purchases	500
		1,100
	Less Closing Stock (160 + 280 + 170)	(610)
	Cost of Goods Sold	490

Note: The cost of sales figure is the same as the total of the changes in inventories of finished goods and work in progress (30) and Raw materials and consumables used (460).

In the event that there is an increase in the inventories of finished goods and work-in-progress this amount will be shown as a credit in the Statement of Comprehensive Income.

N. INFORMATION TO BE PRESENTED EITHER ON THE FACE OF THE STATEMENT OF COMPREHENSIVE INCOME OR IN THE NOTES

When items of income and expense are material, their nature and amount shall be disclosed separately. Examples of these would include:

(a) The write down of inventories to net realisable value

(b) The write down of property, plant and equipment to recoverable amount

(c) Gains/losses on disposal of property, plant and equipment

(d) Gains/losses on disposal of investments

(e) Legal settlements

An entity shall not present any items of income and expenses as extraordinary items. The description extraordinary item was used in the past to represent income and expenses arising from events outside the ordinary activities of the business. IAS 1 has abolished this classification of items.

Example – Statement of Comprehensive Income: Function of Expenditure Method
Set out below are details from the financial records of WAT Limited:

	RWFm
Distribution Costs	5,470
Finance Costs	647
Cost of Sales	18,230
Sales Revenue	44,870
Income Tax Expense	1,617
Administration Expenses	9,740

REQUIREMENT:
Prepare the Statement of Comprehensive Income using the Function of Expenditure Method.

SOLUTION:

WAT Limited
Statement of Comprehensive Income for the year-ended 31st March 20X4

	RWFm
Sales Revenue	44,870
Cost of Sales	18,230
Gross Profit	26,640
Administration Expenses	(9,740)
Distribution Costs	(5,470)
Profit from Operations	11,430
Finance Costs	(647)
Profit Before Tax	10,783
Income Tax Expense	(1,617)
Net Profit for the Year	9,166

Example – Statement of Comprehensive Income : Nature of Expenses Method
Set out below are details from the financial records of FRD Limited for the year-ended 31st March 20X4:

	RWFm
Depreciation	9,430
Decrease in inventories of finished goods and work-in-progress	520
Raw Materials Used	8,750
Staff Costs	10,650
Sales Revenue	44,870
Other Operating Expenses	4,090
Income Tax Expense	1,617
Finance Costs	647

REQUIREMENT:
Prepare the Statement of Comprehensive Income using the Nature of Expenditure Method.

SOLUTION:

FRD Limited
Statement of Comprehensive Income for the year-ended 31st March 20X4

		RWFm
Sales Revenue		44,870
Decrease in inventories of finished goods and work-in-progress	520	
Raw Materials Used	8,750	
Staff Costs	10,650	
Depreciation	9,430	
Other Operating Expenses	4,090	
Total Expenses		33,440
Profit from Operations		11,430
Finance Costs		(647)
Profit Before Tax		10,783
Income Tax Expense		(1,617)
Net Profit for the Year		9,166

Example

Set out below are details from the financial records of FYN Limited for the year-ended 31st March 20X4:

	RWFm
Depreciation	8,760
Increase in inventories of finished goods and work-in-progress	450
Raw Materials Used	6,350
Staff Costs	8,650
Sales Revenue	46,340
Other Operating Expenses	5,180
Income Tax Expense	1,800
Interest Costs	750

REQUIREMENT:

Prepare the Statement of Comprehensive Income using the Nature of Expenditure Method.

SOLUTION:

FYN Limited

Statement of Comprehensive Income for the year-ended 31st March 20X4

		RWFm
Sales Revenue		46,340
Increase in inventories of finished goods and work-in-progress	(450)	
Raw Materials Used	6,350	
Staff Costs	8,650	
Depreciation	8,760	
Other Operating Expenses	5,180	
Total Expenses		28,490
Profit from Operations		17,850
Finance Costs		(750)
Profit Before Tax		17,100
Income Tax Expense		(1,800)
Net Profit for the Year		15,300

O. STATEMENT OF CHANGES IN EQUITY

An entity shall present a statement of changes in equity showing on the face of the statement:

(a) Profit or loss for the period

(b) Each item of income and expense for the period that is recognised directly in equity e.g. a revaluation surplus on the revaluation of property

(c) The effects of changes in accounting policies and correction of errors recognised in accordance with IAS8

(d) The amounts of transactions with equity holders e.g. issue of shares, any premium thereon and dividends to equity holders.

(e) The balance of retained earnings (accumulated profit) at the start of the year, changes during the year and the balance at the end of the year.

(f) The balance on each reserve account at the start of the year, changes during the year and the balance at the end of the year.

Example – Statement of Changes in Equity

	Share Capital RWFm	Share Premium RWFm	Revaluation Reserve RWFm	Accumulated Profit RWFm	Total RWFm
Opening Balance	150	70	110	39	369
Issue of Share Capital	50	20	-	-	70
Revaluation of Property	-	-	40	-	40
Net Profit	-	-	-	51	51
Dividend Paid	-	-	-	(10)	(10)
Closing Balance	200	90	150	80	520

Essentially the statement of changes in equity presents, in a columnar format, all the changes which have affected the various equity balances of share capital and reserves.

P. STATEMENT OF RECOGNISED INCOME AND EXPENSE

Example

	RWF
Gain / Loss on Revaluation of Properties	100,000
Exchange differences on translation of foreign operations	50,000
Net Income recognised directly in Equity	150,000
Profit for the period	460,000
Total Recognised Income and Expense for the Period	610,000

The Statement of Recognised Income and Expense (formerly known as Statement of Recognised Gains and Losses) represents the total income and expenses of the entity for the period. It includes income and expenses that are taken directly to Reserves, for example Revaluation of Non-Current assets and Foreign Currency Translation as well as the profit / loss generated by the entity for the period.

Q. DISCLOSURE OF SIGNIFICANT ACCOUNTING POLICIES

An entity shall disclose the significant accounting policies used in preparing the financial statements.

R. QUESTION/SOLUTION

Question – APA

The following information is available about the balances and transactions of APA, a limited liability company.

Balances at 30th April 20X3		RWF
Non-current assets	- Cost	1,000,000
	- Accumulated Depreciation	230,000
Inventory All Raw Materials		410,000
Trade Receivables		380,000
Cash at Bank		87,000
Trade Payables		219,000
Issued Share Capital – ordinary shares of RWF1 each		400,000
Accumulated Profits		818,000
10% Loan Notes		200,000
Loan Note Interest Owing		10,000

Transactions during year-ended 30th April 20X4	RWF
Sales Revenue	4,006,000
Purchases	2,120,000
Staff Costs	1,340,000
Other Operating Expenses	300,000
Interest on loan notes paid during year	20,000
Issue of 100,000 RWF1 ordinary shares at a premium of RWF0.50 per share	

There were no purchases or sales of non-current assets during the year.

Adjustments at 30th April 20X4

(1) Depreciation of RWF100,000 is to be allowed for

(2) Receivables totalling RWF20,000 are to be written off.

Balances at 30th April 20X4		RWF
(1)	Inventory All Raw Materials	450,000
(2)	Trade Receivables (before writing off debts shown above)	690,000
(3)	Cash at Bank	114,000
(4)	Trade Payables	180,000

REQUIREMENT:

Prepare the Statement of Comprehensive Income for the year-ended 30th April 20X4 and the Statement of Financial Position of APA as at 30th April 20X4 in accordance with IAS 1 Presentation of Financial Statements. The Statement of Comprehensive Income should be prepared using the nature of expenditure method.

SOLUTION:

APA Limited

Statement of Comprehensive Income for the year-ended 30th April 20X4

		RWF'000
Sales Revenue		4,006
Raw Materials Used (410 + 2,120 – 450)	2,080	
Staff Costs	1,340	
Depreciation	100	
Other Operating Expenses (300 + 20)	320	
Total Expenses		(3,840)
Profit from Operations		166
Interest Costs		(20)
Profit Before Tax		146
Income Tax		-
Profit for the Year		146

APA Limited

Statement of Financial Position for the year-ended 30th April 20X4

Assets	RWF	RWF
Non-Current Assets		
Cost	1,000,000	
Accumulated Depreciation	330,000	670,000
Current Assets:		
Inventory	450,000	
Trade Receivables	670,000	
Cash at Bank	114,000	
		1,234,000
Total Assets		1,904,000
Equity and Liabilities		
Shareholders' Equity		
Issued Capital		500,000
Share Premium		50,000
Retained Earnings (818 + 146)		964,000
Total Equity		1,514,000
Non-Current Liabilities		
10% Loan Notes		200,000
Current Liabilities		
Payables	180,000	
Interest accrued	10,000	
Total Current Liabilities		190,000
Total Equity and Liabilities		1,904,000

Question – CNS

The following items have been extracted from the trial balance of CNS, a limited liability company, as at 30th September 20X4.

	Ref. To Notes	RWF	RWF
Opening Inventory		186,400	
Purchases		1,748,200	
Carriage Inwards		38,100	
Carriage Outwards	2	47,250	
Sales Revenue			3,210,000
Trade Receivables		318,000	
Wages & Salaries	2 and 3	694,200	
Sundry Administrative Expenses	2	381,000	
Allowance for doubtful debts, as at 1st October 20X3	4		18,200
Bad Debts written off during the year	4	14,680	
Office Equipment as at 1st October 20X3:			
Cost	5	214,000	
Accumulated Depreciation	5		88,700
Office Equipment: Additions during the year	5	48,000	
Proceeds of sale of items during the year	5		12,600
Interest paid	2	30,000	

Notes:

1. Closing inventory amounted to RWF219,600

2. Prepayments and accruals:

	Prepayments RWF	Accruals RWF
Carriage Outwards		1,250
Wages & Salaries		5,800
Sundry Administrative Expenses	4,900	13,600
Interest Payable		30,000

3. Wages and salaries cost is to be allocated:

Cost of Sales	10%
Distribution Costs	20%
Administrative Expenses	70%

4. Further bad debts totalling RWF8,000 are to be written off, and the closing allowance for doubtful debts is to be equal to 5% of the final trade receivables figure. The bad and doubtful debt expense is to be included in administrative expenses.

5. Office equipment:

   Depreciation is to be provided at 20% per annum on the straight-line basis, with a full year's charge in the year of purchase and none in the year of sale.

   During the year office equipment, which had cost RWF40,000 with accumulated depreciation of RWF26,800 was sold for RWF12,600.

   All office equipment is used for administrative purposes.

6. Income Tax of RWF22,000 is to be provided for.

REQUIREMENT:
Prepare the company's Statement of Comprehensive Income for the year-ended 30th September 20X4 using the function of expenditure layout in accordance with IAS 1 Presentation of Financial Statements.

SOLUTION:

CNS Limited
Statement of Comprehensive Income for the year-ended 30th September 20X4

	RWF	RWF
Sales Revenue		3,210,000
Cost of Sales (W1)		(1,823,100)
Gross Profit		1,386,900
Distribution Costs (W1)	(188,500)	
Administrative Expenses (W1)	(944,680)	(1,133,180)
Profit from operations		253,720
Interest payable (30,000 + 30,000)		(60,000)
Profit before Tax		193,720
Income Tax		22,000
Profit for the Year		171,720

W1

		Cost of Sales RWF	Distribution Costs RWF	Administrative Expenses RWF
Opening Inventory		186,400		
Purchases		1,748,200		
Carriage Inwards		38,100		
Carriage Outwards (47,250 + 1,250)			48,500	
Wages and Salaries	694,200			
	5,800			
	700,000	70,000	140,000	490,000
Sundry administrative expenses (381,000 + 13,600 – 4,900)				389,700
Bad and doubtful debts (14,680 + 8,000 – 2,700) (W2)				19,980
Depreciation of office equipment 20% x (214,000 – 40,000 + 48,000)				44,400
Loss on sale (W3)				600
Closing inventory		(219,600)		
		1,823,100	188,500	944,680

W2 Provision for Bad Debts

Trade Receivables per Question	318,000
Bad Debts to write off	(8,000)
	310,000
Provision Required at 5%	15,500
Current Provision	(18,200)
Decrease in Provision Required	2,700

W3 Profit / Loss on Disposal

Cost	40,000
Accumulated Depreciation	(26,800)
Net Book Value	13,200
Sales Proceeds	12,600
Net Book Value	(13,200)
Profit / (Loss) on disposal	(600)

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Study Unit 10

IAS 2 - Inventories

Contents

A. INTRODUCTION

Introduction - Inventories

An Inventory is a list, but as raw materials, work-in-progress and finished good are detailed on lists or inventories, the term inventories is now commonly used to mean the items on those lists.

The calculation of the amounts at which inventories are stated in the accounts in one of the most important and difficult areas in financial reporting. Relatively small variations in the values at which inventories are stated can have significant impact on reported profits, while the proper valuation of inventories involves the exercise of judgement.

The determination of profit for an accounting year requires the matching of costs with related revenues. The cost of unsold or unconsumed inventories will have been incurred in the expectation of future revenue. It is appropriate to carry forward this cost to be matched with the revenue when it arises. If there is no reasonable expectation of sufficient future revenue to cover cost incurred e.g. as a result of deterioration, obsolescence or a change in demand, the irrecoverable cost should be charged to revenue in the year under review. Thus, inventories need to be stated at the lower of cost and net realisable value.

B. DEFINITIONS

Inventories are assets:

(a) Held for resale in the ordinary course of business

(b) In the process of production for resale e.g. raw materials, work-in-progress and finished goods

(c) In the form of materials or supplies to be consumed in the production process or of services

Cost shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Cost of purchase comprises purchase price including import duties, non-returnable taxes, transport and handling costs and any other directly attributable costs, less trade discounts, rebates and subsidies.

Cost of conversion comprises:

(a) Costs which are directly related to units of production e.g. direct labour, direct expenses and sub-contracted work

(b) Production overheads

(c) Other overheads, if any attributable in the particular circumstances of the business to bringing the product or service to its present location and condition

Production overheads: overheads incurred in respect of materials, labour or services for production, based on the normal capacity as expected on average under normal circumstances, taking one year with another. Each overhead should be classified according to function e.g. production, selling or administration so as to ensure the inclusion, in cost of conversion, of those overheads including depreciation which relate to production, notwithstanding that these may accrue wholly or partly on a time basis.

<u>*Net realisable value is*</u>: the estimated selling price in the ordinary course of business less:

(a) The estimated costs of completion and

(b) Estimated costs necessary to make the sale.

<u>*Fair Value*</u> is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

C. MEASUREMENT

INVENTORIES ARE MEASURED AT THE LOWER OF COST AND NET REALISABLE VALUE FOR EACH SEPARATE ITEM IN THE PERIODIC FINANCIAL STATEMENTS. SIMILAR ITEMS MAY BE GROUPED TOGETHER FOR VALUATION PURPOSES.

D. DISCLOSURE

The accounting policies which have been used in calculating the cost and net realisable value are disclosed in the statements and reports. A suitable description of the amount at which inventories are stated in accounts might be "at the lower of cost and net realisable value".

In general, inventories should be sub-classified in the Statement of Financial Position or in the notes in the financial statements so as to indicate the amounts held in each of the main categories in the standard Statement of Financial Position formats.

Statement of Financial Position (Excerpt)

	RWF
Inventories (Note 9)	2,370,000
Trade Receivables	X
Quoted Investments	X
Cash	X
	X

Note 9

	RWF
Raw materials	500,000
Work in progress	670,000
Finished goods	1,200,000
	2,370,000

EXAMPLE 1

Z Ltd. has an item in closing inventory which cost RWF250 with an expected selling price of RWF290. After the Statement of Financial Position date, due to severe competition, the selling price falls to RWF245.

Under IAS 2 stock should be valued at the lower of cost and net realisable value. The cost is RWF250, however the net realisable value is RWF245. The stock should therefore be stated at RWF245.

EXAMPLE 2

H Ltd. has an item in closing inventory which cost RWF750 with a then expected selling price of RWF850. The item was damaged while being moved in the stores. It will cost RWF90 to repair this item and it can then be sold for RWF800.

The cost of the item is RWF750, its net realisable value is RWF800 – 90 i.e. RWF710. The inventory item should be stated at a value of RWF710.

E. METHODS OF COSTING

It is frequently not practicable to relate expenditure to specific units of inventory. The ascertainment of the nearest approximation to cost gives rise to two problems:

(i) The selection of an appropriate method for calculating the related costs where a number of identical items have been purchased or made at different times i.e.:

   (a) First In, First Out (FIFO)

   (b) Last In, First Out (LIFO)

   (c) Weighted Average

(ii) The selection of an appropriate method for relating costs to inventories i.e.:

   (a) Job costing

   (b) Batch costing

   (c) Process costing

   (d) Standard costing

In selecting the methods referred to above, management must exercise judgement to ensure that the methods chosen provide the fairest practical approximation to 'actual cost'.

<u>FIFO:</u> The assumption underlying it is that the first inventory item to be bought is the first to be sold. The closing inventory is, therefore, the most recently acquired. In a period of rising prices, this method will result in a high stock valuation. This will represent the actual cost of the inventory as long as the issues to production/sales have followed a first-in, first-out pattern.

<u>LIFO:</u> The underlying assumption is that the last inventory to be bought is the first to be sold. The value of the closing inventory is, therefore, that of the earliest inventory acquired. *It should be noted that LIFO is no longer permitted as a valuation method by IAS 2.*

<u>Weighted Average</u>: The underlying assumption in charging out inventory sold is that the value of the closing inventory is the average price paid for it over the period. It is calculated by dividing the total value of purchases by the total number of units/tonnes purchased. In times of rising price levels, this method gives a lower valuation to unsold inventory than FIFO above and a higher valuation than LIFO and vice versa when price levels fall.

EXAMPLE 3

A grain merchant, who has no opening inventory, has four deliveries of a grain made to the same loading bay over a period of three months. The quantities delivered and the invoiced costs are as follows:

	Tonnes	Cost per Tonne	Total RWF
1 January	1,000 tonnes	@ RWF80 per tonne	80,000
4 February	600 tonnes	@ RWF84 per tonne	50,400
26 February	800 tonnes	@ RWF101 per tonne	80,800
15 March	1,200 tonnes	@ RWF100 per tonne	120,000
			RWF331,200

During the same period, he sells 2,200 tonnes of the 3,600 tonnes, delivered, at RWF120 per tonne. Obviously, he has 1,400 tonnes left but what was the cost of these? How much profit was made?

The answers lie in the valuation of closing inventory.

Establish:

Sales	2,200 x RWF120	RWF264,000	- Fact
Purchases		RWF331,200	- Fact

The closing inventory valuation depends on the valuation method used.

Using *FIFO*, the value of the closing inventory would be

1,200 tonnes	@ RWF100	120,000
200 tonnes	@ RWF101	20,200
		RWF140,200

Using *Weighted Average*, the value of the closing inventory would be:

$$\frac{\text{RWF331,200}}{\text{3,600 tonnes}} = \text{(RWF92 per tonne}$$

1,400 tonnes x RWF92 = RWF128,800

	FIFO		Weighted Average	
	RWF	RWF	RWF	RWF
Profit for the Period				
Sales		264,000		264,000
Less: Purchases	331,200		331,200	
Closing Inventory	(140,200)		(128,800)	
Cost of Sales		(191,000)		(202,400)
Profit		73,000		61,600

Summary

	FIFO	Weighted Average
Closing Inventory Valuation	140,200	128,800
Profit	73,000	61,600

COSTING METHODS

Job costing is a costing method where costs are incurred for a specific order undertaken for a customer's special requirements and each order is for a short duration e.g. Manufacturing a sailing boat.

Batch costing is a costing method where costs are incurred for a specific order undertaken but the costs apply to similar articles e.g. bean processing and pea processing.

Process costing is a costing method where goods are produced from continuous operations e.g. pentium chip making.
Standard costing is a budgetary control technique which compares standard costs and standard revenues with actual results obtained.

Absorption costing is a costing method which charges a proportion of fixed overheads for the period against the items produced.

Direct costing or Marginal costing is a costing system which does not charge a proportion of fixed overheads for the period against the items produced i.e. the inventory is charged with variable costs and valued on that basis.

Production Overheads IAS 2 requires that the cost of inventory should include production overheads. The production overheads should be absorbed into inventory based on the normal production capacity.

Example 4
ZEN Ltd. manufactures a single product called the Alpha. The company manufactured 8,000 units of Alpha during the year and sold 6,000 units at RWF12 each. The variable cost of each unit of Alpha is RWF4 per unit and fixed production overheads were RWF50,000 for the year. The normal capacity is assumed to be 10,000 units.

The 2,000 units in closing stock will be valued as follows:

	RWF
Variable Cost	4
Fixed Production Overhead (RWF50,000 ÷ 10,000 units)	5
	RWF9

Closing Inventory Valuation RWF9 x 2,000 units = RWF18,000

Note: The fixed production overhead is calculated based on the normal capacity of 10,000 units and **not** the actual quantity manufactured.

Study Unit 11

IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors

Contents

A. INTRODUCTION

The objectives of IAS 8 Accounting Policies, Changes in Estimate and Errors are:

- Set out the criteria for choosing and changing accounting policies and
- Accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors.

B. DEFINITIONS

Accounting Policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

A change in Accounting Estimate is an adjustment of the carrying amount of an asset, liability, or an amount of the periodic consumption of an asset, that results from the assessment of present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are <u>not</u> corrections of errors.

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the items, or a combination of both, could be the determining factor.

Prior Period Errors are omissions from, and misstatements in, the entity's financial statements for prior periods arising from a failure to use, or misuse, reliable information that:

(a) Was available when financial statements for those periods were authorised for issue; and

(b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

C. ACCOUNTING POLICIES

If there is an accounting standard that applies to a transaction or event, the accounting policy to be applied in reporting that transaction or event shall be chosen by referring to the Accounting Standard. The entity does not have to apply the standard if the effect of applying the standard is immaterial

If there is no Accounting Standard relating to the transaction or event, management should use their judgement in developing and applying an accounting policy that results in information that is:

(a) Relevant to the users of the Financial Statements, and

(b) Reliable:

(i) Faithful presentation of Financial position, financial performance and cash flow,

(ii) Reflect the substance of the transaction and not just the legal form,

(iii) Free from bias,

(iv) Prudent and

(v) Complete.

The entity shall apply accounting standards consistently for similar transactions and events and over time, unless the standard specifically allows or requires categorisation of items for which different policies may be appropriate.

D. CHANGES IN ACCOUNTING POLICIES

An entity can only change an accounting policy if:

(a) It is required by a standard, or

(b) It provides more reliable and relevant information about the effects of the transactions, other events or conditions on the entity's financial position, performance or cash flows.

Transactions that are different from those which have previously occurred and transactions that have not occurred before do not represent a change in an Accounting Policy.

E. DISCLOSURE – CHANGES IN ACCOUNTING POLICY

Where an entity makes a voluntary change in an accounting policy which has an effect on the current period or prior periods, that would have an effect on that period but it is not possible to determine the amount of the adjustment, or might have an effect on future periods, the entity should disclose:

(a) Nature of the change in accounting policy,

(b) Reasons why the change will provide more reliable and relevant information,

(c) Amount of the adjustment for current period and each prior period for each financial statement line item affected,

(d) Amount of the adjustment relating to prior periods before those presented, if practicable,

(e) The circumstances that caused the existence of that condition and a description of how and from when the change in the accounting policy has been applied.

When the effect of the initial application of a standard has an impact on the current period or any prior period, but it is not practicable to estimate the amount of the adjustment, or it might have an effect on future periods, an entity shall disclose:

(a) Title of the Standard,

(b) Where relevant the change in the accounting policy is made in accordance with its transitional provisions,

(c) Nature of the change in accounting Policy,

(d) A description of the transitional provisions,

(e) If applicable, the transitional provisions might have an effect on future periods,

(f) For the current period and each prior period presented the amount of the adjustment for each line item in the financial statements,

(g) Amount of the adjustment relating to periods before those presented to the extent that it is practicable. If retrospective application is not possible the circumstances that caused the existence of that condition and a description of how and from when the change in the accounting policy has been applied.

When an entity has not applied a standard that has been issued but is not yet effective, the entity shall disclose:

(a) This fact and

(b) Known or reasonably estimated information relevant to assessing the possible impact that application of the new standard will have on the entity's financial statement in the period of initial application.

F. CHANGES IN ACCOUNTING ESTIMATES

Some items cannot be measured with precision but can only be estimated. These estimates are based on the most recently available information. Examples of items that require estimation are Bad Debts and Useful lives of assets.
Use of estimates is common practice in Financial Statements they do not mean that the information is unreliable. How estimates are calculated may change over time due to a change in business practices, more experience in the area or the availability of additional information. A revision of an estimate is neither a change in an accounting estimate nor the correction of an error.

A change in a measurement basis being applied is a change in an accounting policy and not a change in an accounting estimate.

When a change in an accounting estimate gives rise to a change in assets, liabilities or equity it should be recognised by adjusting the carrying amount of the asset, liability or equity as appropriate.

G. DISCLOSURE – CHANGES IN ACCOUNTING ESTIMATES

The entity shall disclose the nature and amount of the change in accounting estimate where it has an effect on the current period or future periods. The entity does not have to disclose the effect on future periods if it is impracticable to do so, but must disclose this fact.

H. ERRORS

Errors can occur in the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements that contain errors do not comply with IFRSs, these errors can be either material or immaterial but made intentionally to present a particular aspect of the entity's financial position or performance.

Errors in the current period should be corrected before the financial statements are authorised for issue. However, errors that are not discovered until a subsequent period are corrected in the comparative information presented in the financial statements for that subsequent period, for example, an error is discovered in the financial statements relating to the year-ended 30th September 2008 while finalising the accounts for the year-ended 30th September 2009, the comparative information presented in the "prior year comparatives" in the financial statements for the year-ended 30th September 2009 will be corrected.

A material prior period error shall be corrected in the first set of financial statements authorised for issue after the discovery of the error:

(a) Restate the comparative amount for the prior period(s) presented in which the error occurred, or

(b) If the error occurred before the earliest period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

I. DISCLOSURE OF PRIOR PERIOD ERRORS

The entity has to make the following disclosure:

(a) Nature of the error,

(b) As far as practicable, the amount of the correction for each financial statement line item affected,

(c) Amount of the correction at the beginning of the earliest prior period presented, and

(d) If a retrospective restatement is not possible then the circumstances that led to the existence of the error and a description of how and from when the error has been corrected.

These disclosures do not need to be repeated in subsequent Financial Statements.

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Study Unit 12

IAS 10 – Events after the Reporting Period

Contents

A. OBJECTIVE

The objective of this standard is to set out the circumstances in which an entity should adjust its financial statements for events that occur after the Statement of Financial Position Date but before the Financial Statements are approved by the Board of Directors. The standard also sets out the disclosures to be made about these events.

The standard indicates that an entity should not prepare its financial statements on a going concern basis if events after the Statement of Financial Position clearly indicate that this is no longer appropriate.

B. DEFINITIONS

Events after the Statement of Financial Position date are those events, favourable and unfavourable, that occur between the Statement of Financial Position date and the date when the financial statements are authorised for issue. Two types of Events can be identified:

(a) Those that provide evidence of conditions that existed at the Statement of Financial Position date (adjusting events after the Statement of Financial Position date); and

(b) Those that are indicative of conditions that arose after the Statement of Financial Position date (Non-adjusting events after the balance date).

C. RECOGNITION AND MEASUREMENT

ADJUSTING EVENTS AFTER THE REPORTING PERIOD

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the Statement of Financial Position date. The following are examples of adjusting events that require the entity to adjust the amounts shown in the financial statement:

(a) *Settlement of a Court case* after the Statement of Financial Position date which confirms that the entity has a present obligation

(b) *Discovery of fraud or errors* that show the financial statements are incorrect

(c) *Non-Current Assets* - The subsequent determination of the purchase price or of the proceeds of sale of assets purchased or sold before the year-end

(d) *Property* - A valuation which provides evidence of a permanent diminution in value.

(e) *Investments* - The receipt of a copy of the financial statements or other information in respect of any company which provides evidence of a permanent diminution in the value of a long-term investment.

(f) *Inventory* - The receipt of proceeds of sales after the Statement of Financial Position date or other evidence concerning the net realisable value of inventory.

(g) *Receivables* - The renegotiation of amounts owing by receivables, or the bankruptcy of a customer.

(h) *Taxation* - The receipt of information regarding rates of taxation.

(i) *Claims* - Amounts received or receivable in respect of insurance claims which were in the course of negotiation at the Statement of Financial Position date.

NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD
An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

(a) *A major business combination* after the reporting period or disposing of a major subsidiary.

(b) *Issues* of shares and debentures

(c) *Purchases and sales of non-current assets* and investments

(d) *Losses of non-current assets or inventory* as a result of a catastrophe such as fire or flood

(e) *Announcing or commencing* the implementation of a major restructuring. (See IAS 37)

(f) *Announcing a plan* to discontinue an operation

(g) *Strikes* and other labour disputes

D. DIVIDENDS

If an entity declares dividends to equity shareholders after the Statement of Financial Position date the entity shall not recognise those dividends as a liability at the Statement of Financial Position date.

The dividends are <u>not</u> recognised as a liability at the Statement of Financial Position date because they are not a present obligation at the Statement of Financial Position date.

E. GOING CONCERN

An entity shall not prepare its financial statements on a going concern basis if management determines after the Statement of Financial Position date that it intends to liquidate the entity or to cease trading or that it has no realistic alternative but to do so.

F. DISCLOSURE

An entity shall disclose the date when the financial statements were authorised for issue and who gave the authorisation.

If an entity receives information after the Statement of Financial Position date about conditions that existed at the Statement of Financial Position, it shall update disclosures that relate to those conditions, in the light of the new information.

For non-adjusting events an entity shall disclose:

(a) The nature of the event, and

(b) An estimate of its financial effect or a statement that such an estimate cannot be made.

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Study Unit 13

IAS 16 Property, Plant and Equipment

Contents

A. OBJECTIVE

The Objective of IAS 16 is to set out the accounting treatment for Property, Plant and Equipment. The main areas dealt with in the standard are:

- Recognition of non-current assets(fixed assets),
- Determination of the carrying amount,
- Determination of the depreciation charges
- Determination of the impairment losses to be recognised in the financial statements.

B. DEFINITIONS

Property, Plant and Equipment: Tangible assets held for use in production or supply of goods or services or for rental or administration purposes and are expected to be used during more than one accounting period.

Depreciation: *Systematic allocation of depreciable amount, the cost (or re-valued amount) less residual value over an asset's useful life*

Carrying amount is the amount at which the asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

An *Impairment Loss* is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Fair Value: The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Recoverable Amount: The higher of the asset's net selling price and its value in use.

Value in Use (IAS 36): The present value of estimated future cash flows expected from the continuing use of an asset and from its disposal at the end of its useful life.

C. DEPRECIATION

The assessment of depreciation and its allocation to accounting periods involves the consideration of three factors:

(a) The carrying amount of the asset - whether cost or valuation

(b) The length of the asset's expected useful economic life to the business of the enterprise, having due regard to the incidence of obsolescence
and

(c) The estimated residual value of the asset at the end of its useful economic life in the business of the enterprise

The useful economic life of an asset is the period over which the present owner will derive economic benefits from its use. The following factors need to be considered in determining the useful life of an asset:

(a) The expected usage of the asset by the enterprise. The usage is of an asset is determined by the expected capacity of the asset or its physical output.

(b) The expected physical wear and tear is affected by operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme of the enterprise and the care and maintenance of the asset when idle.

(c) Technical obsolescence arising from changes or improvements in production or from a change in the market demand for the product or service output of the asset

(d) Legal or similar limits on the use of the asset, such as expiry dates of related leases.

The useful economic lives and depreciation methods of assets should be reviewed regularly and, where necessary, revised and accounted for as a change in estimate.

D. ACCOUNTING FOR DEPRECIATION

Provision for depreciation of non-current asset having a finite useful economic life should be made by allocating the cost or re-valued amount less the estimated residual value of the assets as fairly as possible to the periods expected to benefit from their use. The depreciation methods used should be the one which is the most appropriate having regard to the type of asset and their use in the business.

Methods of Calculation

There are a number of different methods used in calculating the depreciation charge. The most common methods are:

(a) The Straight line method

(b) The Reducing balance method

The Straight Line Method

Under this method, the total depreciable amount is charged in ***equal instalments*** to each accounting period over the expected useful life of the asset.

Formula:

$$\frac{\text{Cost of Asset - the Residual Value (e.g. scrap value)}}{\text{Expected useful life of the asset}}$$

Example

CDE Ltd. acquired a non-current asset which cost RWF10,000 on 1st January 20X0. The estimated useful life of the asset is 5 years with no residual value. The depreciation charge in the profit and loss account each year is calculated as follows:

$$\frac{\text{RWF10,000} - \text{nil}}{\text{5 years}} = \text{RWF2,000 per annum}$$

Example

CDE Ltd. acquired a non-current asset which cost RWF60,000 on 1st January 20X0. The estimated useful life of the asset is 5 years with a residual value of RWF5,000. The depreciation charge in the profit and loss account each year is calculated as follows:

$$\frac{\text{RWF60,000} - \text{RWF5,000}}{\text{5 years}} = \text{RWF11,000 per annum}$$

The net book value (NBV) of the non-current asset would be:

Year-end	31.12.X0	31.12.X1	31.12.X2	31.12.X3	31.12.X4
	RWF	**RWF**	**RWF**	**RWF**	**RWF**
Cost	**60,000**	**60,000**	**60,000**	**60,000**	**60,000**
Acc. Dep'n	**11,000**	**22,000**	**33,000**	**44,000**	**55,000**
NBV	**49,000**	**38,000**	**27,000**	**16,000**	**5,000**

Non-current asset is shown in the Statement of Financial Position at its cost less accumulated depreciation to date.

The Reducing Balance Method

Under this method, the annual depreciation charge is a ***fixed percentage*** of the net book value of the asset at the end of the previous accounting period.

Example

CDE Ltd. acquired a non-current asset which cost RWF10,000 on 1st January 20X0. The reducing balance rate is 40%. The depreciation charge in the Statement of Comprehensive Income each year is calculated as follows:

		Acc. Dep'n
	RWF	RWF
Asset Cost	10,000	
Depreciation 20X0	(4,000)	4,000
NBV end of 20X0	6,000	
Depreciation 20X1	(2,400)	6,400 (4,000 + 2,400)
NBV end of 20X1	3,600	
Depreciation 20X2	(1,440)	7,840 (6,400 + 1,440)
NBV end of 20X2	2,160	

Both methods compared

Example

CDE Ltd. acquired a non-current asset which cost RWF8,000 on 1st January 20X1. The estimated useful life of the asset is 4 years with a residual value of RWF500. The reducing balance rate is 50%.

The depreciation charge in the Statement of Comprehensive Income each year is calculated as follows:

Straight Line Method:

$$\frac{RWF8{,}000 - RWF500}{4 \text{ years}} = RWF1{,}875 \text{ per annum}$$

	Straight Line	Reducing Balance	
	RWF	RWF	
Cost	8,000	8,000	
Depreciation 20X1	(1,875)	(4,000)	i.e. 50% x 8,000
NBV ye/ 31.12.X1	6,125	4,000	
Depreciation 20X2	(1,875)	(2,000)	i.e. 50% x 4,000
NBV y/e 31.12.X2	4,250	2,000	
Depreciation 20X3	(1,875)	(1,000)	i.e. 50% x 2,000
NBV y/e 31.12.X3	2,375	1,000	
Depreciation 20X4	(1,875)	(500)	i.e. 50% x 1,000
NBV y/e 31.12.X4	500	500	

Straight Line Method – Statement of Financial Position Extract

Year-end	31.12.X1	31.12.X2	31.12.X3	31.12.X4
	RWF	**RWF**	**RWF**	**RWF**
Cost	**8,000**	**8,000**	**8,000**	**8,000**
Acc. Dep'n	**1,875**	**3,750**	**5,625**	**7,500**
NBV	**6,125**	**4,250**	**2,375**	**500**

Reducing Balance Method – Statement of Financial Position Extract

Year-end	31.12.X1	31.12.X2	31.12.X3	31.12.X4
	RWF	**RWF**	**RWF**	**RWF**
Cost	**8,000**	**8,000**	**8,000**	**8,000**
Acc. Dep'n	**4,000**	**6,000**	**7,000**	**7,500**
NBV	**4,000**	**2,000**	**1,000**	**500**

Exercise

(a) A Van is bought for RWF6,000 on 1st January 20X2. It will be used for 3 years and then sold back to the supplier for RWF3,072. Show the depreciation calculations for each year using:

- (a) The reducing balance method with a rate of 20%
- (b) The straight line method

(b) A company, which makes up its accounts annually to 31 December, provides for depreciation of its machinery at the rate of 10% per annum on the diminishing balance system

On 31 December, 20X2, the machinery consisted of three items purchased as follows:

			RWF
On 1 January 20X0	Machine A	Cost	3,000
On 1 April 20X1	Machine B	Cost	2,000
On 1 July 20X2	Machine C	Cost	1,000

Required:
Your calculations showing the depreciation provision for the year 20X2.

Solution:
(a)

Reducing Line Method

	RWF
Van cost	6,000
2002 Dep'n 20%	1,200
NBV end Yr 1	4,800
2003 Dep'n 20%	960
NBV end Yr 2	3,840
2004 Dep'n 20%	768
NBV end Yr 3	3,072

Straight Line Method

	RWF
Van cost	6,000
2002 Dep'n	976
NBV end Yr 1	5,024
2003 Dep'n	976
NBV end Yr 2	4,048
2004 Dep'n	976
NBV end Yr 3	3,072

"Straight-line" Calculation:

$$\frac{6{,}000 - 3{,}072}{3 \text{ yrs}} = \frac{2{,}928}{3} = 976$$

(b)

		Machines A	B	C
	Bought 1/1/20X0	3,000		
20X0	Dep'n 10% for 12 mths	300		
		2,700		
	Bought 1/4/20X1		2,000	
2001	Dep'n 10% x 2,700	270		
	Dep'n 10% for 9 mths		150	
		2,430	1,850	
	Bought 1/7/20X2			1,000
20X2	Dep'n 10% of 2,430	243		
	Dep'n 10% x 1,850		185	
	Dep'n 10% for 6 mths			50
		2,187	1,665	950
20X2	Total depreciation (243 + 185 + 50)		RWF478	

E. DISPOSAL OF PROPERTY, PLANT AND EQUIPMENT

A profit/loss on the disposal of property, plant and equipment is calculated as the difference between the net disposal proceeds and the net book value. The profit / loss on disposal is included in the Statement of Comprehensive Income in the year in which the disposal occurs.

Example
On 1st July 20X2 M Ltd sold a plant for RWF4,500. The plant was bought on 1st January 20X0 for RWF16,000. Depreciation is calculated on a straight line basis over 4 years. The company's year-end is 31st December.

Solution
Profit/Loss on Disposal

	RWF
Sale proceeds	4,500
Carrying Amount (W1)	(6,000)
Profit/(loss) on disposal	(1,500)

W1 Calculation of Carrying Amount/Net Book Value

	RWF
Cost 1st January 20X0	16,000
Depreciation – Year-end	
31st December 20X0	(4,000)
31st December 20X1	(4,000)
31st December 20X2 (4,000 x 6/12)	(2,000)
Carrying Amount as at 1st July 20X2	6,000

F. LEDGER ACCOUNTS AND JOURNAL ENTRIES

Property, Plant and Equipment – Additions
When a tangible fixed asset is bought the cost is entered into a tangible fixed asset account in the nominal ledger….

Plant and Equipment Account

			RWF		RWF
1st X4	Jan	Bank	10,000		

The journal entry for the purchase of a tangible fixed asset is:

Debit Plant and Equipment Account
Credit Bank

Property, Plant and Equipment – Depreciation
When property, plant and equipment is depreciated the charge for the year is entered in the depreciation expense account and the accumulated depreciation account.

Plant and Equipment – Accumulated Depreciation Account

			RWF				RWF
				1st Jan X4		Opening Balance	X
				31st X4	Dec	Depreciation expense	2,500

Plant and Equipment –Depreciation Expense Account

			RWF				RWF
31st X4	Dec	Statement of Comprehensive Income	2,500	31st X4	Dec	Plant & Equipment Acc Dep'n	2,500

The journal entries for the depreciation charge for the year is:

Debit Plant and Machinery Depreciation Expense Account
Credit Accumulated Depreciation Account

The Depreciation Expense account is cleared out at the end of the year to the Statement of Comprehensive Income.

Debit Statement of Comprehensive Income - Depreciation
Credit Plant & Equipment – Depreciation Expense Account

The balance in the Accumulated Depreciation account represents the total amount of depreciation charged against the asset since the purchase date.

Property, Plant and Equipment – Disposal

When property, plant and equipment is sold or scrapped the cost is transferred to a disposal account. Also the accumulated depreciation to date should be transferred from the accumulated depreciation account to the disposal account.

Lastly the proceeds of sale should be credited to disposal account.

The journal entries for the disposal of property, plant and equipment are:

(1) Debit Disposal Account
Credit Property, Plant and Equipment Cost Account

To transfer the original cost of the asset to the disposal account

(2) Debit Accumulated Depreciation Account
Credit Disposal Account

To transfer the accumulated depreciation charged to the Statement of Comprehensive Income from date of purchase to date of disposal.

(3) Debit Bank

Credit Disposal Account

To record the cash received on sale/disposal of the asset

Disposal Account

		RWF			RWF
1st Jul X4	Plant & Equipment A/C	10,000	1st Jul X4	Acc Depreciation Account	6,125
			1st Jul X4	Bank	3,000
				Loss to Statement of Comprehensive Income	875
		10,000			10,000

Trade in Allowance

Often when a motor vehicle is being replaced it is traded in against a new vehicle. The double entry for this transaction is debit motor vehicles cost account and credit motor vehicles disposal account with the trade in value of the motor vehicle.

Example

X Limited traded in a motor vehicle which originally cost RWF20,000 against a new motor vehicle costing RWF35,000. The garage gave a trade-in allowance to X Limited of RWF10,000. At the date of the trade-in the accumulated depreciation on the old motor vehicle was RWF8,000. X Limited paid the garage a cheque for RWF25,000.

Motor Vehicle - Cost Account

		RWF			RWF
(1)	Balance b/d	20,000	(2)	Disposal Account	20,000
(3)	Disposal A/C	10,000		Balance c/d	35,000
(4)	Bank	25,000			
		55,000			55,000
	Balance b/d	35,000			

Disposal Account

		RWF			RWF
(2)	Motor Vehicle A/C	20,000	(3)	Motor Vehicle A/C	10,000
			(5)	Acc. Depreciation A/C	8,000
			(6)	Loss to Statement of Comprehensive Income	2,000
		20,000			20,000

Notes to Ledger Account

1. Opening balance represents the original cost of the asset on hand at the start of the financial period.

2. The motor vehicle is traded in against a new vehicle, therefore the asset is removed (that is, credited) from the Motor Vehicle Cost Account and debited to the disposal account.
3. On disposal of the vehicle the company is given a trade in allowance rather than cash, the accounting entries are:

   DR Motor Vehicle Cost

   Cr Disposal Account
4. The cash paid out in addition to the trade in allowance for the new vehicle.
5. The total depreciation charged on the asset is debited from the Motor Vehicle – Accumulated Depreciation Account and credited to the Disposal Account.
6. The loss on disposal balances the account, it is calculated as sales proceeds less the net book value:

Sales Proceeds/Trade in Allowance	10,000
Net Book Value (20,000 – 8,000)	(12,000)
Profit/(loss) on disposal	(2,000)

G. RECOGNITION AND MEASUREMENT

An item of property, plant and equipment should be recognised as an asset when:

- It is probable that future economic benefits associated with it will flow to the entity and;
- Cost of the asset can be measured reliably.

Initial Measurement
Property, plant and equipment should initially be measured at cost. Cost is the purchase price, import duties and non-deductible purchase taxes/VAT. Cost should also include directly attributable costs of bringing the asset to working condition for its intended use.

Examples of directly attributable costs include initial delivery and handling costs, site preparation, installation costs, and cost of employee wages arising directly from construction or acquisition.

Exchange of Assets
Cost is measured at fair value of asset received which is equal to fair value of the asset given up e.g. trade-in allowance, plus cash transferred.

Measurement Subsequent to Initial Recognition
An entity may choose between the cost model and the revaluation model. The choice of measurement is applied consistently to the entire class of property, plant and equipment.

Cost Model
In this model the assets are carried at cost less accumulated depreciation and any accumulated impairment losses.

Revaluation Model
In this model the assets are carried at their re-valued amount, being fair value at date of revaluation, less any subsequent depreciation and any accumulated impairment losses.

Accounting Treatment of Revaluation

Any revaluation increase is normally credited directly to the revaluation surplus in equity. However, if the asset had previously been the subject of a revaluation decrease then the entity reverses the amount of the decrease previously taken to the Statement of Comprehensive Income.

Example

Original Cost of Asset	650,000
Current Carrying Amount	500,000

The asset has been re-valued and the surveyor believes its true value is RWF700,000.

Solution

The asset originally cost RWF650,000 but was previously re-valued downwards to RWF500,000, a decrease of RWF150,000. This decrease would have been debited to the Statement of Comprehensive Income, so now that the asset is being re-valued upwards what entries do we pass in our account:

Because of the previous diminution in value:

Dr	Asset		200,000	
	Cr	Statement of Comprehensive Income		150,000
	Cr	Revaluation Reserve – Statement of Financial Position		50,000

If the asset had not been the subject of a previous decrease in value through revaluation then the entries passed would have been:

Dr	Asset		200,000	
	Cr	Revaluation Reserve – Statement of Financial Position		200,000

Any revaluation decrease is normally recognised in the Statement of Comprehensive Income, except where it reverses a previous revaluation increase of the asset then it is offset against the balance on the revaluation reserve.

Example

Original Cost of Asset	400,000
Current Carrying Amount	500,000

The asset has been re-valued and the surveyor believes its true value is RWF450,000.

Solution

The asset originally cost RWF400,000 but was previously re-valued upwards to RWF500,000, an increase of RWF100,000. This increase would have been credited to the Revaluation Reserve Account, so now that the asset is been re-valued downwards what entries do we pass in our account?

Because of the previous revaluation:

Dr	Revaluation Reserve		50,000	
	Cr	Asset		50,000

If the asset had not been the subject of a previous decrease in value through revaluation then the entries passed would have been:

Dr	Statement of Comprehensive Income		50,000	
	Cr	Asset		50,000

H. DISCLOSURE

The financial statements should disclose, for each class of property, plant and equipment:

(a) The measurement bases used for determining the gross carrying amount.

(b) The depreciation methods used

(c) The useful lives or depreciation rates used

(d) The gross carrying amount and the accumulated depreciation at the beginning and end of the period

(e) A reconciliation of the carrying amount at the beginning and end of the period showing:

  (i) Additions

  (ii) Disposals

  (iii) Increases or decreases during the period resulting from revaluations

  (iv) Depreciation

I. EXAMPLES

Question 1

A company makes up its accounts to the 31st December each year. It provides for depreciation on a reducing balance method at a rate of 10%.

On 31st December 20X4 the assets consisted of the following items:

- Machine A purchased April 20X1 for RWF3,000
- Machine B purchased July 20X2 for RWF2,000
- Machine C purchased October 20X3 for RWF1,000

Required:
Calculate the depreciation charge for the year-end 31st December 20X4.

Question 2

An asset was bought in 20X0 for RWF3,000. It had an expected useful life of 10 years with no expected residual value. In February 20X5 a decision was taken to sell the asset for RWF1,200. The Year-end is 31st December 20X5. Assume a full year's depreciation in the year of purchase and none in the year of sale.

Required:
Calculate the profit / loss on disposal under each of the methods:

a) Reducing Balance at 10%,

b) Straight Line Method

Question 3

An asset was purchased on 1st July 20X0 for RWF10,000, if has an expected life of 5 years. The company uses the straight line method of depreciation. The asset was sold in 1st April 20X3 for RWF5,000. Company year-end is 31st December.

Required:
Prepare the ledger accounts for each of the years assuming:

a) The company pro-rates the depreciation charge in the year of purchase and disposal.

b) The company takes a full years charge in the year of purchase of none in the year of disposal.

Solution – Question 1

		A	**B**	**C**
	Bought 1.4.20X1	3,000		
20X1	Dep'n 10% x 3,000 x 3/4	225		
		2,775		
	Bought 1.7.20X2		2,000	
20X2	Dep'n 10% x 2,775	277		
	Dep'n 10% 2,000 x 1/2		100	
		2,498	1,900	
	Bought 1.10.20X3			1,000
20X3	Dep'n 10% of 2,498	249		
	Dep'n 10% x 1,900		190	
	Dep'n 10% x 1,000 x 3/12			25
		2,248	1,710	975
20X4	Depreciation @ 10%	225	171	97
Net Book Value		2,023	1,539	878

Depreciation Charge for 20X4 is (225 + 171 + 97) RWF493

Solution – Question 2

	Straight Line Method	Reducing Balance
COST	3,000	3,000
DEPRECIATION Y/E 31.12.X0	(300)	(300)
NET BOOK VALUE 31.12.X0	2,700	2,700
DEPRECIATION Y/E 31.12.X1	(300)	(270)
NET BOOK VALUE 31.12.X1	2,400	2,430
DEPRECIATION Y/E 31.12.X2	(300)	(243)
NET BOOK VALUE 31.12.X2	2,100	2,187
DEPRECIATION Y/E 31.12.X3	(300)	(219)
NET BOOK VALUE 31.12.X3	1,800	1,968
DEPRECIATION Y/E 31.12.X4	(300)	(196)
NET BOOK VALUE 31.12.X4	1,500	1,772

	Straight Line Method	Reducing Balance
PROCEEDS	1,200	1,200
NET BOOK VALUE	(1,500)	(1,772)
PROFIT/(LOSS) ON DISPOSAL	(300)	(572)

Solution – Question 3

(a)

Asset – Cost Account

		RWF			RWF
1.7.X0	Bank	10,000		Balance c/d	10,000
		10,000			10,000
1.1.X3	Balance b/d	10,000	4.X3	Disposal Account	10,000
		10,000			10,000

Asset – Accumulated Depreciation

		RWF			RWF
31.12.X0	Balance c/d	1,000	31.12.X0	Statement of Comprehensive Income	1,000
		1,000			1,000
31.12.X1	Balance c/d	3,000	1.1.X1	Balance b/d	1,000
			31.12.X1	Statement of Comprehensive Income	2,000
		3,000			3,000
31.12.X2	Balance c/d	5,000	1.1.X2	Balance b/d	3,000
			31.12.X2	Statement of Comprehensive Income	2,000

		5,000			5,000
1.4.X3	Disposal Account	5,500	1.1.X3	Balance b/d	5,000
			31.3.X3	Statement of Comprehensive Income	500
		5,500			5,500

Disposal Account

	RWF		RWF
Motor Vehicle A/C	10,000	Bank	5,000
Profit – Statement of Comprehensive Income	500	Acc. Depreciation A/C	5,500
	10,500		10,500

Depreciation X0: 10,000 x 20% = 2,000 x 6/12 = 1,000

Depreciation X3: 2,000 x 3/12 = 500

(b) Full year Depreciation in the year of purchase and none in the year of sale.

Asset – Cost Account

		RWF			RWF
1.7.X0	Bank	10,000		Balance c/d	10,000
		10,000			10,000
1.1.X3	Balance b/d	10,000	4.X3	Disposal Account	10,000
		10,000			10,000

Asset – Accumulated Depreciation

		RWF			RWF
31.12.X0	Balance c/d	2,000	31.12.X0	Statement of Comprehensive Income	2,000
		2,000			2,000
31.12.X1	Balance c/d	4,000	1.1.X1	Balance b/d	2,000
			31.12.X1	Statement of Comprehensive Income	2,000
		4,000			4,000
31.12.X2	Balance c/d	6,000	1.1.X2	Balance b/d	4,000
			31.12.X2	Statement of Comprehensive	2,000

				Income	
		6,000			6,000
1.4.X3	Disposal Account	6,000	1.1.X3	Balance b/d	6,000
		6,000			6,000

Disposal Account

	RWF		RWF
Motor Vehicle A/C	10,000	Bank	5,000
Profit – Statement of Comprehensive Income	1,000	Acc. Depreciation A/C	6,000
	11,000		11,000

Study Unit 14

IAS 18 – Revenue

Contents

A. OBJECTIVE

The objective of this standard is to provide assistance in determining when to recognise revenue. It should be recognised when it is probable that economic benefits that can be **measured reliably** have accrued to the entity. IAS 18 Revenue sets out the criteria as to when revenue should be recognised and gives practical guidance as to the application of these criteria.

B. DEFINITIONS

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Revenue only represents amounts received by the entity in its own account, it excludes monies received on behalf of third parties, such as sales taxes and value added taxes. When the entity acts as an agent the commission earned is treated as revenue and not the amounts received on behalf of the principal.

Fair Value is the amount for which an asset will be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

C. RECOGNITION AND MEASUREMENT

IAS 18 Revenue states that revenue shall be measured as fair value either received or receivable taking into account any trade discounts or volume rebates allowed. The consideration in the vast majority of cases is in the form of cash and cash equivalents, however, companies may offer interest free credit and in this case the fair value is calculated by discounting the future cash flows using an imputed rate of interest. This imputed rate of interest is determined by either:

1) The prevailing rate of interest on similar credit facilities, or
2) The rate of interest that discounts the nominal amount of the facility to the current cash sales price of the goods or services.

In some circumstances it is necessary to recognise separately identifiable components of a transaction. Forr example, the sale of goods that includes a service contract: the entity should recognise a portion of the proceeds now that relates to the sale of the goods and defer an amount over the period of the service contract.

Goods and services may be exchanged for similar goods and services; this is not recognised as a transaction that generates revenue. If the goods and services swapped are dissimilar then the transaction is recognised as a transaction that generates revenue and the revenue recognised is fair value of the goods / services received adjusted by the amount of any cash or cash equivalents transferred. Fair value of goods received is only appropriate when it can be measured reliably, otherwise use the fair value of goods / services given up adjusted by the amount of cash / cash equivalents transferred.

D. SALE OF GOODS

Revenue from the sale of goods will be recognised when the following conditions are all met:

a) The entity (seller) has transferred all the significant risks and rewards of ownership to the purchaser,

b) The entity has no managerial involvement or control of the asset,

c) The amount of revenue attributed to the sale can be measured reliably,

d) Economic benefits will flow to the entity (seller) as a result of the transaction and

e) The costs associated with the transaction can be measured reliably.

In most cases the transfer of significant risks and rewards usually occurs when legal title to the goods / asset is transferred. Revenue and expenses relating to a particular transaction should be recognised at the same time, this is known as *matching.*

E. RENDERING OF SERVICES

When an entity is involved with the provision of services, the revenue relating to a transaction is recognised in the Statement of Comprehensive Income by considering the stage of completion of the service at the Statement of Financial Position date. The result of a transaction can be estimated reliably when the following conditions are satisfied:

a) Revenue can be measured reliably,

b) Economic benefits will probably flow to the entity,

c) The stage of completion of the transaction can be measured reliably at the Statement of Financial Position date and

d) Both the costs incurred to date and the costs to complete can be measured reliably.

If the outcome of a transaction cannot be measured reliably or there is uncertainty, revenue should only be recognised to the extent of the expenses that have been recognised that are recoverable.

F. INTEREST, ROYALTIES AND DIVIDENDS

Revenue is recognised on the following bases:

a) *Interest* recognised as the effective interest method per IAS39 (not examinable at Formation 2).

b) *Royalties* recognised on an accruals basis.

c) *Dividends* recognised when the shareholder's right to receive payment is established.

G. DISCLOSURE

An entity will make the following disclosures:

1) The entity's accounting policies for recognising revenue and determining the stage of completion of transactions involved in the provision of services.

2) Revenue analysed between:

   (i) Sale of Goods

   (ii) Rendering of Services

   (iii) Interest

   (iv) Royalties and

   (v) Dividends

3) Amount of revenue from exchange of goods or services included in each of the categories identified in (2) above.

Study Unit 15

IAS 37 – Provisions, Contingent Liabilities and Contingent Assets

Contents

A. OBJECTIVE

The objective of this standard is to ensure that the appropriate recognition rules and measurement bases are applied to provisions, contingent liabilities and contingent assets. The standard also sets out the disclosure to be made to ensure that sufficient information is available to assist users in understanding the nature, timing and amount of any provisions, contingent liabilities and contingent assets.

B. DEFINITIONS

A Provision is a liability of uncertain timing or amount.

A liability is a <u>present obligation</u> of an entity arising from <u>past events</u>, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefit.

An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A legal obligation is an obligation that derives from:

a) A contract,

b) Legislation or

c) Operation of law.

A constructive obligation is an obligation that derives from an entity's actions where:

a) By an established pattern or past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities, and

b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A contingent liability is:

a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, and

b) A present obligation that arises from past events but is not recognised because:

    (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligations, or

    (ii) The amount of the obligation cannot be measured with sufficient reliability.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

A restructuring is a programme that is planned and controlled by management, and materially changes either:

a) The scope of the business undertaken by an entity, or

b) The manner in which that business is conducted.

A provision differs from other liabilities due to the uncertainty as to the timing and amount of the expenditure involved.

C. RECOGNITION

A provision is recognised when all of the following conditions are met:

a) An entity has a present obligation as a result of a past event,

b) It is probable that there will be an outflow of economic benefits to settle the obligation,

c) A reliable estimate of the amount of the obligation can be made.

Contingent Liability
If the possibility of an outflow of economic benefit is remote then the entity does not need to disclose the contingent liability.

If the possibility of an outflow of economic benefit is probable and a reliable estimate of the amount can be made then a provision should be made.

Contingent Asset
A contingent asset is the possibility of an inflow of economic benefits. Where the possibility is virtually certain the contingent asset should be recognised.

If the possibility of the inflow of economic benefits is probable then details of the contingent asset should be disclosed.

Both contingent assets and contingent liabilities should be reviewed continually to ensure that are accurately presented in the financial statements.

D. MEASUREMENT

The amount of the provision presented in the financial statements will be the best estimate of the amount of the expenditure required to settle the present obligation as at the Statement of Financial Position date. These estimates are based on the judgement of the management of the entity with reference to their past experience of similar transactions and, on some occasions, the advice of experts.

Example
COD Ltd sells domestic appliances with a warranty that covers the cost of repairs of any manufacturing defects that occur within the first year. If minor defects occurred in all goods sold, the cost would be RWF2m. If major defects occurred in all goods sold, the cost would be RWF8m. Based on COD's past experience 80% of the goods sold will have no defects, 15% will have minor defects and 5% will have major defects.

The expected cost of the entity's warranty is:

No defects	(80% x Nil)	Nil
Minor Defects	(15% x RWF2m)	300k
Major Defects	(5% x RWF8m)	400k
Total Provision for Warranty Claims		700k

In calculating the best estimate of a provision consideration should be given to any risks and uncertainties that exist. This does not justify the creation of excessive provisions or a deliberate overstatement of liabilities.

Future events that may affect the amount required to settle an obligation shall be reflected in the amount of the provision where there is sufficient objective evidence that they will occur.

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision. In the Statement of Comprehensive Income, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

E. CHANGES IN PROVISIONS

Provisions should be reviewed annually at the Statement of Financial Position date to ensure that it represents the best estimate. If there is no longer a requirement for the provision, that is, we do not expect that there will be an outflow of economic benefit, we should reverse the provision.

F. USES OF PROVISIONS

A provision should only be used for expenditure for which the provision was originally established.

G. APPLICATIONOF THE RECOGNITION AND MEASUREMENT RULES

Future Operating Losses
No provision shall be made for future operating losses.

Onerous Contracts
If an entity has an onerous contract then the present obligation under the contract should be recognised and measured as a provision.

Restructuring
The following are examples of events that are considered to be restructuring:

a) Sale or termination of a part of the business,

b) Closure of business in a country or region or the relocation of business activities from one country or region to another,

c) Change in management structure,

d) Fundamental reorganisation that have a material effect on the nature and focus of the entity's operations.

A constructive obligation to restructure arises only when an entity:

a) Has a detailed plan for restructuring, identifying at least:

  (i) Business or part of business concerned,

  (ii) Principal locations affected,

  (iii) Location, function, and approximate number of employees who will be compensated for termination of their services,

  (iv) Expenditure to be undertaken and

  (v) when the plan will be implemented and

b) Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

A decision by the Board of Management prior to the Statement of Financial Position date to implement a restructuring plan does not of itself constitute a constructive obligation unless they have started to implement the restructuring plan or they have announced the main features of the plan to those affected.

No obligation arises for the sale of an operation until the entity is committed to the sale, that is, there is a binding sale agreement.

A restructuring provision shall include only the direct expenditure arising from the restructuring, which is both necessarily entailed by the restructuring and not associated with the on-going activities of the entity.

H. DISCLOSURE

For each class of provision an entity must disclose:

a) The carrying amounts at the beginning and end of the period,

b) Additional provisions made in the period, including an increase to existing provisions,

c) Amounts used during the period,

d) Unused amounts reversed during the period and

e) Any increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Comparative information is not required.

An entity shall disclose for each class of provision:

a) A brief description of the nature and timing of any expected outflow of economic benefit,

b) Details of any uncertainties about the amount and timing of these outflows, it may be necessary to disclose any major assumptions made concerning future events,

c) Amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

For each Contingent liability where the possibility of the settlement is not remote the entity should provide a brief description of the nature of the contingent liability, and where practicable:

a) An estimate of the financial effect,

b) An indication of the uncertainties relating to the amount or timing of any outflow,

c) The possibility of any reimbursement.

For each contingent asset disclose:

a) A brief description of the nature of the contingent asset,

b) An estimate of the financial effect.

I. EXAMPLES - RECOGNITION

Warranties
The obligating event is the sale of the product with a warranty. It is probable that there will be an outflow of resources. A provision is recognised for the best estimate of the cost of correcting the defects on goods sold prior to the Statement of Financial Position date.

Contaminated Land – Legislation virtually certain to be enacted
It is probable that there will be an outflow of resources as the enactment of the legislation is virtually certain and therefore an obligating event. It is necessary to recognise a provision for the best estimate of the cost to clean up the contaminated land.

Contaminated Land – No environmental legislation but company has a widely publicised environmental policy to clean up any contamination
The company has an obligation to clean up the contaminated land as a result of its past practice. The likelihood that there will be an outflow of resources to correct the contamination is probable. The entity will recognise a provision for the best estimate of the costs of the clean-up.

Offshore Oilfield
A licensing agreement requires it to remove the oil rig at the end of the production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the rig and the restoration of the damage to the seabed, the remaining ten per cent arises through the extraction of the oil.

The obligating event is the construction of the oil rig and its removal and restorationof the seabed. The likelihood attaching to the event is highly probable. A provision should be raised for the best estimate of the cost of removing the oil rig and restoring the sea bed, that is, the ninety per cent of the eventual costs. The balance is recognised as a liability when the oil is extracted.

Refunds Policy
A retail company refunds dissatisfied customers even though this is not required by legislation. The obligating event is the sale of goods to customers who have an expectation

based on past experience that they will receive a refund if they are unhappy with their purchases. The likelihood that the company will have to refund customers is probable. A provision is recognised for the best estimate of the cost of the refunds.

Closure of a Division – No implementation before the Statement of Financial Position Date

There is no obligating event as no action has been taken at the Statement of Financial Position date so therefore no provision can be raised.

Closure of a Division – Communication / Implementation before Statement of Financial Position Date

The fact that the company has communicated its plans to close a division. As a result of the communication it is highly probable that the division will be closed. A provision should be recognised, this should represent the best estimate of the cost involved in closing the division.

Staff retraining as a result of changes in the Statement of Comprehensive Income

For example, changes in Income Tax Legislation: certain companies will need to retrain their administrative staff to ensure compliance with the legislation. At the Statement of Financial Position date no retraining has taken place. There is no obligating event because no retraining has taken place, so no provision is recognised.

Onerous Contract

A company has moved during the year to new premises but their old premises still has 4 years remaining on its lease. The company cannot cancel the lease and they cannot sublet the premises. The obligating event is the signing of the original lease agreement and this gives rise to a legal obligation. A provision is recognised for the best estimate of the unavoidable lease payments.

Refurbishment Costs – No legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the Statement of Financial Position date, the lining has been in use for three years. There is no obligating event as at the Statement of Financial Position date as the lining exists independently of the company's future actions – even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, that is, it is depreciated over five years. The re-lining costs then incurred are capitalised with the consumption of each new lining shown by depreciation over the subsequent five years. There is noevent so no provision is recognised.

Refurbishment Costs – Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years. There is no event so therefore no provision is recognised.

The rationale is the same as in the previous example of Refurbishment costs where there is no legislative requirement.

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Study Unit 16

Sole Traders

Contents

A. PREPARING FINANCIAL STATEMENTS FOR DIFFERENT FORMS OF BUSINESS ENTITY

There are a number of different forms of business entity. These are:

(i) Sole-trader e.g. shop-keeper

(ii) Companies, limited by shares or by guarantee

(iii) Companies, unlimited

A number of substantial differences exist between all of these. These are:

1. The business of the sole trader is not governed by one identifiable Act but is subject to provisions of customary / common law and other acts related to commercial activities..

2. A sole trader operates as a single individual. A private company must have a minimum of two members and a maximum of one hundred, while a public company must have a minimum of seven members with no maximum number of members. (Companies Act 7/2009 , Article 6)

3. A sole trader operates his business on a personal basis; a company is a separate legal entity, distinct from its members.

4. The sole trader has the capacity to enter into binding contracts. The management of a company must act within the terms outlined in the Memorandum and Articles of Association of the company and is deemed to be an agent of the company.

5. A sole trader may commence trading without much formality. A company must complete a number of formalities before business can commence. Such legal documents include memorandum and articles of association.

6. A sole trader is liable for the debts of his business without limit.
   Company Limited by Guarantee
   Company formed on the principle of having the liability of its members limited by its constitution to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.
   Company Limited by Shares
   Company in which the liability of shareholders is limited to the number of subscribed shares, whether paid or not.

Company Limited by Shares & Guarantee

Is a Company formed on the principle of having the following liability of its members limited to:-

(a) the amount paid by shareholders or the amount agreed to pay on the shares respectively held by them, if any;

(b) the security issued by shareholders equivalent to the amount agreed as surety in case of liquidations.

Reference: Companies Act Law No 07/2009 of 27/04/09

7. Payables of a sole trader's business have a right of action against the sole trader personally. The payables of a company have a right of action against the company itself and not against its members.

8. The property of a sole trader belongs to the individual himself and may be used for his own purposes, irrespective of whether for business or private use. The assets of the company do not belong to the members but rather to the company in its own separate legal right.

9. A sole trader often experiences difficulty in negotiating loans as lending institutions seek security on such a loan by way of charges on assets. A company has that capacity as the shareholders do not have the capacity to remove the assets for their own personal use.

10. On death, the business of the sole trader ceases. The business of a company is unaffected by death of a member.

11. A sole trader may sell his business to another (the original owner is liable for all debts up to the date of sale).

12. The accounts of sole traders need not be filed with any public office except possibly the Rwandan Revenue Authority for Income tax purposes. Subsequently, those accounts are not available for inspection by other interested parties. A company, on the other hand, must make annual returns to the Office of Registrar General and these are available for inspection.

When preparing financial statements for any of the above, the principles of double-entry still apply. However, each will have their own individual requirements.

B. SOLE TRADER ACCOUNTS - INTRODUCTION

The business activities of a sole trader should be separate from his personal transactions. To assist in preparing the accounts, the sole trader should operate two bank accounts - one for the business and one for personal expenses. Any money put into the business from the sole trader's private resources are treated as capital. Any assets withdrawn from the business during the course of the year is known as drawings e.g. stock taken for own use, cash, motor vehicle. Drawings are not included as expenses in the Statement of Comprehensive Income. Rather, the drawings are debited to the capital account in the Statement of Financial Position. The profit at the end of the period belongs solely to the trader. At the end of the accounting period, the profit is credited to the capital account in the Statement of Financial Position while a loss is debited.

One major disadvantage of being a sole trader is that the sole trader has not got limited liability; i.e. should the business incur debts and there are insufficient resources in the business to pay all the payables, the sole trader must pay the payables from private funds. In some instances, the sole trader's private assets i.e. house, may have to be sold to pay the debts involved.

When preparing the accounts of sole traders or other small businesses, the books or records may fall short of a complete system of double entry. Such situations may vary from cases where virtually no records or bank accounts are maintained to cases where bank accounts and some record of transactions are maintained. Such accounting records, which fall short of a system of complete double entry, are known as ***incomplete records.***

The approach of the accountant in preparing accounts from incomplete records will depend on the extent of the incompleteness of the records. However, in all cases he will be attempting to:

(a) Compute a Statement of Comprehensive Income for the accounting period

(b) Prepare a Statement of Financial Position at the end of the accounting period

C. TWO APPROACHES IN PREPARING ACCOUNTS

Incomplete records can be divided into two types and there are, therefore, two methods of preparing accounts from such records. These are:

(a) Double Entry Approach

In cases where the double entry approach is used, bank statements will exist and probably some other record of transactions for the year - possibly cash records and cheque books. The approach here is prepare an opening statement of affairs, to establish the balance on the capital account and then to open ledger accounts and complete the double entry for the year. A final trial balance at the year-end will then be prepared and from this, a trading, a Statement of Comprehensive Income, together with a Statement of Financial Position can be completed.

(b) Single Entry Approach

In cases where the single entry approach is used, no bank account will have been maintained which means that it will not be possible to prepare a cash account for the year. In such cases, the accountant will prepare a statement of affairs as at the beginning and end of the accounting period, showing the total assets, total liabilities and net worth of the business at each of those dates. The increase in net worth i.e. net assets will be adjusted for cash introduced and drawings during the year and the resulting balance will represent the profit or loss for the year. In such cases, it will not be possible to prepare a Statement of Comprehensive Income for the year.

D. DOUBLE ENTRY APPROACH

The followings are the steps that should be taken in preparing final accounts under the double entry approach.

1. Opening Statement of Affairs

A statement of affairs should be prepared as at the commencement of the accounting period. This will include a list of all the balances on the asset and liability accounts at that date and the resulting balance of net assets will represent the opening balance of the capital account for the period.

Each of the different classes of assets and liabilities will then be posted to the relevant ledger account as an opening balance.

2. Preparation of Cash Account

Using the bank statements, lodgement dockets and cheque stubs, all of the receipts and payments should be analysed for the year. In practice, ruled analysis sheets will be used in the preparation of such an analysis of expenditure. A cash account will then be prepared for the year showing the different classes of income received and expenditure incurred during the year. It is important to include in the cash account, cash receipts during the year which were not lodged and which may have been taken as drawings or used to purchase further goods or pay for expenses in cash.

Example

Cash Account – Year Ended 31 December 20X4

		RWF			RWF
1.01.X4	Balance b/d	1,500	Payments to trade payables (goods)		11,000
	Receipts from		Expense payments	- ESB	1,500
	Trade Receivables	12,500		- Rent	2,500
	Cash Sales	2,000	Drawings		600
	Capital Introduced	3,500	31.12.X5 Balance c/d		3,900
		19,500			19,500
1.01.X5	Balance b/d	3,900			

In order to complete the double entry, the individual items of income and expenditure will be posted to the appropriate ledger accounts.

3. Trade Receivables Control Account

The next step is the preparation of the trade receivables control account. This account should already contain an opening debit balance, which will be the figure posted from the statement of affairs. It will also contain a credit entry being the cash received from trade receivables during the year.

A listing of the outstanding trade receivables at the end of the accounting period should now be prepared and posted to the credit of the account as the closing balance. No adjustment should be made in the trade receivables control account for bad debts.

The balancing debit figure in the account will represent the value of sales during the period.

Example

You are given the following information at 31 Dec 20X4 and are requested to prepare a debtors control account.

	RWF
Balance of trade receivables at 1 Jan 20X4	**6,000**
Cash received from trade receivables	**27,500**
Balance on trade receivables control 31 Dec 20X4	**7,500**

Trade Receivables Control Account

		RWF			**RWF**
1.01.X4	**Balance b/d**	**6,000**		**Cash received – trade receivables**	**27,500**
*******	**Total sales for year**	**29,000**	**31.12.X4**	**Balance c/d**	**7,500**
		35,000			**35,000**
1.01.X5	**Balance b/d**	**7,500**			

***** Balancing figure**

4. Trade Payables Control Account

Similarly, a trade payables control account will be prepared for the year. This account will show an opening credit balance being the trade payables transferred from the statement of affairs and a debit entry being the payments made to trade payables during the year. A list of credit balances will be prepared and posted to the debit of the account as a closing balance. The value of cash purchases will also be posted to the debit of the account.

The balance on the account will now represent the value of purchases during the year.

Example

Prepare a creditors control account from the following information extracted for the year ended 31 Dec 20X4.

	RWF
Balance on trade payables control at 1 Jan 20X4	**15,000**
Payments to trade payables	**13,000**
Balance on trade payables at 31 Dec 20X4	**9,000**

Trade Payables Control Account

	RWF			RWF
Payments to trade payables	**13,000**	**1.01.X4**	**Balance b/d**	**15,000**
31.12.X4 Balance c/d	**9,000**	*******	**Total purchases for year**	**7,000**
	22,000			**22,000**
		1.01.X5	**Balance b/d**	**9,000**

***** Balancing figure**

5. **Accruals and Prepayments**

At the end of the accounting period, a list of accruals and prepayments should be prepared, journalised and posted to the appropriate ledger account. Example of accounts on which accruals and prepayments might arise are:

- Rent Account
- Rates Account
- Electricity Account
- Subscription Account

6. **Other asset and liability accounts**

Postings should now be made on any other asset or liability accounts which affect the financial results of the business and which are not included above i.e. provision accounts. Examples:

(a) Provision for depreciation
DR Depreciation account
CR Accumulated depreciation account/provision for depreciation account

(b) Provision for bad debts
DR Bad debts account
CR Provision for bad debts account

7. **Preparation of final accounts**

(i) An inventory figure at the end of the accounting period will be calculated.

(ii) Transfer from the various accounts will be made to the Statement of Comprehensive Income. Accounts should be balanced and balances carried down to the next period.

(iii) A Statement of Financial Position will be prepared from the list of closing balances. The balance on the Statement of Comprehensive Income will be added to the capital account. Having adjusted this account for drawings during the year, the closing balance will represent the capital of the business at the end of the accounting period.

8. Reasonableness check on results for year

A reasonableness check on the results for the year could be carried out, by comparing the gross profit ratios extracted from the accounts with:

(a) The gross profit ratio in previous accounting periods

And/or

(b) Gross profit ratios produced by similar business concerns.

A divergence in this ratio from the expected figure might raise doubts about accuracy of the stock figure or whether stock has been drawn from business for private use.

9. Inventory for Private use

The owner of the business may take goods for private use. This is accounted for by the following journal entry:

Debit Drawings Account
Credit Purchases Account

E. QUESTION/SOLUTION

Question

Joseph Otto has been in business five years. He does not maintain a ledger. His summary receipts and payments account for the year ended 31st March 20X4 is as follows:

	RWF			RWF
Balance 1/4/20X3	8,400	Drawings		31,500
Sales receipts	211,550	Purchases		188,500
Loan from Pascal Otto	25,000	Van Expenses		14,500
Sale of private car	4,350	Workshop:	Rent	3,500
Balance 31/3/20X4	7,550		Rates	2,850
		Wages:	Yves Moller	16,000
	256,850			256,850

Additional information:

(a) Depreciation is provided on the van annually at the rate of 20% of the book value.

(b) The loan from Pascal Otto was received on 1st January 20X4; interest is payable on the loan at the rate of 10% per annum.

(c) In addition to the items mentioned above, the assets and liabilities of Joseph Otto were as follows:

At 31st March	**20X3**	**20X4**
Van purchased 1/10/20X2, at cost	20,000	20,000
Accumulated depreciation on van	2,000	2,000
Inventory	25,000	40,000
Trade receivables	23,000	61,450
Van expenses prepaid	-	500
Workshop rent accrued due	-	1,000
Trade payables	14,500	11,000

Requirement:
Prepare the trading and Statement of Comprehensive Income for the year ended 31st March 20X4, and a Statement of Financial Position as at that date.

Solution

1. Opening Statement of Affairs 1st April 20x3

	RWF
Assets	
Van	20,000
Less Accumulated Depreciation	(2,000)
	18,000
Inventory	25,000
Trade Receivables	23,000
Bank	8,400
	74,400
Liabilities	
Trade Payables	14,500
∴ Opening Capital	RWF59,900

2. Bank Account as Per Question

3.

Trade Receivables Control Account

	RWF		RWF
Opening	23,000	Closing	61,450
∴ Sales	250,000	Bank	211,550
	273,000		273,000

4.

Trade Payables Control Account

	RWF		RWF
Closing	11,000	Opening	14,500
Bank	188,500	Purchases	185,000
	199,500		199,500

5. (a)

Accruals and Prepayments: Van Expenses Account

	RWF		RWF
Bank	14,500	Prepaid c/d	500
		Statement of Comprehensive Income	14,000
	14,500		14,500

(b)

Workshop Rent Account

	RWF		RWF
Bank	3,500	Statement of Comprehensive Income	4,500
Accrued c/d	1,000		
	4,500		4,500

6. Other Asset/Liability Accounts

(a) Depreciation on Van:

Net book value at 1/4/X3 RWF18,000 x 20% = RWF3,600

(b) Loan Interest:

Loan from Pascal Otto RWF25,000 x 10% x 3/12 = RWF625

7. Preparation of Final Accounts:

Statement of Comprehensive Income

	RWF	RWF
Sales		250,000
Inventory 1/4/X3	25,000	
Purchases	185,00 0	
Inventory 31/3/X4	40,000	
Cost of Sales		170,000
Gross Profit		80,000
Rent	4,500	
Rates	2,850	
Wages	16,000	
Van Expenses	14,000	
Loan Interest	625	
Depreciation	3,600	41,575
Net Profit		38,425

Statement of Financial Position

	Cost	Accumulated Depreciation	Net Book Amount
Non-currentNon-Current Assets	RWF	RWF	RWF
Van	20,00 0	5,600	14,400
Current Assets			
Inventories		40,000	
Trade Receivables		61,450	
Prepayment		500	

			101,950
			116,350
Capital:		RWF	
Balance 1/4/X4		59,900	
Sales of Private Car – capital introduced		4,350	
Add net Profit		38,425	
		102,675	
Less Drawings		31,500	
			71,175
Non-current Liabilities			(25,000)
Current Liabilities			
Creditors	11,000		
Bank Overdraft	7,550		
Interest Due	625		
Rent Due	1,000		20,175
			116,350

F. SINGLE ENTRY APPROACH

Introduction

In certain cases, owing to the deficiency of the records, it will be impossible to complete double entry accounts as described above. This might occur because no bank accounts were maintained and the records of the cash received and payments made were insufficient to give details of the transactions entered into.

In order to establish the profit for the year and the financial position at the year end, the following steps should be taken: -

1. **An opening statement of affairs should be prepared as described above.**
2. **A statement of affairs at the end of the accounting period should be prepared.**
3. The net increase in capital for the year can then be found by subtracting the balances on the capital accounts in 1 and 2 above from one another. This net increase in capital will then be reduced by the capital introduced during the year, increased by the drawings during the year and the resulting balance will represent the profit or loss for the year.

G. QUESTION/SOLUTION

J.Klopper

J.Klopper is a dealer who has not kept proper books of account. At 31st August 20X4 his state of affairs was as follows:

	RWF
Cash	115
Bank Balance	2,209
Fixtures	4,000
Inventory	16,740
Trade Receivables	11,890
Trade Payables	9,052

Motor Van	3,000

During the year to 31st August 20X5 his drawings amounted to RWF7,560. Winnings from a Casino RWF2,800 were put into the business. Extra fixtures were bought for RWF2,000.

At 31st August 20X5 his assets and liabilities were: Cash RWF84, Bank Overdraft RWF165, Inventory RWF21,491, Trade Payables for goods RWF6,002, Payables for Expenses RWF236, Fixtures to be depreciated RWF600, Motor Van to be valued at RWF2,500, Trade Receivables RWF15,821, Pre-paid Expenses RWF72.

Draw up a statement showing the profit or loss made by Klopper for the year ended 31st August 20X5.

Solution

J. Klopper Opening Capital: 1st September 20X4

	RWF	RWF
Cash	115	
Bank	2,209	
Fixtures	4,000	
Inventory	16,740	
Trade Receivables	11,890	
Motor Van	3,000	37,954
Less Trade Payables		9,052
		28,902

J. Klopper Statement of Financial Position as at 31st August 20X5

	RWF	RWF
Non-current Assets		
Motor Van	3,000	
Less Depreciation	500	2,500
Fixtures	6,000	
Less Depreciation	600	5,400
		7,900
Current Assets		
Inventories	21,491	
Trade Receivables	15,821	
Prepaid Expenses	72	
Cash	84	37,468
		45,368
Financed By:		
Capital		28,902
Add Net Profit (W1)		14,823
Add Cash Introduced		2,800
		46,525
Less Drawings		7,560

		38,965
<u>Current Liabilities</u>		
Trade Creditors	6,002	
Expenses Owing	236	
Bank Overdraft	165	6,403
		45,368

(W1) Net Profit Calculation

	RWF
Closing Net Assets	38,965
Minus Opening Net Assets	28,902
Increase	10,063
Add Drawings	7,560
	17,623
Less Capital Introduced	(2,800)
Net Profit	14,823

H. USE OF RATIOS

Occasionally, ratios may be required to complete the question. Two key ratios are used – Mark-up and margin.

$$\text{Margin} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

Often referred to as the Gross Profit Percentage

$$\text{Mark Up} = \frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100$$

These two ratios are examined in a number of ways. Therefore, it is important to be fully familiar with them.

Example 1:
Goods cost RWF10,000. Mark-up by 20%. What is the selling price?

Solution:

$$\text{Selling Price} = \frac{10{,}000 \times 120}{100} = \text{RWF}12{,}000$$

Example 2:

GOODS COST RWF10,000. GROSS PROFIT PERCENTAGE IS 20%. WHAT IS THE SELLING PRICE?

Solution:

$$\text{Selling Price} = \frac{10{,}000 \times 100}{80} = \text{RWF}12{,}500$$

Example 3:
Goods sold for RWF10,000. Gross Profit Percentage is 20%. What is the cost price? What is the mark-up expressed as a % of cost?

Solution:

$$\text{Cost Price} = \frac{10{,}000 \times 80}{100} = \text{RWF}8{,}000$$

$$\text{Mark Up} = \frac{10{,}000 - 8{,}000 \times 100}{8{,}000} = 25\%$$

Example 4:
GOODS SOLD FOR RWF10,000. MARK-UP IS 10%. WHAT IS THE COST PRICE

Solution:

$$\text{Cost Price} = \frac{10{,}000 \times 100}{110} = \text{RWF}9{,}091$$

I. QUESTION/SOLUTION

Eric Grewar - Incomplete Records
Eric Grewar commenced business as a retailer on 1st April 20X2. On the same date he opened a Bank Account but has not kept any proper accounting records. In May 20X4 you are called in to assist in the preparation of accounts for tax purposes. You ascertain that on 1st April 20X3 Grewar had the following assets and liabilities.

	RWF
Furniture and Equipment (Cost RWF5,400)	3,800
Motor Vehicles (Cost RWF2,800)	2,100
Goodwill (at cost)	2,000
Inventory	6,300
Loan from Jean Jones	1,500
Bank Overdraft	1,000
Trade Receivables	1,000
Trade Payables	3,200
Prepaid Expenses	500
Accrued Expenses	650

An analysis of the Bank Account for the year ended 31st March 20X4 revealed the following information:

Receipts	RWF	Payments	RWF
Trade Receivables	5,200	Cash Purchases	23,200
Cash Sales	34,300	Trade Payables	8,900
New Loan from Jean Jones	5,500	Expenses	5,300
		Motor Vehicles	1,750
		Drawings	5,200
	45,000		44,350

The following additional information also came to light.

(1) Mr Grewar has taken goods costing RWF100 for his own personal use.

(2) The amounts outstanding for trade receivables and trade payables at the end of the current financial year were RWF1,300 and RWF3,800 respectively. Bad Debts of RWF100 had been taken into account in arriving at the trade receivables figure.

(3) RWF450 was accrued and RWF520 prepaid at 31st March 20X4.

(4) The inventory valuation at the end of the current year was RWF5,850.

(5) Interest of 10% is to be provided for on both loans.

(6) The agreed maximum on the bank overdraft is RWF5,000 and RWF50 interest is outstanding.

(7) Depreciation of 20% on the original cost of all furniture, equipment and Motor Vehicles is to be provided.

You are required to:
Prepare the Statement of Comprehensive Income for the year ended 31st March 20X4 and a Statement of Financial Position at the same date, showing all relevant workings.

Solution - Eric Grewar
Step 1 Prepare an opening statement of affairs in order to ascertain the capital at the beginning of the year.

Assets	RWF
Furniture and Equipment	3,800
Motor Vehicles	2,100
Goodwill	2,000
Inventory	6,300
Trade Receivables	1,000
Prepaid Expenses	500
	15,700
Liabilities	
Loan from Jean Jones	1,500
Bank Overdraft	1,000
Trade Payables	3,200
Accrued Expenses	650
	6,350
∴ Opening Capital	RWF9,350

Step 2 Prepare Cash and Bank Account

Bank Account

	RWF		RWF
Trade Receivables	5,200	Balance b/d	1,000
Cash Sales	34,300	Cash Purchases	23,200
New loan from Jean Jones	5,500	Trade Payables	8,900
Balance c/d	350	Expenses	5,300
		Motor Vehicles	1,750
		Drawings	5,200
	45,350		45,350
		Balance b/d	350

Step 3 Prepare Trade Receivables and Trade Payables Accounts to find Sales and Purchase

Trade Receivables

	RWF		RWF
Balance	1,000	Bank	5,200
Sales	5,600	Bad debts	100
		Balance	1,300
	6,600		6,600

Trade Payables

	RWF		RWF
Bank	8,900	Balance b/d	3,200
Balance c/d	3,800	Purchases	9,500
	12,700		12,700

Step 4 Deal with Accruals and Payments

Expenses Account

	RWF		RWF
Balance b/d	500	Balance b/d	650
Bank	5,300	Statement of Comprehensive Income	5,080
Balance c/d	450	Balance c/d	520
	6,250		6,250

Eric Grewar Statement of Comprehensive Income for the Year ended 31st March 20X4

	RWF	RWF
Sales (5,600 + 34,300)		39,900
Cost of Sales		
Opening Inventory	6,300	
Purchases (W1)	32,600	
	38,900	

Less Closing Inventory			5,850	
Cost of Goods Sold				33,050
Gross Profit				6,850
Deduct	Expenses		5,080	
	Bad Debts		100	
	Loan Interest (7,000 x 10%)		700	
	Overdraft Interest		50	
	Depreciation 20% x 5,400	1,08 0		
	Motor Vehicles (W2)	910	1,990	
Net Loss				7,920
				RWF(1,070)

W1

	RWF
Credit Purchases	9,500
Cash Purchases	23,200
	32,700
Less Goods for Own Use	100
	32,600

W2

	RWF
Motor Vehicles at start of the year	2,800
Acquired during the year	1,750
Total Cost of Motor Vehicles	4,550
Depreciation @ 20%	910

Eric Grewar Statement of Financial Position as at 31st March 20X4

	Cost	Accumulated Depreciation		Net Book Value
Non-current Assets	RWF	RWF	RWF	RWF
Goodwill	2,000			2,000
Furniture & Equipment	5,400	2,680		2,720
Motor Vehicles	4,550	1,610		2,940
	11,950	4,290		7,660
Current Assets				
Inventories			5,850	
Trade Receivables			1,300	
Prepaid Expenses			520	
				7,670
				15,330
Represented by:				
Eric Grewar Capital 1/4/20X2				9,350
Less Loss for Year		1,070		
Drawings 5,200 + 100		5,300		6,370

		2,980
Loan – Eric Grewar (5,500 + 1,500)		7,000
Current Liabilities		
Trade Payables	3,800	
Accrued Expenses (W3)	1,200	
Bank Overdraft	350	
		5,350
		15,330

W3

	RWF
Accrued Expenses	450
Bank Overdraft	50
Loan Interest	700
	1,200

Study Unit 17

Income and Expenditure Accounts

Contents

A. INCOME AND EXPENDITURE ACCOUNTS INTRODUCTION

Clubs, societies, credit unions and other non-profit organisations do not draw up Statement of Comprehensive Incomes; instead they prepare an INCOME AND EXPENDITURE ACCOUNT.

Where income is greater than expenditure the excess is referred to as the surplus of income over expenditure.

Where expenditure is greater than income the excess is referred to as the excess of expenditure over income.

In the Statement of Financial Position commercial entities describe the net assets as CAPITAL whereas non-profit organisations describe net assets as accumulated funds.

B. SOURCES OF INCOME

The main sources of income for clubs and societies are:

1. Social events
2. Members subscriptions
3. Life members' subscriptions
4. Special events e.g. annual dinner evening
5. Investment income

1. Social event - Example

The RGT Sports and Social Club have provided you with the following information:

	RWF
Takings	4,552
Payments for purchases	2,674
At the start of the year Restaurant and Bar Inventory was	190
And Trade Payables were	275
At the year-end Inventory was	225
And Trade Payables were	324
Staff wages	764

Requirement:

Prepare a Statement of Comprehensive Income for the year assuming the steward is entitled to a bonus of 10% of the surplus after charging the bonus.

Solution

Social events Statement of Comprehensive Income for the Year Ended ...

	RWF	RWF
Sales		4,552
Opening Inventory	190	
Purchases (324 + 2674 - 275)	2,723	
Closing Inventory	(225)	
Cost of Sales		2,688
Gross Surplus		1,864
Staff Wages		764
Profit before Bonus		1,100
Bonus RWF1,100 x 10/110		100
Surplus		RWF 1,000

2. Members Subscriptions

Members of clubs and societies usually pay an annual subscription to the club/society. The income received plus arrears of subscriptions for the current year, less arrears subscriptions for the previous year are treated as income in the income and expenditure account. Subscriptions received in advance are treated as an accrual in the Statement of Financial Position.

Example

The RGT Sports and Social Club has provided you with the following details in relation to its subscriptions:-

	RWF
Members subscriptions received	4,970
Members subscriptions owing at the start of the year	140
Members subscriptions owing at the end of the year	175
Members subscriptions received in respect of the forthcoming year	70

Solution

Members Subscription Club

	RWF		RWF
Balance b/d	140	Bank	4,970
Balance c/d	70	Balance c/d	175
Income and Expenditure Account	4,935		
	5,145		5,145
Balance b/d	175	Balance b/d	70

3. Life Members' Subscription

Often members of a club/society may pay a life members subscription, this should be recognised in the income and expenditure account over a defined period of time for example 10 years. The residue should be shown in the Statement of Financial Position beneath the accumulated fund.

Example

The RGT Sports and Social Club received RWF12,000 in life members' subscriptions during the year. It is the accounting policy of the club to amortise life members' subscriptions to the income and expenditure account over 10 years.

In the income and expenditure account RWF1,200 is recognised as income. In the Statement of Financial Position RWF12,000 - RWF1,200 i.e. RWF10,800 is shown beneath the accumulated fund and described as the life members fund account.

4. Special Events

It is usual to show the surplus/deficit arising on special events as a separate item of income/expenditure in the income and expenditure account.

Example

The RGT Sports and Social Club has supplied you with the following information regarding its competitions:

	RWF
Competition receipts	722
Competition prizes	311
Stock of competition prizes at the start of the year	40
Stock of competition prizes at the end of the year	48

Solution

The surplus on competitions to be shown in the income and expenditure account is as follows:

Income and Expenditure Account for the Year Ended ...

Surplus on competitions	RWF419

This is calculated as follows:

	RWF	RWF
Competition receipts		722
Competition Prizes:		
Opening Inventory	40	
Purchases/Payments	311	
Closing Inventory	(48)	
		303
Surplus		419

5. Investment Income

The investment income accruing for the year should be included in the income and expenditure account.

Example

The RGT Sports and Social Club has a building society bank deposit account. Interest is credited by the bank to the deposit account on 2 January and 2 July. On 2 July 20X8, RWF25 was credited; RWF27 was credited on 2 January 20X9 and RWF31 on 2 July 20X9. The club's year end is the 30 June 20X9.

Solution
The investment income to be included in the income and expenditure account for the year ended 30 June 20X9 is RWF27 + RWF31 i.e. RWF58. The amount received on 2 July 20X8 relates to the year ended 30 June 20X8.

C. EXPENDITURE

The main items of expenditure for clubs and societies are: rent, rates, light and heat, postage and stationery, depreciation of equipment, staff wages and a secretary's/treasurer's honorarium.

D. STATEMENT OF FINANCIAL POSITION

The Statement of Financial Position of a club/society follows the same format as commercial entities. However, the net assets are represented by an accumulated fund rather than capital.

E. QUESTION/SOLUTION

The treasurer of the OT Social & Sports Club has produced the following receipts and payments account for the year ended 30 June 20X1.

RECEIPTS	RWF	**Payments**	RWF
Balance at Bank 1/7/20X0	229	Bar purchases	2,642
Credit Union a/c 1/7/20X0	400	Rent	600
Members subscriptions	1,824	Rates	120
Entrance fees	160	Staff wages	840
Bar takings	3,175	Electricity & water	435
Competition receipts	412	Competition prizes	210
Interest received	35	Postage & stationery	320
		Credit Union a/c 30/6/X1	835
		Balance at bank 30/6/X1	233
	6,235		6,235

The assets of the club on 1 July 20X0 were furniture and equipment RWF3,200, prizes RWF50 and bar inventory RWF180. Bar suppliers were owed RWF290.

On 30 June 20X1 bar suppliers were owed RWF310; bar inventory amounted to RWF175 and prizes on hand had cost RWF30; subscriptions unpaid totalled RWF50.

During the year ended 30 June 20X1 subscriptions received included RWF35 in respect of the previous year and RWF20 in respect of the year beginning 1 July 20X1.

The Steward is to receive a bonus of 5% of the restaurant profits after deducting the bonus.

Interest on the Credit Union account is credited on 2 January and 2 July each year.

On 2 July 20X0 RWF15 was credited; RWF20 was credited on 2 January 20X1 and RWF25 on 2 July 20X1.

Furniture and equipment should be depreciated by 10%.

The rent paid was for the year ending 31 December 20X1. The rent for 20X0 was RWF480.

Requirement:

(a) A Restaurant trading account for the year ending 30 June 20X1.

(b) An income and expenditure account for the year ending 30 June 20X1.

(c) A Statement of Financial Position as at 30 June 20X1.

Solution

Restaurant Trading Account for the Year Ended 30 June 20X1

	RWF	RWF
Sales		3,175
Opening inventory	180	
Purchases (W1)	2,662	
	2,842	
Closing inventory	175	
Cost of Sales		2,667
Gross profit		508
Bonus		24
Profit		484

OT SOCIAL AND SPORTS CLUB

Income and Expenditure Account for the year ended 30 June 20X1

	RWF	RWF
Income		
Subscriptions (W2)		1,819
Financial Institution Interest (W3)		45
Entrance fees		160
Surplus on competitions (W4)		182
Restaurant profit		484
		2,690
Expenditure		
Rent (W5)	540	
Rates	120	
Staff wages	840	
Electricity & water	435	
Postage & stationery	320	
Depreciation (W6)	320	2,575
Surplus		115

Statement of Financial Position as at 30 June 20X1

	RWF	RWF
Non-Current Assets		
Furniture (3,200 – 320)		2,880
Current Assets		
Inventory: bar	175	
Prizes	30	205
Prepayment: Rent		300
Subscription in arrears		50
Credit Union account		835
Interest due		25
Bank		233
		4,528
Current Liabilities		
Bar Creditors	310	
Subscriptions in advance	20	
Bonus due to Steward	24	354
		4,174
Accumulated fund: Balance 1/7/20X0		4,059
Surplus for year		115
		4,174

Workings

1.

Restaurant Trade Payables

	RWF		RWF
Bank	2,642	Balance b/d	290
Balance c/d	310	Purchases	2,662
	2,952		2,952

2.

Subscriptions

	RWF		RWF
Balance b/d	35	Cash	1,824
Income and Expenditure	1,819	Balance c/d	50
Balance c/d	20		
	1,874		1,874

Statement of Opening Accumulated Fund

	RWF
Bank	229
Credit Union	400
Rent	240
Furniture	3,200
Bar inventory	180
Interest due	15
Prizes	50
Subs. in arrears	35
	4,349
Owing	290
	4,059

3. Credit Union Interest: RWF20 + 25 = RWF45

4. Surplus on Competitions

		RWF
Competition Receipts		412
Competition Prizes		
Opening Inventory	50	
Purchases	21	
	0	
	26	
	0	
Closing Inventory	30	
		230
Surplus on Competitions		182

5. Rent

		RWF
Prepaid at start of Year RWF480 x 6/12	=	240
Paid for Year		600
		840
Prepaid at end of Year RWF600 x 6/12	=	300
		540

6. Depreciation

Furniture and Equipment	RWF3,200
Depreciation at 10%	RWF320