INSTITUTE OF CERTIFIED
PUBLIC ACCOUNTANTS
OF RWANDA

CPA

F1.3
FINANCIAL ACCOUNTING

Study Manual

2nd edition February 2020,

ICPAR
Unlimited possibilities

Acknowledgement

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INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Foundation F1

F1.3 FINANCIAL ACCOUNTING

2nd Edition, February 2020

This Manual has been fully revised and updated in accordance with the current syllabus/curriculum.
It has been developed in consultation with experienced tutors and lecturers.

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SUBJECT TITLE: F1.3 FINANCIAL ACCOUNTING

Aim

The aim of this subject is to ensure that students understand the role,function and basic principles of financial accounting and master the rules of double entry bookkeeping. They also develop the ability to prepare,analyse and reporting entities in accordance with International Financia lReporting Standards (IFRSs) andInternational Public Sector Accounting Standard (IPSAS).

Financial Accounting as an Integral Part of the Syllabus

The concepts and principles learnt in this subject area in essential foundation for the later studies of Financial Reporting,Advanced Financial Reporting,Auditing and Audit Practice and Assurance Services.

Learning Outcomes

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

- Identifying users of financial accounts and explain their requirements.
- Discuss and explain accountancy concepts and principles.
- Apply the principles and procedures of double entry bookkeeping.
- Prepare and present financial statements for sole traders, limited companies, partnerships and other organizations in accordance with current IFRS. Discuss, explain and apply the accounting treatment of non-current assets, current assets, events after the reporting period and contingencies in accordance with IFRS and IPSAS.
- Prepare and present statements of cash flow and interpret and reconcile the movements in cash balances.
- Analyze and interpret financial statements and prepare accounting information for management control and decision-making.
- Prepare financial statements on the basis of Vote books balances for various Departments / Ministries

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- The regulatory environment.
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TOPIC 1

ACCOUNTING FRAMEWORK

INTRODUCTION

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

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.

USERS OF FINANCIAL STATEMENTS

Users of financial statements include the following:

- **Existing and potential shareholders**

  Information is required in relation to profit, dividends, trends and prospects in connection with share price.

- **Loan Creditors**

  Information is required in relation to liquidity and to highlight the risk of non-payment.

- **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.

- **Analysts and investors**

  Information on performance, trends and prospects is required for clients

- **Government**

  Information is required as a base for taxation and to ensure compliance with company law

- **Employees**

  Information about employment security and to assist with collective pay bargaining

- **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 QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION

The Conceptual Framework states that qualitative characteristics are the attributes that make the information provided in financial statements useful to users.
The two fundamental qualitative characteristics are **relevance** and **faithful representation**. Enhancing qualitative characteristics are **comparability**, **verifiability**, **timeliness** and **understandability**

'Relevance.
Relevant financial information is capable of making a difference in the decisions made by users… Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both'

The predictive and confirmatory roles of information are interrelated. Information on financial position and performance is often used to predict future position and performance and other things of interest to the user, e.g. likely dividend, wage rises. The manner of showing information will enhance the ability to make predictions, e.g. by highlighting unusual items. The relevance of information is affected by its nature and materiality.

Materiality
'Materiality. Information is material if omitting it or misstating it could influence decisions that the primary users of general-purpose financial reports make on the basis of those reports which provide financial information about a specific reporting entity'

Information may be judged relevant simply because of its nature. In other cases, both the nature and materiality of the information are important. An error which is too trivial to affect anyone's understanding of the accounts is referred to as immaterial. In preparing accounts, it is important to assess what is material and what is not, so that time and money are not wasted in the pursuit of excessive detail. Determining whether or not an item is material is a very subjective exercise. There is no absolute measure of materiality.

It is common to apply a convenient rule of thumb (for example, material items are those with a value greater than 5% of net profits). However, some items disclosed in the accounts are regarded as particularly sensitive and even a very small misstatement of such an item is taken as a material error. An example, in the accounts of a limited liability company, is the amount of remuneration (salaries and other rewards) paid to directors of the company. The assessment of an item as material or immaterial may affect its treatment in the accounts.

For example, the statement of profit or loss of a business shows the expenses incurred grouped under suitable captions (administrative expenses, distribution expenses etc); but in the case of very small expenses it may be appropriate to lump them together as 'sundry expenses', because a more detailed breakdown is inappropriate for such immaterial amounts. In assessing whether or not an item is material, it is not only the value of the item which needs to be considered. The **context** is also important.

(a) If a statement of financial position shows non-current assets of RWF2,000 million and inventories of RWF30 million an error of RWF200,000 in the depreciation calculations might not be regarded as material. However, an error of RWF20 million in the inventory valuation would be material. In other words, the total of which balance the error forms, must be considered.

(b) If a business has a bank loan of RWF50 million and a RWF55 million balance on bank deposit account, it will be a material misstatement if these two amounts are netted off on the statement of financial position as 'cash at bank RWF5 million'. In other words, incorrect presentation may amount to material misstatement even if there is a very small or even no monetary error.

Faithful representation

'Faithful representation. Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena but must faithfully represent the substance of the phenomena that it purports to represent'

To be a faithful representation, information must be complete, neutral and free from error. A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.

A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, de-emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users. Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. Free from error means there are no errors or omissions in the description of the phenomenon and the process used to produce the reported information has been selected and applied with no errors in the process. In this context free from error does not mean perfectly accurate in all respects.

Prudence was removed from the 2010 Conceptual Framework as it was deemed to be implied within the depiction of neutrality, and that the term was being interpreted in different ways. However, it was felt that the exercise of prudence, along with understanding the substance of the transitions, rather than the pure legality of them, was required to be explicitly stated in the 2018 revisions to the Conceptual Framework. Furthermore, the Conceptual Framework 2018 revision included a clear definition of the term in order to clarify any potential areas of confusion

Substance over form

This is a characteristic of faithful representation. To be useful, financial information must…faithfully represent the substance of the phenomena that it purports to represent. In many circumstances the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon. For example, a business may have entered into a leasing agreement for some equipment. However, the terms are such that the business is really buying the equipment. The equipment should therefore be included in the statement of financial position as an asset of the business and the leasing agreement should be treated as a financing arrangement.

Enhancing qualitative characteristics

Comparability

Comparability. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items' (Conceptual Framework: para. 2.25). 'Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or date'

(Conceptual Framework: para. 2.24).
'Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items (ie consistency of treatment) either from period to period within a reporting entity or in a single period across entities' (Conceptual Framework: para. 2.26). The disclosure of accounting policies is particularly important here. Users must be able to distinguish between different accounting policies in order to be able to make a valid comparison of similar items in the accounts of different entities. Comparability is not the same as uniformity. Entities should change accounting policies if those policies become inappropriate. Corresponding information for preceding periods should be shown to enable comparison to be made over time.

Verifiability
Verifiability. Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. It means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation' Conceptual Framework: para. 2.30).

Information that can be independently verified is generally more decision-useful than information that cannot.

Timeliness
Timeliness. Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older information is the less useful it is' (Conceptual Framework: para. 2.33).
Information may become less useful if there is a delay in reporting it. There is a balance between timeliness and the provision of reliable information. If information is reported on a timely basis when not all aspects of the transaction are known, it may not be complete or free from error. Conversely, if every detail of a transaction is known, it may be too late to publish the information because it has become irrelevant. The overriding consideration is how best to satisfy the economic decision-making needs of the users.

Understandability
Understandability. Classifying, characterizing and presenting information clearly and concisely makes it understandable' (Conceptual Framework: para. 2.34).

Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyses the information diligently. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information on those phenomena might make the information easier to understand, but without it those reports would be incomplete and therefore misleading. Therefore, matters should not be left out of financial statements simply due to their difficulty, as even well-informed and diligent users may sometimes need the aid of an adviser to understand information about complex economic phenomena.

The elements of financial statements
Transactions and other events are grouped together in broad classes and in this way their financial effects are shown in the financial statements. These broad classes are the elements of financial statements.
Financial position. The elements affecting financial position are assets, liabilities and equity

- **Asset** is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits'
- **Liability** is a present obligation of the entity to transfer an economic resource as a result of past events'
- **Equity** is the residual interest in the assets of the entity after deducting all its liabilities'

Whether an item satisfies any of the definitions above will depend on the substance and economic reality of the transaction, not merely its legal form.

Asset

We can look in more detail at the components of the definitions given above. Potential to produce economic benefits. An economic resource is a right that has the potential to produce economic benefits (Conceptual Framework, para. 4.14).

Assets are usually employed to produce goods or services for customers; customers will then pay for these. Cash itself renders a service to the entity due to its command over other resources. The economic benefits can come in various forms, including x Cash flows, such as returns on investment sources x Exchange of goods, such as by trading, selling goods, provision of services x Reduction or avoidance of liabilities, such as paying loans.

Liabilities

Again, we can look more closely at some aspects of the definition of a liability as per the Conceptual Framework: For a liability to exist, three criteria must all be satisfied:

- The entity has an obligation
- The obligation is to transfer an economic resource
- The obligation is a present obligation that exists as a result of past events

An essential characteristic of a liability is that the entity has an obligation. Obligation. 'A duty or responsibility that the entity has no practical ability to avoid' (para. 4.29).

A present obligation exists as a result of past events if the entity has already obtained economic benefits or taken an action, and as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer (para. 4.43). (Conceptual Framework) It is important to distinguish between a present obligation and a future commitment. A management decision to purchase assets in the future does not, in itself, give rise to a present obligation.

EXAMPLE

Consider the following situations. In each case, do we have an asset or liability within the definitions given by the Conceptual Framework? Give reasons for your answer.

- Mucyo Ltd has purchased a patent for RWF20,000,000. The patent gives the company sole use of a particular manufacturing process which will save RWF3,000,000 a year for the next five years.
- Kalisa Ltd paid René Gatera RWF10,000,000 to set up a car repair shop, on condition that priority treatment is given to cars from the company's fleet.
- Deals on Wheels Ltd provides a warranty with every car sold.

ANSWER

- This is an asset, albeit an intangible one. There is a past event, control and future economic benefit (through cost savings).
- This cannot be classified as an asset. Kalisa Ltd has no control over the car repair shop and it is difficult to argue that there are 'future economic benefits'.
- The warranty provided constitutes a liability; the business has taken on an obligation. It would be recognized when the warranty is issued rather than when a claim is made

Equity

Equity is defined above as a residual, but it may be sub-classified in the statement of financial position. This will indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. Some reserves are required by statute or other law, eg for the future protection of creditors. The amount shown for equity depends on the measurement of assets and liabilities. It has nothing to do with the market value of the entity's shares.

Performance

The elements affecting financial performance are income and expenses.
Profit is used as a measure of performance, or as a basis for other measures (e.g. earnings per share). It depends directly on the measurement of income and expenses, which in turn depend (in part) on the concepts of capital and capital maintenance adopted.

The elements of income and expense are therefore defined. x Income. 'Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.' x Expenses. 'Decreases in assets, or increases in liabilities, that result in decreases in equity other than those relating to distributions to holders of equity claims.

Income and expenses can be presented in different ways in the statement of profit or loss and other comprehensive income, to provide information relevant for economic decision making. For example, income and expenses which relate to continuing operations are distinguished from the results of discontinued operations.

Income. Revenue arises in the course of ordinary activities of an entity. 'Increases in assets' include those arising on the disposal of non-current assets. The definition of income also includes unrealized gains, e.g. on revaluation of marketable securities.

Expenses As with income, expenses include losses as well as those expenses that arise in the course of ordinary activities of an entity. Losses will include those arising on the disposal of non-current assets. The definition of expenses will also include **unrealized losses**, e.g. the fall in value of an investment.

Recognition of the elements of financial statements

Recognition. 'The process of capturing for inclusion in the statement of financial position or statement(s) of profit or loss and other comprehensive income an item that meets the definition of one of the elements of financial statements – an asset, a liability, equity, income or expenses' (Conceptual Framework: para. 5.1).

An asset or liability should be recognized if it will be both relevant and provide users of the financial statements with a faithful representation of the transactions of that entity, The Conceptual Framework takes these fundamental qualitative characteristics along with the definitions of the elements of the financial statements as the key components of recognition. Previously, recognition of elements would have been affected by the probability of whether the event was going to happen and the reliability of the measurement.

The IASB has revised this as they believed this set too rigid a criterion as entities may not disclose relevant information which would be necessary for the user of the financial statements because of the difficulty of estimating both the likelihood and the amount of the element. Even if an item is not recognized, then the preparers of the financial statements should consider whether, in order to meet the faithful representation requirement, there should be a description in the notes to the financial statements.

Derecognition is the removal of all or part of a recognized asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or liability. (Conceptual Framework: para. 5.26)

The Conceptual Framework considers derecognition to be a factor when the following occurs:

- Loss of control or all or part of the recognized asset; or
- The entity no longer has an obligation for a liability. The IASB has brought these concepts of recognition and derecognition into the Conceptual Framework so that they can be revisited when visiting new standards or revising existing ones

MEASUREMENT IN FINANCIAL STATEMENTS

In order that an asset or liability can be recognized, 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 recognized 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 realizable value and value in use. Realizable 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.

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:

- Consistent with fundamental accounting concepts
- Objective and the information it produces is easily verified.
- Simple and inexpensive to record the information.
- Easily understood by the users of financial statements.

Disadvantages of Historical Cost Accounting:

- Assets values unrealistic, in particular land and buildings.
- Comparisons over time meaningless
- Maintenance of the physical substance of business ignored.

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 characterized by **integrity** and an objective approach to professional work. A practicing 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 endeavor 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 practicing part- time, 10% of his gross earned income. It is recognized 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:-

- **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
- **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
- **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
- **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
- **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
- **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.

THE TRAINEE ACCOUNTANT

The current development is that this becomes an important pillar of developing the would-be accountants of the future. The trainee learns with the help of an already established qualified accountant who acts as a supervisor and guides him/her through professional developments.

The role of a trainee accountant

- Inputs income and expense transactions into the organization accounting system
- Manages organization invoices, these can range from customer invoices to payables invoices
- Checks data accuracy, this involves confirming from source documents
- Present Information, this involves doing simple reports to illustrate information
- Performs administrative duties such as inventory count participation, payroll preparation and cost accounting

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:

- Company Law
- International and Local Accounting Standards
- Stock Exchange Requirements
- The International Framework for the preparation and presentation of financial statements.
- Any other generally accepted concepts and principles e.g. the money measurement concept.

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 balance sheet events.

In Rwanda: The Companies Act, Law No 07/2018 of 13/4/2018 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 harmonization 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.

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.

Discussion Documents

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.

Exposure Draft

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.

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.

Advantages of Standards

- Provide the accounting profession with a manual of useful working rules
- Forces improvements in the quality of the work of the accountant
- Strengthen the accountant's resistance against pressure from directors to use an accounting policy which may be suspect
- Ensure that the users of financial statements get more complete and clearer information on a consistent basis from period to period
- Help in the comparison users may make between the financial statements of one organisation and another
- Direct financial statements towards establishing the economic truth of the entity's performance

Disadvantages of Standards

- The working rules are bureaucratic and lead to rigidity
- 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.
- Official acceptance reduces the accountant's strength to resist the application of an inappropriate standard when the directors wish to follow it
- Users are likely to think that the financial statements produced using accounting standards are infallible
- 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
- They have been derived through social or political pressures which may reduce the freedom and lead to manipulation of the profession
- They impair the development of critical thought
- 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 FRW15,000,000 and its expected useful life is five years, the cost of FRW15,000,000 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 issue

THE REGULATORY FRAMEWORK – STATUTORY

Company Law
The main law governing financial statements is the Companies Act Law no. 7/2018 of 13/4/2018 relating to companies.

- It applies to companies both private and public.
- All companies should file accounts with the Office of Registrar General.
- All accounts must show a true and fair view.
- 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 recognized only when realized 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 Form**

Recognizes economic substance from legal form e.g. assets acquired on hire purchase

TOPIC 2

BOOK-KEEPING

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 Day Book
- Sales returns book
- Cash receipts book
- Debtors(trade receivables) ledger
- Purchases Day Book
- Purchases returns book
- Cheque payment book
- Creditors(trade payables) ledger
- Petty cash book

SALES DAY BOOK: Written from Sales Invoice

Each sales invoice should be entered in the Sales Day Book as follows:

- Date of invoice
- Customers name
- Invoice number - all sales invoices should be sequentially numbered at the printers
- Total amount of invoice
- Trade Receivables ledger account
- Cash sale amount - if not a credit sale
- 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 analyzed under a sundry column with a brief narrative as to their nature beside that item.

The Sales Day Book should be totaled 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 Day 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 Day 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:

- Date received
- Details of receipt i.e. from whom received
- The amount of the receipt
- 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 analyzed in the Sales Day Book both for the type of transaction and VAT analysis
- Lodgment column - This should be the last column and should record all lodgments 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 lodgment column. The total column ought to agree with the total of the lodgment column, provided daily lodgments are being made. The cash receipts book should be totaled and ruled off monthly and each month should be commenced on a new page.
Bank stamped lodgment 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 from DRS	A/C Ref	VAT	Analyisi of Col

PURCHASES DAY BOOK- Written from Purchases Invoice

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:

- Date of invoice - i.e. date received and entered
- Supplier's name
- Internal sequential number of invoices
- Total amount
- Creditor's ledger amount - if applicable
- 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 analyzed under a sundry column and a brief narrative as to their nature beside that item.

The purchase book should be totaled 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 Day 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 Day 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:

- Date of cheque
- Details of payment i.e. to whom payable and for what
- Cheque number
- Cheque total
- 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 Day 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 analyzed 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 initialed 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 totaled 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 Day 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 Day 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 analyses 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 analyzed under appropriate columns as follows:

- Date
- Narrative
- Petty cash docket reference number
- Total amount
- 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
- 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. FRW100,000 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. FRW10,000. Thereafter, any amounts in excess of that amount are paid by cheque.

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 FRW10,000 introduced into business and lodged to the Bank Account

BANK ACCOUNT

Debit Side			**Credit Side**
		FRW	FRW
1 Jan	Capital Account	10,000	

CAPITAL ACCOUNT

Debit Side	FRW			Credit Side FRW
		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 15th 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 FRW	Credit FRW
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

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:

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

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 FRW2,000, Motor Vehicle FRW5,000 and stock of FRW3,500. Although he has paid in full for the fixtures and motor vehicle, he still owes FRW1,400 for some of the goods. J. Ayim. has lent him FRW3,000, which is payable within 1 year. T. Chahine., after the above, has FRW2,800 in the business bank account and FRW100 cash in hand.

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

T. Chahine.

Statement of Financial Position as at …

	FRW	FRW
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

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

	FRW		FRW
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

	FRW	FRW		FRW
Administration			Gross Profit	20,300
Expenses:				
Salaries/Wages	8,300			
Rent and Rates	3,200			
Depreciation	1,100	12,600		
Financial Expenses:				
Irrecoverable 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

	FRW	FRW	FRW
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:			
Irrecoverable Debts	200	200	
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

	FRW
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

	FRW	FRW
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

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.

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

		FRW			FRW
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	1500
		15,000			15,000

Vertical Format

Example Limited

Statement of Financial Position as at 31 December 20XX

	FRW	FRW	FRW
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 FRW10,000 into a business bank account

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

ASSETS	LIABILITIES
FRW	FRW

2. **The Purchase of an Asset by Cheque and the Incurring of a Liability**:
January 2 - Purchase of premises for FRW5,000 satisfied by cheque FRW1,000 and mortgage FRW4,000

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

ASSETS	LIABILITIES
FRW	FRW

3. **Purchase of Assets for Credit and for Cash:**
January 3 - Purchase of van FRW500, on credit and office furniture FRW400 for cash

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

ASSETS	LIABILITIES
FRW	FRW

4. **Purchase of asset for cash:**
January 4 - Purchase of Inventory for cash FRW4,000

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

ASSETS	LIABILITIES
FRW	FRW

5. **Sale of an Asset on Credit at a Profit**:
January 5 - Sale of Inventory, which cost FRW1,500, for FRW2,500 on credit

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

ASSETS	LIABILITIES
FRW	FRW

6. **The Payment of a Liability by Cheque:**
January 6 - FRW250, being half the cost of the van, is paid by cheque

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

ASSETS	LIABILITIES
FRW	FRW

7. **The Payment of an Expense by Cheque:**

January 7 - Electricity bill paid, FRW50

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

ASSETS	LIABILITIES
FRW	FRW

8. **Purchase of an Asset on Credit:**

January 8 - Further Inventory purchased on credit at a cost of FRW3,000

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

ASSETS	LIABILITIES
FRW	FRW

9. **Collection of an Asset:**

January 9 - FRW1,500 is received in part settlement of the original debt for FRW2,500

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

ASSETS	LIABILITIES
FRW	FRW

Solutions

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

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

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

The business is separate from G. arr. as an individual. Therefore, the business has an asset of FRW10,000 and a liability, i.e. an amount owing to a person, of FRW10,000. 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

	FRW		FRW
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

	FRW		FRW
Non-current Assets:			
Premises	5,000	Capital	10,000
Furniture	400	**Non-current Liabilities**	
Van	500	Mortgage	4,000
Current Assets:	5,900	**Current Liability:** 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

	FRW		FRW
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

	FRW		FRW
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 FRW1,500 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, FRW2,500, 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

	FRW		FRW
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 FRW250.

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

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

	FRW		FRW
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

	FRW		FRW
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

	FRW		FRW
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
		FRW			FRW
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

Debit Side				**Credit Side**
		FRW		FRW
2 Jan	Bank	5,000		

FURNITURE A/C

Debit Side				**Credit Side**
		FRW		FRW
2 Jan	Bank	400		

VAN A/C

Debit Side				**Credit Side**
		FRW		FRW
3 Jan	Bank	500		

INVENTORY A/C

Debit Side			**Credit Side**		
		FRW			FRW
4 Jan	Bank	4,000	Statement of Comprehensive Income		15000

Debit Side			**Credit Side**		
		FRW			FRW
8 Jan	Creditor	3,000	9 Jan	Balance c/d	5,500
		7,000			7,000

TRADE RECEIVABLES A/C

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

ELECTRICITY EXPENSE A/C

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

CAPITAL A/C

DR				**CR**
		FRW		FRW
1 Jan	Bank	10,000		

MORTGAGE LOAN A/C

DR			CR		
		FRW			FRW
2 Jan	Bank	4,000			

TRADE PAYABLE A/C

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

SALES A/C

DR			CR		
		FRW			FRW
	Statement of Comprehensive		5 Jan	Trade Receivables	2500
		2500			
	Income				
		,500			2,500

STATEMENT OF COMPREHENSIVE INCOME A/C

DR		CR	
	FRW		FRW
Inventory	1500	sales	2,500
	1000		
Profit c/d			
Electricity	50		2,500
Profit c/d	950	Profit c/d	1,000
	1000		1000

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
	FRW	FRW
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

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

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:

- Purchase of leasehold premises
- Lawyers' fees in connection with the purchase of leasehold premises
- Annual depreciation charge for the use of leasehold premises
- Annual ground rent of lease
- Cost of new machinery
- Customs duty charged on new machinery from supplier to factory
- Carriage on new machinery from supplier to factory
- Cost of installing new machinery
- Removal expenses
- Annual patent renewal fees

SOLUTION:

- Capital
- Capital
- Revenue
- Revenue
- Capital
- Capital
- Capital
- Capital
- Revenue
- 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:

- On 1 January 20X2, Mr. Balewa. commenced business with FRW5,000 which he lodged to the business bank account
- During the period, total purchases amounted to FRW4,000 and payments made to suppliers were FRW3,550. On 31 December, 20X2, FRW450 was still due to suppliers in respect of these purchases
- Sales for the year totaled FRW9,000 all on credit. Amounts received from customers during the year were FRW8,100. On 31 December, 20X2, FRW900 was still owing from customers
- Mr. B. purchased a van in December costing FRW2,500
- Administration Expenses were FRW2,300 for the year

Required:

- Write up the ledger accounts for Mr Balewa,
- Extract the Trial Balance
- Prepare the Statement of Comprehensive Income for the year ended 31 December,
- 20X2 given that the value of Inventory at 31 December 20X2 was FRW500
- 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:

- On 1 January, 20X9 Mr. A. Igwe. paid FRW4,000 into the business bank account
- Credit sales totaled FRW8,000 - FRW6,500 was received and FRW1,500 was outstanding at the end of the year
- Cash sales amounted to FRW15,000
- A delivery van was purchased on 1 January 20X9 at a cost of FRW3,900

- During the period, purchases amounted to FRW7,800, Suppliers had been paid FRW7,200 for meat and invoices totaling FRW600 remained unpaid at 31 December 20X9
- Sundry expense (all paid during the period and relating to it) amounted to FRW2,200. During the year, Mr. A. Igwe. drew FRW2,000 from the business
- The annual rent of the shop was FRW1,200 and Mr. A. Igwe. paid this amount on 1 January 20X9
- Mr. A. Igwe. paid his assistant FRW1,900 during the year

Required:

- Write up the ledger accounts and cash book of Mr. A. Igwe. to 31 December, 20X9
- Extract a Trial Balance
- Prepare the Statement of Comprehensive Income for the year ended 31 December 20X9 - closing Inventory at 31 December was FRW850
- 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, 2013

	FRW
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?

- Buildings
- Cash Balance
- Trade Receivables
- Loan from Mrs. K.Diop.

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

- Machinery
- Trade Payables for goods
- Motor Vehicles
- Cash at Bank

Q.3 Gross Profit is:

- Excess of sales over cost of goods sold
- Sales less purchases
- Cost of goods sold plus Opening Inventory
- 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:

- Inventory, Trade Receivables, Bank, Cash
- Cash, Bank, Trade Receivables, Inventory
- Trade Receivables, Inventory, Bank, Cash
- Inventory, Trade Receivables, Cash, Bank

Capital expenditure is:

- The extra capital paid in by the proprietor
- The cost of running the business on a day-to-day basis
- Money spent on buying Non-current assets or adding value to them
- Money spent on selling Non-current assets

Q7. Working capital is:

- The Trade Receivables of a business
- The balance at bank of a business
- The current assets less long-term liabilities of a business
- 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	

LILY 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 LILY Limited which commenced business on 1st January 20X0. The figures are presented in the form of a list of balances:-

	FRW
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:

- Statement of Comprehensive Income for year ended 31st December, 20X0
- The Statement of Financial Position as at 31st December, 20X0

EXERCISE 2

Q.1 Which of the following is incorrect?

- Assets - Capital = Liabilities
- Liabilities + Capital = Assets
- Liabilities + Assets = Capital
- Assets - Liabilities = Capital

Q.2 Which of the following is incorrect?

	Assets	**Liabilities**	**Capital**
	FRW	FRW	FRW
(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
	FRW	FRW	FRW
(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

FRW FRW

Purchases

FRW FRW

Sales

FRW FRW

Non-current Asset - Vehicle

FRW FRW

Administration Expenses

FRW FRW

Bank

FRW FRW

Trade Payables

FRW FRW

Trade Receivables

FRW FRW

(b) **Trial Balance**

	Debit FRW	**Credit** FRW
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

	Debit FRW	**Credit** FRW
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**

	Debit FRW	**Credit** FRW
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			
	FRW		FRW
		Bank	5,000

Purchases			
	FRW		FRW
Creditors	4,000		

Sales			
	FRW		FRW
		Trade Receivables	9,000

Non-current Asset - Vehicle			
	FRW		FRW
Bank	2,500		

Administration Expenses			
	FRW		FRW
Bank	2,300		

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

Trade Receivables			
FRW		FRW	
Sales	9,000	Bank	8,100
	9,000	Balance c/d	900
			9,000

(b)

Trial Balance

	Debit FRW	**Credit** FRW
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**

	FRW	FRW
Sales		9,000
Purchases	4,000	
Less Closing Inventory	(500)	
Cost of Goods Sold		3,500
Gross Profit		5,500
Administration Expenses		(2,300)
Net Profit		3,200

(d) **Statement of Financial Position as at 31st December 20X2**

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

Mr A. Igwe. : ProForma Solution

Trade Receivables			
	FRW		FRW
Sales 31 December 20X9 Balance b/d		Bank 31 December 20X9 Balance c/d	

Capital Account			
	FRW		FRW
		1 Jan 20X9 Bank	

Delivery Van			
	FRW		FRW
1 Jan 20X9 Bank			

Trade Payables			
	FRW		FRW
Bank 31 December 20X9 Balance c/d		Purchases 31 December 20X9 Balance b/d	

Purchases	
FRW	FRW
Suppliers	

Sundry Expenses	
FRW	FRW
Bank	

Drawings	
FRW	FRW
Bank	

Rent	
FRW	FRW
Bank	

(b) **Trial Balance as at December 20X9**

	FRW	FRW
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**

		FRW	FRW
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**

	FRW	FRW
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

	FRW		FRW
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
	25,500	Rent	1,200
Balance b/d	7,100	Assistant's Wages	1,900
		31 December 20X9	
		Balance c/d	7,100
			25,500

Sales Account

	FRW		FRW
Bank	1900		15,000
		Trade Receivables	8,000
			23,000

Trade Receivables

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

Capital Account

	FRW		FRW
		1 Jan 20X9 Bank	4,000

Delivery Van

	FRW		FRW
1 Jan 20X9 Bank	3,900		

Trade Payables

	FRW		FRW
Bank	7,200	Purchases	7,800
31 December 20X9			7,800
Balance c/d	600	31 December 20X9	
	7,800	Balance b/d	600

Purchases

	FRW	FRW	
Suppliers	7,800		

Sundry Expenses

	FRW		FRW
Bank	2,200		

Drawings

	FRW		FRW
Bank	2,000		

Rent

	FRW		FRW
Bank	1,200		

(b) Trial Balance as at December 20X9

	FRW	FRW
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**

		FRW	FRW
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

	FRW	FRW
Non-current Assets		3,900
Delivery Van		
Current Assets		
Inventory	850	
Trade Receivables	1,500	
Cash at Bank	7,100	9,450
		13,350

PTT Limited

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

	FRW	FRW
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

	FRW	FRW
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

LILY LIMITED: ProForma Solution

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

		FRW	FRW
Sales			
Less:	Cost of Sales		
Gross Profit			
Less:	Administration Expenses		
	Selling and Distribution Expenses		
Net Profit			

LILY Limited

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

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

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

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

LILY LIMITED: Solution

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

	FRW	FRW
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

LILY Limited

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

	FRW		FRW
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

LILY Limited

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

	FRW	FRW
Employment of Capital Non-current Assets Current Assets		8,800
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. FRW

(a) 38,100

(b) 51,600

(c) 7,600

(d) 104,100

(e) 26,00

(f) 159,000

TOPIC 3

ACCOUNTING ADJUSTMENTS

3.1 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 recognized only when realized 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**

  Recognizes 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
		FRW		FRW
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 FRW6,600. 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 FRW7,200 transferred to the Statement of Comprehensive Income . The figure of FRW600 will appear in the Statement of Financial Position under current liabilities. In Jan, the accrual of FRW600 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
		FRW		FRW
Feb	Invoice – Jan	600	31 Dec Statement of Comprehensive Income	7200
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		

EXAMPLE 2

ACC LTD paid an insurance bill in January 20X4, for FRW3,000, 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 FRW7,000 for the year, which was paid immediately.

INSURANCE ACCOUNT

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

If this account is closed now, with the costs transferred to the Statement of Comprehensive Income , the profit or loss would be distorted by FRW3,500. 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 FRW6,500 transferred to the Statement of Comprehensive Income . The figure of FRW3,500 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
		FRW			FRW
Jan	Invoice	3,000	31 Dec	Statement of Comprehensive Income	6,500
June	Invoice	7,000			
		10,000			3,500
Jan	Prepayment	3,500			10,000

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

EXAMPLE 2

INSURANCE ACCOUNT

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

B. QUESTIONS/SOLUTIONS

Questions

1. Mr T. Mugambo.

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

- Lighting, (Dr) FRW277.
- Insurance, (Dr) FRW307.

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

  - Fire insurance, FRW960, covering the year ended 30 April was paid.
  - General insurance, FRW630, covering the year ended 31 August 20X5 was paid.
  - An insurance rebate of FRW55 was received on 30 June 20X4. (iv) Electricity bills of FRW874 were paid.
  - An electricity bill of FRW83 for December 20X4 was unpaid as on 31 December 20X4.
  - Fuel bills of FRW1,260 were paid.
  - Stock of oil as on 31 December was FRW92.

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:

- Stationery: Paid for the year to 30 June 20X4 FRW855; Stocks of stationery at 30 June 20X3 FRW290; at 30 June 20X4 FRW345.
- General expenses: Paid for the year to 30 June 20X4 FRW590; Owing at 30 June 20X3 FRW64; Owing at 30 June 20X4 FRW90.
- Rent and Rates (combined account): Paid in the year to 30 June 20X4 FRW3,890; Rent owing at 30 June 20X3 FRW160; Rent paid in advance at 30 June 20X4 FRW250; Rates owing at 30 June 20X3 FRW205; Rates owing 30 June 20X4 FRW360.
- Motor Expenses: Paid in the year to 30 June 20X4 FRW4,750; Owing as at 30 June 20X3 FRW180; Owing as at 30 June 20X4 FRW375.
- Commission Receivable: Received during the year to 30 June 20X4 FRW850; owing at 30 June 20X3 FRW80; owing as at 30 June 20X4 FRW145.

1. Mr. T. Mugambo.

Solutions

LIGHTING & FUEL

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

INSURANCE

		FRW				FRW
						55
Jan 1	Balance b/d	307		Jun 30	Bank	
Dec 31	Bank (Fire)	960		Dec31	Statement of	1,102
					Comprehensive	
Dec 31				Dec 31	Income	
					Prepaid c/d*	
	Bank (General)	630				740
		,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 1,145	Jun 30	Stock c/d	345 1,145

(b) **GENERAL EXPENSES**

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

(c) **RENT & RATES**

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

(d) **COMMISSION RECEIVABLE**

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

(e) COMMISSION RECEIVABLE

20X4			20X3		
July 1 20x4 Jun 30	Cash & Bank Statement of Comprehensive Income	80 915 995	June 30 Jun 30	Cash & Bank Owing c/d	850 145 995

3.2 SUSPENSE ACCOUNT AND JOURNAL ENTRIES

SUSPENSE ACCOUNTS

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

- If the trial balance does not balance the difference is placed in a suspense account; and
- 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.

EXAMPLE

After the preparation of a trial balance, an unexplained difference of DR FRW406 remains; a Suspense Account is opened for that amount. Subsequent investigations reveal:

- FRW35 received from A. Mugambo and credited to his account has not been entered in the bank account.
- A payment of FRW47 to M. Strauss has been credited to that account.
- Discounts allowed (FRW198) and discounts received (FRW213) have been posted to the discount accounts as credits and debits respectively.
- Bank interest received of FRW111 has not been entered in the bank account.
- (The carriage outwards (FRW98) 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

		FRW			FRW
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

- The double entry is not complete. It is necessary to debit bank and credit suspense account.
- 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.
- 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.
- The double entry is not complete it is necessary to debit the bank account and credit the suspense account.
- 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.

ERRORS NOT AFFECTING THE TRIAL BALANCE

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

- The complete omission of a transaction.
- Posting to the correct side of the ledger but to the wrong account.
- Compensating errors e.g. if the sales account was added up to by FRW20 too much and the purchases account was also added up to by FRW20 too much, then these two errors would cancel out in the trial balance.
- 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.
- Errors of original entry – where the original figure is incorrect yet double entry is observed using this incorrect figure.
- 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 FRW200 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.

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 FRW3,769.48. To balance the Trial Balance he opened a suspense account on the credit side.

His bookkeeper further investigated and discovered the following discrepancies:

- Sale of goods to J G Ltd. was posted to sales a/c as FRW990 and not FRW99 as originally recorded in sales day book.

- A machine was sold on 28th October to Michael Quint. The proceeds were FRW3,700.The book value of the machine at 28th October was FRW3,970. Unfortunately when posting the entry to machinery account the proceeds were entered as FRW4,470 and the profit/loss computed accordingly.
- Purchase of motor vehicle costing FRW3,750 was posted to purchases account.
- Purchases returns in the sum of FRW350 were posted to the debit side of purchases returns account.
- FRW760 discounts allowed posted to the credit side of the discounts received account.
- Bank overdraft in the sum of FRW3,000 was entered on the incorrect side of the trial balance.
- A trade payable account in the sum of FRW1,765 entered in the incorrect side of the trial balance.
- Sale of goods in the sum of FRW78,52 was posted in error to the account of John Hugo instead of Ernest Hugo.
- Goods taken from stock in the sum of FRW1,900 were credited to the sales account only.
- Purchase of wrapping paper in the sum of FRW210.10 was included in the purchases day book but was not posted to the relevant account in the nominal ledger.
- Carriage inwards in the sum of FRW584.71 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

	FRW		FRW
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
	13,930.00	Drawings	1,900.00
		Carriage Inwards	1,169.42
		Wrapping Paper	210.10
			13,930.00

Notes

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

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:

- Opening and closing entries of the business.
- Correcting and adjusting entries.
- The purchase and sale of non-current assets
- 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:

- The date
- The name of the account to be debited.
- The name of the account to be credited.
- The amount of money.
- A brief description of the transaction.
- The ruling of the Journal and the method of entry are as follows:

Journal

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

Notes

- The amount to be debited appears first in the Journal by convention. Note the use of the word "Dr".
- 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.
- The folio column should be entered when the transaction is posted to the ledger.
- 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 journalese 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 journalized.

Example
A. Limited commenced trading on 1st April 20X4, with capital introduced of FRW5,000. He acquired the following:

	FRW
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
			FRW5,000	FRW5,000
	Being capital introduced and assets acquired on commencement of trading.			

Note
The balancing figure of FRW1,300 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 10 th March 20X4, it was discovered that a cheque for FRW30, paid to M. Mugambo 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. Mugambo, thus:

JOURNAL

Date		Folio	Dr.	Cr.
20X4			FRW	FRW
March 10	M. Mugambo	J5	30	
	T. Everts	E3		30
	Cheque No. ... paid to M. Mugambo 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:

- Purchase of property, plant and equipment on credit/cash.
- Disposal of property, plant and equipment.
- Scrapping of property, plant and equipment.

Transferring Items Incorrectly Posted.

The principle here is similar to the correction of errors.

QUESTIONS/SOLUTIONS

Question - E. Truter

Record the following transactions as journal entries.

- Sale of a machine used by the business for FRW5,000 cash, this being the book value.
- Purchase of FRW10,000 of goods on credit.
- Withdrawal of FRW1,000 cash by the proprietor for his personal use.
- Collection of FRW1,000 from E. Mugambo who has an account receivable with the firm.

- Return of FRW2,000 of goods to a supplier because it is faulty. The supplier has granted the firm credit for the original goods.
- Payment of FRW15,000 by the business to a supplier on account of an account payable. (g) Purchase for machinery for FRW3,000 on credit.
- Additional cash of FRW10,000 invested in the business by the proprietor.
- Sale of machine for FRW2,000 on credit (at book value).

Solution - E. Truter

Journal Entries

(a)	Dr	Cash	FRW5,000
	Cr	Non-Current Assets	FRW5,000

To record the sale of a printing machine at book value

(b)	Dr	Purchases	FRW10,000
	Cr	Trade Payables	FRW10,000

To record the purchase of goods on credit

(c)	Dr	Drawings	FRW1,000
	Cr	Cash	FRW1,000

To record the withdrawal of cash by the proprietor

(d)	Dr	Cash	FRW1,000
	Cr	Trade Receivables (E Jones)	FRW1,000

To record the collection of cash from E Jones

(e)	Dr	Trade Payables	FRW2,000
	Cr	Purchase Returns	FRW2,000

To record the return of goods

(f)	Dr	Trade Payables	FRW15,000
	Cr	Cash	FRW15,000

To record a payment made to a supplier

(g)	Dr	Non-Current Assets	FRW3,000

	Cr	Trade Payables	FRW3,000

To record the purchase of machinery on credit

(h)	Dr	Cash	FRW10,000
	Cr	Capital	FRW10,000

To record additional cash invested in the business by the proprietor

(j)	Dr	Trade Receivables	FRW2,000
	Cr	Non-Current Assets – Net Book Value	FRW2,000

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.

- Interest paid by Jean Claude FRW100 had been entered on the incorrect side of the interest account.
- Bank charges FRW15 entered correctly in the cash book had not been posted to the ledger.
- A payment of FRW140 for repairs to motor vehicles had been debited to the motor vehicles account.
- A cheque for FRW96 received from a debtor M. Otto, had been entered correctly in the cash book but credited to the trade receivables account as FRW69.
- Goods sold on credit for FRW180 had not been entered in the books.
- The purchases day book had been over-cast by FRW25.

You are required to:

- Journalese the necessary corrections.
- Show the Suspense Account.
- Calculate the correct net profit if the original figure was FRW9,800.

Solution - Jean Claude

Journal

		DR	CR
(a)	• Interest Account	200	
	• Suspense Account		200
	To reverse posting to incorrect side of interest account		

		Dr	Cr
•	Bank Charges Account	15	
•	Suspense Account		15

To post amount omitted

•	Motor Repairs Account	140	
•	Motor Vehicles Account		140

To correct error of posting to incorrect Account

•	Suspense Account	27	
•	M Otto (debtor)		27

To correct error of crediting trade payables with FRW69 instead of FRW96

•	Trade Receivable Account	180	
•	Sales Account		180

Correction of omission of sale

•	Suspense Account	25	
•	Purchases Account		25

Correction of error whereby purchases were overstated

(b) JEAN CLAUDE - SUSPENSE ACCOUNT

		FRW			FRW
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**

			FRW
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 FRW8,735. Your investigations reveal the following:

- A refund of rates FRW150 had been debited to the rates account.
- A payment of FRW750 for motor expenses had been debited to motor vehicles account.
- A payment of FRW538 for cash purchases had been credited to the purchase account as FRW358.
- The Sales Day Book had been under-cast by FRW1,000.
- Discounts received FRW750 had been debited to discounts allowed account.
- A payment to trade payable P. Henning of FRW690 had been debited to the purchases account.
- An invoice for stationery FRW365 had been debited to purchases account.

Required:

- The journal entries for the above.
- Show entries in the suspense account.
- Show your calculation of the corrected net profit.

Solution - J. Kemp
Journal Entries

	DR	CR
• Suspense	300	
• Rates 2 x 150		300

Being correction of error; rates refund debited to rates account

	DR	CR
• Motor Expenses	750	
• Motor Vehicles		750

Being correction of error; payment for motor expenses posted to motor vehicles

	DR	CR
• Purchases	896	
• Suspense		896

Being correction of error; payment of FRW538 for purchases posted to credit side as FRW358

• Suspense	1,000	
• Sales		1,000

Being correction of error; the Sales Day Book had been under cast by FRW1,000

• Suspense	1,500	
• Discounts Allowed		750
• Discounts Received		750

Being correction of error; discounts received FRW750 debited to discounts allowed

• Trade Payables (P Henning)	690	
• Purchases		690

Being correction of error; a payment to a creditor debited to purchases

• Stationery	365	
• Purchases		365

Being correction of error; an invoice for stationery posted to purchases

(b) SUSPENSE ACCOUNT

		FRW		FRW
20X4 Jan 31			20X4 Jan 31	
Rates	(i)	300		
Sales	(iv)	1,000	Trial Balance	1,904
Discounts Received	(v)	750	difference	
Discounts Allowed	(v)	750	Purchases	896
		2,800		2,800

(c) Calculation of Corrected Net Profit Year-ended 31/1/20X4

			FRW
Original Net Profit			8,735
Add Back:			
	(i)	Rates	300
	(iv)	Sales	1,000
	(v)	Discounts	1,500
	(vi)	Purchases	690
			12,225

	(ii) Motor Expenses	(750)
Less:	(iii) Purchases	(896)
	Current Net Profit	10,579

3.3 BANK RECONCILIATION STATEMENTS

THE CASHBOOK AND BANK RECONCILIATION STATEMENT

The Cash Book - Introduction

Cash transactions are the simplest and most universal form of business transaction.

For example:

- A sells B some goods for FRW150.
- From A's point of view, he has gained FRW150 in cash but sold the goods. This, in book-keeping terms, is the double aspect of every transaction.
- A debit "cash a/c" with FRW150 and credits "sales a/c" with FRW150.

- From B's point of view, he has decreased cash by FRW150 but has gained the goods.
- In book-keeping terms, B debits "purchase account" with FRW150 and credits his "cash account" with FRW150.

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 banking's 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 FRW100 may be settled for FRW95 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 (FRW95),the discount in the discount column (FRW5), 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.

- Bank Charges and Commission
- Bank Interest
- Standing Orders
- Credit Transfers (Bank Giro)
- Returned Cheques
- 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 (lodgments 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 lodgments 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:

- Bank Interest
- Bank Charges
- Standing Orders
- Direct debits
- 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 into 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).

Lodgments not credited are added to the balance at bank as if they have been credited by the bank. Conversely, lodgments 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.

BANK RECONCILIATIONS STATEMENTS QUESTIONS/SOLUTIONS

B Bank

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

		FRW			FRW
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 30^{th} September.

Bank Reconciliations

B BANK

Bank Reconciliation Statement as at 30^{th} September

		FRW	FRW
	Balance per Bank Statement		400
Add:	Lodgments 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				FRW325

C Count

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

			FRW				FRW
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
		FRW	FRW	FRW
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

		FRW			FRW
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

			FRW	FRW
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

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
		FRW				**FRW**
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

PB 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:

- From the above data, correct the cash book and prepare a bank reconciliation as at 31st December.
- List the reasons for preparing such a statement.
- 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** FRW	**Receipts** FRW	**Balance** FRW
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	FRW	Date	Detail	Cheque No.	FRW
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:

- From the above data correct the cash book and prepare a bank reconciliation statement.
- 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:

	FRW
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 lodgment of FRW176 that does not appear in the cash book records. Given that this lodgment 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 lodgments 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
Lodgment	(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

	FRW		FRW
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 Lodgment	1
		Balance c/d	19,500
			19,982
	19,982		

(a)Bank Reconciliation as at 31st December

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

(b) A bank reconciliation is prepared:

- To provide an independent check on the legitimacy of the entries in the cash book.
- To provide an independent check on the accuracy of cash book entries.

(c) Aspects requiring further investigation are:

- Correct amount of payment to David
- Validity of standing order – is it A Mostert?
- Payment of FRW297 – Cheques are not in 'sequence' number.
- The nature of the bank charges – why are there any at all with a current account balance of almost FRW20,000?

2. Mr Rabe

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

		FRW
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.

(a)

		FRW	FRW
Balance as per Bank Statement			1,166.45
Add:	Outstanding Lodgments		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:

- Authority for and nature of standing order for FRW32.52.
- Authenticity of the cheque for FRW19.47 – the cheque number would indicate that it may have been wrongly charged by the bank.
- Correct amount for cheque 236130 – is it FRW87.77 or FRW77.87? (iv) Authenticity and nature of the bank giro credit for FRW21.47.

3.4 TRADE RECEIVABLES, IRRECOVERABLE DEBTS AND PROVISIONS

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:

- Irrecoverable debts
- Provision for irrecoverable debts
- Irrecoverable debts recovered

Provisions for discounts - both discounts allowed and received.

TRADE RECEIVABLES, IRRECOVERABLE DEBTS, IRRECOVERABLE DEBTS RECOVERED AND PROVISION FOR IRRECOVERABLE DEBTS

The overriding criterion is the prudence concept - provide for all Irrecoverable Debts. Such Irrecoverable Debts are written off as an expense in the Statement of Comprehensive Income . A provision for Irrecoverable Debts is an estimate of the expense for Irrecoverable 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).

IRRECOVERABLE 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 FRW1,000 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 FRW1,000 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

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

On receipt of notice of Liquidation

		FRW	FRW
DR	Irrecoverable Debts A/C	1,000	
CR	Trade Receivables – DE Ltd		1,000

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

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

IRRECOVERABLE DEBTS RECOVERED

Where the liquidator states that x Rwandan Francs in the FRW1 will be paid, *prudence* prevails - profits are recognized only when realized 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 Irrecoverable 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.

ALLOWANCE FOR IRRECOVERABLE DEBT

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

Specific provision
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 Irrecoverable Debts
CR Provision for Irrecoverable Debts Account

ALLOWANCE FOR IRRECOVERABLE DEBT A/C

DR					CR
		FRW			FRW
Yr 1	Balance c/d	7,000 7,000	Yr. 1	Irrecoverable Debts	7,000
			Yr. 2		7,000
				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 recognized 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 Irrecoverable Debts is agreed, the Provision for Irrecoverable Debts Account may comply with one of these three situations:

- The amount for the provision for this year *agrees exactly* with the provision for last year.
- The amount for the provision for this year is *higher* than the provision for last year.
- 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 Irrecoverable Debts account.

ALLOWANCE FOR IRRECOVERABLE DEBT A/C

DR				CR
	FRW			FRW
	7,000 7,000	Yr. 1		7,000
Yr 2	7,000 7,000	Yr. 2	Balance b/d	7,000 7,000
		Yr. 2	Balance b/d	7,000

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

DR Provision for Irrecoverable Debts – Statement of Comprehensive Income
CR Provision for Irrecoverable Debts Account

ALLOWANCE FOR IRRECOVERABLE DEBT A/C

DR				CR
	FRW			FRW
Yr 1 Balance c/d	7,000 7,000	Yr 1	Irrecoverable Debts	7,000
		Yr 2		7,000
	8000 8000	Yr 2	Statement of Comprehensive Income	1,000

Yr 2 Balance c/d		Yr 3	Balance b/d	7,000
				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 Irrecoverable Debts Account
- CR Provision for Irrecoverable Debts – Statement of

Comprehensive Income

ALLOWANCE FOR IRRECOVERABLE DEBT A/C

DR				CR
	FRW			FRW
Yr 1 Balance c/d	7,000 7,000	Yr 1	Irrecoverable Debts	7,000
	1000	Yr 2		7,000
Yr 2 Statement of Comprehensive Income	6,000 7,000	Yr 2		
Yr 2 Balance c/d		Yr 3	Balance b/d	7,000 7,000
			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:

Current Assets

	FRW
Trade Receivables	100,000
Less Bad Debt Provision	6,000
	94,000

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
		FRW			FRW
Yr 1	Balance c/d	1,000 1,000	Yr 1	Discount Allowed	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:

- The amount for the provision for this year *agrees exactly* with the provision for last year.
- The amount for the provision for this year is *higher* than the provision for last year
- 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 Irrecoverable 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 yearend Trade Receivables figure for ALL Ltd was FRW20,400. You are supplied with the following information:

- A customer has been declared bankrupt owing FRW400. This is to be written off.
- t has been decided that a 1% provision for discounts allowed should be made.
- The provision for doubtful debts should be 3% of Trade Receivables.
- The Irrecoverable Debts provision was FRW360.

Solution

- Bad Debt Expense ... FRW400
- Bad Debt Provision (FRW20,400 – 400) x 3% = FRW600.
- The increase in the bad debt provision is FRW600 – 360 i.e. FRW240.
- The discount allowed provision is calculated as follows: (FRW20,400 – 400 – 600) x 1% ... FRW194.

Statement of Comprehensive Income Entries

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

Statement of Financial Position

	FRW	FRW
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
		FRW			FRW
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			

n 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:

- The amount for the provision for this year *agrees exactly* with the provision for last year.
- The amount for the provision for this year is *higher* than the provision for last year.
- 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
		FRW			FRW
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

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
- Provision for Discount Received – Statement of Comprehensive Income

PROVISION FOR DISCOUNT RECEIVED A/C

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

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
		FRW			FRW
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
		1,500			
					1,000
Yr 3	Balance c/d	1,000			1,500

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**
	FRW	FRW	FRW	FRW	FRW	FRW
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.

QUESTION/SOLUTION

1. Mr N. Keita.

The books of Mr N. Keita. showed a Provision for Irrecoverable Debts amounting to FRW1,400 on 1st February 20X4. The total debts, at that date, amounted to FRW36,000 of which it was known that FRW1,000 would not be received. It was decided to make the Provision for Irrecoverable Debts to an amount equal to 5% of the Trade Receivables.

You are required to show:

- The Provision for Bad Debts Account after implementing the foregoing transactions.
- How the Trade Receivables will appear on the Statement of Financial Position.

Solution - Mr N. Keita.

PROVISION FOR IRRECOVERABLE DEBTS

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

IRRECOVERABLE DEBTS A/C

DR			CR
	FRW		FRW
Balance c/d (W1)	1,750	Statement of Comprehensive Income	1,000

W1 Provision for Irrecoverable Debts

Trade Receivables	36,000
Less Irrecoverable 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

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

Statement of Financial Position Extract

	FRW
Trade Receivables	35,000
Less: Provision for Irrecoverable 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 Irrecoverable Debts account on the dates stated.

31	August	20X6	MR W Balewa	FRW85
30	September	20X6	MR S Ayim	FRW140
28	February	20X7	MR LJ Fofana	FRW180
31	August	20X7	MR N Muller	FRW60
30	November	20X7	MR A Orji	FRW250

On 31st December 20X6 there had been a total of trade receivables remaining of FRW40,500. It was decided to make a provision for doubtful debts of FRW550.

On 31st December 20X7 there had been a total of trade receivables remaining of FRW47,300. It was decided to make a provision for doubtful debts of FRW600.

You are required to show:

- The Irrecoverable Debts Account for each of the two years, with the provisions included in this account.
- The charges to the Statement of Comprehensive Income for each of the two years.
- The relevant extracts from the Statement of Financial Position as at 31st December 20X6 and 31st December 20X7.

Solution – A Business

DR					CR
		FRW			FRW
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 Income	540
Nov 30	MR AOrji	250			
Dec 31	Provision c/d	600			
		1,090			1,090

(b) **Statement of Comprehensive Income (Extracts)**

		FRW
20X6	Irrecoverable Debts	775
20X7	Irrecoverable Debts	540

(c) **Statement of Financial Position (Extracts)**

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

3.5 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 emphasize at this point that control accounts are not necessarily a part of the double entry system. They are merely *arithmetical proofs* performing the same function as a trial balance to a particular ledger.

- **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.

- **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.

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

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

Notes to Illustration

- 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.
- The total amount of credit sales for the period will be obtained from the sales daybook, the totals of which should be posted monthly or at other regular intervals to the Trade Receivables control account.
- Dishonored bills and cheques will be detailed in the bills receivable book, and bank statements respectively.
- 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.

- Bills receivable will be total of the bills receivable book.
- Irrecoverable Debts written off will be obtained from an analysis from the journal.
- 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.
- Cash refunded to Trade Receivables will be obtained from the credit side of the cash book.
- When a Bad debt is written off the balance on the receivable account is cleared to zero, the accounting entry are:

  Dr Irrecoverable 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 Irrecoverable 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.

- 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.
- 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.

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

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

Notes to Illustration

- 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.
- The total amount of goods purchased during the period will be obtained from the payables ledger column in the cash book.
- The total amount of cash paid to Trade Payables during the period will be obtained from the payables ledger column in the cash book.
- 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.
- Bills payable will be obtainable from the totals of the bills payable book.
- 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:

- 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.
- 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.
- 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.

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
		FRW	FRW	FRW	FRW	FRW
LK & Co.	Credit	20,000	116,000	8,000	109,000	3,000
Mr. Becker	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. Becker account proved irrecoverable during the year and was written off.
You are asked to:

- Write up the Trade Receivables ledger as at 31st December 20X1.
- Prepare the Trade Receivables control account as at 31st December 20X1.

Solution DB Limited

LK & Co. Trade Receivables Account

		FRW			FRW
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
		36,000			136,000
1 Jan X2	Balance b/d	16,000			

Mr. Bekker Trade Receivables Account

		FRW			FRW
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	Irrecoverable Debts	6,000
		40,000			40,000

SM Ltd. Trade Receivables

		FRW			FRW
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 Acc **ount**

	FRW		FRW
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:	FRW
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 31 st December 20X1.

Supplier	Cash/ Credit	Balance at 1 st Jan	Purchases	**Purchases** Return	Cash Paid	**Discount** Received
		FRW	FRW	FRW	FRW	FRW
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:

- Write up the Trade Payables ledger as at 31st December 20X1.
- Prepare the Trade Payables control account as at 31st December 20X1

CC Limited

Mr. Marx – Trade Payables Account

		FRW			FRW
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

		FRW			FRW
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

		FRW			FRW
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

	FRW		FRW
	6,000		36,000
Purchases Returns		Balance b/d	
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:

	FRW
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.

	FRW
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 Dishonored	100
Cash Paid to Suppliers	5,814
Discount Allowed	178

Discount Received	117
Interest Charged to Customers on Overdue Accounts	5
Irrecoverable 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

		FRW			FRW
1 Jan	Balance b/d	9,753	1 Jan	Sales Returns	97
	Sales	19,506		Cash	18,912
	Cheques Dishonored	100		Discount Allowed	178
	Interest Charged	5		Irrecoverable 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

		FRW			FRW
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 FRW7,560 debit and FRW32 credit, and the trade payables ledger balances FRW4,250 credit and FRW59 debit.

During the year-ended 30th June, 20X2, sales amounted to FRW52,130; purchases to FRW42,173; discount allowable FRW1,825; discount receivable FRW1,524; returns inwards FRW725; returns outwards FRW520; Irrecoverable Debts written off FRW220; a debit balance FRW25 in Trade Payables ledger was transferred to the Trade Receivables ledger; a contra entry of FRW1,000 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 FRW48,270; cash paid to Trade Payables FRW40,250.

On 30th June, 20X2, Trade Receivables ledger balances were FRW7,643 debit, FRW nil credit and the Trade Payables ledger balances were FRW3,126 credit, FRW34 debit.

You are required to prepare:

- A Trade Payables control account for the year-ended 30th June, 20X2, and
- A Trade Receivables control account for the year-ended 30th June, 20X2.

Solution 2
Trade Receivables Control Account 30 June 20X2

	FRW		FRW
Balance b/d	7,560	Balance b/d	32
Sales	52,130	Discount Allowed	1,825
Contra	25	Returns Inwards	725
		Irrecoverable 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

	FRW		FRW
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 FRW12,876, 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:

- The sales return daybook had been overcast by FRW200.
- A balance owing by A.Debt of FRW478 had been written off as irrecoverable on 31
- December 20X9 and debited to Irrecoverable Debts but no entry had been made on the control account.
- No entries had been made in the control accounts in respect of a transfer of FRW360

standing to the credit of C. Sekibo's account in the Trade Payables ledger to his account in the Trade Receivables ledger.

- A debit balance of FRW1,470 and credit balances amounting to FRW46 had been omitted from the list of balances.
- A cheque for FRW254 received from D.I.S. had been dishonored but the entry recording this fact in the cash book had not been posted to D.I.S. account.

You are required (where applicable):

- To amend the list of balances extracted from the personal ledger.
- 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**

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

(b)**Trade Receivables Ledger Control Account**

		FRW			FRW
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

TOPIC 4:

ACCOUNTING TREATMENT OF SELECTED IAS'S

INTERNATIONAL ACCOUNTING STANDARDS (IAS 1) PRESENTATION OF FINANCIAL STATEMENTS

OBJECTIVE

This Standard prescribes the basis for presentation of general-purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

SCOPE

An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with International Financial Reporting Standards (IFRSs).

KEY DEFINITIONS

The following terms are used in this Standard with the meanings specified:

- **General purpose financial statements** (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.
- **Impracticable** Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
- **International Financial Reporting Standards (IFRSs)** are Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise
    - International Financial Reporting Standards;
    - International Accounting Standards; and Interpretations developed by the International Financial Reporting Interpretations committee (IFRIC)
- **Material** ----Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.
- **Notes to accounts** contain information in addition to that presented in the statement of financial position, statement of comprehensive income
- **Other comprehensive income** comprises items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRSs
- **Owners** are holders of instruments classified as equity.
- **Profit or loss** is the total of income less expenses, excluding the components of other comprehensive income.
- **Total comprehensive income** is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

PURPOSE OF FINANCIAL STATEMENTS

The main objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's: Assets, liabilities, equity; income and expenses, including gains and losses; contributions by and distributions to owners in their capacity as owners; and cash flows.

COMPLETE SET OF FINANCIAL STATEMENTS

Financial statements comprise:

- Statement of financial position as at the end of the period;
- Statement of comprehensive income for the period;
- Statement of changes in equity for the period;
- Statement of cash flows for the period,
- Notes to accounts

An entity may use titles for the statements other than those used in this Standard.

GENERAL FEATURES OF FINANCIAL STATEMENTS

- **Fair presentation and compliance with IFRSs**

  Financial statements shall present fairly the financial position, financial performance and cash flows of an entity

- **Going concern**

  When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so

- **Accrual basis of accounting**

  An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

- **Materiality and aggregation**

  An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial

- **Offsetting**

  An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS.

- **Frequency of reporting**

  An entity shall present a complete set of financial statements (including comparative information) at least annually.

- **Consistency of presentation**

  An entity shall retain the presentation and classification of items in the financial statements from one period to the next

IAS 2 - INVENTORIES

Introduction

Inventory is comprised of:

- Raw materials, material supplies used in the process of production
- Work in progress, in the process of production. Not yet completed
- Finished goods, held for sale in the ordinary course of business

The calculation of the amounts at which inventories are stated in the accounts in one of the most important and difficult areas in financial accounting but this is simplified by application of IAS 2. 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 realizable value.

Key definitions

Inventories are assets:

- Held for resale in the ordinary course of business
- In the process of production for resale e.g. raw materials, work-in-progress and finished goods
- 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:

- Costs which are directly related to units of production e.g. direct labour, direct expenses and sub-contracted work
- Production overheads
- 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.

Net realizable value is the estimated selling price in the ordinary course of business less:

- The estimated costs of completion and
- Estimated costs necessary to make the sale.

Fair Value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Measurement
Inventories are measured at the lower of cost and net realizable value for each separate item in the periodic financial statements. Similar items may be grouped together for valuation purposes.

Disclosure
The accounting policies which have been used in calculating the cost and net realizable 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 realizable 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)

	FRW
Inventories (Note 9)	2,370,000
Trade Receivables	X
Quoted Investments	X
Cash	X
	X

Note 9

	FRW
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 FRW250 with an expected selling price of FRW290. After the Statement of Financial Position date, due to severe competition, the selling price falls to FRW245

Under IAS 2 stock should be valued at the lower of cost and net realizable value. The cost is FRW250, however the net realisable value is FRW245. The stock should therefore be stated at FRW245.

EXAMPLE 2
H Ltd. has an item in closing inventory which cost FRW750 with a then expected selling price of FRW850. The item was damaged while being moved in the stores. It will cost FRW90 to repair this item and it can then be sold for FRW800.

The cost of the item is FRW750, its net realisable value is FRW800 – 90 i.e. FRW710. The inventory item should be stated at a value of FRW710.

Inventory valuation
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:

- 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.:
    - First In, First Out (FIFO)
    - Last In, First Out (LIFO)
    - Weighted Average
- The selection of an appropriate method for relating costs to inventories i.e.:
    - Job costing
    - Batch costing
    - Process costing
    - Standard costing

In selecting the methods referred to above, management must exercise judgement to ensure that the methods chosen to provide the fairest practical approximation to 'actual cost'.

FIFO: 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.

LIFO*:* 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. ***I*t should** be noted that LIFO is no longer permitted as a valuation method by IAS 2.
Weighted Average*:* 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/tones 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
Lily is 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
			FRW
1 January	1,000 tonnes	@ FRW80 per ton	80,000
4 February	600 tonnes	@ FRW84 per tonne	50,400

26 February	800 tonnes	@ FRW101 per tonne	80,800
15 March	1,200 tonnes	@ FRW100 per tonne	120,000
			FRW331,200

During the same period, he sells 2,200 tonnes of the 3,600 tonnes, delivered, at FRW120 per tonne. Obviously, she has 1,400 tonnes left but what was the cost of these? How much profit did she make?
The answers lie in the valuation of closing inventory. Establish:

Sales	2,200 x FRW120	FRW264,000	- Fact
Purchases		FRW331,200	- Fact

The closing inventory valuation depends on the valuation method used.

Using FIFO, the value of the closing inventory would be

1,200 tonnes	@ FRW100	120,000
200 tonnes	@ FRW101	20,200 FRW140,200

Using Weighted Average, the value of the closing inventory would be:

$$\frac{\text{FRW331,200}}{\text{3,600 tonnes}} = \text{(FRW92 per tonne}$$

1,400 tonnes x FRW92 = FRW128,800

	FIFO		Weighted Average		
	FRW	FRW		FRW	FRW
Profit for the Period					
Sales		264,000			264,000
Less: Purchases	331,200			331,200	
Closing	(140,200)			(128,800)	
Inventory					
Cost of Sales		(191,000)			(202,400)
Profit		73,000			61,600
Summary					

Closing Inventory Valuation		140,200			128,800
Profit		73,000			61,600

IAS 8 – ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

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.

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 not 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:

- Was available when financial statements for those periods were authorised for issue; and
- 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.

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:

- Relevant to the users of the Financial Statements, and
- Reliable:
    - Faithful presentation of Financial position, financial performance and cash flow, Reflect the substance of the transaction and not just the legal form,
    - Free from bias,
    - Prudent and
    - Complete.

The entity shall apply accounting standards consistently for similar transactions and events and over time, unless the standard specifically allows or requires categorization of items for which different policies may be appropriate.

Changes in accounting policies

An entity can only change an accounting policy if:

- It is required by a standard, or
- 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.

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:

- Nature of the change in accounting policy,
- Reasons why the change will provide more reliable and relevant information,
- Amount of the adjustment for current period and each prior period for each financial statement line item affected,
- Amount of the adjustment relating to prior periods before those presented, if practicable,
- 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:

- Title of the Standard,
- Where relevant the change in the accounting policy is made in accordance with its

transitional provisions,

- Nature of the change in accounting Policy, (d) A description of the transitional provisions,
- If applicable, the transitional provisions might have an effect on future periods,
- For the current period and each prior period presented the amount of the adjustment for each line item in the financial statements,
- 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:

- This fact and
- 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.

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 Irrecoverable 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.

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.

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 finalizing 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 authorized for issue after the discovery of the error:

- Restate the comparative amount for the prior period(s) presented in which the error occurred, or
- If the error occurred before the earliest period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Disclosure of prior period errors
The entity has to make the following disclosure:

- Nature of the error,
- As far as practicable, the amount of the correction for each financial statement line item affected,
- Amount of the correction at the beginning of the earliest prior period presented, and
- 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

IAS 10 – EVENTS AFTER THE REPORTING PERIOD

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 Balance Sheet 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 balance sheet clearly indicate that this is no longer appropriate.

Definitions

Events after the Reporting Period are those events, favorable and unfavorable, that occur between the balance sheet date and the date when the financial statements are authorized for issue. Two types of Events can be identified:

- (Those that provide evidence of conditions that existed at the balance sheet date (adjusting Events after the Reporting Period); and
- Those that are indicative of conditions that arose after the balance sheet date (Non- adjusting events after the balance date).

Recognition and measurement
Adjusting events after the reporting period
An entity shall adjust the amounts recognized in its financial statements to reflect adjusting Events after the Reporting Period. The following are examples of adjusting events that require the entity to adjust the amounts shown in the financial statement:

- Settlement of a Court case after the Balance sheet date which confirms that the entity has a present obligation
- Discovery of fraud or errors that show the financial statements are incorrect
- 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
- Property - A valuation which provides evidence of a permanent diminution in value.
- 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.
- Inventory - The receipt of proceeds of sales after the balance sheet date or other evidence concerning the net realizable value of inventory.
- Receivables - The renegotiation of amounts owing by receivables, or the bankruptcy of a customer.
- Taxation - The receipt of information regarding rates of taxation.
- Claims - Amounts received or receivable in respect of insurance claims which were in the course of negotiation at the balance sheet date.

EXAMPLE

A company Munene Ltd deals in selling laptop computers to its local customers in Kigali. Its financial reporting period ends 31/12 each year.
Shortly after the reporting period date in February 2019, a major credit customer of an entity went into liquidation because of heavy trading losses and it is expected that a debt of Frw 12,500,000 will not be recoverable.

Frw 10,000,000 of the debt relates to sales made prior to the end of the year and Frw 2,500,000 relates to sales made in the first two weeks of the new financial year.
In the year 2018 financial statements, the whole debt has been written off, but one of the directors has suggested that as the liquidation is an event after reporting date, the debt should not in fact be written off but a disclosure should be made by note to this year financial statements and the debt written off in the year 2019's financial statements.

ANSWER

As per IAS 10, Event after reporting period is an event which occurs between the financial period end and the date of approval by board of directors.
Frw 10.000.000 of the receivable existed at the reporting date and the liquidation of major customer provides more information about that receivable, therefore, this is an adjusting event which would require the debt existing at the reporting date (Frw 10 million) to be written off in the year 2019 financial statements.
The remaining receivable (2.5 million) did not exist at the reporting date and should therefore be written off in the year 2019 financial statements. However, a disclosure explaining the scenario must be published in the financial statements of the year ended 31st December 2018

REQUIRED

Advice whether the director suggestion is correct and explain how this scenario should be treated in financial statements for the year ended 31/12/2018.

Non-adjusting events after the reporting period
An entity shall not adjust the amounts recognized in its financial statements to reflect non-adjusting Events after the Reporting Period.

- A major business combination after the balance sheet or disposing of a major subsidiary.
- Issues of shares and debentures
- Purchases and sales of non-current assets and investments
- Losses of non-current assets or inventory as a result of a catastrophe such as fire or flood
- Announcing or commencing the implementation of a major restructuring. (See IAS 37)
- Announcing a plan to discontinue an operation
- Strikes and other labour disputes

Dividends
If an entity declares dividends to equity shareholders after the balance sheet date the entity shall not recognise those dividends as a liability at the balance sheet date.
The dividends are not recognized as a liability at the balance sheet date because they are not a present obligation at the balance sheet date.

Going concern
An entity shall not prepare its financial statements on a going concern basis if management determines after the balance sheet date that it intends to liquidate the entity or to cease trading or that it has no realistic alternative but to do so.

Disclosure
An entity shall disclose the date when the financial statements were authorized for issue and who gave the authorization.
If an entity receives information after the balance sheet date about conditions that existed at the balance sheet, it shall update disclosures that relate to those conditions, in the light of the new information.

For non-adjusting events an entity shall disclose:

- The nature of the event, and
- An estimate of its financial effect or a statement that such an estimate cannot be ma

INCOME TAX: IAS 12

OBJECTIVE OF IAS 12

The objective is to prescribe the accounting treatment for the income taxes

INTRODUCTION

In almost all countries, business entities are taxed on trading income. The principle of charging/determining the income tax under IAS 12 is to determine the current tax and future tax.
Income Tax is a component of three elements which include the following:

- Estimate for the Year xx
- Under/Over Provision (Last Year) xx/(xx)
- Transfer to/from Deferred Tax a/c xx/(xx)
- Income Tax Expense xx

ESTIMATE FOR THE YEAR
In many countries, the exact tax expense is not known until after the end of the year when the financial statements have been audited and authorized for use. Therefore, business entities have to make estimates for Income Tax expense to make the financial statements complete. These estimates are made by the management based on the tax paid last year plus other adjustments regarding the company's performance in the current year.

UNDER OR OVER PROVISION
Due to the estimates above, there could be a variance between the estimates and the actual tax paid.
If the amount which was charged in the income statement is higher than the actual tax paid, it will result in over provision.
While if the amount that was charged in the income statement is less than the actual tax paid, it results in under provision.

Adjustments to over or under provisions are in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors (prospective application). Prospective application is correction made this year and the year to come.

Example 1
The tax estimate for the year ending 2006 was Rwf 200,000. The estimate for the year ending 2007 was Rwf 250,000. Actual tax for last year (2006) was Rwf 235,000 which was paid in 2007.

Required:
Show the extract of the Income Statement and the Statement of Financial Position for the year ended 2006 and 2007.

Example 2
The estimate for the year ending 2006 was Rwf 200,000 and the estimate for the year ending 2007 was Rwf 250,000. Actual tax for last year (2006) which was paid in 2007 was Rwf 180,000.

Required
Show the extract of the P&L and SOFP for year 2006 and 2007

DISCLOSURE

- Current Tax and Deferred Tax chargeable
- An explanation of the relationship between taxable profit and accounting profit.
- Changes in tax rates
- Tax relating to discontinued operations

IFRS 15– REVENUE FROM CONTRACTS WITH CUSTOMERS

IFRS 15 Revenue from Contracts with Customers replaces IAS 18 Revenue (effective for annual reporting periods beginning on or after 1 January 2018).
For straightforward transactions of sales of goods, the change to IFRS 15 from IAS 18 will have little, if any, effect on the amount and timing of revenue recognition. For contracts such as long-term service contracts it could result in changes either to the amount or to the timing of revenue recognized. However, the only significant area in which the FA syllabus will be affected is the recognition of revenue for sales where a cash/settlement discount allowed is offered to the customer.

IFRS 15 is concerned with reporting the nature, amount, timing and uncertainty of revenue and cash flows resulting from contracts with customers.
Revenue from contracts with customers arises from fairly common transactions:
The sale of goods
The rendering of services
Generally, revenue is recognized when the entity has transferred control of goods and services to the buyer. Control of an asset is described in the standard as 'the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.' (IFRS 15)

Introduction
Accruals accounting is based on the **matching of costs with the revenue they generate**. It is crucially important under this convention that we establish the point at which revenue is recognized, so that the correct treatment can be applied to the related costs. For example, the costs of producing an item of finished goods should be carried as an asset in the statement of financial position until such time as it is sold; they should then be written off as a charge to the trading account. Which of these two treatments should be applied cannot be decided until it is clear at what moment the sale of the item takes place? The decision has a direct impact on profit since it would not be prudent to recognise the profit on sale until a sale has taken place, in accordance with the criteria of revenue recognition.
Revenue is generally recognized as earned at the point of sale, because at that point four criteria will generally have been met.

The product or service has been provided to the buyer.
The buyer has recognized his liability to pay for the goods or services provided. The converse of this is that the seller has recognized that ownership of goods has passed from himself to the buyer.
The buyer has indicated his willingness to hand over cash or other assets in settlement of his liability.
The monetary value of the goods or services has been established.

However, there are situations where revenue is recognized at other times than at the point of sale, for example, the sale of a cell phone contract. This is a long-term service contract which may involve multiple services and goods delivered at different points over the contract. In this scenario, revenue is recognized upon the fulfilment of various performance obligations of each distinct good and service. IFRS 15 applies to long-term service contracts as well as simpler sales transactions involving single products and services. However, revenue recognition of long-term service contracts is beyond the scope of this syllabus.

IFRS 15

IFRS 15 governs the recognition of revenue arising from contracts with customers. Revenue is income arising in the ordinary course of an entity's activities, such as sales and fees.
The key principle of IFRS 15 is that revenue is recognized to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This is achieved by applying a five-step model:

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognise revenue when (or as) the entity satisfies a performance obligation

Definitions
The following definitions are given in the standard.
b is income arising in the course of an entity's ordinary activities.

Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

A contract is an agreement between two or more parties that creates enforceable rights and obligations.

A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

A performance obligation is a promise in a contract with a customer to transfer to the customer either: a good or service (or a bundle of goods or services) that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

Revenue does not include sales taxes, value added taxes or goods and service taxes which are only collected for third parties, because these do not represent economic benefits flowing to the entity. The same is true for revenues collected by an agent on behalf of a principal. Revenue for the agent is only the commission received for acting as agent.

Measurement of revenue

This is the transaction price, as defined above in the standard, allocated to each performance obligation. This will take account of any trade discounts and volume rebates. At Foundation level, this is simply the amount at which the goods/services are sold to the customer, with one exception; where a sale involves a cash (or settlement) discount.

Cash/settlement discounts allowed

IFRS 15 refers to 'variable consideration'. This means the variable element of the payment a business expects to receive for a sale. A cash/settlement discount allowed for payment by cash/ prompt payment is one such variable consideration. IFRS 15 requires a business to estimate the amount of variable consideration it expects to receive and reflect this in the transaction price (IFRS 15: para 50).

This gives rise to the following accounting treatment of cash/settlement discounts allowed:
If a customer is expected to take up a cash/settlement discount allowed, the discount is deducted from the invoiced amount when recording the revenue.
If the customer subsequently does not take up the discount, the discount is then recorded as revenue. x If the customer is not expected to take up the discount, the full invoiced amount is recognized as revenue when recording the sale. If the customer subsequently does take up the discount, revenue is then reduced by the discount.

EXAMPLE

In this example, the five-step model is applied to a simple sales transaction involving the sale of a single product.
TDF is a company that manufactures office furniture. A customer placed an order on 22 December 20X4 for an office desk at a price of RWF300,000 plus sales tax at 20% of RWF60,000. The desk was delivered to the customer on 25 January 20X5, who accepted the goods as satisfactory by signing a delivery note. TDF then invoiced the customer for the goods on 1 February 20X5. The customer paid RWF360,000 to TDF on 1 March 20X5.
Required
How should TDF account for revenue?

ANSWER

Applying the five-step model:

- Identify the contract(s) with a customer:

A customer placed an order for a desk. This represents a contract to supply the desk.

- Identify the performance obligations in the contract:

There is one performance obligation, the delivery of a satisfactory desk.

- Determine the transaction price:

This is the price agreed as per the order, i.e. RWF300,000. Note that sales tax is not included since transaction price as defined by IFRS 15 does not include amounts collected on behalf of third parties.

- Allocate the transaction price to the performance obligations in the contract:

There is one performance obligation, therefore the full transaction price is allocated to the performance of the obligation of the delivery of the desk.

- Recognise revenue when (or as) the entity satisfies a performance obligation:

Since the customer has signed a delivery note to confirm acceptance of the goods as satisfactory, this is evidence that TDF has fulfilled its performance obligation and can therefore recognise RWF300,000 in January 20X5.

Note. The timing of payment by the customer is irrelevant to when the revenue is recognized. For most simple transactions with a single performance obligation, the full transaction price will be recognized when control of goods or services has transferred to the customer.

It gets more complex however when there are multiple performance obligations, e.g., as mentioned in the previous topic, the sale of a cell phone contract. This often involves a 'free' phone and monthly network service bundled together as a single monthly fee.

In this scenario there are two performance obligations; the delivery of the phone at the start of the contract and the network service. The transaction price of the monthly fee would need to be apportioned between these two performance objectives and recognized thereon.

Don't worry about learning this particular example, since long-term contracts are beyond scope of this syllabus. However, it is shown here to demonstrate how the standard is applied to more complex revenue arrangements.

EXAMPLE

Now work through this example to give you practice in preparing financial statements in accordance with IAS 1. Note that very little detail appears in the statement of profit or loss – all items of income and expenditure are accumulated under the standard headings. Write out the standard proformas and then go through the workings, inserting figures as you go.

USB Ltd, a limited liability company, has the following trial balance at 31 December 20X9.

	RWF'000	RWF'000
Cash at bank	100	
Inventory at 1 January 20X9	2,400	
Administrative expenses	2,206	
Distribution costs	650	
Non-current assets at cost:		
Buildings	10,000	
Plant and equipment	1,400	
Motor vehicles	320	
Suspense		1,500
Accumulated depreciation		

Buildings		4,000
Plant and equipment		480
Motor vehicles		120
Retained earnings		120
Trade receivables	876	
Purchases	4,200	
Dividend paid	200	
Sales revenue		11,752
Sales tax payable		1,390
Trade payables		1,050
Share premium		500
RWF1 ordinary shares		1,000
	22,352	**22,352**

The following additional information is relevant.

- Inventory at 31 December 20X9 was valued at RWF1,600,000. While doing the inventory count, errors in the previous year's inventory count were discovered. The inventory brought forward at the beginning of the year should have been RWF2.2m, not RWF2.4m as above.
- Depreciation is to be provided as follows.
    - Buildings at 5% straight line, charged to administrative expenses
    - Plant and equipment at 20% on the reducing balance basis, charged to cost of sales
    - Motor vehicles at 25% on the reducing balance basis, charged to distribution costs
- No final dividend is being proposed.
- A customer has gone bankrupt owing RWF76,000. This debt is not expected to be recovered and an adjustment should be made. An allowance for receivables of 5% is to be set up.
- 1m new ordinary shares were issued at RWF1.50 on 1 December 20X9. The proceeds have been left in a suspense account.

Required

Prepare the following.

- Statement of profit or loss for the year ended 31 December 20X9 **(3 marks)**
- Statement of changes in equity for the year ended 31 December 20X9 **(4 marks)**
- Statement of financial position as at 31 December 20X9 **(8 marks)**

All statements are to be prepared in accordance with the requirements of IFRSs. Ignore taxation. **(Total: 15 marks)**

ANSWER

USB LTD
STATEMENT OF PROFIT OR LOSS

FOR THE YEAR ENDED 31 DECEMBER 20X9

	RWF'000
Revenue	11,752
Cost of sales (W2)	(4,984)
Gross profit	6,768
Administrative expenses (W3)	(2,822)
Distribution costs (650 + 50 (W1))	(700)
Profit for the year	3,246

(b)

USB LTD

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 20X9

	Share capital RWF'000	Share premium RWF'000	Retained earnings RWF'000	Total RWF'000
Balance at 1 January 20X9	1,000	500	560	2,060
Prior period adjustment	–	–	(200)	(200)
Restated balance	1,000	500	360	1,860
Total comprehensive income for the year	–	–	3,246	3,246
Dividend paid	–	–	(200)	(200)
Share issue	1,000	500	–	1,500
Balance at 31 December 20X9	2,000	1,000	3,406	**6,406**

(c)

USB LTD

STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 20X9

	RWF'000	RWF'000
Non-current assets		

Property, plant and equipment (W4)		6,386
Current assets		
Inventory	1,600	
Trade receivables (876 – 76 – 40)	760	
Cash	100	
		2,460
Total assets		8,846
Equity and liabilities		
Equity		
Share capital (1000 + 1000)		2,000
Share premium (500 + 500)		1,000
Retained earnings (W5)		3,406
Current liabilities		
Sales tax payable	1,390	
Trade payables	1,050	
		2,440
Total equity and liabilities		8,846

Workings

1 Depreciation

	RWF'000
Buildings (10,000 u 5%)	500
Plant (1,400 – 480) X20%	184
Motor vehicles (320 – 120) 25%	50

2 Cost of sales

	RWF'000
Opening inventory	2,200
Purchases	4,200
Depreciation (W1)	184
Closing inventory	(1,600)

	4,984
3 Administrative expenses	RWF'000
Per T/B	2,206
Depreciation (W1)	500
Irrecoverable debt	76
Receivables allowance ((876 – 76) X5%)	40
	2,822

4 Property, plant and equipment

	Cost	Acc. dep	Dep. chg.	Carrying amount
	RWF'000	RWF'000	RWF'000	RWF'000
Buildings	10,000	4,000	500	5,500
Plant	1,400	480	184	736
Motor vehicles	320	120	50	150
	11,720	4,600	734	6,386

5 Retained earnings

	RWF'000
B/f per T/B	560
Prior period adjustment (inventory)	(200)
Profit for period	3,246
Dividend paid	(200)
	3,406

IAS 16 PROPERTY, PLANT AND EQUIPMENT

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 depreciation charges
- Determination of the impairment losses to be recognized in the financial statements

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 recognized 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.

Depreciation
The assessment of depreciation and its allocation to accounting periods involves the consideration of three factors:

- The carrying amount of the asset - whether cost or valuation
- 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***
- 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:

- 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.
- 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.
- 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
- 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.

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:

- The Straight-line method
- 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 FRW10,000 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:

(RWF 10,000-0)/5Years= RWF 2,000

Example

Terrie Ltd acquired a non-current asset which cost FRW60,000 on 1st January 20X0. The estimated useful life of the asset is 5 years with a residual value of FRW5,000. The depreciation charge in the profit and loss account each year is calculated as follows:

(RWF 60,000-RWF 5,000)/5Years= RWF 11,000 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
	FRW	FRW	FRW	FRW	FRW
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

Terrie Ltd acquired a non-current asset which cost FRW10,000 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

Asset Cost	FRW 10,000	FRW
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		

Terrie Ltd. acquired a non-current asset which cost FRW8,000 on 1st January 20X1. The estimated useful life of the asset is 4 years with a residual value of FRW500. The reducing balance rate is 50%.

The depreciation charge in the Statement of Comprehensive Income each year is calculated as follows:

Straight Line Method: FRW8,000 – FRW500 = FRW1,875 per annum

4 years	Straight Line		Reducing Balance	
	FRW		FRW	
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.X 4
	FRW	FRW	FRW	FRW
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.X 4
	FRW	FRW	FRW	FRW
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 Van is bought for FRW6,000 on 1st January 20X2. It will be used for 3 years and then sold back to the supplier for FRW3,072. Show the depreciation calculations for each year using:
    - The reducing balance method with a rate of 20%
    - The straight-line method
- 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:

			FRW
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 **Straight Line Method**

	FRW		FRW
Van cost	6,000	Van cost	6,000
2002 Dep'n 20%	1,200	2002 Dep'n	976
NBV end Yr 1	4,800	NBV end Yr 1	5,024

2003 Dep'n 20%	960	2003 Dep'n	976
NBV end Yr 2	3,840	NBV end Yr 2	4,048
2004 Dep'n 20%	768	2004 Dep'n	976
NBV end Yr 3	3,072	NBV end Yr 3	3,072

"Straight-line" Calculation:
(6,000-3,072)/3 Years= 2,928/3 Years=976

		Machines		
		A	**B**	**C**
	hs	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			FRW478		

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 Patricia Ltd sold a plant for FRW4,500. The plant was bought on 1st January 20X0 for FRW16,000. Depreciation is calculated on a straight line basis over 4 years. The company's year-end is 31st December.

Solution

Profit/Loss on Disposal

	FRW
Sale proceeds	4,500
Carrying Amount (W1)	(6,000)
Profit/(loss) on disposal	(1,500)

W1 Calculation of Carrying Amount/Net Book Value

	FRW
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

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

		FRW			FRW
1st Jan X4	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

		FRW			FRW
			1st Jan X4	Opening Balance	X
			31st Dec X4	Depreciation expense	

Plant and Equipment –Depreciation Expense Account

		FRW			FRW
31st Dec X4	Statement of Comprehensive Income	2,500	31st Dec X4	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:

- Debit Disposal Account
- Credit Property, Plant and Equipment Cost Account

To transfer the original cost of the asset to the disposal account

- 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.

- Debit Bank
- Credit Disposal Account

To record the cash received on sale/disposal of the asset

Disposal Account

		FRW			FRW
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 FRW20,000 against a new motor vehicle costing FRW35,000. The garage gave a trade-in allowance to X Limited of FRW10,000. At the date of the trade-in the accumulated depreciation on the old motor vehicle was FRW8,000. X Limited paid the garage a cheque for FRW25,000.

Motor Vehicle - Cost Account

		FRW			FRW
(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

		FRW			FRW
(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
2,000			20,000

Notes to Ledger Account

- Opening balance represents the original cost of the asset on hand at the start of the financial period.
- 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.
- 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
- The cash paid out in addition to the trade in allowance for the new vehicle.
- The total depreciation charged on the asset is debited from the Motor Vehicle – Accumulated Depreciation Account and credited to the Disposal Account.
- 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)
	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 FRW700,000.

Solution
The asset originally cost FRW650,000 but was previously re-valued downwards to FRW500,000, a decrease of FRW150,000. 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 recognized 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 FRW450,000.

Solution

The asset originally cost FRW400,000 but was previously re-valued upwards to FRW500,000, an increase of FRW100,000. 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

Disclosure

The financial statements should disclose, for each class of property, plant and equipment:

- The measurement bases used for determining the gross carrying amount.
- The depreciation methods used
- The useful lives or depreciation rates used
- The gross carrying amount and the accumulated depreciation at the beginning and end of the period
- A reconciliation of the carrying amount at the beginning and end of the period showing: (i) Additions
    - Disposals
    - Increases or decreases during the period resulting from revaluations
    - Depreciation

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 FRW3,000
- Machine B purchased July 20X2 for FRW2,000
- Machine C purchased October 20X3 for FRW1,000

Required:

Calculate the depreciation charge for the year-end 31st December 20X4.

Question 2

An asset was bought in 20X0 for FRW3,000. 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 FRW1,200. 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:

- Reducing Balance at 10%,
- Straight Line Method

Question 3

An asset was purchased on 1st July 20X0 for FRW10,000, 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 FRW5,000. Company year-end is 31st December.

Required:

Prepare the ledger accounts for each of the years assuming:

- The company pro-rates the depreciation charge in the year of purchase and disposal.
- The company takes a full year's 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 ¾	225		
		2,775		
	Bought 1.7.20X2		2,000	
20X2	Dep'n 10% x 2,775	277		
	Dep'n 10% 2,000 x ½		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) FRW493

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**

		FRW			FRW
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

		FRW			FRW
		1,000			1,000
31.12.X0	Balance c/d		31.12.X0	Statement of Comprehensive Income	
		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

Motor Vehicle A/C	10,000	Bank	5,000
Profit – Statement of Comprehensive Income	500		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

	FRW			FRW
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

31.12.X0	Balance c/d	FRW 2,000	31.12.X0	Statement of	FRW 2,000
				Comprehensive Income	
		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 Income	2,000
		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

	FRW			FRW
Motor Vehicle A/C	10,000		Bank	Bank
Profit – Statement of Comprehensive Income	1,000			
			Depreciation A/C	6,000
	11,000			11,000

International Accounting Standard 20(IAS 20) Accounting for Government Grants and Disclosure of Government Assistance

KEY DEFINITIONS
The following terms are used in this Standard with the meanings specified:

Government refers to government, government agencies and similar bodies whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.
Forgivable loans are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

Presentation of grants related to assets
Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset**.**
Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to assets are regarded as acceptable alternatives.
One method recognizes the grant as deferred income that is recognized in profit or loss on a systematic basis over the useful life of the asset.
The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognized in profit or loss over the life of a depreciable asset as a reduced depreciation charge.

Presentation of grants related to income
Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.

IAS 37 – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

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.

Definitions
A Provision is a liability of uncertain timing or amount.
A liability is a present obligation of an entity arising from past events, 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 contract,
- Legislation or
- Operation of law.

A constructive obligation is an obligation that derives from an entity's actions where:

- 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
- 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 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
- A present obligation that arises from past events but is not recognized because:
    - It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligations, or
    - 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:

- The scope of the business undertaken by an entity, or
- 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.
Recognition

A provision is recognized when all of the following conditions are met:

- An entity has a present obligation as a result of a past event,
- 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 recognized.
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.

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 FRW2m. If major defects occurred in all goods sold, the cost would be FRW8m. 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 FRW2m)	300k
Major Defects	(5% x FRW8m)	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 recognized when, and only when, it is virtually certain that reimbursement will be received. The reimbursement shall be treated as a separate asset. The amount recognized 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 recognized for a reimbursement.

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.

Uses of provisions

A provision should only be used for expenditure for which the provision was originally established.

Application of 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 recognized and measured as a provision.

Restructuring
The following are examples of events that are considered to be restructuring:

- Sale or termination of a part of the business,
- Closure of business in a country or region or the relocation of business activities from one country or region to another,
- Change in management structure,
- Fundamental reorganization 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:

- Has a detailed plan for restructuring, identifying at least:
    - Business or part of business concerned,
    - Principal locations affected,
    - Location, function, and approximate number of employees who will be compensated for termination of their services,
    - Expenditure to be undertaken and
    - when the plan will be implemented and

- 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.

Disclosure
For each class of provision an entity must disclose:

- The carrying amounts at the beginning and end of the period,
- Additional provisions made in the period, including an increase to existing provisions, c) Amounts used during the period,

- Unused amounts reversed during the period and
- 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 brief description of the nature and timing of any expected outflow of economic benefit,
- 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,
- Amount of any expected reimbursement, stating the amount of any asset that has been recognized 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:

- An estimate of the financial effect,
- An indication of the uncertainties relating to the amount or timing of any outflow,
- The possibility of any reimbursement.

For each contingent asset disclose
:

- A brief description of the nature of the contingent asset,
- An estimate of the financial effect.

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 recognized 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 publicized 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 restoration of 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 seabed, that is, the ninety per cent of the eventual costs. The balance is recognized 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 recognized 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 recognized, 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 them 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 recognized.

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 recognized 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 recognized, 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 capitalized with the consumption of each new lining shown by depreciation over the subsequent five years. There is no event, so no provision is recognized.

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 recognized.

The rationale is the same as in the previous example of Refurbishment costs where there is no legislative requirement.

IAS 38 – INTANGIBLE ASSETS

Objective

IAS 38 sets out the accounting treatment to be followed for Intangibles in so far as not covered by other International Accounting Standards. The standard lays down the criteria to be met before an entity recognizes an Intangible asset.

Definition

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

Research is original and planned investigation undertaken with the prospect of gaining scientific or technical knowledge and understanding.

An Intangible asset is an identifiable non-monetary asset without physical substance. Examples of intangible assets include patents, trademarks, licenses, copyrights, motion picture films and video recordings.

Note: Whilst the device on which the film or video has been recorded is tangible, the art itself is not tangible.

Non-monetary assets that have no physical substance are held for use in the production or supply of goods or services or for rental to others or for administrative purposes.

Recognition and measurement

Recognition

An intangible asset should be recognized when it complies with the definition of an intangible asset and meets the recognition criteria for an asset i.e. probable that future economic benefits will flow to the entity and the cost of the asset can be measured reliably.

Initial Measurement

Intangible assets should be measured at cost initially.

Internally generated intangible assets

Internally generated goodwill should not be recognized. It is difficult to identify separately and cannot be measured reliably. Other internally generated assets may be recognized but it is difficult to identify whether there is an identifiable asset that will generate probable future economic benefits and to determine the cost of the asset reliably. An entity must classify expenditure into a research phase and a development phase. In the event that expenditure cannot be distinguished it should be regarded as research expenditure.

Acquisition of intangible assets

Intangible assets may be acquired in a number of different ways:

Separately - For example the purchase of computer software

As part of a business combination - H Limited bought 100% of S Limited for FRW2m. The net assets of S Limited at the date of acquisition were FRW1.7m. The intangible asset of Goodwill of FRW0.3m arises.

By way of a government grant e.g. mobile phone operating license.

By an exchange of assets

Accounting for development expenditure

Development expenditure should be recognized as an intangible asset if the entity can demonstrate all of the following criteria:

The technical feasibility of completing the intangible asset

The intention to complete and use or sell it

The ability to use or sell the intangible asset

How the intangible asset will generate probable future economic benefits

The availability of adequate technical financial and other resources to complete the development and use or sale of the intangible asset

The ability to measure expenditure attributable to the intangible asset.

Examples of development expenditure activities include the design, construction and testing of new or improved materials, devices, products, processes, systems or services, the design of tools, jigs, molds and dies involving new technology.

Accounting for research expenditure

Expenditure on research should be recognized as an expense in the Statement of Comprehensive Income when it is incurred.

Examples of research expenditure include amounts spent on activities aimed at obtaining new knowledge, the search for alternatives for materials, devices, products, processes, systems.

The following costs would probably be treated as an expense in the Statement of Comprehensive Income : research costs, customer lists and publishing titles that are internally generated, advertising and related costs.

Amortization

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life.

There is a presumption that the useful life will not exceed 20 years unless there is persuasive evidence to the contrary, in which case the intangible asset is amortized over a longer period.

Disclosure

The financial statements should disclose:

- the accounting policies adopted for intangible assets, the amortization method used and the useful life or the amortization rate used;
- the gross carrying amount and the accumulated amortization at the start and end of the year including movements that have arisen during the year;
- the line item of the Statement of Comprehensive Income in which the amortization is included;
- the total cost of research and development that has been recognized as an expense in the Statement of Comprehensive Income .

AS 40 INVESTMENT PROPERTY

Overview

IAS 40 Investment Property applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Investment properties are initially measured at cost and, with some exceptions. may be subsequently measured using a cost model or fair value model, with changes in the fair value under the fair value model being recognised in profit or loss.

Definition of investment property

Investment property is property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both. Examples of investment property:

land held for long-term capital appreciation
land held for a currently undetermined future use building leased out under an operating lease
vacant building held to be leased out under an operating lease
property that is being constructed or developed for future use as investment property
The following are not investment property and, therefore, are outside the scope of IAS 40:
Property held for use in the production or supply of goods or services or for administrative purposes property held for sale in the ordinary course of business or in the process of construction of development for such sale (IAS 2 Inventories)
Property being constructed or developed on behalf of third parties (IAS 11 Construction Contracts)
Owner-occupied property (IAS 16 Property, Plant and Equipment), including property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees and owner- occupied property awaiting disposal

Recognition

Investment property should be recognized as an asset when it is probable that the future economic benefits that are associated with the property will flow to the entity, and the cost of the property can be reliably measured.

Initial measurement

Investment property is initially measured at cost, including transaction costs. Such cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy.

Measurement subsequent to initial recognition

IAS 40 permits entities to choose between;
A fair value model, and a cost model.
One method must be adopted for all of an entity's investment property. Change is permitted only if this results in a more appropriate presentation.

Fair value model

Investment property is remeasured at fair value, which is the amount for which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction.
Gains or losses arising from changes in the fair value of investment property must be included in net profit or loss for the period in which it arises.

Cost model

After initial recognition, investment property is accounted for in accordance with the cost model as set out in IAS 16 Property, Plant and Equipment – cost less accumulated depreciation and less accumulated impairment losses. [IAS 40.56]

Transfers to or from investment property classification

Transfers to, or from, investment property should only be made when there is a change in use, evidenced by one or more of the following:

commencement of owner-occupation (transfer from investment property to owner-occupied property)

commencement of development with a view to sale (transfer from investment property to inventories)

end of owner-occupation (transfer from owner-occupied property to investment property)

commencement of an operating lease to another party (transfer from inventories to investment property)

end of construction or development (transfer from property in the course of construction/ development to investment property

When an entity decides to sell an investment property without development, the property is not reclassified as inventory but is dealt with as investment property until it is derecognized.

The following rules apply for accounting for transfers between categories:

For a transfer from investment property carried at fair value to owner-occupied property or inventories, the fair value at the change of use is the 'cost' of the property under its new classification [IAS 40.60]

For a transfer from owner-occupied property to investment property carried at fair value, IAS 16 should be applied up to the date of reclassification. Any difference arising between the carrying amount under IAS 16 at that date and the fair value is dealt with as a revaluation under IAS 16

For a transfer from inventories to investment property at fair value, any difference between the fair value at the date of transfer and it previous carrying amount should be recognized in profit or loss when an entity completes construction/development of an investment property that will be carried at fair value, any difference between the fair value at the date of transfer and the previous carrying amount should be recognized in profit or loss.

When an entity uses the cost model for investment property, transfers between categories do not change the carrying amount of the property transferred, and they do not change the cost of the property for measurement or disclosure purposes.

Disposal

An investment property should be derecognized on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal. The gain or loss on disposal should be calculated as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognized as income or expense in the income statement. [IAS 40.66 and 40.69] Compensation from third parties is recognized when it becomes receivable.

TOPIC 5:

PREPARING FINANCIAL STATEMENTS OF DIFFERENT FORMS OF BUSINESS ENTITIES

4.1 SOLE TRADERS

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:

- Compute a Statement of Comprehensive Income for the accounting period
- Prepare a Statement of Financial Position at the end of the accounting period

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.

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, lodgment dockets and cheque stubs, all of the receipts and payments should be analyzed 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

		FRW	FRW		
1.01.X4	Balance b/d	1,500	Payments to trade payables		11,000
	Receipts from (goods)		Expense	- ESB	
	Trade	12,500	payments	Rent	1,500
	Receivables	2,000	Drawings		2,50
	Cash Sales	3,500	31.12.X5 Balance c/d		600
	Capital				
	Introduced	19,500			
	1.01.X5 Balance b/d	3,900			19,500

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 Irrecoverable 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.

	FRW
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

		FRW			FRW
1.01.X4	Balance b/d	6,000	Cash received		27,500
***	Total sales for year	29,000	trade receivables		
			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.

	FRW
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

	FRW		FRW
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
*** Balancing figure		1.01.X5 Balance b/d	9,000

5. Accruals and Prepayments

At the end of the accounting period, a list of accruals and prepayments should be prepared, journalized 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:

- Provision for depreciation
  - DR Depreciation account
  - CR Accumulated depreciation account/provision for depreciation account
- Provision for Irrecoverable Debts
  - DR Irrecoverable Debts account
  - CR Provision for Irrecoverable Debts account

7. **Preparation of final accounts**

- An inventory figure at the end of the accounting period will be calculated.
- 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.
- 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:

- The gross profit ratio in previous accounting periods

And/or

- 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:

	FRW			FRW
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:

- Depreciation is provided on the van annually at the rate of 20% of the book value.
- The loan from Pascal Otto was received on 1st January 20X4; interest is payable on the loan at the rate of 10% per annum.
- In addition to the items mentioned above, the assets and liabilities of Joseph Otto were as follows:

At 31st March		
Van purchased 1/10/20X2, at cost	**20X3**	**20X4**
	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

Assets	FRW
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	FRW59,900

2. Bank Account as Per Question

3.

Trade Receivables Control Account

FRW			FRW
Opening	23,000	Closing	61,450
Sales	250,000	Bank	211,550
273,000			273,000

4.

Trade Payables Control Account

FRW			FRW
Closing	11,000	Opening	14,500
Bank	188,500		185,000
Purchases			
199,500			199,500

5. **(a) Accruals and Prepayments: Van Expenses Account**

	FRW		FRW
Bank	14,500	Prepaid c/d	500
		Statement of Comprehensive Income	14,000
	14,500		14,500

(b) **Workshop Rent Account**

	FRW		FRW
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 FRW18,000 x 20% = FRW3,600

(b) Loan Interest:

Loan from Pascal Otto FRW25,000 x 10% x 3/12 = FRW625

7. **Preparation of Final Accounts:**

Statement of Comprehensive Income

	FRW	FRW
Sales	250,000	
Inventory 1/4/X3	25,000	
Purchases	185,000	
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-current				
Non-Current Assets	FRW	FRW		FRW
Van		20,000		
Current Assets				
Inventories				40,000
Trade Receivables				61,450
Prepayment				500
				101,950
				116,350
Capital:			FRW	
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

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: -

- An opening statement of affairs should be prepared as described above.
- A statement of affairs at the end of the accounting period should be prepared.
- 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.

Question/solution

Lloyd Cornelius is a dealer who has not kept proper books of account. At 31st August 20X4 his state of affairs was as follows:

	FRW
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 FRW7,560. Winnings from a Casino FRW2,800 were put into the business. Extra fixtures were bought for FRW2,000.

At 31st August 20X5 his assets and liabilities were: Cash FRW84, Bank Overdraft FRW165, Inventory FRW21,491, Trade Payables for goods FRW6,002, Payables for Expenses FRW236, Fixtures to be depreciated FRW600, Motor Van to be valued at FRW2,500, Trade Receivables FRW15,821, Pre-paid Expenses FRW72.

Draw up a statement showing the profit or loss made by Klopper for the year ended 31st August 20X5.

Solution

Lloyd Cornelius Opening Capital: 1st September 20X4

	FRW	FRW
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

Lloyd Cornelius Statement of Financial Position as at 31st August 20X5

	FRW	FRW
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
Current Liabilities		
Trade Creditors	6,002	
Expenses Owing	236	
Bank Overdraft	165	6,403
		45,368

(W1) Net Profit Calculation	FRW
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.

$$\text{Margin} = \frac{\text{Gross Profi}}{\text{Sales}} \times 100$$

Often referred to as the Gross Profit Percentage

$$\text{Mark up} = \frac{\text{Gross Profi}}{\text{Cost Sales}} \times 100$$

These two ratios are examined in a number of ways. Therefore, it is important to be fully familiar with them.

Example 1:
Goods cost FRW10,000. Mark-up by 20%. What is the selling price?

Solution:

Selling price = $\frac{10,000\text{x } 120}{100}$ = FRW12,000

Example 2:

GOODS COST FRW10,000. GROSS PROFIT PERCENTAGE IS 20%. WHAT IS THE SELLING PRICE?

Solution:

Selling Price = $\frac{10,000\text{x } 100}{80}$ = FRW12,500

Example 3:

Goods sold for FRW10,000. Gross Profit Percentage is 20%. What is the cost price? What is the mark-up expressed as a % of cost?

Solution:

Cost Price = $\frac{10,000\text{x } 80}{100}$ = FRW8,000

Mark Up = $\frac{10,000 - 80\ 000}{80\ 000}$ x100 = 25%

Example 4:

GOODS SOLD FOR FRW10,000. MARK-UP IS 10%. WHAT IS THE COST PRICE

Solution:

Cost price = $\frac{10,000\ \text{x}100}{1100}$ = FRW9,091

I. QUESTION/SOLUTION

Incomplete Records

Salesius Rwandex 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.

1st April 20X3 Salesius had the following assets and liabilities. You ascertain that on

	FRW
Furniture and Equipment (Cost FRW5,400)	3,800
Motor Vehicles (Cost FRW2,800)	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		Payments	
	FRW		FRW
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.

- Mr Salesius has taken goods costing FRW100 for his own personal use.
- The amounts outstanding for trade receivables and trade payables at the end of the current financial year were FRW1,300 and FRW3,800 respectively. Irrecoverable Debts of FRW100 had been taken into account in arriving at the trade receivables figure.
- FRW450 was accrued and FRW520 prepaid at 31st March 20X4.
- The inventory valuation at the end of the current year was FRW5,850. (5) Interest of 10% is to be provided for on both loans.
- The agreed maximum on the bank overdraft is FRW5,000 and FRW50 interest is outstanding.
- 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 -

Salesius Rwandex

Step 1 Prepare an opening statement of affairs in order to ascertain the capital at the beginning of the year.

Assets	FRW
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
	6350
Opening Capital	FRW9,350

Step 2 Prepare Cash and Bank Account

Bank Account

	FRW			FRW
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

	FRW		FRW
Balance	1,000	Bank	5,200
Sales	5,600	Irrecoverable Debts	100
		Balance	1,300
	6,600		6,600

Trade Payables

	FRW		FRW
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

	FRW		FRW
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

Statement of Comprehensive Income for the Year ended 31st March 20X4

		FRW			FRW
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	33,050	
Cost of Goods Sold					
Gross Profit				6,850	
Deduct Expenses			5,080		
Irrecoverable Debts			100		
Loan Interest (7,000 x 10%)			700		
Overdraft Interest			50		
Depreciation 20% x 5,400	1,080				
Motor Vehicles (W2)	910		1,990		
Net Loss				7,920	
				FRW(1,070)	

W1

	FRW
Credit Purchases	9,500
Cash Purchases	23,200
	32,700
Less Goods for Own Use	100
	32,600

W2	FRW
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

Statement of Financial Position as at 31st March 20X4

	Cost	Accumulated Depreciation		Net Book Value
Non-current Assets	FRW	FRW	FRW	FRW
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:			
Capital 1/4/20X2		9,350	
Less Loss for Year	1,070		
Drawings 5,200 + 100	5,300	6,370	
			2,980
Loan (5,500 + 1,500)			7000
Current Liabilities			
Trade Payables	3,800		
Accrued Expenses (W3)	1,200		
Bank Overdraft	350		
			5,350
			15,330

W3

		FRW
Accrued Expenses	450	
Bank Overdraft	50	
Loan Interest	700	
		1,200

4.2 PARTNERSHIPS

A partnership is a relationship that exists between two or more persons carrying on a business common with a view to making profit.

Reasons for partnership

- Additional capital incase a sole trader or one person is not able to raise sufficient capital.
- Incase there is need for skills or expertise in certain areas of the business.
- To involve more persons in the business especially for a family.

Membership

A partnership has minimum membership of two (2) maximum of fifty (50) except for professional firms (e.g.) lawyers, doctors, accountants etc. whose maximum membership is twenty (20) persons.

Types of Partners

General partners

These are the real partners in new sense of the partners which refers to those partners who are the most active partners in the partnership. In most cases the general partner is a reliable of the debts of the partnership.

Limited partners

This is a partner whose liabilities are limited to the amount of capital contributed to the partnership business.

This type of partners do not usually participate in the management of the partnership becus4 if thy do they loose their limited liability in respect to the transaction and decisions participated in.

Active partner
This is the type of partner who takes the active part in the running of the business. In most cases such a partner may be employed somewhere or may be in another business all together. The partner contributes capital to the partnership business and the profits or losses at lower proportions.

Quasi partner
This is a partner who is already retired or left the partnership but he left his stake with the farm. From this stake he earns interest just like in a loan situation.

Partnership deed
Where two or more persons wish to form a partnership, then it is recommended that they agree on the terms upon which the partnership will be run and the relationship between each other. This is done in writing and signed off as agreed by all the partners and therefore it becomes a partnership deed or agreement.

Contents of partnership agreement

- Name(s) and address(s) of both the firm and the partners
- Capital to be contributed by each partner
- The profit sharing ratios that may be expressed as a fraction or as a percentage.

- Salaries to be paid to any partners who will be involved in the active management of the business
- Any interest to be charged on drawings made by the partners.
- Interests to be given to the partners on their capital balances.
- Procedures to be taken on the retirement or admission of a partner.

Accounting for partnerships.
The interest of the partners in the business is either long term or short-term.
The long-term interest is the capital contributed by each partner and the balance is expected to remain fixed. It will only change when the partners agree or incase of any changes in the partnership like admission of or retirement of a partner.
The short-term interest is reflected in form of a current account which is affected by the trading activities of the partnership (i.e.) the profits or losses and any drawings made by the partners.
In most partnerships, both a capital and a current account are maintained and therefore the capital account becomes a fixed capital account. When there is no distinction between a capital account and a current account then any short- term changes are passed through the capital account therefore the capital account becomes a fluctuating capital account.
Some of the transactions to be passed through the capital account and the current account are shown in the following formats:

(Assume a firm of 3 partners X, Y and Z)

CAPITAL ACCOUNT							
	X	Y	Z		X	Y	Z
	FRW	FRW	FRW		FRW	FRW	FRW
Loss or revaluation	xx	xx	xx	Bal b/d	xx	xx	xx
Goodwill written off	xx	xx	xx	Additional capital (c/book or asset)	xx	xx	xx
				Gains on revaluation	xx	xx	xx
Bal c/d	xx	xx	xx	Goodwill	xx	xx	xx
	xx	xx	xx		xx	xx	xx
				Bal b/d	xx	xx	xx

CURRENT ACCOUNT							
	X	Y	Z		X	Y	Z
	FRW	FRW	FRW		FRW	FRW	FRW
Bal b/d		xx		Bal b/d	xx		Xx
Interest on drawings	xx	xx	xx	Interest on capital	xx	xx	Xx
Drawings	xx	xx	xx	Salaries	xx	xx	Xx
				Share of profits	xx	xx	Xx
Bal c/d	xx	xx	-	Loan interest	-	xx	-
				Bal c/d			Xx
	xx	xx	xx		xx	xx	Xx
			xx	Bal b/d	xx	xx	Xx

Format for final accounts:

Profit or Loss Appropriations Account
The profit and loss account is exactly as the one for the sole trader and in addition to the profit and loss account, a new section called the Appropriation account is included and this account shows how the partners share the Net Profit for the period. (In addition to other expenses in the

profit and loss, an expense for interest on loan given by one of the partners is included and the credit entry is made on the partner's current account.)
The format for the Appropriation account is as follows:

FRW			FRW
Net Profit for the year			xx
Add:		Interest on drawings.	
X	xx		
Y	xx		
Z	xx		xx
			xx
Less: Interest on capital.			
X	xx		
Y	xx		
Z	xx		(xx)
	FRW		FRW
			xx
Less: Salaries			
X	xx		
Y	xx		
Z	xx		(xx)
xx			
Balance of profit to be shared in percentage ratio			
X (ratio)	xx		
Y (ratio)	xx		
Z (ratio)	xx	(xx)	

Statement of financial position
The balance sheet also the same as that for a sole trader but the interest of each partner in the business should be shown separately and any loan given by a partner to the firm is also shown separately in the non-correct liability section therefore, the format will be as follows:

	FRW	FRW	FRW
Net assets.			xx
Capital: X			xx
Y			xx
Z			xx

			xx
Current account X	xx		
Y	xx		
Z (debit balance).	(xx)	xx	
			xx
Non-curent labilités			
10% loan – Y	xx		
10% loan – bank	xx		xx
			xx

Illustration:
Gasore(G) and Jerome(J) own a grocery shop. Their first financial year ended on 31 December 20X8.

The following balances were taken from the books on that date:

Capital:	G- FRW60,000	J - FRW48,000
Partnership salaries:	G - FRW9,000	J - FRW6,000
Drawings:	G - FRW12,000	J - FRW13,400

The firm's net profit for the year was FRW32,840.

Interest on capital is to be allowed at 10% per year.

Profits and losses are to be shared equally.

(a) From the information above prepared the firm's appropriation account and the partners' current accounts.

SOLUTION
G and J

Profit and Loss Appropriation account for the year ended 31 Dec 20X8

	FRW	FRW
Net Profit for the year		32,840
Less: Interest on capital		
G	6000	
J	4800	(10,800)
		22,040
Less: Salaries		
G	9000	
J	6000	(15,000)

Balance of profit to be shared in Profit Share Ratio		7,040
G ½	3520	
J ½	3520	(7,040)

CURRENT ACCOUNT					
	G	J		G	J
	FRW	FRW		FRW	FRW
Drawings	12,860	13,400	Interest on capital	6,000	4,800
			Salaries	9,000	6,000
Bal c/d	5,660	920	Profit shared.	3,520	3,520
	18,520	14,320		18,520	14,320
			Bal b/d	5,660	920

Illustration

Draw up a profit and loss appropriation account for the year ended 31 December 20X8 and balance sheet extracts at the date, from the following:

- Net profits FRW30,350
- Interest to be charged on capitals: Anastace(A) FRW2,000; Benjamin(B) FRW1,500; Christe(C) FRW900
- Interest to be charged on drawings; A FRW240; B FRW180; C FRW130
- Salaries to be credited: B FRW2,000; C FRW3,500.
- Profits to be shared: A 50%; B 30%; C 20%.
- Current accounts: balances b/f A FRW1,860; B FRW946; C FRW717
- Capital accounts: balances b/f A FRW40,000; B FRW30,000; C FRW18,000
- Drawings: A FRW9,200; B FRW7,100; C FRW6,900.

SOLUTIONS

A, B & C Partners

Profit and Loss Appropriation Account for the year ended 31 December 20X8

		FRW	FRW
	Net profit for the year		30,350
Add:	Interest on drawings		
	A	240	
	B	180	
	C	130	550
			30,900

Less:	Interest on capital		
	A	2,000	
	B	1,500	
	C	900	(4,400)
			26,500
Less:	Salaries		
	A	2,000	
	B	3,500	(5,500)
Balance of profit to be shared			21,000
	A 50%	10,500	
	B 30%	6,300	
	C 20%	4,200	(21,000)

Current Account

	A	B	C		A	B	C
	FRW	FRW	FRW		FRW	FRW	FRW
Interest on draw	240	180	130	Bal b/d	1,860	946	717
Drawings	9,200	7,100	6,900	Interest on capital	2,000	1,500	900
Bal c/d				Salaries		2,000	3,500
				Share of profits	10,000	6,300	4,200
Bal c/d	4,920	3,466	2,287				
	14,360	10,746	9,317		14,360	10,746	9,317

Statement of financial position (extract) as at 31 Dec 20X8

	FRW	FRW	FRW
Net Assets			xx
Capital: A			40,000
B			30,000
C			18,000

			88,000
Current Accounts			
	A	4,920	
	B	3,466	
	C	2,287	10,673
			98,673

Illustration

The following list of balances as at 30 September 20X8 has been extracted from the books of Byron and Stephen, trading partnership, sharing the balance of profits and losses in the proportions 3:2 respectively.

		FRW
Printing, stationery and postage		3,500
Sales		322,100
Stock in hand at 1 October 20X8		23,000
Purchases		208,200
Rent and rates		10,300
Staff salaries		36,100
Telephone charges		2,900
Motor vehicle running costs		5,620
Discounts allowable		950
Discount receivable		370
Sales returns		2,100
Purchases returns		6,100
Carriage inwards		1,700
Carriage outwards		2,400
Fixtures and fittings: at cost		26,000
Provision for depreciation		11,200
Motor vehicles: at cost		46,000
Provision for depreciation		25,000
Provision for doubtful debts		300
Drawings:	Byron	24,000
	Stephen	11,000

Current account balances

At 1 October 20X8:

Byron	3,600	credit
Stephen	2,400	credit

Capital account balances

At 1 October 20X8:

Byron	33,000
Stephen	17,000
Debtors	9,300
Creditors	8,400
Balance at bank	7,700

Additional information

- FRW10,000 is to be transferred from Brick's capital account to a newly opened Brick Loan Account on 1 July 20X8.
- Interest at 10 per cent per annum on the loan is to be credited to Brick.
- Stone is to be credited with a salary at the rate of FRW12,000 per annum from 1 April 20X8.
- Stock in hand at 30 September 20X8 has been valued at cost at FRW32,000.
- Telephone charges accrued due at 30 September 20X8 amounted to FRW400 and rent of FRW600 prepaid at that date.
- During the year ended 30 September 20X8 Stone has taken goods costing FRW1,000 for his own use.
- Depreciation is to be provided at the following annual rates on the straight line basis:
    - Fixtures and fittings 10%
    - Motor vehicles 20%

Required:

- Prepare a profit or loss account for the year ended 30 September 20X8.
- Prepare a balance sheet as at 30 September 20X8 which should include summaries of the partners' capital and current accounts for the year ended on that date.

SOLUTION

Brick And Stone.

Trial Balance As At 30 September 20X8

	Debit	Credit
	FRW	FRW
Printing and stationery and postage	3,500	

Sales			322,100
Stock (1 October 19X8)		23,000	
Purchases		208,200	
Rent and rates			10,300
Heat and light		8,700	
Staff salaries		36,100	
Telephone charges		2,900	
Motor vehicle running expenses		5,620	
Discounts allowable		950	
Discounts receivable			370
Sales returns		2,100	
Purchases returns			6,100
Carriage inwards		1,700	
Carriage outwards		2,400	
Fixtures and fittings at cost		26,000	
Provision for depreciation			11,200
Motor vehicles at cost		46,000	
Provision for depreciation			25,000
Provision for doubtful debts			300
Drawings:	B	24,000	
	S	11,000	
Current accounts:			
	B		3,600
	S		2,400
Capital accounts:			
	B		33,000
	S		17,000
Debtors			9,300
Creditors			8,400

Balance at bank	7,700		
	429,470	429,470	

PROFIT OR LOSS ACCOUNT
FOR THE YEAR ENDED 30 SEPTEMBER 20X8

	FRW	FRW	FRW
Sales			322,100
Less: Sales returns			2,100
			320,000
Less : cost of sales			
Opening Stock		23,000	
Purchases (adjustment)	207,200		
Add: Carriage inwards	1,700		
	208,900		
Less: Purchases returns	(6,100)	202,800	
		225,800	
Less: Closing Stock		(32,000)	(193,800)
Gross profit			126,200
Discount receivable			370
Less Expenses			
Telephone charges (adjustment))	3,300		
Printing and stationery and postage	3,500		
Rent and rages (adjustment)	9,700		
Heat and light	8,700		
Staff salaries	36,100		
Motor vehicle running expense	5,620		
Discount allowable	950		
Carriage outwards	2,400		
Depreciation on fixtures and fittings	2,600		
Depreciation on motor vehicles	9,200		
Interest on loan (adjustment)	250		(82,320)

	Net profit			44,250
Less:	Salaries	S (adjustment)		(6,000)
	Balance of profit to be shared			38,250
		B $\frac{3}{5}$	22,950	
		S $\frac{2}{5}$	15,300	(38,250

Statement of financial position as at 30 September 20X8

Noncurrent Asset				FRW	FRW	FRW	
Fixtures and fittings				26,000	(13,800)	12,200	
Motor vehicles		46,000	(34,200)	11,800			
				72,000	48,000	24,000	
Current Asset							
Stock				32,000			
Debtors		9,300					
Less:	Provision	(300)		9,000			
Payments				600			
Cash at bank				7,700			
					49,300		
Current Liabilities							
Creditors				8,400			
Accruals				400	(8,800)		<u>40,500</u>
						<u>64,500</u>	
Capital							
	B (adjustment)					23,000	
	S					17,000	
Current:							
	B adjustment				2,800		
	S				11,700	14,500	
						54,500	
Non-Current Liabilities							
10% loan – Brick						<u>10,000</u>	
						<u>64,500</u>	

Current Account					
	B	S		B	S
	FRW	FRW		FRW	FRW
Drawings	24,000	12,000 (adj)	Bal b/d	3,600	2,400
			Interest on loan	250	
Bal c/d	2,800	11,700	Salaries.		6,000
			Share profits	22,950	15,300
	26,800	26,800		26,800	23,700

GOODWILL AND REVALUATION OF ASSETS

This is defined as the advantage, whatever it may be, a person gets by continuing to be entitled to represent to the outside would that he is carrying on a business which has been carried on for some time previously.

Factors that contribute to goodwill:

- Quality of products/Services
- Good personnel
- Marketing
- Location

In accounting, goodwill is very important for ascertaining the element or the share of a partner's effort to improve the business. The problem is normally to ascertain the value or cost of goodwill. There are two types of goodwill:

Non-Purchase goodwill
Non- purchased goodwill is determined by using subjective estimates. There are various approaches to these. Goodwill maybe arrived at by taking the average profits for lets say three previous years of trading.
Due to this subjective estimate, this type of goodwill is not maintained or shown in the accounts.

Purchased goodwill
This is less subjective because it is the excess amount paid for a business above its net assets. This is less subjective because it is the excess amounts paid for a business above its net assets. (e.g) If a business pays Sh.3.5 m to acquire the net assets (i.e. in these case the net assets will be total assets less total liabilities) of another business that is still trading on and the value of the net asset is 3 M, therefore the purchased goodwill may be shown in the accounts as an intangible asset. Purchased goodwill can be treated in the following three main ways:

- Goodwill is written off from the accounts
- Is carried at its value an amortized over a period of time
- Carried at its value without being amortized.

The practice is normally to carry it in the accounts together with the other assets (as an intangible asset) and amortize it over estimated period of time.

In a partnership, there are normally three situations where goodwill is accounted for in the accounts:

- If there is a change in the profit sharing ratio.
- On admission of a new partner.
- On retirement of an old partner.

Example (when there is a change in profit sharing ratio)
When there is a change in the profit sharing ratio, then goodwill is introduced in the accounts by

- Dr. Goodwill account
- Cr. Partner's capital account (the credit is based on the old profit sharing ratio.)

The goodwill may remain in the accounts and therefore no partner entries will be made.
If the goodwill is to be written off from the accounts, this will be done by
Debiting partner's capital account (in the New profit sharing ratio)
Crediting goodwill account

Example:
K and M have been trading as partners sharing profits and losses equally. They decided to change profit sharing ration to 3:2. The capital balances are:

- K: - Sh.1,000,000
- M: - Sh.1,500,000

Goodwill has been agreed at Sh.500,00.
Required: The partner's capital balances assuming that

- Goodwill is to be retained in the accounts
- Goodwill is to be written off form the accounts.

Solution:
1) **CAPITAL ACCOUNT**

	K'000	M'000		K'000	M'000
			Bal b/d	1,000	1,500
			Goodwill(OPSR)	250	250
Bal c/d	1,250	1,750			
	1,250	1,750		1,250	1,750

2) **CAPITAL ACCOUNT**

	K	M		K	M
Goodwill (NPRS)	300,000	200,000	Bal b/d	1,000,000	1,500,000

Bal c/d (NPSR)	950,000	1,550,000	Goodwill (OPSR)	250,000	250,000
	12,500,000	1,750,000		12,500,000	1,750,000

REVALUATION OF ASSETS.

The business may revalue some of the assets to reflect their fair values (e.g.) based on market price.
The revaluation is normally done when a new partner is to be admitted or an old partner is retiring.

Any revaluation gains or losses are passed through a new account (i.e) a Revaluation account and the balance on this account profit or low on revaluation is transferred to the partner's capital accounts in the existing profit sharing ratio.

If there is a profit on revaluation, then the profit will be transferred to the partner's capital account by:

- Dr. Revaluation
- Cr. Partner's capital account in the profit share ratio

If there is loss then

- Dr. Partner's capital account
- Cr. Revaluation in the profit share ratio

EXAMPLE
Alexis, Bob and Christine are in partnership sharing profits and losses in the ratio 3:2:1 respectively.
The balance sheet for the partnership as at 30 June 20X8 is as follows;

Fixed Assets	FRW	FRW
Premises		90,000
Plant		37,000
Vehicles		15,000
Fixtures		2,000
		144,000
Current Assets		
Stock	62,379	
Debtors	34,980	
Cash	760	98,119
		242,119
Capital		
Alexis		85,000

Bob		65,000
Christine		35,000
		185,000
Current account		
Alexis	3,714	
Bob	(2,509)	
Christine	4,678	5,883
Loan – Christine		28,000
Current liabilities		
Creditors		19,036
Bank overdraft		4,200
		242,119

Christine decides to retire from the business on 30 June 20X8, and Domina is admitted as a partner on that date. The following matters are agreed:
Certain assets were revalued;

- Premises FRW120,000
- Plant FRW35,000
- Stock FRW54,179

Provision is to be made for doubtful debts in the sum of FRW3,000.
Goodwill is to be recorded in the books on the day Christine retires in the sum of FRW42,000. The partners in the new firm do not wish to maintain a goodwill account so that amount is to be written back against the new partners' capital accounts.
Alexis and Bob are to share profits in the same ratio as before, and Domina is to have the same share of profits as Bob.

Christine is to take his car at its book value of FRW3,900 in part payment, and the balance of all he is owed by the firm in cash except FRW20,000 which he is willing to leave as a loan account. The partners in the new firm are to start on an equal footing so far as capital and current accounts are concerned. Domina is to contribute cash to bring his capital and current accounts to the same amount as the original partner from the old firm who has the lower investment in the business. The original partner in the old firm who has the higher investment will draw out cash so that his capital and current account balances equal those of his new partners.

Required;

- Account for the above transactions, including goodwill and retiring partners' accounts.
- Draft a statement of financial position for the partnership of Alexis, Bob and Domina as at 30 June 20X9.

Solution:

Capital Accounts

	Domina	Alexis	Bob	Christine		Domina	Alexis	Bob	Christine
	FRW	FRW	FRW	FRW		FRW	FRW	FRW	FRW
Goodwill written off	12,000	18,000	12,000	-	Bal b/d	-	85,000	65,000	35,000
Motor vehicle	-	-	-	3,900	Goodwill	-	21,000	14,000	7,000
Cash book	-	21,000		38,100	Cash book	79,000	-	-	-
Bal c/d	67,000	67,000	67,000	-					
	79,000	106,000	79,000	42,000		79,000	106,000	79,000	42,000

Current Accounts

	Domina	Alexis	Bob	Christine		Domina	Alexis	Bob	Christine
	FRW	FRW	FRW	FRW		FRW	FRW	FRW	FRW
Bal b/d	-	-	2,509	-	Bal b/d	-	3,714	-	4,678
Cash book	9,023			7,478	Revaluation a/c	-	8,400	5,600	2,800
Bal c/d	3,091	3,091	3,091	-	Cash book	3,091	-	-	-
	3,091	12,114	5,600	7,478		3,091	12,114	5,600	7,478

Revaluation Account

	FRW		FRW
Plant	2,000	Premises	30,000
Stock	8,200		
Debtors	3,000		
Profits shared:			
Alexis	8,400		
Bob	5,600		
Christine	2,800		_____
	30,000		30,000

Cash book

	FRW		FRW
Bal b/d	760	Christine – capital account	38,100
Domina - capital account	79,000	Loan	8,000
Current account	3,091	Current account	7,478
		Alexis – capital account	21,000
		Current account	9,023
		Bal c/d	******

Cash book

	FRW		FRW
		Bal b/d	4,200
Domina - capital account	79,000	Christine – capital account	38,100
Current account	3,091	Loan account	8,000
		Current account	7,478
		Alexis – capital account	21,000
		Current account	9,023

Alexis, Bob and Domina Partnership
Statement of financial position as at 30 June 20X9

NCA	Cost	Depreciation	NBV
Premises			120,000
Plant			35,000
Vehicles			1,100
Fixtures			2,000
			168,100
Current Assets			
Stock		54,179	
Debtors		31,980	
Cash		__760	
		86,919	
Less Current Liabilities			
Creditors	19,036		
Bank overdraft	5,710	(24,746)	62,173
			230,273
Capital accounts			
Alexis	67,000		
Bob	67,000		
Domina	67,000		201,000
Current Accounts			
Alexis	3,091		
Bob	3,091		
Domina	3,091		9,273
			210,273
Non current liabilities			
Loan – Christine			20,000
			230,273

NOTE:

- Goodwill introduced shared among the partners in the old partnership in current profit sharing ratios.
- Same case applies for any gain or loss in the revaluation of assets.
- Goodwill written off in the new profit sharing ratios against the capital accounts only for the new partners

- When there is no enough cash to be paid to the retiring partners, his balance remains in the business as a loan.

Admission of a new partner.

When a new partner is admitted into the firm, this marks the end of the old partnership and the beginning of a new one.

The new partner will have to bring in the capital that is due from him as per the agreement and also pay for a share of the goodwill.

Goodwill is credited to the partner's account(only the old) and is again written off by debiting the partner's account(inclusive of the new one in the new Profit Sharing Ratio).

If the admission is taking place part way through the financial period, then the new partner will be entitled to the profits or losses for the remaining part of the financial period. (i.e from the point of joining the partnership).

Care should be taken when apportioning interest on capital, salaries and profits because of the changes

Retirement of a partner

When a partner retires (i.e.) leaves the firm and the others partners are left to continue with the business then the retirement marks the end of one partnership and the start of a new one. The partner who is leaving should be paid all the amounts due to him. This include:

- Capital balance
- This will be all the amounts the partner has invested in the firm. Some firms may not be able to refund the amount in full and therefore it may be transferred t o a loan account whereby interest will be paid on the balance.
- Goodwill
- Because this partner contributed to the improvement (existence) of the partnership therefore it will be fair to pay him his share of the goodwill. Goodwill is introduced to the accounts in the old profit sharing ratio ((i.e.) credited to all the partner's capital accounts in the old profit sharing ratio), then written off from the accounts by debiting the capital accounts of the remaining partners in the new profit share ratio.

Credit balance on the current account

This amount due to the partner is paid directly from the cashbook or transferred to the capital account whereby the total cash payable is to be determined.

The transfer is made by:

- Dr. Current account
- Cr. Capital account

Share of profits

If the retirement takes place during the financial period, then the retiring partner is entitled to take profits made up to the point of retirement. Any interest of capital, salaries and balance of profit shared in profit share ratio will be credited to the partner's current account.

Therefore the profit and loss account will be split between the two periods and appointment of profits done and this will be based on the terms of the partnership in each period.

EXAMPLE

Kyamba, Onyango and Wakil were partners in a manufacturing and retail business and shared profits and losses in the ratio 2:2:1 respectively

Given below is the balance sheet of the partnership as at 31 March 20X9.

Statement of financial position as at 31 March 20X9

Assets	FRW.	FRW.
Non-current assets:		
Fixed assets		465,000
Current assets:		
Stock	294,000	
Debtors	209,000	503,000
		968,000
Capital and liabilities:		
Capital accounts:		
K	160,000	
O	140,000	
W	200,000	
		500,000
Current accounts:		
K	65,300	
O	49,000	
W	53,000	
		167,300
		667,300
Current Liabilities:		
Bank overdraft	48,000	
Trade creditors	252,000	
		300,700
		968,000

Additional information:

- On 1 April 2001, W retired from the partnership and was to start a business as a sole trader while K and O continued in partnership.
- On retirement of W, the manufacturing business was transferred to him while K and O continued with the retail business

The assets and liabilities transferred to W were as follows:

	Net book value	Transfer value
	FRW	FRW
Fixed assets	260,000	306,000
Stocks	166,000	157,000
Debtors	172,000	165,000
Creditors	156,000	156,000

W obtained a loan from a commercial bank and paid into the partnership the net amount due for him.

- On retirement of W form the partnership, goodwill was valued at Sh.200, 000 but was not to be maintained in the books of the partnership of K and O.
- After retirement of W on 1 April 2001, K and O agreed on the following terms and details of the new partnership.
    - K and O to introduce additional capital of Sh.48, 000 and Sh.68, 000 respectively.
    - Each partner was entitled to interest on capital at 10% per annum with effect from 1 April 2001 and the balance of the profits be shared equally after allowing for annual salaries of Sh.72, 000 to K and Sh.60, 000 to O.
- The profit of the new partnership before interest on capitals and partners' salaries was Sh.240,000 for the year ended 31 March 2002.
- The profits made by the new partnership increased stocks by Sh.100,000, debtors by Sh.90,000 and bank balance by Sh.50,000.
- Drawings by the partners in the year were K Sh.85,000 and O Sh.70,000.

Required:

- Profit or loss and appropriation account for the year ended 31 March 20X8.
- Capital accounts for the year ended 31 March 20X8
- Current accounts for the year ended 31 March 20X8.
- Balance sheet of the new partnership as at 31 March 20X8.

SOLUTION

K and O

Profit or loss appropriation account for the year ended 31.3.20X8

	FRW	FRW
Net profit for the year	240,000	
Less: Interest on capital		
K	20,000	
O	20,000	(40,000)
		200,000
Less: Salaries		
K	72,000	
O	60,000	(132,000)
Balance of profits shared in PSR		68,000
K ½	34,000	
O ½	34,000	(68,000)

b) CAPITAL ACCOUNT

	K	O	W		K	O	W
(2) Goodwill in New PSR	100,000	100,000	-	Bal b/d	160,000	140,000	200,000
(4) Fixed Assets			306,000	(1)Goodwill in old PSR	80,000	80,000	40,000
Stocks			157,000	Cashbook	48,000	68,000	-
Debtors			165,000	Profit on transfer in old PSR	12,000	12,000	6,000
				Creditors			156,000
Bal c/d	200,000	200,000		Current account (3)			53,000
				Cash book (**)			173,000
	300,000	3000,000	628,000		300,000	300,000	628,000

c) CURRENT ACCOUNT

	K	O	W		K	O	W
Capital	-	-	53,000	Bal b/d	65,300	49,000	53,000
Drawings	85,000	70,000	-	Interest on capital	20,000	20,000	-
				Salaries	72,000	60,000	-
Bal c/d	106,300	93,000	-	Share of profits	34,000	34,000	-
	191,300	163,000	53,000		191,300	163,000	53,000

K AND O

Statement of financial position as at 31 March 20X8.

Non-Current Assets	FRW	FRW
Current Assets		205,000
Stock		228,000
Debtors	127,000	
Bank	135,300	
	490,300	
Liabilities		
Creditors	(96,000)	394,300
		599,300
Capital:		
Kyamba		200,000
Onyango		200,000
		400,000
Current:		
Kyamba	106,300	
Onyango	93,000	199,300
		599,300

b) Bank

Working capital	173,00	Bal b/d	48,700
K- capital	48,000	Drawings	
O – capital	68,000	K	85,000
Increase	50,000	O	10,000
	________	Bal c/d	135,300
	339,000		339,000

Workings:

Non Current Assets:

Bal b/f	465,000
Transfer	260,000
Balance	205,000

Stock:

Bal b/f	294,000
Transfer	(166,000)
Increase	100,000
	228,000

Debtors:

Bal b/f	209,000
Transfer	(172,000)
Increase	90,000
	127,000

Creditors:

Bal b/f	252,000
Transfer	156,000
	96,000

END OF TOPIC QUESTION THREE

Amber and Beryl are in partnership sharing profits in the ratio 60:40 after charging annual salaries of FRW20,000 each. The regularly make up their accounts to 31 December each year.
On July 20X8 they admitted Coral as a partner and agreed profits shares from that date of 40% Amber, 40% Beryl and 20% Coral. The salaries credited to Amber and Beryl ceased from 1 July 20X8.

The partnership trial balance at 31 December 20X8 was as follows:

	FRW	FRW
Capital accounts as at 1.1.20X8:		
Amber		280,000
Beryl		210,000
Capital account Coral (see note (d) below)		140,000
Current accounts as at 1.1.20X8		
Amber		7,000
Beryl		6,000
Drawing accounts		
Amber	28,000	
Beryl	24,000	
Coral	15,000	
Loan account Amber		50,000

Sales		2,000,000
Purchases	1,400,000	
Stock 1.1.20X8	180,000	
Wages and salaries of staff	228,000	
Sundry expenses	120,000	
Provision for doubtful debts at 1.1.20X8		20,000
Freehold land at cost (see not (e) below)	200,000	
Buildings: cost	250,000	
Aggregate depreciation 1.1.20X8		30,000
Plant, equipment and vehicles: cost	240,000	
Aggregate depreciation 1.1.20X8		50,000
Trade debtors and creditors	420,000	350,000
Cash at bank	38,000	
	3,143,000	3,143,000

In preparing the partnership accounts the following further information is to be taken into account:

- Closing stock at 31 December 20X8 was FRW200,000
- Debts totaling FRW16,000 are to be written off and the provision for doubtful debts increased by FRW10,000.
- Provision is to be made for staff bonuses totaling FRW12,000.
- The balance of FRW140,000 on coral's capital account consists of FRW100,000 introduced as capital and a further sum of FRW40,000 paid for a 20% share of the goodwill of the partnership. The appropriate adjustments to deal with the goodwill payment are to be made in the capital accounts of the partners concerned, and no goodwill account is to remain in the records.
- It was agreed that the freehold land should be revalued upwards on 30 June prior to the admission of Coral from FRW200,000 to FRW280,000. The revised value is to appear in the balance sheet at 31 December 20X8.
- Amber's loan carries interest at 10% per annum and was advanced dot the partnership some years ago.
- Provide depreciation on the straight-line basis on cost as follows:
- Buildings 2%
- Plant, equipment and vehicles 10%
- Profits accrued evenly during the year.

Required:

- Prepare a profit or loss and appropriation account for the year ended 31 December 20X8 and a balance sheet as at that date.
- Prepare the partners' capital accounts and current accounts for the year in columnar form.

4.3 LIMITED LIABILITY COMPANY

DEFINITION

A company is a legal entity which is made up with one physical person or corporate person for commercial purposes and after filling in a form thereto related and basing up on the provisions of this Law. (Law relating to companies - N°07/2009 of 27/04/2009)

TYPES OF COMPANIES

There are two types of companies:

- **Private companies**

  These have the words limited (Ltd) at the end of the name. Being private, they cannot invite the members of the public to invest in their ownership.

- **Public companies**

  There much larger in size as compared to private companies. They have the words public limited company (plc) at the end of their name.

They can invite the members of the public to invest in their ownership and the companies may be quoted on the Inventory exchange.
A company can also be categorized as follows:

- Limited by Shares - is a company formed on the principle of having the following liability of its members limited to the amount paid by shareholders or the amount agreed to pay on the shares respectively held by them, if any.
- Limited by Guarantee - is a company formed on the principle of having the following liability of its members limited to the security issued by shareholders equivalent to the amount agreed as surety in case of liquidation
- Limited by Both shares and guarantee
- A company can also be unlimited company - a company formed on the principle of having no limit placed on the liability of its shareholder

A public company can either be limited by shares or both by shares and guarantee A private company can be in any of the categories

FORMATION OF COMPANY

Stage of business:

- -Idea generation
- -Incorporation
- -Commencement of the business

A company is formed by incorporation. Incorporation is done by filling appropriate forms for Memorandum of association and may have also articles of association given to registrar of companies with appropriate fees. Once the registrar is satisfied, a certificate of incorporation is issued.

Memorandum of association is a document that shows the relationship between the company and the outsiders. It contains the name and address of the company, the objectives of the company, showing whether it is limited or unlimited, showing whether it is private or public and the authorized share capital Articles of association shows the rules and regulations for the company internal structure. It contain items like the number of directors, when the annual general meetings are to be held. The voting rights of the shareholders, dividends policy, and other rule.

SHARE CAPITAL OF A COMPANY

Definition

The owner's interest in a limited company consists of share capital. The share capital is divided into shares. The investor will then pay for and be issued with the shares and therefore, they become owners.

Each share has a flat value called Par value/face value/nominal value. (e.g.) If a company decides to set up a share capital of FRw. 200,000, it may decide to issue:

200,000 shares of FRw. 1 each per value. 100,000 shares of FRw. 2 each per value. 400,000 shares of FRw. 50 each per value.

There are 2 main types of share capital

- **Preference share capital** - This is made up of preference shares and a preference share carries the right to a final dividend, which is expressed as a percentage of their par value. E.g. 10% preference shares. Preference shares do not carry a right to vote and therefore no control in the company.
- **Ordinary Share capital -** These are the most common shares. They carry no right to a fixed dividend but are entitled to residual value of the business during winding up, and all profits after

the claim on the entire preference dividend have been paid. The more the no. of ordinary share held, the higher the control.

Type of preference share:

- Cumulative
- Non-cumulative
- Redeemable
- Non-redeemable
- Participative
- Non-participative

Other terms in share capital

- **Authorized share capital**

Also called, registered or nominal capital. Is the total of the share capital which the company is allowed to issue to shareholders. A company cannot issue more shares than the amount that is authorized.

- **Issued share capital**

This is the total of the share capital actually issued to the shareholders.

- **Called up share capital**

This is the amount the shareholders have been asked to pay where the amount of capital required is less than the issued share capital.

(e.g.) If a firm issues ordinary shares of FRw1 each and request the shareholders to pay 60p. Assuming that the issued 100,000 shares, then the called up share capital will be:

60p 100,000 = FRw60,000

- **Uncalled share capital**

This is part of the issued share capital for which the company has not requested for payment and therefore these amounts will be received in the future.

In the above (e.g.) because the firm had not requested for 40p, therefore the uncalled capital is 40p 100,000 = FRw40,000.

- **Paid-up share capital**

This is the total of the share capital, which has been paid for by the shareholders.

Illustration

A limited has an authorized share capital of 200,000 shares of FRw1 each out of which only 150,000 shares have been issued, Although the firm requested the shareholders to pay 80p per share, the shareholders were able to pay 50p per share.

Required:

Determine the:

Authorized share capital Issued share capital Called up share capital Uncalled up share capital Paid up share capital

FORMAT OF FINANCIAL STATEMENTS

- Internal purpose

The Income statement of a company is the same as that of a sole trader, but there are additional expenses that are unique to the company and therefore, they should be included in the Income statement they include

Director's fees salaries and other expenses; Audit fees; Debenture interest

In addition to the Income statement, just like a partnership has an appropriation account which shows the allocation of the profit for the period. Therefore, the format will be as shown:

Kroito Ltd, Income statement and appropriation
For the year ended Date

	FRW	FRW
Sales	XXX	
Less Returns in	(XXX)	

		XXX
Opening inventory	XXX	
Purchases	XXX	
Less Returns out	(XXX)	
Carriage in	XXX	
Less Closing inventory	(XXX)	
Cost of sales		(XXX)
Gross profit		XXX
Other income:		
Commission income	XXX	
Discount received	XXX	
Allowance for doubtful debt	XXX	
Total other income		XXX
Total income		XXX
Expenses:		
Director's fees salaries and other expenses	XXX	
Audit fees		
Irrecoverable Debts	XXX	
Salaries and wages	XXX	
Discount allowed	XXX	
Carriage out	XXX	
Rent expense	XXX	
Electricity and water	XXX	
Depreciation and amortisation:		
Buildings	XXX	
Plant and Machinery	XXX	
Furniture and equipment	XXX	
Patents and copyright	XXX	
Debenture interest	XXX	
Total expenses		(XXX)
Profit/(loss) before tax		XXX
Taxation		(XXX)
Profit/(loss) for the year		XXX
Transfer to general reserve	XXX	
Dividends		
Preference Interim	XXX	
Preference Final proposed	XXX	
Ordinary Interim	XXX	
Ordinary Final proposed	XXX	
		(XXX)
Retained profit for th year		XXX
Retained earning b/f		XXX
Retained earnings c/f		XXX

Kroito Ltd, Statement of financial position
As at date

ASSETS	FRW	FRW	FRW
Non-current assets:			
Land and buildings	XXX	(XXX)	XXX
Plant and machinery	XXX	(XXX)	XXX

Furniture & Equipment	XXX	(XXX)	XXX
Patents ans copyrights	XXX	(XXX)	XXX
Financial assets (Investment)	XXX		XXX
Total non-current assets			XXX
Current assets:			
Inventory		XXX	
Accounts receivable		XXX	
Accrued income		XXX	
Prepaid expense		XXX	
Bank		XXX	
Cash		XXX	
Total current assets			XXX
Total assets			XXX
EQUITY AND LIABILITIES			
Capital and reseves:			
(Authorised, issued and paid) Ordinary shares of FRW100 each		XXX	
Share premium		XXX	
General reserve		XXX	
Retained earnings		XXX	
5% Preference shares of FRW100 each		XXX	
Total equity			XXX
Non-Current liabilities:			
8% Debentures			XXX
Current liabilities:			
Accounts payable		XXX	
Accrued expense		XXX	
Unpaid interest		XXX	
Unpaid tax		XXX	
Total current liabilities			XXX
Total liabilities			XXX
Total equity and liabilities			XXX

Director's salaries:
Salaries, fees and other expenses in relation to the directors are expenses as far as company accounts are concerned.
This is different from that of Partnerships & Sole traders which are shown as appropriations – expenses.

Audit fees
All companies are required to prepare the accounts which should be audited and therefore any fees paid in relation to audit and accountancy is an expense.

Debenture interest
Loans taken up by companies are called debentures. The interest paid on these loans are charged as an expenses and unpaid amount are shown as current liabilities in the business.
The debenture is classified under non-current liability.

Corporation tax
Companies pay corporation tax on the profits they earn. This is shown in the accounts because a company is a separate legal entity unlike for sole traders and partnerships whose tax is shown as drawings.

The tax is listed under those 2 items as shown in the (under/over provision for previous period and corporation tax for the year).
The under provision and corporation tax relate to direct liability to the government and therefore is a deduction from the net profit for the period .
Assume that a firm had estimated that the corporation tax for the year ended 31.12.99 is FRw150,000. In 2000, the liability is now agreed at FRw160,000, which the company pays and at the end of the year 2000, the company estimates that the tax liability is FRw140,000.
Prepare a tax account and show the amount to be deducted as tax for the year (ignore deferred tax).

Taxation Account

Cashbook	160,000	Bal b/d	150,000
Bal c/d	140,000	Income statement	150,000
	300,000		300,000

Under provision	10,000 (160 -150)
Corporation tax	140,000

- **Dividends**

Shareholders are also entitled to a share of profits made by the company and this is because the shareholders do not make drawings from the company.
A company may pay dividends in 2 stages during the course of the financial period:

- Interim dividends

Is paid part way in the financial period. (e.g.) after the 6 months

- Final proposed

Is paid after the year-end or after the completion to final accounts.
If a company pays in these 2 stages, then the dividend section of the income statement and appropriation should disclose interim paid and final proposed.

- Reserves

Capital reserves
Amounts reflected in Capital reserves cannot be paid out or distributed to shareholders. The three types of capital reserves are:

Share Premium:
A share premium arises when accompany issues shares at a price that is more than the par value. The share Premium may be applied in:

- 1.Paying un-issued shares.
- 2.Writing off preliminary expenses.
- 3.Write off discounts on shares.

Example:
A Ltd wish to raise capital by issuing 100,000 ordinary shares at FRW1 each (per value) and the issue price (selling price) is FRW1.5 each.
The following are the entries to be made in the A/C.

Dr Cashbook (100,000	FRW1.5) 150,000	
Cr Ordinary shares capital	(100,000 FRW1)	100,000
Cr Share Premium A/C	(100,000 FRW0.5)	50,000

Issue of shares at a premium of FRw0.5

Revaluation Reserve:
Any gain made on revaluation of non-current Assets especially for Land and buildings.
When company sills it's property to realize the gain, the amount is transferred to the Income statement.

Capital Redemption Reserve:
A reserve created after redemption or purchase of Preference shares without issuing new shares. The transfer is made from either the share premium or the Income statement.

Revenue reserves
This can be distributed and includes the retained profits (P & L Accounts) and the General Reserves. Transfers are made from the Profits to the General reserves to provide for expansion or purchase of non-current assets. The General Reserves can also be used to issue bonus Share

- Debenture loans

The term debenture is used when a limited company receives money on loan, and certificates called debenture certificates are issued to the lender.

They are also called loan Inventory or loan capital. Debenture interest has to be paid whether profits are made or not. A debenture may either be redeemable of irredeemable. Redeemable is repayable at or by a particular date and irredeemable is payable when the company is officially terminated.

- Bonus and Rights issue

Bonus shares
Shares issued to existing shareholders free of charge. They are paid out from either the share premium, balance of retained profits of the General Reserves.
A scrip issue
Is similar to bonus issue only that a scrip issue gives the shareholder the choice of receiving cash or Inventory dividends. In a bonus issue the shareholder has no choice but to take up the shares.

Example

A Ltd has 100,000 shares at FRW1 each to form an ordinary share capital of FRW100,000 and a balance on the share premium A/C of FRW50,000. It issues some bonus shares to existing shareholders at a rate of 1 share for every 5shares held. This amount is to be financed by the share premium. The entries will be as follows:

Shares to be issued:

100,000 1 =20,000

Dr share premium A/C FRW1] 20,000
[20,000

Cr ordinary share capital 20,000

A bonus issue of 20,000 shares

Statement of financial position (extract)

Ordinary shares of FRW1	120,000
Capital Reserves	
Share premium	30,000

Rights Issue

A right issue is an option on the part of the shareholder given by the company to existing shareholders at a price lower than the market price.

It involves selling ordinary shares to existing shareholders of the company on a prorate basis. When the rights are issued the shareholders have 2 options available.

Buy the new shares and exercise their rights Sell the rights in the market,

Ignore the rights.

A rights issue therefore gives the shareholder the right (but not an obligation) to buy the new shares issued by the company.

Example:

A Ltd has a share capital of FRW200,000 trade up of 100,000shares of FRW2 each. The balance on the share premium is FRW60,000. Additional capital is raised by way of a right issue. The terms are:

For every 5 shares held in the company, a shareholder can buy 2 shares at a price of FRW2.5 per share.

Required:

The journal entries to reflect the above transaction assuming that all the shareholders exercise their rights and the relevant Statement of financial position extract.

Shares to be issued 100,000 2 =40,000 shares

Dr cash book [40,000 FRW2.5] = FRw100,000

Cr Ordinary share capital [40,000 FRW2] = FRW80,000

Cr Share Premium [40,000 FRW0.5] = FRW20,000

Statement of financial position (extract)

140,000 Ordinary shares @ FRW2	280,000
Capital Reserves	
Share premium	80,000

External purpose
Financial statements for external purpose are more summarized and prepared according to IFRS's. IFRS's are the financial authoritative statements used in accounting and preparation of financial statements.
Income statement can be prepared classifying the expenses according to functions of the entity or by their nature as follows:

- By function – the expenses are classified as cost of sales, administration expense and distribution cost Rae prepared for a wide range of users they are prepared using (IFRS: International financial reporting standard

Example.IAS: Presentation of financial statement consist of:

- statement of financial position n(SOFP)
- STATEMENT OF PROFIT /LOSS AND OTHER COMPREHENSIVE INCAMES
- Or incomes statement and other comprehensive
- Statement of changes in equity
- statement of cash Methods of depreciation used
- expenses are presented accordingly

Kroito Ltd, Income statement
For the year ended Date

	FRW
Sales Revenue	XXX
Less Cost of sales	(XXX)
Gross profit	XXX
Other income:	(XXX)
Administration expenses	(XXX)
Distribution cost	(XXX)
Finance cost	(XXX)
Profit/(loss) before tax	XXX
Taxation	(XXX)
Profit/(loss) for the year	XXX

The makeup of the cost of sales, administration expenses and distribution costs are shown in the notes to the accounts.

- By nature – the expenses are shown as they are rather than classified into the functions of the entity

Kroito Ltd, Income statement
For the year ended Date

	FRW
Sales Revenue	XXX

Other income:	XXX
Change in inventory of raw materials and work in progress	XXX/(XXX)
Purchases	(XXX)
Depreciation	(XXX)
Staff cost	(XXX)
Other expenses	(XXX)
Finance cost	(XXX)
Profit/(loss) before tax	XXX
Taxation	(XXX)
Profit/(loss) for the year	XXX

Notice for the two formats that the appropriation is not shown in the income statement. The appropriation is shown in the statement of changes in equity. Statement of changes in equity shows the changes that have occurred in the period in equity and transactions with the owners.

Kroito Ltd, Statement of changes in equity For year ended Date

	Ord shares	Pref shares	Share Premium	General reserve	Retained earnings	Total
	FRW	FRW	FRW	FRW	FRW	FRW
Balance b/f	XX	XX	XX	XXX	XXX	XXX
Profit for the					XXX	XXX
Dividends : Preference					(XXX)	XXX
Dividends :					(XXX)	XXX
Transfer to				XXX	(XXX)	XXX
Issue of shares	XX		XX		XXX	XXX
	XX	XX	XX	XXX	XXX	XXX

The following example will illustrate the preparation of final Account for companies.

The chief accountant of Kanombe Limited has extracted the following trial balance as at April 2016:

	Dr "FRW"	Cr "FRW"
Land and buildings at cost	355,000	
Plant and machinery at cost	558,000	
Provision for depreciation		158,000
Motor vehicles at cost	685,000	
Provision for depreciation		125,000
Furniture and equipment at cost	188,000	

Provision for depreciation		78,000
Stocks as at 1st May 2015	320,000	
Trade receivable and trade payable	430,000	333,000
Cash at bank	168,000	
Purchases and sales	1,840,000	2,980,000
Salaries and wages	420,000	
Rent and rates	125,000	
Office expenses	84,000	
Bank charges	12,600	
Telephone and postage	16,350	
Vehicles running expenses	230,000	
Repairs and maintenance	6,850	
Issued share capital		800,000
Profit and loss bal b/f 1st May 2015		814,800
Share premium		150,000
	5,438,800	5,438,800

Additional notes:

- The closing stocks was valued at FRW 432,600
- Goods sold at FRW 1,500 were returned on 30 April 2016 but the transaction was not recorded in the books. Their cost was FRW 1,200 the goods were received after stock taking was completed.
- Accrued wages and telephone bills amounted to FRW 2,500 and FRW 6,250 respectively
- Depreciation of the fixed assets is calculated on reducing balance at the following rates:

Plant and machinery	20% per annum
Motor vehicles	25% per annum
Furniture and fittings	15 % per annum

- Prepaid rates amounted to 2,000
- **The directors have proposed a dividend of 10% on the issued capital and a transfer of FRW 200,000 to General** reserve
- The corporation tax was assessed to be 30% of net profit before tax.

Required:

- Income statement for the year ended 30th April 2016.
- Statement of change in Equity
- Statement of Financial position as at 30th April 2016.

Suggested solution Workings

- Depreciation of plant and machinery (558000-158000)*20% = 80000
- Depreciation of motor vehicle (68500-125000)*25% = 140000
- Depreciation of furniture and equipment (188000-78000) = 16500
- Trade receivable (430000-1500) = 528500
- Revenue (2980000-1500) = 2978500
- Inventory (432600+1200) = 433800
- Salaries and wages (42000+2500) = 422500
- Rent and rates (25000-2000) = 22600
- Dividend (800000*10%) = 80000

Kanombe ltd.'s income statement for the year ended 30APril 20x6

Revenue		2978500
less cost of sales		
opening stock	320000	
Purchase	1840000	
less closing stock	(433800)	
		(1726200)
gross profit		1252300
others incomes		
_		
total incomes		1252300
less operating expenses		
depreciation of plant and machinery(1)	80000	
depreciation of motor vehicle (2)	140000	
depreciation of furniture& equipment	16500	
salaries and wages(3)	422500	
rent and rates (8)	123000	

office expense	84000	
bank charges	12600	
telephone and postage(9)	22600	
vehicle running expense	230000	
repair and maintenance	6850	
		(1138050)
net profit		114250
income tax(30%*114250)		(34275)
profit after tax		79975

kanombe ltd's statement of changes in equity as at 30 April,20x6

Details	share capital	share premium	general reserves	retained earnings
bal b/f	800000	150000		814800
Dividend				(80000)
transfer to general reserve			200000	(200000)
profit for the year				79975
bal c/f	800000	150000	200000	614775

kanombe Ltd's statemrnt of financial position as at 30April,20x6

ASSETS			
NCA	cost	acc, deprec	NBV
land and building	35500		355000
plant and equipment	558000	(158000+80000)	320000
Motor vehicle	685000	(125000+140000)	420000
furniture and equipment	188000	(78000+16500)	93500
total NCA			1188500
CA			
Inventory		433800	
trade receivable(4)		428500	
prepaid rates		2000	
cash at bank		168000	
total CA			1032300
TOTAL ASSETS			2220800

Equity and liabilities Equity issued share capital		
		800000
share premium		150000
general reserve		200000
retained earning		614775
total equity NCL		1764775
CL		
TRADE payable	333000	
accrued wages	2500	
accrued telephone	6250	
accued dividend	80000	
income tax	34275	
total CL		456025
total equity and liabilities		2220800

Example (iCPAR 2012 q1-b)
You are presented with the following trial balance of Eyowe Ltd at 31 October 2012:

	Dr	Cr
	FRW'000	FRW'000
Buildings at cost	14,800	
Buildings, accumulated depreciation, 1 November 2011		1,200
Plant at cost	6,800	
Plant, accumulated depreciation, 1 November 2011		2,200
Land at cost	4,700	
Bank balance		1,000
Revenue		36,000
Purchases	22,200	
Discounts received		1,800
Returns inwards	700	
Salaries and wages (30% administration and 70% cost of sales)	3,600	

Energy expenses (10% administration and 90% cost of sales)	2,000	
Inventory at 1 November 2011	3,200	
Trade payables		5,000
Government grant received		2,400
Trade receivables	6,400	
Administrative expenses	1,600	
Allowance for receivables, at 1 November 2011		200
Director's remuneration	1,400	
Retained earnings at 1 November 2011		2,600
10% Loan notes		1,000
Dividend paid	600	
Selling and distribution cost	2,600	
Frw10 Ordinary shares		15,600
Share premium account		1,600
	70,600	70,600

Additional information as at 31 October 2012:

- Closing inventory has been counted and its cost was Frw 3,750,000 and net realizable value was Frw 3,720,000
- Land was revalued to FRW 5,900,000
- An invoice of FRW 800,000 for energy expenses for October 2012 has not been received.
- Loan note interest has not been paid for the year and the effective interest rate is 12%.
- The allowance for receivables is to be adjusted to 5% of trade receivables after write off of Irrecoverable Debts of FRW 200,000
- Grant received is in respect of plant that cost FRW 3,000,000 at the start of the year.
- Plant is depreciated at 20% per annum using the reducing balance method. The entire charge is to be allocated to cost of sales.
- Buildings are depreciated at 5% per annum on their original cost and charged on cost of sales
- Tax has been calculated as FRW 4,500,000 for the year.
- Dividend proposed of FRW. 1 per share

Required:
Prepare the following for external purposes

- Statement of comprehensive income for the year ended 31 October 2010.
- Statement of financial position as at 31 October 2010.

Issuance of Shares

Issue and Forfeiture of shares:

When shares are sold in exchange for lump sum cash payment and this is at par value, the entries to be made are:

- DEBIT: Cashbook
- CREDIT: Share Capital

When shares are sold in exchange for lump sum cash payment and this is at a premium, the entries to be made are:

- DEBIT: Cashbook
- CREDIT: Share Capital
- CREDIT: Share Premium

Sale of shares which are to be paid for in installments are normally dealt with as follows: The number of installments may vary from 2 – 4. Each installment is collected through a comprehensive set of processed(called a stage). The 4 possible stages are:

- Application stage
- Allotment stage
- Application Stage

In this stage, the company invites members of the public to send in applications for share they (the public) are interested in purchasing.
The application firms must be accompanied by the 1st installment money when the public respond to the company's offer.
When the company requests members of the public to send in application forms & application money it will make the following entries in its books:

- DEBIT: Application $^{A}/_{C}$
- CREDIT: Share Capital

When the public responds by sending funds, the company will then

- DEBIT: Cashbook
- CREDIT: Application $^{A}/_{C}$

There may be an over or under subscription. If there is an under subscription,

- DEBIT: Cashbook
- CREDIT: Application

If there is an over-subscription, then the excess applications may either be rejected outright and the applicants' money refunded, or applications awarded on a pro-rata basis. (i.e. a lower number of shares allotted compared to the number applied for)
If outright rejection, the company will:

- DEBIT: Application
- CREDIT: Cashbook

If pro-rata issue, the company will:

- DEBIT: Application
- CREDIT: Allotment

This marks the end of the application stage.

- Allotment Stage

In this stage, the company selects the applicants and informs them of their allotment. It also requests them to bring in a second installment. As it requests for the second installment the entries to be made are:

- DEBIT: Allotment $^{A}/_{C.}$
- CREDIT: Share Capital.

When the public respond by sending in the second installment money, the company, will in its books: -

- DEBIT: Cashbook
- CREDIT: Allotment.

Generally, only the correct amount of money is collected at this stage. Since the account has closed by this stage, the stage is deemed to be over.

4.4 MANUFACTURING ACCOUNTS

GENERAL

A manufacturing account is prepared in addition to the trading and profit and loss accounts. It is produced for internal use, mainly for the owners and managers of organizations.

DIVISION OF COSTS
Costs in a manufacturing business are divided into different types. These can be defined as

- Prime Costs and Production Costs.
- Cost of Production = Prime Cost + Factory Overheads+ Opening Work in Progress- Closing Work in Progress.

A direct cost is known as a prime cost,
Examples:

- direct materials
- direct labour
- direct expenses.

If a cost cannot easily be traced to the item being manufactured, then it is an indirect cost and will be included under indirect manufacturing costs.
Examples of Indirect Costs:-

- Wages to Cleaners
- Rent of a factory
- Factory lighting
- Factory Power

Administration expenses include manager and administrative salaries, legal and accountancy fees, depreciation of machinery.

Selling and distribution expenses include sales staff salaries and commission, carriage outwards, depreciation of delivery vans, promotion and display expenses.
Financial charges include expenses items such as bank charges and discounts allowed, Irrecoverable Debts.

Administration expenses, selling and distribution expenses and financial charges are charged to the Profit and Loss account part of the manufacturing account.
Rent can be allocated as following in the manufacturing account:-

- Selling and Distribution
- Factory Part
- Administration Buildings

Only one figure of rent may be paid, and can be apportioned using a range of methods including Floor area
Property valuations of each part of the buildings and land

LAYOUT OF A MANUFACTURING ACCOUNT

Company Name

Manufacturing, Trading and Profit and Loss Account

for the year ended 31 December 200X

	FRW	FRW	FRW
Raw Materials			
Opening Stock		xxx	
Purchases (Raw Materials)	xxxx		
Add : Carriage Inwards	xx		
	xxxx		
Less Return Outwards	(xx)		
			xxxx
			xxxx
Less: Closing Stock (Raw Materials)			(xx)

Cost of Raw Materials consumed			**xxxx**
Direct Materials			**xxx**
Direct Expenses (Royalty)			**xxx**
PRIME COST			**XXXX**
FACTORY OVERHEADS:			
Factory rent and rates		**xxx**	
Fuel and power		**xxx**	
Indirect wages		**xx**	
Lubricants	**xxx**		
Depreciation of plant and machinery		**xxx**	
			XXXX
WORK-IN-PROGRESS			
Opening Work-in-Progress (1.1.200x)		**xxxx**	
Less: Closing Work-in-Progress (31.12.200y)		**(xxx)**	
			XXX
PRODUCTION COST OF GOODS COMPLETED c/d			**XXXX**
(Trading Account) Finished Goods			
Sales		xxxx	
Less: Cost of Goods Sold			
Opening Stock	xxx		
Add: **Production Cost of Goods Completed b/d**	xxxx		
		xxxx	
Less: Closing Stock	(xxx)		
		(xxx)	
GROSS PROFIT		**XXX**	
Less: Expenses			
Administrative Expenses (Office expenses)			
e.g. Office rent and rates			
Administrative salaries			

General administration expenses

Depreciation of office furniture, office equipment

Selling and Distribution Expenses

e.g. Advertising expenses

Sales Commissions

Carriage Outwards

Financial Expenses

e.g. Discounts allowed

Irrecoverable Debts

Provisions for Irrecoverable Debts

	(xxx)
NET PROFIT FOR THE YEAR	**XXX**

Statement of Financial Position as at 31 December 200X

FIXED ASSETS	**Cost**		**Accumulated** Depreciation	**Net** Book Value
Machinery	xxxxx		xxx	xxxx
Office Equipment	xxxx		xxx	xxxx
	xxxxx		xxx	xxxx
CURRENT ASSETS				
Stock: Raw Materials				xxx
Work in Progress				xx
Finished Goods(Less prov for unrealized profits)				xxx
Debtors		xxx		
Less: Provisions for Irrecoverable Debts		(xxx)		
				xxx
Prepaid Expenses				xx
Bank				xxx
Cash				xxx
				xxxx

Less: CURRENT LIABILITIES	
Creditors	xxx
Accrued expenses	xx
	(xxx)
Working Capital	**xxx**
	xxxx
FINANCED BY:	
Capital on 1.1.200x	
Add: Net Profit for the year	xxxx xxx
	xxxx
Less: Drawings	(xxx)
	xxxx

EXAMPLE

Patricia owns and manages a small manufacturing business. The following balances have been extracted from her books of account at 31 January 20x9:

	Dr	Cr
	FRW	FRW
Capital at 1 February 20x8		171,120
Accounts payable		86,000
Bank and cash balance	5,400	
Accounts receivable	92,000	
Drawings	60,000	
Administration expenses	150,360	
Advertising expenses	12,000	
Factory direct wages	60,000	
Factory indirect wages	24,000	
Factory power	36,000	
Furniture and fittings (all offices)	18,400	
Heat and light	16,000	
Plant and equipment	276,800	
Motor vehicle (used by salesmen)	144,000	

Plant hire	4,000	
Provision for Irrecoverable Debts		3,200
Provision for depreciation 1 February 20x8:		
Furniture and fittings		9,200
Plant and equipment		138,400
Motor vehicle		24,000
Raw material purchases	228,000	
Rent rates	20,000	
Sales		829,440
Selling and distribution expenses	66,400	
Inventories at cost, 1 February 20x8:		
Raw materials	8,000	
Work in progress	16,000	
Finished goods	24,000	
	1,261,360	1,261,360

The following additional information is provided:

(i) Accruals at 31 January 20x9 were:

Factory power - FRW.1,600
Rent and rates - FRW. 4,000

There was also prepayment of Sh. 800 for salesmen's motor vehicle insurance.

(ii) Inventories at 31 January 20x9, were valued at cost as follows:

Raw materials - FRW. 15,200
Work in progress - FRW. 30,400
Finished goods - FRW. 45,600

(iii) Depreciation is to be charged on plant and equipment, motor vehicle, furniture and fittings at the rates of 20%, 25% and 10% per annum respectively on cost.

(iv) Expenditure on heat and light, and rent and rates is to be apportioned between the factory and office in the ratio of 9 to 1 and 3 to 2 respectively.

(v) The provision for Irrecoverable Debts is to be made equal to 5% of accounts receivable at 31 January 20x9.

Required:

Patricia's manufacturing, trading and profit or loss account for the year ended 31 January 20x9 and a statement of financial position as at that date.

UNREALISED PROFITS ON CLOSING STOCK

In most cases where business transfers finished goods at a profit to the selling department and the goods are reflected in the balance sheet at the transfer price, then the closing stock includes a profit that has not been earned or realised. If the mark up profit (the profit based on cost of production is always uniform, then any changes in the value of closing stock will result in a reduction or an increase in the unrealised profits.

If there is an increase on unrealised profit on the closing stock, then this increase will be reduced from the gross profit from our profit and loss account and if there is a reduction in unrealised profits, then this reduction will be added to the gross profit in our profit and loss account.
Any unrealised profit of closing stock should be deducted from the closing stock in the balance sheet.
The slight change in the format of the Profit and Loss Account and Balance Sheet will be as follows

Increase in unrealised profit in closing stock (UPCS)
Profit or loss (extract) Account for year ended...........

	FRW	FRW
Gross profit		X
Add: factory profit		X
Add: other expenses		X
		X
Less expenses		
Other expenses	X	
Increase in unrealised profit on closing stock	X	(X)
Net profit		X

Decrease in UPCS
Profit or Loss Account (extract) for year ended ....

	£	£
Gross profit		X
Add: factory profit		X
Add: other incomes		X
Add: decrease in UPCS		X
		X
Less expenses		
Other expenses		(X)
Net profit		X

Example:
A firm always values its stock (finished goods) at a mark-up of 20% on cost of production. The opening stock of finished goods for the period was valued at Sh. 100,000. (The marked up cost) The closing stock at the end of the financial period was Sh.160,000.

Opening Stock:	100,000 (marked up)	= 120%
	(16,667)	= (20%)
	83,333	= 100%

Closing Stock	160,000 (marked up)	= 120%
	(26,667)	= (20%)
	133,333	= 100%

UPCS

		Balance b/f	16,667
Balance c/d	26,667	Profit and loss a/c	10,000
	26,667		26,667

Profit or Loss (Extract)

Less: Expenses:	Sh	Sh
Increase in unrealized profits on closing stock	10,000	

Statement of financial position (Extract)

Current Assets		Sh	Sh
Stock:			
Raw materials		X	
Work in progress	X		
Finished goods		160,000	
Less: UPCS	(26,667)		133,333

4.5 NOT FOR PROFIT ORGANIZATION

INCOME AND EXPENDITURE ACCOUNTS INTRODUCTION

Clubs, societies, credit unions and other non-profit organizations do not draw up Statement of Comprehensive Income s; 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 organizations describe net assets as accumulated funds.

SOURCES OF INCOME

The main sources of income for clubs and societies are:

- Social events
- Members subscriptions
- Life members' subscriptions
- Special events e.g. annual dinner evening

Investment income

1. Social event - Example

The RGT Sports and Social Club have provided you with the following information:

	FRW
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 an 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 ...

	FRW	FRW
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 FRW1,100 x 10/110		100
Surplus		FRW 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:-

	FRW
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

	FRW		FRW
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 recognized 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 FRW12,000 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 FRW1,200 is recognised as income. In the Statement of Financial Position FRW12,000 - FRW1,200 i.e. FRW10,800 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:

	FRW
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 FRW419

This is calculated as follows:

	FRW	FRW
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, FRW25 was credited; FRW27 was credited on 2 January 20X9 and FRW31 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 FRW27 + FRW31 i.e. FRW58. The amount received on 2 July 20X8 relates to the year ended 30 June 20X8.

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.

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.

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	FRW	Payments		FRW
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 FRW3,200, prizes FRW50 and bar inventory FRW180. Bar suppliers were owed FRW290.

On 30 June 20X1 bar suppliers were owed FRW310; bar inventory amounted to FRW175 and prizes on hand had cost FRW30; subscriptions unpaid totalled FRW50.

During the year ended 30 June 20X1 subscriptions received included FRW35 in respect of the previous year and FRW20 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 FRW15 was credited; FRW20 was credited on 2 January 20X1 and FRW25 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 FRW480.

Requirement:

- A Restaurant trading account for the year ending 30 June 20X1.
- An income and expenditure account for the year ending 30 June 20X1.
- A Statement of Financial Position as at 30 June 20X1.

Solution

Restaurant Trading Account for the Year Ended 30 June 20X1

	FRW	FRW
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

	FRW	FRW
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

	FRW	FRW
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**

	FRW		FRW
Bank	2,642	Balance b/d	290
Balance c/d	310	Purchases	2,662
	2,952		2,952

2. **Subscriptions**

	FRW		FRW
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

	FRW
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: FRW20 + 25 = FRW45

4. Surplus on Competitions

	FRW
Competition Receipts	412
Competition Prizes	
Opening Inventory	50
Purchases	210

		260
Closing Inventory		30
		230
Surplus on Competitions		182

5. Rent

		FRW
Prepaid at start of Year FRW480 x 6/12	=	240
Paid for Year		600
		840
Prepaid at end of Year FRW600 x 6/12	=	300
		540

6. Depreciation

Furniture and Equipment	FRW3,200
Depreciation at 10%	FRW320

TOPIC 6:

ANALYSIS OF FINANCIAL STATEMENTS

International Accounting Standard 7 (IAS 7)– STATEMENT OF CASHFLOWS

OBJECTIVE

The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flow which classifies cash flows during the period from operating, investing and financing activities

SCOPE

An entity shall prepare a statement of cash flow in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

BENEFITS OF CASH FLOW INFORMATION

It provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency)

It is useful in assessing the ability of the entity to generate cash and cash equivalents

It enables users to develop models to assess and compare the present value of the future cash flows of different entities

It also enhances the comparability of the reporting of operating performance by different entities

It helps in predicting the future cash-flows

KEY DEFINITIONS

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity

PRESENTATION OF A STATEMENT OF CASH FLOW

The statement of cash flow shall report cash flows during the period classified by operating, investing and financing activities.

Operating activities

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. They include:

- cash receipts from the sale of goods and the rendering of services;
- cash receipts from royalties, fees, commissions and other revenue;
- cash payments to suppliers for goods and services;
- cash payments to and on behalf of employees;
- cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
- cash payments or refunds of income taxes

Investing activities.
Those include

- cash payments to acquire property, plant and equipment, intangibles and other long-term assets.
- cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
- cash payments to acquire equity or debt instruments of other entities
- cash receipts from sales of equity or debt instruments of other entities
- cash advances and loans made to other parties (other than advances and loans made by a financial institution);
- cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

Financing activities
Those include:

- cash proceeds from issuing shares or other equity instruments;
- cash payments to owners to acquire or redeem the entity's shares;
- cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
- cash repayments of amounts borrowed; and
- cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

REPORTING CASH FLOWS FROM OPERATING ACTIVITIES
An entity shall report cash flows from operating activities using either:
The direct method: under this method, only major classes of gross cash receipts and gross cash payments are disclosed; or
The indirect method: under this method, profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows

INTEREST AND DIVIDENDS
Cash flows from interest and dividends received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as operating, investing or financing activities.

TAXES ON INCOME

Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

NON-CASH TRANSACTIONS

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flow. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

REPORTING CASH FLOWS FROM OPERATING ACTIVITIES

The reporting of cash flows from operating activities can be either by:

- The **Direct Method**, whereby major classes of gross cash receipts and gross cash payments and cash receipts from customers, and cash payments to suppliers are disclosed
- OR
- The **Indirect Method** whereby profit or loss is adjusted for the effects of transactions of a non-cash nature and the accrual or deferral of past or future operating cash receipts or payments e.g. profit adjusted for depreciation and any increase in trade payables and accruals.

The standard encourages the use of the direct method as it provides information which may be useful in estimating future cash flows.

Interest and Dividends

Cash flows from interest and dividends received and paid should each be disclosed separately. IAS 7 does not specify the classification of these under operating, investing or financing activities. However, each should be classified in a consistent manner.

Taxes on Income

Cash flows from taxes on income should be separately disclosed and classified under operating activities unless they can be specifically identified with financing and investing activities.

Indirect Method Cash Flow Statement

Cash Flow from Operating Activities	FRW'm	FRW'm
Profit before taxation	3,450	
Adjustments for:		
Depreciation	470	
Investment Income	(400)	
Interest Expense	350	
	3,870	
Increase in Trade Receivables	(600)	
Increase in Inventory	(1,120)	
Increase in Trade Payables	400	
Cash Generated from Operations	2,550	
Interest Paid	(270)	

Income Tax Paid	(900)	
Net Cash from Operating Activities		1,380
Cash Flow from Investing Activities		
Purchase of Property, Plant and Equipment	(900)	
Proceeds from Sale of Plant and Equipment	20	
Interest Received	200	
Dividends Received	200	
Net Cash Used in Investing Activities		(480)
Cash Flow from Financing Activities		
Proceeds from Issue of Shares	250	
Proceeds from Long Term Borrowing	160	
Dividend Paid	(1,200)	
Net Cash Used in Financing Activities		(790)
Net Increase in Cash and Cash Equivalents		110
Cash and Cash Equivalents at Start of Year		120
Cash and Cash Equivalents at End of Year		230

Direct Method Cash Flow Statement

Cash Flow from Financing Activities	FRWm	FRWm
Cash Received from Customers	30,150	
Cash Paid to Suppliers and Employees	(27,600)	
Cash Generated from Operations	2,550	
Interest Paid	(270)	
Income Taxes Paid	(900)	
Net Cash Flow Operating Activities		1,380

The remainder of the cash flow statement is the same as the indirect method.

WORKED EXAMPLES

A cash flow statement essentially links together the opening Statement of Financial Position, the Statement of Comprehensive Income and the closing Statement of Financial Position.

Example 1

Z Ltd's opening Statement of Financial Position had cash of FRW60,000 and ordinary shares of FRW60,000. Its trading activities for the year ended 31 December 20X4 are as follows:

	FRW	FRW
Cash Sales		100,000
Cash Purchases	70,000	
Closing Inventory	Nil	
Cost of Sales		(70,000)
Gross Profit		30,000
Cash Expenses		(12,000)
Profit		18,000

The Statement of Financial Positions at the year end and at the start of the year are set out below:

	Year End		Start
	FRW'000		FRW'000
	Nil		Nil
Non-Current Assets		78	60
Cash (60 + 18)			
		78	60
Shareholders' Equity			
Ordinary Shares	60		60
Retained Earnings		18	-
	78		60

CASH FLOW STATEMENT - INDIRECT METHOD

	FRW
Profit	18,000
Adjusted for depreciation and changes in inventory etc.	Nil
Net cash from operating activities	18,000
Net increase in cash	18,000
Cash at Start of Year	60,000
Cash at End of Year	78,000

Cash Flow Statement – Direct Method

	FRW
Cash received from customers	100,000
Cash paid to suppliers	(70,000)
Cash paid to employers and other cash payments	(12,000)
Net Cash from operating activities	18,000
Net increase in Cash	18,000
Cash at Start of Year	60,000
Cash at End of Year	78,000

Example 2

In the year ended 31 December 20X3, Z Ltd borrowed FRW40,000 on a long-term basis. It bought equipment for FRW20,000. Its trading activities for the year ended 31 December 20X3 are as follows:

	FRW	FRW
Cash sales		130,000
Cash purchases	90,000	
Closing Inventory	Nil	
Cost of sales		(90,000)
Gross profit		40,000
Cash expenses		(14,000)
Depreciation		(5,000)
		21,000
Interest paid		2,000
Profit before Taxation		19,000

The opening and closing Statement of Financial Positions are set out below:-

Statement of FinanciaLPosition

	Year End	Start
	FRW	FRW
	’000	’000
	15	Nil
Non-Current Assets (20 – 5) Cash*	122	78
	137	78
Liabilities	40	
Loan		-
	40	-
Shareholders’ Equity		
Ordinary Shares	60	60
Retained Earnings	37	18
	97	78
Total Liabilities and Equity	137	78

	FRW
	’000
*Cash at start	78
Cash sales	130
Cash purchases	(90)
Cash expenses	(14)

Loan	40
Interest Paid	(2)
Non-Current Asset	(20)
	122

Cash Flow Statement – Indirect Method

Cash Flows from Operating Activities	FRW	FRW
Profit before Taxation	19,000	
Adjustments for:		
Depreciation	5,000	
Interest Expense	2,000	
Cash Generated from Operations	26,000	
Interest Paid	(2,000)	
Net Cash from Operating Activities		24,000
Cash Flows from Investing Activities		
Purchase of Equipment	(20,000)	
Net Cash used in Investing Activities		(20,000)
Cash Flows from Financing Activities		
Proceeds from Loan	40,000	
Net Cash from Financing Activities		40,000
Net Increase in Cash		44,000
Cash and Cash equivalents at Start of Year		78,000
Cash and cash equivalents at End of Year		122,000

Cash Flow Statement – Direct Method	FRW' 000
Cash Received from Customers	130
Cash Paid to Suppliers	(90)
Cash Paid to Employees and Other Cash Payments	(14)
Interest Paid	(2)
Net Cash Inflow from Operating Activities	24

Investing and Financing Activities as above.

Example 3
In the year ended 31 December 20X3 Z Ltd had the following trading activities:

	FRW'000	FRW'000
Sales		175
Opening Inventory	Nil	
Purchases	116	
Closing Inventory	(25)	
Cost of Sales		(91)
Gross Profit		84
Cash Expenses		(22)
Depreciation		(5)
Operating Profit		57
Interest Paid		(4)
Profit before Taxation		53
Income Tax Paid		(14)
Profit after Taxation		39

The opening and closing Statement of Financial Positions are as follows:

Statement of Financial Position

	Year End FRW' 000	Start FRW '000
Non-Current Assets	10	15
Inventory	25	-
Receivables	18	-
Bank*	139	122
	182	122
Total Assets	192	137
Liabilities		
Trade Payables	16	-
Tax Payable	-	-
	16	-
Loan	40	40
Total Liabilities	56	40
Shareholders' Equity		
Ordinary Shares	60	60
Retained Earnings	76	37
Total Shareholders' Equity	136	97
Total Liabilities and Shareholders' Equity	192	137

*Bank at Start	122
Received from Customers (175 – 18)	157
Paid to Suppliers (116 – 16)	(100)
Cash Expenses	(22)
Interest Paid	(4)
Tax Paid	(14)
	139

Opening Inventory	25	
Purchases	127	
Closing Inventory	(34)	
Cost of Sales		(118)
Gross Profit		102
Cash Expenses		(28)
Depreciation		(5)
Operating Profit		69
Interest Expense		(4)
Profit before Taxation		65
Income Tax		(22)

Cash Flow Statement – Indirect Method

Cash Flows from Operating Activities	FRW 000	FRW 000
Profit before Taxation	53	
Adjustments for:		
Depreciation	5	
Interest Expense	4	
	62	
Increase in Inventory	(25)	
Increase in Trade Receivables	(18)	
Increase in Trade Payables	16	
Cash Generated from Operations		35
Interest Paid		(4)
Income Tax Paid		(14)
Net Cash from Operating Activities		17
Cash Flows from Investing Activities		-
Cash Flows from Financing Activities		-
Net Increase in Cash		17
Cash at Start of Year		122
Cash at End of Year		139

Cash Flow Statement – Direct Method

Cash Flows from Operating Activities	FRW	FRW
	’000	000
Cash Receipts from Customers (175 – 18)	157	
Cash Paid to Suppliers (116 – 16)	(100)	
Cash Paid to Employees and Other Cash Payments	(22)	
Interest Paid	(4)	
Income Tax Paid	(14)	
Net Cash from Operating Activities		17

Example 4

In the year ended 31st December 20X4 Z Ltd had the following trading activities:

		FRW’000	FRW’000
Sales			220
Opening Inventory	25		
Purchases	127		
Closing Inventory	(34)		
Cost of Sales			(118)
Gross Profit			102
Cash Expenses			(28)
Depreciation			(5)
Operating Profit			69
Interest Expense			(4)
Profit before Taxation			65
Income Tax			(22)
Profit after Taxation			43
Dividend Paid			(10)
Retained for Year			33

The opening and closing Statement of Financial Positions are as follows:

Statement of Financial Position

	Year End FRW’000	Start FRW’000
Non-Current Assets	5	10
Inventory	34	25
Trade Receivable	23	18
Bank	186	153

	243	196
Total Assets	258	206
Liabilities		
Trade Payables	25	16
Interest Accrued	2	-
Income Tax Payable	22	14
	49	30
Loan	30	40
Total Liabilities	79	70
Shareholders' Equity		
Ordinary Shares	60	60
Retained Earnings	109	76
	169	136
Total Liabilities and Shareholders' Equity	248	206

CASH FLOW STATEMENT – INDIRECT METHOD

Cash Flows from Operating Activities	FRW'000	FRW'000
Profit before Taxation	65	
Adjustments for:		
Depreciation	5	
Interest Expense	4	
	74	
Increase in Inventory	9)	
Increase in Trade Receivable	(5)	
Increase in Trade Payable	9	
Cash Generated from Operations	69	
Interest Paid (4 – 2)	(2)	
Income Tax Paid	(14)	
Net Cash from Operating Activities		53

Cash Flow from Investing Activities -

Cash Flow from Financing Activities

Loan Repaid	(10)		
Dividend Paid		(10)	
Net Cash Used in financing Activities			(20)
Net Increase in Cash			33
Cash and Cash Equivalents at Start of Year			153
Cash and Cash Equivalents at End of Year			186

DISPOSAL OF A TANGIBLE NET ASSET

The disposal of a tangible net asset has two implications for a cash flow statement:

- Adjust the profit before taxation for any profit or loss on disposal, if a loss, add to profit before taxation and if a profit deduct from profit before taxation

  and

- The sale proceeds will be included under the heading "investing activities".

Example

		Yr 1	Yr 2
		FRW'000	FRW'000
Plant	- cost	1,000	800
	- depreciation	400	480

During the year plant costing FRW200,000 which had been depreciated by FRW120,000 was sold for FRW90,000.

The depreciation charge and profit/loss on disposal can be ascertained using 'T' accounts:

Plant – Depreciation

	FRW000		FRW000
Disposal	120	Balances b/f	400
Balance c/f	480	Statement of Comprehensive Income (bal. Figure)	200
	600		600

PLANT – DISPOSAL

	FRW000		FRW000
Plant – cost	200	Plant – depreciation	120
Profit on disposal (bal. figure)	10	Bank	90
	210		210

Cash Flow Statement (Extracts)

Cash Flows from Operating Activities

	FRW 000
Profit before Taxation	X
Adjustments for:	
Depreciation	200
Profit on Disposal of Plant	(10)
Cash Flow from Investing Activities	
Proceeds from Sale of Plant	90

TAXATION

The taxation paid figure in the cash flow statement is calculated as follows:

Taxation Account

	FRW000		FRW000
Balance b/d	135	Balance b/d	120
Bank tax paid	120	Statement of Comprehensive Income	135
	255		255

DIVIDENDS

The dividends paid figure in the cash flow statement is calculated in a similar fashion to the taxation paid:

Dividend Account

	FRW000		FRW000
Balance c/d	100	Balance b/d	80
Bank Dividend paid	80	Statement of Comprehensive Income	100
	180		180

WORKED EXAMPLE

The financial statements of Triple 'A' Ltd are set out below:

Triple 'A' Ltd Statement of Comprehensive Income For The Year Ended 31 December Year 2

	FRW000
Sales	2,553
Cost of sales	1,814
Gross profit	739
Distribution costs	125
Administrative expenses	264
Operating profit	350
Interest received	25
Interest paid	75
Profit before taxation	300
Taxation	140
Profit after taxation	160
Dividends	100
Retained profit for the year	60

Statement of Financial Positions As At 31 December

	Yr 2	**Yr 1**
	FRW000	FRW000
Non-Current Assets		
Tangible	380	305
Intangible	250	200
Investments	-	25
	630	530
Current Assets		
Inventory	150	102
Trade receivables	390	315
Investments	50	-
Cash in hand	2	1
	592	418
Total Assets	1222	948
Shareholders' Equity		
Share Capital	200	150
Share Premium	160	150

Retained Earnings	260	200
	620	500
Non-Current Liabilities	100	-
	520	500
Current Liabilities		
Trade Payables	127	119
Bank Overdraft	85	89
Income Tax Payable	190	160
Dividend Payable	100	80
Total Liabilities and Shareholders' Equity	1,222	948

Notes:

- (Non-current asset investments were sold in Yr 2 for FRW30,000.
- Non-current assets (cost FRW85,000, net book value FRW45,000) were sold for FRW32,000 in Yr 2.
- The following information relates to the fixed assets:

	31.12.Yr 2	**31.12.Yr1**
	FRW**000**	FRW**000**
Cost	720	595
Depreciation	340	290
Net book value	380	305

- 50,000 ordinary FRW1 shares were issued at a premium of FRW0.2 per share during Yr2.
- The current asset investments are readily disposable.

Required:
Prepare a cash flow statement for the year ended 31 December Yr 2 using the indirect method to comply with the provisions of IAS 7 Cash Flow Statements.

Triple 'A' Ltd Cash Flow Statement for the Year Ended 31 December Year 2

Cash Flows from Operating Activities	FRW '000	FRW' 000
Profit before Taxation	300	
Adjustments for:		
Interest Paid	75	
Interest Received	(25)	
Depreciation	90	
Profit on Disposal of Investment	(5)	
Loss on Disposal	13	
	448	
Increase in Inventory	(48)	

Increase in Trade Receivables	(75)	
Increase in Trade Payables	8	
Cash Generated from Operations	333	
Interest Paid	(75)	
Income Tax Paid	(110)	
Net Cash from Operating Activities		148
Cash Flows from Investing Activities		
Payments for Tangible Non-Current Assets	(210)	
Payments for Intangible Assets	(50)	
Proceeds from Disposal of Tangibles	32	
Proceeds from Disposal of Investments	30	
Interest Received	25	
Net Cash Used in Investing Activities		(173)
Cash Flows from Financing Activities		
Proceeds from Issue of Shares	60	
Proceeds from Long-Term Loan	100	
Dividend Paid	(80)	
Net Cash from Financing Activities		80
Net Increase for Cash and Cash Equivalents		55
Cash and Cash Equivalents at Start of Year (89 – 1)		(88)
Cash and Cash Equivalents at End of Year		(33)

Cash and Cash Equivalents at End of Year

Investments	50
Cash	2
Bank Overdraft	(85)
	(33)

Workings

1. non-Current Assets

	FRW'000		FRW'000
Opening	595	Closing	720
Additions	210	Disposal	85
	805		805

Accumulated Depreciation

	FRW'000		FRW'000
Closing	340	Opening	290
Disposal	40	Depreciation	90
	380		380

Disposal

FRW'000		FRW'000
85	Accumulated Depreciation	40
	Bank	32
	Loss	13
Cost 85		85

2. Income Tax

	FRW'000		FRW'000
Closing	190	Opening	160
Bank	110	Statement of Comprehensive Income	140
	300		300

Dividends

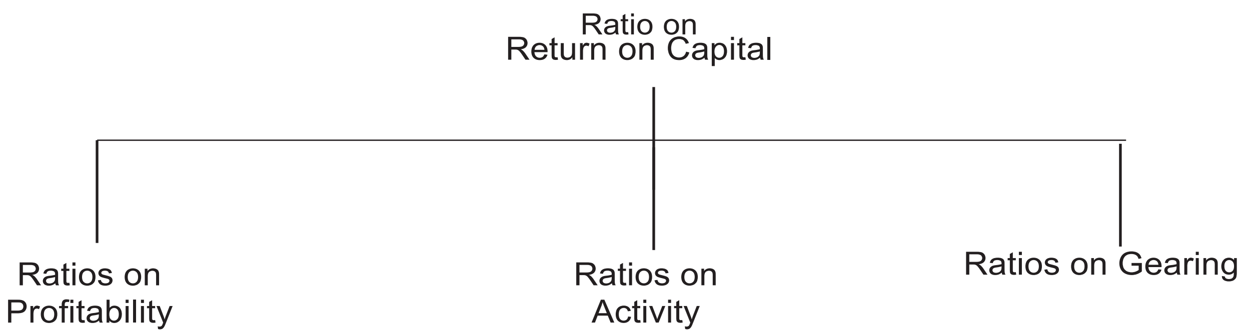
	FRW'000		FRW'000
Closing	100	Opening	80
Bank	80	Statement of Comprehensive	100
		Income	
	180		180

B) RATIO ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

GENERAL

Accounting ratios provide a useful basis on which to review a company's performance from its accounts. The essence of the approach is to measure company performance by a criterion, which takes account of the profit generated by the company, and the resources utilised to generate that profit. This criterion is called return on capital which is referred to as the primary ratio. In essence, it is the return, which the shareholders earn for every FRW1 invested by them in the company for the time being. The ratio is compared from one period to the next. In order to establish the reasons for changes in the ratio i.e. improvement or deterioration in return on capital, the ratio is broken down into its component elements. The component elements are also ratios and are referred to as secondary ratios.

The relationship between the primary ratio, return on capital, and the secondary ratios of which it is composed can be seen from the following ratio pyramid.



The mathematical relationship can be simply expressed as can be seen from the following:

Profitability x Activity x Gearing

$$\frac{\text{Profit}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Capital Employed}} \times \frac{\text{Capital Employed}}{\text{Shareholders' Funds}}$$

A movement in any one of these four components will affect the return on shareholders' funds. A fall in any one of the ratios will yield a lower return on shareholders' funds. Correspondingly if any one of the ratios increases, there will be an increase in return to the shareholders.

In addition to the categories of ratios referred to above, there are also ratios of liquidity which are used to gauge the solvency of the enterprise. Ratios, therefore, come under the following headings:

- Ratios of Return on Capital
- Ratios of Profitability
- Ratios of Activity
- Ratios of Gearing
- Ratios of Liquidity

RATIOS ON RETURN ON CAPITAL

The ratio that the shareholders are concerned with is: - =Net profit before tax/shareholders' funds Average shareholders' funds would be the average amounts of the shareholders' funds during the year, usually a simple average of the amounts shown by the opening and closing Statement of Financial Positions. This is the return to the shareholders, which is derived by the business.

Another way of measuring return on capital is: - =Net Profit Before Interest and tax/average capital employed

Average capital employed is again the average of the opening and the closing Statement of Financial Positions figures for capital employed. Capital employed, however, includes both shareholders' funds and long-term liabilities. This ratio shows the average return generated by the company on all long term capital used by it. As such, it is of less significance to the shareholder. It is useful to management in assessing the overall performance of the company in utilising all of its long-term capital.

C. RATIOS ON PROFITABILITY

These ratios measure the profitability of the company's sales. They state the average amount of profit or the amount of specific expenses included per FRW1 of sales by the company. The following are the ratios commonly computed and their interrelationship.

Ratios of Profitability - commonly computed

(a) Cost of goods sold to Sales **(Key ratio)**

(b) Net profit to Sales (Key ratio)

(c) Production materials to Sales

(d) Direct Labour to Sales

(e) Overhead costs to Sales

Gross Profit to Sales
This ratio is invariable expressed as a percentage. It reveals the gross profit as a percentage of the sales value. The figure obtained should be uniform for all firms in the same industry whether they are the largest or the smallest.

Any significant deviation or change in the ratio may be due to:

- Manipulation of Inventory, purchase or sales figures
- Changes in price policy
- Changes in the purchases or sales mix
- Changes in the cost of raw materials without a corresponding change in sales prices

Businesses with a faster Inventory turnover usually have a low gross profit margin e.g. a supermarket. On the other hand the lower the Inventory turnover the higher the gross profit margin e.g. a furniture retailer.

Net Profit to Sales
The profit margin indicates the extent to which the business is protected against potential losses arising from increased costs or falling prices.

A low ratio indicates that a firm's selling prices are too low or that its costs are too high or both. However, the ratio may be lowered by a high charge for depreciation on Non-Current Assets and raised by a low charge for depreciation.

Profit Margin on Sales

$$\frac{\text{Profit Before Interest and Taxation}}{\text{Sales}}$$

Production Materials to Sales

$$\frac{\text{Production Materials Costs}}{\text{Sales}}$$

Direct Labour to Sales

$$\frac{\text{Direct Labour}}{\text{Sales}}$$

Other ratios, which may prove useful in the analysis of Operating Statements, include administration/ sales, showing the percentage of administrative costs to sales; selling and distribution costs/ sales showing the percentage of sales costs to sales. Care should be taken with the latter ratio,

as high selling and distributive costs may be incurred in a new product launch.
Questions prompted by the use of Profitability Ratios:

- Manipulation of Inventories, purchases and sales figures
- Changes in product mix
- Changes in pricing policy
- Changes in costs of raw materials
- The velocity of Inventory turnover
- The incidence of costs including depreciation in earning profits
- The margin of safety
- The proportions of materials, direct labour, administrative cost to sales

RATIOS OF ACTIVITY

Ratios of activity measure the extent of use made of the assets of the company measured in terms of turnover generated per FRW1 of asset used. Turnover is related to total assets and to each category of asset individually to establish by comparison from year to year if the efficiency of usage of any asset is declining. The following is the inter-relationship between the ratios: -

The following should be noted about the individual ratios.

Sales/Non-Current Assets

This ratio is not of great value because the numerator and denominator are very often not comparable.

Non-Current assets are stated at their cost, perhaps many years prior to the Statement of Financial Position date. Sales, however, are valued at prices prevailing in the current year and hence the two values are incomparable. Furthermore, non-Current assets will decline in value due to depreciation without any reduction in the capacity of the plant and equipment. However, the reduction in value of the denominator increases the ratio and gives a false impression of higher utilisation of non-current assets. For this reason, a ratio-measured in terms of tonnage produced per unit of plant capacity tends to be more meaningful than the sales to non-current assets ratio.

Sales/Inventory

There are three main ways of presenting the relationship of sales to Inventories

$$\frac{\text{Cost of Sales (Cost of Goods Sold) Average}}{\text{Inventory}}$$

This relationship expresses the frequency with which the average level of inventory investment was ‘recouped’ or ‘turned over’ through operations. Presumably, the higher the turnover, the better the performance by the firm, for it has managed to operate with a relatively small average commitment of funds. This, in turn, may indicate that the inventory

must be relatively ‘current’ and useful, and contains little unusable inventory. On the other hand, a high turnover could mean Inventory shortages and incomplete satisfaction of customer desires. The final judgement will depend upon the industry, company and the method of valuing inventory and any observable trends.

$$\frac{\text{Sales}}{\text{Closing Inventory}}$$

The ratio is a cruder standard for the same purposes as (a). The most important shortcoming is in the use of the ending inventory figure, which may not be representative of the level of inventory throughout the year. Furthermore, the investment in inventory corresponds in terms of value to the cost of goods sold, whereas sales contain the mark-up for other costs and profit over and above the recorded cost of the goods as carried in inventory. Thus, the relationship is not entirely that of comparable figures. Finally, comparability between companies may be impaired through differences in the gross margin taken on sales, which is more adequately represented by cost of goods sold.

The Sales/Inventory ratio can also be broken down into:-

- Sales/Raw Materials Inventories
- Sales/Work-in-Progress
- Sales/Finished Goods Inventory

Sales/Trade Receivables

The result is expressed in terms of "days' sales represented by Trade Receivables" or, more commonly, as the "collection period". This measure can be compared to the credit terms granted to customers in the industry in question and a major deviation from this norm toward slower collections will be a warning signal, especially if there is a trend over a number of periods. The promptness with which accounts are collected is an indicator of the managerial effectiveness of the credit department, as well as a reflection of the quality of the Trade Receivables. Extremely close adherence to credit terms could, on the other hand, mean that the credit policies of the company are unduly strict and profits from sales to somewhat slower customers are being lost. The ratio can be computed as follows:

Trade

Receivables credit sales x365 days

As pointed out before, the collection period is a rough measure of the overall quality of the Trade Receivables and of the credit policies of a business, but is subject to distortion, especially if sales fluctuate widely in a given period. Also, a business selling both for cash and on account presents a problem, since a separation of credit sales must be made. For a more exact picture, a detailed "ageing" of Trade Receivables can be prepared, through a classification of accounts into groups by dates of sale, in monthly or other relevant time intervals (depending on the credit terms) to see which portion is current and which is overdue. A ratio analysis of overdue accounts in proportion to outstanding accounts from selected or all periods can then be made. This information is not always available to the outsider, however.

RATIOS OF LEVERAGE/GEARING

These ratios measure the extent to which the company has managed to finance its assets from sources of finance other than the shareholders and in particular from:

- Trade Payables

  And

- Long term loan capital

Capital employed is the total long-term finance of the business from shareholders and by way of loan capital. If total assets exceed capital employed, Trade Payables must finance them. A measure of the extent of the financing by Trade Payables is got from the total assets to Capital Employed ratio. It should be remembered that this form of finance is free since no interest would normally be paid to Trade Payables on their outstanding balances (as would be paid on Loan Capital finance).
This ratio of capital employed to shareholders funds indicates the proportion of the long-term capital of the business provided by shareholders.

Another important ratio of gearing is the average period of credit received from Trade Payables.

Average Period of Credit Received

Trade Payables

Credit Purchases x365 days

From the point of view of the creditor of a business, as well as the financial analyst, it is often desirable to apply a test to Trade Payables similar to the one for Trade Receivables. The basis of this measure is a comparison of the creditor balance with the purchases for the period. Again, a detailed ageing of the accounts would yield the most exact picture of the way in which the business handles its obligations to Trade Payables, that is, how promptly its bills are paid. In the absence of such data, the rougher measure must suffice. This ratio can be compared to the credit terms extended by the suppliers of the business to see if any abuses of these terms are made, and trends may be significant.

However, this ratio is seldom available to outsiders, since the amount of purchases are not commonly made public. In the case of a manufacturing firm, purchases may be approximated by taking the material cost from the Manufacturing Account, if available and adjusting for the change in the raw materials content of Inventories. Lacking such detail, some analysts take cost of goods sold, if available, and adjust for the change in Inventories. The latter measure is a very crude approximation, since usually cost of goods sold contains many cash charges, such as labour, repairs and so forth. It can be used without difficulty in the case of a wholesales or retailer, however. Another difficulty lies in the fact that Trade Payables often include debts incurred for purposes other than raw material purchases and such debts may vary greatly from time to time. Consequently, the ratio, if obtained, is usually less reliable than the Trade Receivables measure.

Finally, the remaining gearing ratio to be considered is the coverage of fixed interest charges. This ratio tells the number of times by which profit before interest would have to fall before the company is unable to pay its interest on loan capital. It is computed as follows:

$$\frac{\text{Profit Before}}{\text{Interest Total Interest Payable}}$$

RATIOS OF LIQUIDITY

There are two key ratios of liquidity:

- The Current Ratio
- The Acid Test Ratio

The Current Ratio $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

The current ratio is one of the most commonly used indices of financial strength, although it is a rather crude measure. The basic question underlying this ratio is the ability of the business to meet its current obligations with a margin of safety to allow for a possible shrinkage of value in its various current assets, such as Inventories and Trade Receivables. This test, applied at a single point in time, implies a liquidation approach rather than a judgement on the going concern, for it does not explicitly take into account the revolving nature of current assets and current liabilities.

The general impression regarding this measure is that the higher the ratio the better. In fact, there are many instances where financial managers try to improve the current ratio of periodic Statement of Financial Positions by paying off with cash as many of their current obligations as possible on the day prior to the Statement of Financial Position date. If the company has a current ratio of better than 1:1, this process will raise the current ratio, since the same amount will be deducted from both sides of the ratio. The process will worsen the picture if the ratio is less than 1:1. From the point of view of the Trade Payables, this may be true. From the standpoint of prudent management, there may be serious doubts about the wisdom of an excessive build-up, especially of redundant cash lying idle, or worse, a build-up of Inventories out of proportion to the needs of the business. Another distorting factor is the seasonal character of some businesses, which can be reflected to a great extent in a fluctuating current ratio. In the interpretation of this ratio thought should, therefore, be given to the components (for example, cash, Trade Receivables, Inventories, Trade Payables, and so forth) forming the ratio, the character of the business and the industry, as well as future expectations.

A general popular rule of thumb for the current ratio is considered to be a 2:1 relationship. Used without caution and discrimination, however, such a vague overall standard is rather dangerous. A 2:1 current ratio or even a 10:1 current ratio does not of itself guarantee reserve strength to meet current obligations, or the ability to turn current assets (especially Inventories) into cash as needed liquidity. Much depends on the quality and character of the current assets. Furthermore, the type of industry involved plays a major role in the need for more or less current financial strength and liquidity. For instance, a public utility with a preponderance of Non-Current Assets and a steady cash flow faces a need for current payment much different from those of wholesalers whose primary investment is in Inventory and Trade Receivables subject to changes in value. A manufacturer has financial problems different from those of a rental store, because of differences in the character of investments and operations.

A figure related to the current ratio is the item “net current assets” or “net working capital”. This is simply the difference between current assets and current liabilities. The analyst (especially the credit analyst) looks upon this figure, and its movements over several periods, as an indicator of reserve strength to weather adversities. Bank loans are often tied to a minimum requirement for working capital (i.e. restrictive covenants).

The Liquidity Ratio or "Acid Test"

Trade Receivables, Cash, Marketable Securities	Current Assets – Closing Inventory
Current Liabilities	Current Liabilities

This ratio arises from the same basic desire to measure a business' ability to meet its current obligations through the use of its current assets as does the current ratio. It is, however, a far more severe test since it is an attempt is eliminate some of the disadvantages of the current ratio by concentrating on strictly liquid assets whose value is fairly certain. By excluding investors from consideration, the questions asked in fact become: "If the business were to stop selling today, what are its chances for paying off its current obligations with the readily convertible funds on hand?" The acid test thus again backs away from the assumption of a going concern, by not considering future funds flows of the business.
A rule of thumb of 1:1 is commonly applied here with a little more justification, since a pre-selection of presumable liquid assets has been made. A result far below 1:1 can be a warning signal, but a blind application of this rule should be avoided.

LIMITATIONS OF RATIO ANALYSIS
There are a number of points, which should be borne in mind when using ratio analyses in interpreting accounting information.

- The source information on which ratios are based is usually the final accounts of a business comprising of the Statement of Comprehensive Income and the Statement of Financial Position of the concern in question. The Statement of Financial Position is a position of the firm at a specific point in time. If the Statement of Financial Position has been drawn up one month earlier or later it would perhaps have shown a completely different picture especially the Current Asset/Current Liability situation. The Statement of Financial Position is a static piece of accounting information and therefore any ratio based wholly or partly on Statement of Financial Position figures must suffer from the same defect. In addition seasonal variations must also be considered.

- The revenue accounts of a business i.e. the Statement of Comprehensive Income show a cumulative or dynamic situation. In other words, the underlying trends of the concern would be equally well shown by revenue accounts drawn up for periods of less than one year bearing in mind seasonal variation. Therefore, more reliability may be placed on those ratios computed wholly from revenue account figures.

- A ratio by itself may be almost worthless, a standard will, therefore, have to be established, this may be found either from a firm at a similar stage of development in the same industry, or from previous years accounts of the same firm.. As sources of information, these have their limitations as they are based on published accounts.

- Ratio analysis does not provide the answers to business problems. It is a tool, which enables the financial manager or investigator to ask the right questions.

SUMMARY

The prime objectives of analysis and interpretation of accounting information is to ascertain: (i) The operating performance of the firm in terms of how well the business is utilising its assets

- Whether there is excessive investment in Non-Current Assets
- If the business is adequately financed
- The Inventories position of the firm and find out if it carries excessive or obsolete
- Inventories
- The liquidity position of the concern
- Whether its profit margin are in line with comparable businesses

In other words, the objective of ratio analysis is to discover the reality behind the situation.

CHECKLIST

Introduction

The purpose of this checklist is to illustrate in a logical sequence the main points, which should be highlighted when analysing and interpreting financial information. It may be used in a general situation where an overall analysis is required or in a specialised situation where only particular information is needed by making reference to specific sections.

SECTION 1

Liquidity

(i) **Current Ratio**

The ability of the firm to meet its current obligations.
1.5 to 1 leaves a reasonable margin: greater than 2 indicate idle assets.
Less than 1 indicates inability to satisfy current obligation out of current assets.

(ii) **Liquidity Ratio**

1 to 1.1 is ideal
Compare with Current ratio to show incidence of Inventory as a current asset.
General - Large Trade Receivables/Trade Payables, little cash or large overdraft may indicate **overtrading**.
Overtrading - A firm is said to be 'overtrading' when it conducts a volume of trade far in excess of that justified by the proprietors "own funds", so that the substantial circulating assets needed to support the high level of trade are unduly dependent on outside finance.

(iii) **Trade Receivables Ratio**

- The question of Credit Control
- Incidence of Irrecoverable Debts
- Suggest preparation of age Analysis of Trade Receivables
- Examine the mix of cash to credit sales

(iv) **Trade Payables Ratio -**

- Easing or tightening of credit by suppliers
- Mix of cash to credit purchases

Express (iii) and (iv) above in terms of days. Take a year as being 365 days. In practice, it is customary to take the figure for Trade Receivables or Trade Payables at the year end and express the Trade Receivables/Trade Payables Ratios by the number of months' sales or purchases the figure represents.

General - Trade Payables Ratio should exceed Trade Receivables Ratio so as to take maximum advantage of finance provided. However, take note nature of business e.g. in supermarket business, there are cash sales and, therefore, no Trade Receivables while in the professional business, there are few Trade Payables, but normally a high debtor's figure.

(v) **Inventories**

- Over/undervaluation
- Obsolete or slow moving Inventory
- Second quality/sub-standard goods
- Too much/too little to support level of business activity
- Poor Inventory control

Definitions
Solvency A business is said to be SOLVENT when it can meet its CURRENT AND FIXED LIABILITIES out of its TOTAL ASSETS

Liquid A business is said to be LIQUID when it can meet its CURRENT LIABILITIES out of its CURRENT ASSETS

SECTION 2

Efficiency
(i) **Return on Capital Employed**

- Compute in terms of MARKET VALUE of assets
- Prime yardstick for measuring EFFICIENCY of business

(ii) **Net Asset Turnover**

- Utilisation of assets, but note incidence of costs to achieve this objective
- Compute in conjunction with Profit/Sales Ratio to achieve (i) above

(iii) **Fixed Asset Turnover**

- High Ratio - Greater efficiency in fixed asset utilisation
- Low Ratio - Poor efficiency. Remedy dispose of idle assets

(iv) **Sales to Net Current Assets**

The amount of capital required achieving an additional FRW1 of sales, given no shortage of capacity

SECTION 3

Profitability

(i) **Gross Profit to Sales**

- Use of comparison with previous years and other firms in the same industry
- Deviations
  - Manipulations in Inventory, purchases, sales
  - Changes in purchases/sales mix
  - Changes in raw materials costs with a corresponding
  - Change in sales prices
  - Poor cut-off

(ii) **Profit Margin on Sales**

- Compute with Net Asset Turnover above
- Selling price too low/costs too high

(iii) **Other ratios, which are Significant in Analysis of Operating Statements.**

- i.e. Production Materials/Sales
- Direct Labour/Sales
- Employee Ratio - Sales per employee

EXAMPLE

Bank of Kigali Ltd is reviewing the financial statements of two companies, Imana Ltd and Sulfo Ltd. The companies trade as wholesalers, selling electrical goods to retailers on credit. Their most recent financial statements appear below.

PROFIT AND LOSS ACCOUNTS FOR THE YEAR ENDED 31 MARCH 20

Balance Sheets As At 31 March 20x8

	Imana Limited		Sulfo Limited	
	FRW'000	FRW'000	FRW'000	FRW'000
Fixed assets				
Tangible assets				
Warehouse and office buildings	1,200		5,000	
Equipment and vehicles	600		1,000	
		1,800		6,000
Current assets				
Stock	400		800	
Debtor – trade	800		900	
- sundry	150		80	
Cash at bank	-		100	
	1,350		1,180	
Current liabilities				
Creditors – trade	(800)		(800)	
- sundry	(80)		(100)	
Overdraft	(200)		-	

Taxation	(120)	150	(90)	890
		1,950		6,890
		-		(4,000)
Long-term loan (interest		1,950		2,890
10% pa)		1,000		1,600
		-		500
Share capital		950		790
Revaluation reserve		1,950		2,890
Profit and loss account				

Required:

- Calculate for each company a total of eight ratios which will assist in measuring the three aspects of profitability, liquidity and management of the elements of working capital. Show all workings.

- Based on the ratios you have calculated in (a), compare the two companies as regards their profitability, liquidity and working capital management.

- Imana Ltd is much more highly geared than Sulfo Ltd. What are the implications of this for the two companies?

Solution:

PROFITABILITY		
Gross profit margin		
Gross profit x100%		
Sales		
Net profit margin	1000 x100% = 25%	1200 x 100% = 20%
Net profit x 100%	4000	6000
Sales		
	500 x 100% = 12.5%	400 x100% = 6.7%
	4000	6000
Return on capital employed		
Profit before interest and tax		
Capital employed		800 = 11.6%
	510 = 26.2%	6890
LIQUIDITY	1950	
Current ratio		
Current assets		1880 = 1.9:1
Current liabilities	1350 = 1.1:1	990
	1200	

Quick ratio	950 = 0.8:1	1080 = 1.1:1
Current assets – stock	1200	990
Current liabilities	nil = nil	4000 = 58%
Gearing	1950	6890
Long – term loans		
Capital		
	510 = 51	800 = 2 times
Interest cover	times	400
Profit before interest and tax	10	
Interest charges		
		900x365 = 55
WORKING CAPITAL MANAGEMENT	800 x365 =	days
Debtors days	73 days	6000
Trade debtors x 365 days	4000	
Sales		
Creditor days		800x 365 = 61
Trade creditors x 365 days	800 x365 =	days
Purchases	91 days	4800
	3200	
Stock days		
Average stock x365 days		800 x 365 =
Cost of sales	300 x 365	61 days
	= 37 days	4800
	3000	

Note. We have used average stock here. When you have the information use it.

Profitability

Imana has a higher gross margin than Sulfo. This may indicate a differing pricing policy. Sulfo's net margin is lower than Imana's. Imana's expenses are therefore proportionally higher. It should be noted that Imana's bottom line profit is reduced significantly by the interest charge.
Return on Imana's capital is around half of Sulfo's. Imana has a higher fixed asset base due in part to a revaluation. It may be that a revaluation of Imana's assets will partially close the gap.

Liquidity

Sulfo has nearly twice as many current assets as current liabilities. Although both companies' quick ratios are much closer, Imana's liquidity does appear to be an issue especially as there is no cash at hand. It would be wise to examine projected cashflows to see how readily Imanaa's profits will improve this situation. As Imanaa has no long-term loans they may be able to borrow in order to improve liquidity.

Working capital management

Imana is turning stock over more quickly than Omega. This is beneficial in a market which can be subject to obsolescence.

Imana's creditor and debtor days are a cause for concern. Debtors should be collected within 60 days if not sooner. 60 day collection would improve cash flow by over £140,000 reducing the debtors balance to £658,000(60/73 x £800,000).

Creditors should be paid at least as quickly as Omega pays theirs. Imana risks damaging the goodwill it has with its suppliers. Paying creditors within 60 days would have an adverse effect on cash flow of over £270,000. The creditors balance would be £527,000 (60/91 □ £800,000).

Sulfo is highly geared whereas Imana has no long-term loans. Sulfo's gearing means that should profits fall they may not be in a position to pay the loan interest. Imana's capital is entirely share capital and so a fixed return is not required.

Sulfo's loan appears to be fixed rate. This means that in times of falling interest rates Omega will have higher interest costs than say, Imana, if Imana borrowed the same amount. The converse is true in times of rising interest rates.

TOPIC 7:

PUBLIC SECTOR ACCOUNTING

INTRODUCTION

International Public Sector Accounting Standards (IPSASs)

Recent years have seen ongoing efforts to codify a set of accounting standards that can be applied specifically to the public sector. Most of these have focused on variations of private sector accounting based on the IFRS regime. In some countries, such as the United Kingdom, New Zealand and Australia a national version of the IFRSs for the public sector has been prepared. However a set of international –public sector standards have also been developed, the IPSASs, and these are gaining increasing credibility across the globe. They have been adopted by a number of countries, including Rwanda, in theory although there is still a considerable amount of practical work to be done before they may be considered to be practically implemented. They have also been adopted by some leading international organisations such as the United Nations and the World Food Programme.

IPSASs have been in existence from 2000 but a major updating process on them took place in 2009. Recognising that cash accounting is still in place for the public sectors of many countries, there is a Cash-Basis IPSAS. There are also 32 accruals-based IPSASs in existence as at the end of 2011. Recognising that there are many countries that plan to transition from a cash to an accruals based method of accounting in the public sector, there is also a section of the IPSAS devoted to disclosures that could be made under a modified cash basis, which essentially provides guidance on the data that could be collected and disclosed as part of an interim step from one to the other.

The IPSAS are published by the IPSAS Board (IPSASB) which is part of the IFAC (International Federation of Accountants) organisation based in New York. In the same way as would be the case with an IFRS there will be a consultation process involving the issuance of an Exposure Draft for public comment before publication.

The 32 accruals-based IPSAS are:

- IPSAS 1—Presentation of Financial Statements
- IPSAS 2—Cash Flow Statements
- IPSAS 3—Accounting Policies, Changes in Accounting Estimates and Errors
- IPSAS 4—The Effects of Changes in Foreign Exchange Rates
- IPSAS 5—Borrowing Costs
- IPSAS 6—Consolidated and Separate Financial Statements
- IPSAS 7—Investments in Associates
- IPSAS 8—Interests in Joint Ventures
- IPSAS 9—Revenue from Exchange Transactions
- IPSAS 10—Financial Reporting in Hyperinflationary Economies
- IPSAS 11—Construction Contracts
- IPSAS 12—Inventories

- IPSAS 13—Leases
- IPSAS 14—Events after the Reporting Date
- IPSAS 15—Financial Instruments: Disclosure and Presentation
- IPSAS 16—Investment Property
- IPSAS 17—Property, Plant, and Equipment
- IPSAS 18—Segment Reporting
- IPSAS 19—Provisions, Contingent Liabilities and Contingent Assets
- IPSAS 20—Related Party Disclosures
- IPSAS 21—Impairment of Non-Cash-Generating Assets
- IPSAS 22—Disclosure of Financial Information about the General
- Government Sector
- IPSAS 23—Revenue from Non-Exchange Transactions
- (Taxes and Transfers)
- IPSAS 24—Presentation of Budget Information in Financial Statements
- IPSAS 25—Employee Benefits
- IPSAS 26—Impairment of Cash-Generating Assets
- IPSAS 27—Agriculture
- IPSAS 28—Financial Instruments: Presentation
- IPSAS 29—Financial Instruments: Recognition and Measurement
- IPSAS 30—Financial Instruments: Disclosures
- IPSAS 31—Intangible Assets
- IPSAS 32 – Service Concessions

There is an increasing recognition that good accounting is good accounting whether it be in the private or public sector, though there is also an understanding that the uses for which financial information is used is often different in each case. For example, financial information in the private sector is frequently prepared with the aim of meeting the needs of investors including shareholders whereas in the public sector it is more an aid to assisting in holding spenders of public funds accountable for their actions.

There are though many similarities in good practice. As a result, most of the accruals-based IPSASs are derived from an IFRS (the sequencing of this is important: normally an IFRS will come first and will be followed by an IPSAS that is derived from it). Whilst there will be some redrafting to take account of the specific needs of the public sector in a number of cases the most marked difference between an IFRS and its connected IPSAS is one of terminology (for example whereas an IFRS will talk about an Statement of Comprehensive Income an IPSASs will discuss a Statement of Financial Position or an IFRS will mention equity whereas an IPSAS will discuss net assets). Each IPSAS will explain how it is different in any material way from the IFRS from which it is derived. In common with IFRS, the IPSAS regime is an accounting and reporting tool, explaining both how to account for various transactions and also the level of disclosures that are required.

The exceptions to the general rule that an IPSAS is normally linked to an IFRS are as follows:

IPSAS 21: Impairment of Non-Cash Generating Assets – non-cash-generating assets are those which are not used for a commercial purpose, which covers many in the public sector
IPSAS 22: Disclosure of Financial Information about the General Government Sector
IPSAS 23: Revenue from non-exchange transactions, which gives guidance on how to account for taxes and transfers as revenues
IPSAS 24: Presentation of budget information in financial statements, which recognises that budgeting is an important method of ensuring accountability in the public sector whereas in the private sector it is more a method of internal control

IPSAS 1

Presentation of Financial Statements - IPSAS 1

IPSAS 1 ("Presentation of Financial Statements") gives general guidance as to the types of financial statements to be prepared in the public sector (along with IPSAS 2 on the cash flow statement). It is drawn primarily from IAS 1. It should be applied to all general purpose financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs. In common with most IPSASs, it applies to all public sector entities other than Government Business Enterprises which use IFRSs for their financial reporting.

It outlines that there are six basic components of financial statements namely a Statement of Financial Position, a Statement of Financial Performance, a statement of changes in net assets/ equity, a cash flow statement, a comparison of budget and actual amounts (only if the budget is made publicly available) and the notes to the financial statements. It is important to emphasise that the disclosures in the notes are considered a fundamental part of the financial statements – but detailed guidelines on what should go into the notes for specific elements of the financial statements are found in individual IPSASs on the topics involved and not in IPSAS 1, which sets out high level contents only.

Many of these financial statements are similar to those in use within the private sector. One important difference however is the comparison of budget and actual amounts. This reflects the fact that in the public sector the budget has a greater and different significance than it does in the private sector. In particular it is a tool to help ensure accountability of those responsible for the control of resources and their effective, efficient and economic use. IPSAS 1 does not give detailed guidance on the budget v actual comparison statement which is covered in more detail within IPSAS 24, "Presentation of Budget Information in Financial Statements" (this is one of the few IPSASs for which there is no equivalent IFRS).

Entities are encouraged to present other information than that included in the financial statements to assist users in assessing the performance of the entity, its stewardship of assets and making an informed evaluation about decisions on the allocation of resources. Such information might include performance indicators, statements of service performance, program reviews and other reports by management. These areas will be further covered in the "Conceptual Framework" which is currently being prepared by IFAC to provide a framework within which future IPSASs will be prepared and current IPSASs possibly revised.

IPSAS 1 states that financial statements shall present fairly the financial position, financial performance, and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue, and expenses set out in IPSASs. The application of IPSASs, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.

An entity whose financial statements comply with IPSASs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of IPSASs
– in other words selective application of IPSASs is not permitted.
In addition to the over-arching consideration of 'fair presentation' other important concepts are included, for example;

- that the financial statements are prepared on the basis that the entity is a 'going concern'
- that there is in normal circumstances consistency of presentation from one reporting period to the next
- the concept of materiality and aggregation of large numbers of transactions into classes for reporting purposes
- that the offsetting of assets and liabilities, or revenue and expenses, is not permitted unless specifically allowed or required by an IPSAS
- that comparative information for previous periods will be included in the financial statements unless an IPSAS allows or requires its non-inclusion (e.g. in the first reporting period for a new entity)

Much of the detailed guidance in IPSAS 1 replicates that found in IAS 1 and is therefore not replicated here. The main differences between the two are shown below:

- Commentary additional to that in IAS 1 has been included in IPSAS 1 to clarify the applicability of the Standard to accounting by public sector entities, e.g., discussion on the application of the going concern concept has been expanded.
- IAS 1 allows the presentation of either a statement showing all changes in net assets/ equity, or a statement showing changes in net assets/equity, other than those arising from capital transactions with owners and distributions to owners in their
- capacity as owners. IPSAS 1 requires the presentation of a statement showing all changes in net assets/equity.
- IPSAS 1 uses different terminology, in certain instances, from IAS 1. The most significant examples are the use of the terms "statement of financial performance," and "net assets/equity" in IPSAS 1. The equivalent terms in IAS 1 are "income statement," and "equity".
- IPSAS 1 does not use the term "income," which in IAS 1 has a broader meaning than the term "revenue."
- IPSAS 1 contains commentary on timeliness of financial statements, because of the lack of an equivalent Framework in IPSASs (paragraph 69). However this may be revised once the Conceptual Framework is finalised.
- IPSAS 1 contains an authoritative summary of qualitative characteristics (based on the IASB framework) in Appendix A. Again, this may be revised once the Conceptual Framework is finalised.

IPSAS 2

Cash Flow Statements – IPSAS 2

IPSAS 2 is drawn primarily from International Accounting Standard (IAS) 7, *Cash Flow Statements.* You should note that although cash flow statements are discussed in detail in IPSAS 2, IPSAS 1 on the presentation of financial statements also makes reference to them.

In practice, there are no significant differences between IPSAS 2 and IAS 7. However there are some differences in the detail, namely:

- Commentary additional to that in IAS 7 has been included in IPSAS 2 to clarify the applicability of the standards to accounting by public sector entities. IPSAS 2 uses different terminology, in certain instances, from IAS 7. The most significant examples are the use of the terms "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 2. The equivalent terms in IAS 7 are "income," "income statement," and "equity."
- In common with IAS 7, IPSAS 2 allows either the direct or indirect method to be used to present cash flows from operating activities. Where the direct method is used to present cash flows from operating activities, IPSAS 2 encourages disclosure of a reconciliation of surplus or deficit to operating cash flows in the notes to the financial statements (paragraph 29).

IPSAS 12

Inventories - IPSAS 12

IPSAS 12 ("Inventories") is drawn substantially from IAS 2. As the name suggests, its objective is to prescribe the accounting treatment for inventories. Specifically it provides guidance on the calculation of cost and the subsequent recognition of inventories as expenses when they are consumed or sold. They also provide guidance on the write-down of inventories to their Net Realisable Value (in the case of inventories held for re-sale, defined as the future sales proceeds of any inventory less any future costs that would be incurred to make that sale happen).

The IPSAS outlines a number of situations where the rules outlined do not apply, for example:

- Work-in-progress on construction contracts (specific rules are in IPSAS 11)
- Financial instruments (see IPSASs 28 and 29)
- Biological assets (IPSAS 27)

The basic rule, as it is in IAS 2, is that inventories should be carried in the Statement of Financial Position (sometimes known as the Balance Sheet) until it is used or sold, at which point the inventory will be charged to the Statement of Financial Performance. The accounting is quite simple as the following example shows:

Entity X, a public sector education establishment buys 20,000,000 FRW of fuel oil in December 2012, which it does not plan to use until 2013:

In the financial statements, the double entry for this transaction (assuming it is paid for in cash when purchased is):

DEBIT Inventories (Statement of Financial Position)	20,000,000
CREDIT Cash	(20,000,000)

When it is then used in 2013, the double entry would be:

DEBIT Expenses (Statement of Financial Performance)	20,000,000
CREDIT Inventories	(20,000,000)

Inventories in the public sector may take a number of different forms, some of them quite unusual. These include:

- Ammunition
- Consumable stores
- Maintenance materials
- Energy reserves
- Stocks of unissued currency

The cost of inventories shall comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition. Costs of purchase includes any non-reclaimable taxes and import duties. If there are any conversion costs, such as would be the case with a publicly-owned manufacturing environment which takes raw materials and turns them into finished goods then any attributable overheads may also be added to the cost as long as these overhead costs are allocated in a systematic fashion.

The accounting treatment in IPSAS 12 is similar to that in IAS 2. Basically, when inventories are sold, exchanged, or distributed, the carrying amount of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. If there is no related revenue, the expense is recognized when the goods are distributed or the related service is rendered.

There are only a few differences between IPSAS 12 and IAS 2. IPSAS 12 requires that where inventories are provided at no charge or for a nominal charge, they are to be valued at the lower of cost and current replacement cost (in the public sector it is not as unusual for inventories to move from one organisation to another on a free-of-charge basis as it is in the private sector). In addition the financial statement known as the 'Statement of Financial Performance' is known as the 'Income Statement' in IAS 2, which also uses the term 'income' rather than 'revenue'.

IPSAS 3

Accounting Policies, Changes in Accounting Estimates and Errors - IPSAS 3

IPSAS 3 ("Accounting Policies, Changes in Accounting Estimates and Errors") is drawn from IAS 8. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the (a) accounting treatment and disclosure of changes in accounting policies, (b) changes in accounting estimates, and (c) the corrections of errors. This Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

In the public, as in the private, sector an entity has some discretion as to the accounting policies it adopts to most fairly represent the financial transactions of the business. Therefore it is important that there is some guidance laid out to ensure that there is an appropriate methodology for the adoption of accounting policies and also around how they are changed. Equally, mistakes will from time to time be made in the preparation of financial statements and they may not always be picked up in the audit subsequently. Therefore guidance is also required to ensure that if errors are not discovered until after the financial statements have been formally approved then there are appropriate measures adopted to react to the situation.

It should be noted that one of the allowable reasons for changing an accounting policy is the publication of a new IPSAS. Entities will always have a transition period during which they may move from the existing accounting treatment to that which is required by the new IPSAS. On the other hand the management of the entity may feel that a different policy is required because of changes that have taken place within the entity itself. Changes of accounting policy, which usually require restatement of comparative figures and opening balances should not be confused with changes in accounting estimate, which do not.

Estimates may often be used in government accounting for example estimated amounts of tax revenues, estimated bad debt provisions for uncollected debts or the obsolescence of inventory. When these estimates turn out to be in need of correction – and remember that an estimate is almost certain to be incorrect to some extent because the outcome is uncertain. These estimates should be corrected in the current financial period and not previous ones.

Errors can arise in respect of the recognition, measurement, presentation, or disclosure of elements of financial statements. Financial statements do not comply with IPSASs if they contain either material errors, or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance, or cash flows. Nevertheless some financial statements may inadvertently contain material errors which are not picked up. If they do and the financial statements have not yet been finalised then the drafts of these should of course be collected before publication. However if they are only picked up once the financial statements are approved then the correct accounting treatment is to adjust the comparative figures in the next year's financial statements and adjust the opening balances accordingly.

Once more the major differences between IPSAS 3 and IAS 8 mainly revolve around terminology. IPSAS 3 uses the terms 'Statement of Financial Performance', accumulated surplus or deficit and net assets/equity whereas in IAS 8 these are termed 'income statement',
'retained earnings' and 'equity'. Also IPSAS 3 talks of 'revenue', which is called 'income' in IAS 8. In addition, unlike IAS 8 IPSAS 3 does not require disclosures about earnings per share, which are not normally relevant in a public sector context.

IPSAS 14

Events after the reporting date - IPSAS 14

IPSAS 14, "Events after the reporting date", is drawn from IAS 10, "Events after the balance sheet date". Its objective is to prescribe;

- When an entity should adjust its financial statements for events after the reporting date; and
- The disclosures that an entity should give about the date when the financial statements were authorized for issue, and about events after the reporting date.

It also requires that an entity should not prepare its financial statements on a going concern basis if events subsequent to the reporting date mean that this is not appropriate.

Events after the reporting date may be analysed into adjusting and non-adjusting in nature. Adjusting events occur when information is received after the reporting date which gives more evidence about a condition that already existed at the reporting date. One example would be when a court case has been commenced against the entity where, say, a provision of 30,000,000 FRW has been established. If the court case is decided after the reporting date but before the financial statements are organised and the court finds that the entity is liable to make payments of 40,000,000 FRW then the financial statements should be adjusted accordingly.

Non-adjusting events are those which occur after the reporting date and, although significant, do not normally give evidence of a condition existing at the balance sheet date. Examples given by IPSAS 14 include a major fire after the reporting date that destroys a substantial asset, a major acquisition or disposal, changes in tax rates or tax laws, large falls in asset values or big foreign exchange losses. These non-adjusting events do not require the financial statements to be re-stated but they should be disclosed in the notes to the financial statements if they are material.

There are no major differences in principle between IPSAS 14 and IAS 10, although some extra guidance is given in the former to explain better how it applies to the private sector. Other than that the differences are once more largely in terminology.

IPSAS 17

Property, Plant and Equipment - IPSAS 17

IPSAS 17 ("Property, Plant and Equipment") is drawn primarily from IAS 16, which has the same name. It provides one of the major challenges when public sector accounting moves from a cash to an accruals basis for the first time. It is often a major exercise to assemble all the information required to accurately state an entity's Property, Plant and Equipment (PPE) values for the first time. It is also necessary to establish policies on depreciation, that is allocating the cost of the asset over the period in which it is expected to have a useful life and amortisation, which is effectively a write-down that must be made when an asset suffers a permanent diminution in value.

The objective of IPSAS 17 is to prescribe the accounting treatment for property, plant, and equipment so that users of financial statements can discern information about an entity's investment in this and the changes in such investment. The principal issues in accounting for property, plant, and equipment are
(a) the recognition of the assets,
(b) the determination of their carrying amounts (a carrying amount is the value that the asset has

in the Statement of Financial Position), and
(c) the depreciation charges and impairment losses to be recognized in relation to them.

The Standard applies to all assets (except some which are specifically dealt with by other IPSAS) including some that are quite specific to the public sector such as specialist military equipment and infrastructure assets (these would be for example roads or bridges). It does not however apply to mining activities when mineral reserves such as oil or gas are depleted by uses. It does not apply either to biological assets (these include animals kept for resale or slaughter or crops grown for harvesting) which are dealt with by IPSAS 27. Other IPSAS also deal with assets in specific situations, such as IPSAS 16, which deals with properties held for investment purposes, or IPSAS 13 on leased assets.

As in private sector accounting, the general rules are that the cost of an item of property, plant, and equipment shall be recognized as an asset if, and only if:

- It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
- The cost or fair value of the item can be measured reliably (fair value is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction).

The cost of an item of property, plant, and equipment comprises:

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired, or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Only directly attributable costs may be capitalised as part of the asset value. IPSAS 17 says that these include:

- The costs of employee benefits (as defined in the relevant international or national accounting standard dealing with employee benefits – the IPSAS dealing with this is IPSAS 25) arising directly from the construction or acquisition of the item of property, plant, and equipment;
- Costs of site preparation;
- Initial delivery and handling costs;
- Installation and assembly costs;
- Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
- Professional fees.

An important element of IPSAS 17 is that entities that are making the transition to accruals accounting based on IPSAS for the first time have a five-year period to make that transition as far as the recognition of plant, property and equipment under this particular Standard is concerned.

Further, an entity that adopts accrual accounting for the first time in accordance with IPSASs shall initially recognize property, plant, and equipment at cost or fair value. For items of property, plant, and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition (this might be the case if for example an asset was gifted as part of a legacy or was transferred at no cost from another government department).

In such situations, the entity shall recognize the effect of the initial recognition of property, plant, and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant, and equipment is initially recognized.

Although IPSAS 17 is drawn primarily from IAS 16, *Property, Plant and Equipment,* as amended by IAS 16 (part of the *Improvements to IFRSs* which was issued in May 2008) there are some differences between the private and public sector versions of the Standard. As one detailed example, at the time of issuing IPSAS 17, the IPSASB has not yet considered the applicability of IFRS 5, *Non-current Assets Held for Sale andDiscontinued Operations* to public sector entities; therefore, IPSAS 17 does not reflect amendments made to IAS 16 consequent upon the issue of IFRS 5.

However, the main differences between IPSAS 17 and IAS 16 (2003) are as follows:

- IPSAS 17 does not require or prohibit the recognition of heritage assets. An entity that recognizes heritage assets is required to comply with the disclosure requirements of this Standard with respect to those heritage assets that have been recognized and may, but is not required to, comply with other requirements of this Standard in respect of those heritage assets. IAS 16 does not have a similar exclusion. (A heritage asset is one which has particular historic or cultural significance, such as a Parliament building or an archaeological site which makes the use of conventional asset valuation rules of limited relevance)
- IAS 16 requires items of property, plant, and equipment to be initially measured at cost. IPSAS 17 states that where an item is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date it is acquired.
- IAS 16 requires, where an enterprise adopts the revaluation model and carries items of property, plant, and equipment at revalued amounts, the equivalent historical cost amounts should be disclosed. This requirement is not included in IPSAS 17.
- Under IAS 16, revaluation increases and decreases may only be matched on an individual item basis. Under IPSAS 17, revaluation increases and decreases are offset on a class of asset basis (this could make a significant difference).
- IPSAS 17 contains transitional provisions for both the first time adoption and changeover from the previous version of IPSAS 17. IAS 16 only contains transitional provisions for entities that have already used IFRSs. Specifically, IPSAS 17 contains transitional provisions allowing entities to not recognize property, plant, and

- equipment for reporting periods beginning on a date within five years following the date of first adoption of accrual accounting in accordance with IPSASs. The transitional provisions also allow entities to recognize property, plant, and equipment at fair value on first adopting this Standard. IAS 16 does not include these transitional provisions. This is an important concession in that it can sometimes be very difficult to assemble all the necessary data to allow the transition to an accruals-based approach to asset accounting and it allows public sector entities a significant amount of time to do so.
- IPSAS 17 contains definitions of "impairment loss of a non-cash-generating asset" and "recoverable service amount." IAS 16 does not contain these definitions. This is an important distinction. A non-cash generating asset is one that is not held for the generation of a commercial return and there are a number of these in use in the public sector which would not be the case in the private sector.
- IPSAS 17 uses different terminology, in certain instances, from IAS 16. The most significant examples are the use of the terms "statement of financial performance," and "net assets/equity" in IPSAS 17. The equivalent terms in IAS 16 are "income statement" and "equity." IPSAS 17 does not use the term "income," which in IAS 16 has a broader meaning than the term "revenue."

INTANGIBLE ASSTS – IPSAS 31

This is one of the most recent IPSASs to be created and is based on International Accounting Standard (IAS) 38, Intangible Assets published by the International Accounting Standards Board (IASB). It also contains extracts from the Standing Interpretations Committee Interpretation 32 (SIC 32), Intangible Assets—Web Site Costs. It includes useful application guidance on how to deal with website costs and has a number of illustrative examples which show how accounting for intangible assets could be applied in various situations such as when a patent, copyright or license is acquired from a public sector entity.

The main differences between IPSAS 31 and IAS 38 are as follows:

- IPSAS 31 incorporates the guidance contained in the Standing Interpretation Committee's Interpretation 32, *Intangible Assets—Web Site Costs* as Application Guidance to illustrate the relevant accounting principles.
- IPSAS 31 does not require or prohibit the recognition of intangible heritage assets (as is also the case with tangible assets dealt with by IPSAS 17). An entity that recognizes intangible heritage assets is required to comply with the disclosure requirements of this Standard with respect to those intangible heritage assets that have been recognized and may, but is not required to, comply with other requirements of this Standard in respect of those intangible heritage assets. IAS 38 does not have similar guidance.
- IAS 38 contains requirements and guidance on goodwill and intangible assets acquired in a business combination. IPSAS 31 does not include this guidance.
- IAS 38 contains guidance on intangible assets acquired by way of a government grant.
- Paragraphs 50–51 of IPSAS 31 modify this guidance to refer to intangible assets acquired through non-exchange transactions. IPSAS 31 states that where an intangible asset is acquired through a non-exchange transaction, the cost is its fair value as at the date it is acquired.

- IAS 38 provides guidance on exchanges of assets when an exchange transaction lacks commercial substance. IPSAS 31 does not include this guidance. The examples included in IAS 38 have been modified to better address public sector circumstances.
- IPSAS 31 uses different terminology, in certain instances, from IAS 38. The most significant examples are the use of the terms "revenue," "statement of financial performance," "surplus or deficit," "future economic benefits or service potential," "accumulated surpluses or deficits," "operating/operation," "rights from binding arrangements (including rights from contracts or other legal rights)," and "net assets/equity" in IPSAS 31. The equivalent terms in IAS 38 are "income," "statement of comprehensive income," "profit or loss," "future economic benefits," "retained earnings," "business," "contractual or other legal rights," and "equity."

IPSAS 16

Investment Property – IPSAS 16

IPSAS 16 is drawn primarily from International Accounting Standard (IAS) 40 (Revised 2003), Investment Property. In common with some other IPSASs, there are some transitional arrangements that apply when an entity adopts accrual accounting for the first time in accordance with IPSASs. These state that in such circumstances the entity shall initially recognize investment property at cost or fair value. For investment properties that were acquired at no cost, or for a nominal cost, cost is the investment property's fair value as at the date of acquisition. The entity should recognize the effect of the initial recognition of investment property as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which accrual accounting is first adopted in accordance with IPSASs.

In terms of the comparison of IPSAS 16 to IAS 40 (2003), Investment Property, the IPSAS notes that the IPSASB has not yet considered the applicability of IFRS 4, Insurance Contracts, and IFRS 5, Non-current Assets
Held for Sale and Discontinued Operations, to public sector entities; therefore
IPSAS 16 does not reflect amendments made to IAS 40 consequent upon the issue of those IFRSs.

The other main differences between IPSAS 16 and IAS 40 are as follows:

- IPSAS 16 requires that investment property initially be measured at cost and specifies that where an asset is acquired for no cost or for a nominal cost, its cost is its fair value as at the date of acquisition. IAS 40 requires investment property to be initially measured at cost. There is additional commentary to make clear that IPSAS 16 does not apply to property held to deliver a social service that also generates cash inflows. Such property is accounted for in accordance with IPSAS 17, *Property, Plant, and Equipment*.
- IPSAS 16 contains transitional provisions for both the first time adoption and changeover from the previous version of IPSAS 16. IAS 40 only contains transitional provisions for entities that have already used IFRSs. IFRS 1 deals with first time adoption of IFRSs. IPSAS 16 includes additional transitional provisions that specify that when an entity adopts the accrual basis of accounting for the first time and recognizes investment property that was previously unrecognized, the adjustment should be reported in the opening balance of accumulated surpluses or deficits. Commentary additional to that in IAS 40 has been included in IPSAS 16 to clarify the applicability of the standards to accounting by public sector entities. IPSAS 16 uses

different terminology, in certain instances, from IAS 40. The most significant example is the use of the term "statement of financial performance" in IPSAS 16. The equivalent term in IAS 40 is "income statement." In addition, IPSAS 16 does not use the term "income," which in IAS 40 has a broader meaning than the term "revenue."

IPSAS 19

Provisions, Contingent Liabilities and Contingent Assets – IPSAS 19

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 37 (1998), Provisions, Contingent Liabilities and Contingent Assets. It includes guidance on what action should be taken when transitioning to using IPSAS 19 for the first time, namely that the effect of adopting this Standard shall be reported as an adjustment to the opening balance of accumulated surpluses/(deficits) for the period in which the Standard is first adopted. Entities are encouraged, but not required, to (a) adjust the opening balance of accumulated surpluses/(deficits) for the earliest period presented, and (b) to restate comparative information. If comparative information is not restated, this fact shall be disclosed.

There are some differences between IPSAS 19 and IAS 37 as follows:

IPSAS 19 includes commentary additional to that in IAS 37 to clarify the applicability of the standards to accounting by public sector entities. In particular, the scope of IPSAS 19 clarifies that it does not apply to provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of the goods and services provided directly in return from recipients of those benefits (this is to take account of the fact that public sector entities often provide goods or services that are "free at the point of delivery" to the end user or at least provided in return for consideration that is below normal market values). However, if the entity elects to recognize provisions for social benefits, IPSAS 19 requires certain disclosures in this respect.

- The scope paragraph in IPSAS 19 makes it clear that while provisions, contingent liabilities, and contingent assets arising from employee benefits are excluded from the scope of the Standard, the Standard, however, applies to provisions, contingent liabilities, and contingent assets arising from termination benefits that result from a restructuring dealt with in the Standard.
- IPSAS 19 uses different terminology, in certain instances, from IAS 37. The most significant examples are the use of the terms "revenue" and "statement of financial performance" in IPSAS 19. The equivalent terms in IAS 37 are "income" and "income statement."
- The Implementation Guidance included in IPSAS 19 has been amended to be more reflective of the public sector.
- IPSAS 19 contains an Illustrated Example that illustrates the journal entries for recognition of the change in the value of a provision over time, due to the impact of the discount factor (the discount factor measures the way that time affects the value of money and is built into the calculations of long-term provisions).

IPSASs 9 and 23

Accounting for revenues in the public sector (IPSASs 9 and 23)
There are two IPSASs in particular that focus on accounting for revenues in the public sector. IPSAS 9 deals with accounting for what is known as exchange transactions and IPSAS 23 deals with accounting for non-exchange transactions, especially taxes and transfers. As IPSAS 23 has no IFRS equivalent it will be necessary to discuss this in more detail than some other IPSASs.

What is the difference between exchange and a non-exchange transactions?
Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange. This might be thought of as being equivalent to a commercial transactions which explains why this IPSAS is based on an IFRS (IAS 18, *Revenue).* So when, for example, a public sector provides goods and/or services for which it receives in return a payment that is related to their market value then it should apply IPSAS 9 in its accounting treatment.

If on the other hand there is no exchange of approximately equal value then IPSAS 23 will apply – such transactions will be described as 'non-exchange' in nature. This will be the case for many public sector transactions. For example when governments raise taxation revenues, there is no direct correlation between them and consequent expenditures. Although the taxpayer will rightly expect 'value' from their tax contributions, it is not normally possible to directly match their individual contributions to say expenditures on health, education, defence or many other public services.

IPSAS 9 – Exchange Transactions
As already mentioned these have a similar nature to commercial transactions and are therefore based on IAS 18. IPSAS 9 reminds us that revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and when such benefits can be measured reliably.
There are no significant variations between IPSAS 9 and IAS 18, with the differences in detail being as follows:

- The title of IPSAS 9 differs from that of IAS 18, and this difference clarifies that
- IPSAS 9 does not deal with revenue from non-exchange transactions.
- The definition of "revenue" adopted in IPSAS 9 is similar to the definition adopted in IAS 18. The main difference is that the definition in IAS 18 refers to ordinary activities (IPSAS 9 makes no such distinction).
- Commentary additional to that in IAS 18 has also been included in IPSAS 9 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 9 uses different terminology, in certain instances, from IAS 18. The most significant example is the use of the term "net assets/equity" in IPSAS 9. The equivalent term in IAS 18 is "equity."

IPSAS 23 – Non-Exchange Transactions
The introduction to IPSAS 23 notes that the majority of government revenues is generated in the form of taxes and transfers but that, until the passing of the Standard, there was no specific guidance in how to deal with transactions involving such items.

In summary, IPSAS 23:

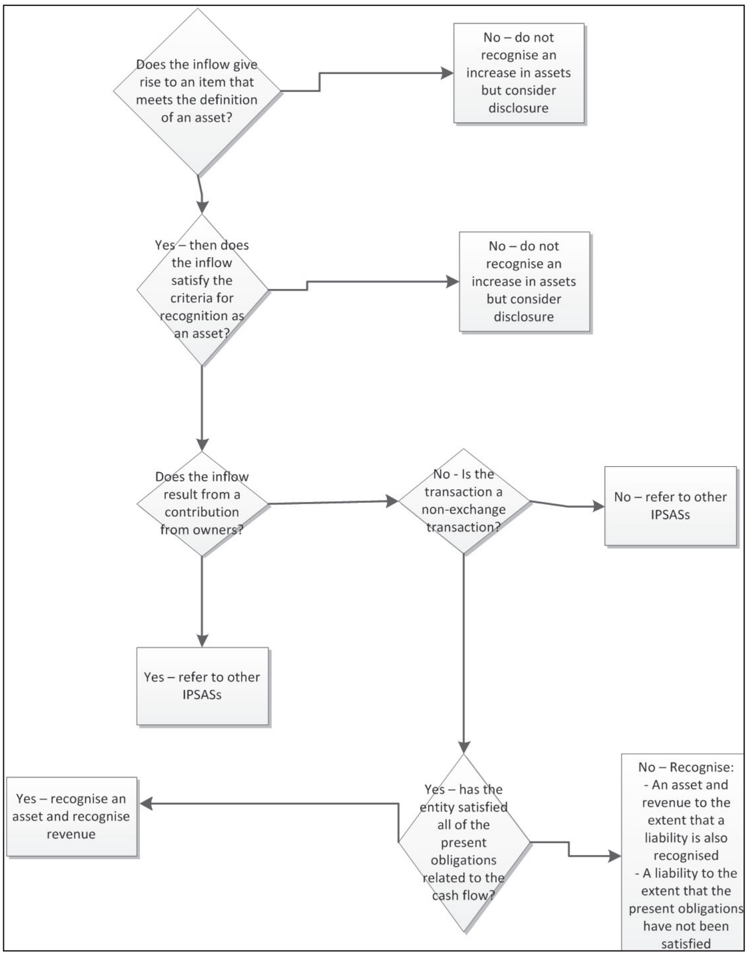
- Takes a transactional analysis approach whereby entities are required to analyse inflows of resources from non-exchange transactions to determine if they meet the definition of an asset and the criteria for recognition as an asset, and if they do, determine whether a liability is also required to be recognized;
- Requires that assets recognized as a result of a non-exchange transaction initially be measured at their fair value as at the date of acquisition;
- Requires that liabilities recognized as a result of a non-exchange transaction be
- recognized in accordance with the principles established in IPSAS 19, *Provisions, Contingent*
- *Liabilities and Contingent Assets*;
- Requires that revenue equal to the increase in net assets associated with an inflow of resources be recognized;
- Provides specific guidance that addresses:

    - Taxes; and
    - Transfers, including:
    -

- Debt forgiveness and assumption of liabilities;
- Fines;
- Bequests;
- Gifts and Donations, including goods in-kind;
- Services in-kind;
- Permits, but does not require, the recognition of services in-kind; and
- Requires disclosures to be made in respect of revenue from non-exchange transactions.

An entity will recognize an asset arising from a non-exchange transaction when it gains control of resources that meet the definition of an asset and satisfy the recognition criteria. Contributions from owners do not give rise to revenue, so each type of transaction is analysed, and any contributions from owners are accounted for separately. Consistent with the approach set out in this Standard, entities will analyse non-exchange transactions to determine which elements of general purpose financial statements will be recognized as a result of the transactions.

Two kinds of revenue transaction are relevant within the framework of IPSAS 23. The first is when an asset comes under the control of an entity without an approximately equivalent exchange taking place in return. This would be the case when for example an asset is transferred to an organisation free of charge (or, if there is a charge, it is significantly below market value). In such circumstances a simple yes/no decision tree needs to be followed which is illustrated below.



Simplistically summarised, the flowchart shows that in certain circumstances when a non-exchange transaction takes place then it creates both an asset and also revenue. For example, if an entity were given an asset for which they paid nothing but its market value was worth 5,000,000 FRW then the double entry for this would be to create an asset of 5,000,000 FRW and to recognise revenue (as a credit entry) also of 5,000,000 FRW. However, if the entity incurs a liability for that asset which is below its market value then the revenue should be reduced to the extent of that liability.

Revenue from taxes

The general rule is that an entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met. The definition of an asset is met when the entity controls the resources as a result of a past event (the taxable event) and expects to receive future economic benefits or service potential from those resources. In addition, it must be probable that the inflow of resources will occur and that their fair value can be reliably measured.

Taxation revenue arises only for the government that imposes the tax, and not for other entities. For example, where the Rwandan government imposes a tax that is collected by the RRA, assets and revenue accrue to the government, not the taxation agency which is effectively acting as a collection agency on behalf of government.

Taxes do not satisfy the definition of contributions from owners, because the payment of taxes does not give the taxpayers a right to receive (a) distributions of future economic benefits or service potential by the entity during its life, or (b) distribution of any excess of assets over liabilities in the event of the government being wound up. Nor does the payment of taxes provide taxpayers with an ownership right in the government that can be sold, exchanged, transferred, or redeemed.

On the other hand, taxes satisfy the definition of a non-exchange transaction because the taxpayer transfers resources to the government, without receiving approximately equal value directly in exchange. While the taxpayer may benefit from a range of social policies established by the government, these are not provided directly in exchange as consideration for the payment of taxes.

Recognition of taxation revenue is based on the time at which the taxable event takes place, examples of which are when:

- Income tax is the earning of assessable income during the taxation period by the taxpayer;
- Value-added tax is the undertaking of taxable activity during the taxation period by the taxpayer;
- Goods and services tax is the purchase or sale of taxable goods and services during the taxation period;
- Customs duty is the movement of dutiable goods or services across the customs boundary;
- Property tax is the passing of the date on which the tax is levied, or the period for which the tax is levied, if the tax is levied on a periodic basis.

Other types of non-exchange revenue

Fines are economic benefits or service potential received or receivable by a public sector entity, from an individual or other entity, as determined by a court or other law enforcement body, as a consequence of the individual or other entity breaching the requirements of laws or regulations.

Fines normally require an entity to transfer a fixed amount of cash to the government, and do not impose on the government any obligations which may be recognized as a liability. As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset which have already been discussed. Where an entity collects fines in the capacity of an agent, the fine will not be revenue of the collecting entity. Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.

Sometimes a **bequest** may be made to a government entity. A bequest is a transfer made according to the provisions of a deceased person's will. The past event giving rise to the control of resources embodying future economic benefits or service potential for a bequest occurs when the entity has an enforceable claim, for example on the death of the person making the bequest.
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Bequests that satisfy the definition of an asset are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity, and the fair value of the assets can be measured reliably. Determining the probability of an inflow of future economic benefits or service potential may be problematic if a period of time elapses between the death of the testator and the entity receiving any assets.

The entity will need to determine if the deceased person's estate is sufficient to meet all claims on it, and satisfy all bequests. If the will is disputed, this will also affect the probability of assets flowing to the entity. Therefore it can be seen that asset and revenue recognition is not always a straightforward situation with bequests. It is necessary to obtain an estimate of the fair value of bequeathed assets, for example by obtaining the latest market values for assets bequeathed.

Disclosures

Both IFRSs and IPSASs are as much about disclosure as they are about accounting treatment. IPSAS 23 has a list of disclosure requirements that apply specifically to non-exchange transactions. These include a requirement to disclose the following details:

Either on the face of, or in the notes to, the general purpose financial statements:
The amount of revenue from non-exchange transactions recognized during the period by major classes showing separately:

- Taxes, showing separately major classes of taxes; and
- Transfers, showing separately major classes of transfer revenue.

The amount of receivables recognized in respect of non-exchange revenue;
The amount of liabilities recognized in respect of transferred assets subject to conditions
The amount of assets recognized that are subject to restrictions and the nature of those restrictions; and
The existence and amounts of any advance receipts in respect of non-exchange transactions.
An entity shall disclose in the notes to the general purpose financial statements:

The accounting policies adopted for the recognition of revenue from non-exchange transactions;
For major classes of revenue from non-exchange transactions, the basis on which the fair value of inflowing resources was measured;
For major classes of taxation revenue that the entity cannot measure reliably during the period in which the taxable event occurs, information about the nature of the tax; and
The nature and type of major classes of bequests, gifts, and donations.

EMERGING ISSUES AND TRENDS IN FINANCIAL ACCOUNTING (NATIONAL, REGIONAL AND GLOBAL)

CORPORATE GOVERNANCE

This is a new discipline of management which evolved in the last quarter of the 20th century. This is one of the leading concepts in accounting and management circles. Emphasis is on role of the board on running an organization. The board has the sole responsibility of designing a working internal control system. This will culminate by preparation of financial statements which comply with standards.

Elements of good corporate governance

Since agents are custodian trustees and stewards of the organization they are answerable and accountable to the owners.
For successful corporate governance the role of shareholders directors and other employees must be clearly defined.

Reasons for corporate governance:

- Ensure enterprise prosperity and survival
- Furthers ethics, integrity and responsibility
- Ensure participative model in decision making
- Guarantees administration of justice on employees and other stakeholders through the application of rules and regulations.
- Ensures protection of employees right to employment by providing job security
- Ensures a good positive corporate culture is established and enhanced

PUBLIC PRIVATE PARTNERSHIPS

This is a cooperation kind of relationship between two or more public and private sector entities. In this relationship, the public partner delegates some of its responsibilities to private-partner under a long term contract that clearly stipulates the rights and duties of the other party during the term as well as the deliverables.
It is important that both parties evaluate risk well before settling on this contract as it can lead to catastrophic risks.

ACCOUNTING DIFFERENCES AMONG COUNTRIES

Different countries of regions use different accounting bases. These differences have to be ironed out before different financial statements can be compared. IFRS helps in settling the same.
The following may be some of the causes of these differences:

- Different economic systems
- Different cultures
- Different languages
- Different currencies and their strengths

NOTE BELOW:
It is evident that so many things are changing not just in financial world but in all spheres of accounting. New issues such as money laundering, crypto currency, cloud accounting, financial frauds and so on affect accountants of today and tomorrow. It is therefore imperative that accounts should keep on updating themselves to ensure they stay abreast of world changes.