NATIONAL OPEN UNIVERSITY OF NIGERIA
DEPARTMENT OF FINANCIAL STUDIES
Course Guide

COURSE TITLE; ELEMENTS OF BOOK-KEEPING II

COURSE CODE; ACC 102

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CONTENT

INTRODUCTION

What you have in your hand is the course guide for ACC 102 (Elements of Bookkeeping II). The purpose of the course guide is to relate to you the basic structure of the course material you are expected to study as a B.Sc. Entrepreneurship Student in National Open University of Nigeria. Like the name ‘course guide’ implies, it is to guide you on what to expect from the course material and at the end of studying the course material.

COURSE CONTENT

The course content consists basically of the methods of recording accounting data: manual and mechanical; the final account of a sole trader which consists of the statement of profit or loss account, statement of financial position and end of year adjustments; accounting treatment of control accounts; bank reconciliation statement; cost accounting with emphasis on elementary break-even analysis.

COURSE AIM

The aim of the course is to introduce you to basic principles of accounting and to understand how financial documents are posted into accounting record in order to determine the profit or loss of an organisation and the financial position of the organization. It also includes practical treatment of accounting transactions conducted through the bank and how errors associated with the trial balance are treated. This course will also introduce the break-even analysis using the formula or the mathematical and graph methods.

COURSE OBJECTIVES

At the end of studying the course material, among other objectives, you should be able to:

1. Distinguish between book keeping and accounting;
2. Explain the methods of preparing accounting data using manual accounting system and computerized accounting system;
3. Explain key accounting concepts and the building blocks of accounting
4. Explain the meaning of the key terms and concepts in the accounting equation.
5. List the books of prime entry and state what each is used for.
6. Describe common methods of valuing inventory and inventory costing
7. Identify the errors affecting the trial balance as well as those not affecting the trial balance

8. Prepare a statement of profit or loss and a statement of Financial position Explain and prepare the different types of control accounts
9. Prepare an adjusted cash book and bank reconciliation statement
10. Calculate the Breakeven point using formula or the mathematical method and graph

COURSE MATERIAL

The course material package is composed of:

The Course Guide

The Study Units

Self-Assessment Exercises

Tutor Marked Assignment

References/Further Reading

THE STUDY UNITS

The study units are as listed below:

Unit 1	Basic Accounting
Unit 2	Methods of recording data: manual and mechanical
Unit 3	Accounting concepts
Unit 4	The accounting equation and its components
Unit 5	Basic documentation and prime books
Unit 6	Prime books, general journals and the ledgers
Unit 7	Inventory valuation
Unit 8	Trial balance
Unit 9	Final accounts of a sole trader 1: Statement of profit or loss
Unit 10	Final accounts of a sole trader 1: Statement of Financial position
Unit 11	End of year adjustments in final accounts
Unit 12	Accounting treatment of control accounts
Unit 13	Bank reconciliations
Unit 14	Cost accounting
Unit 15	Elementary Break-even analysis

ASSIGNMENTS

Each unit of the course has a self assessment exercise. You will be expected to attempt them as this will enable you understand the content of the unit.

TUTOR MARKED ASSIGNMENT

The Tutor Marked Assignments (TMAs) at the end of each unit are designed to test your understanding and application of the concepts learned. Besides the preparatory TMAs in the course material to test what has been learnt, it is important that you know that at the end of the course, you must have done your examinable TMAs as they fall due, which are marked electronically. They make up to 30 percent of the total score for the course.

SUMMARY

It is important you know that this course material consists of both academic and professional materials. This provides you the opportunity of obtaining a BSc. degree in Entrepreneurship and preparation for your professional examinations. Therefore, it is very important that you commit adequate effort to the study of the course material for maximum benefit.

UNIT 1: BASIC ACCOUNTING

CONTENTS

1.0 INTRODUCTION

Accounting is concerned basically with accountability. The underlying purpose of accounting is to provide financial information about an economic entity. The information is provided, periodically, to shareholders and others connected with the organization to enable them decide the extent to which they want to continue to associate with the organization.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain the historical development of accounting

- Distinguish between bookkeeping and accounting

- State the qualities of a good accounting information system

3.0 MAIN CONTENT

3.1 The Historical Development of Accounting

Rudimentary form of accounting started with bookkeeping by *Lucia Pacioli*, an Italian monk. In his book titled "*Summa de Arithmetical, Geometrica, proportioni et proportionalita*," published in 1494 on Arithmetic, Geometry and Proportion, he devoted a chapter to expound the principles of the double entry system. It became necessary for managers to report to the owners of their business activities during the period under review. Such report mainly includes the following:

- How the financial resources of the business have been invested during the period,
- The profit earned or loss incurred during the period, and
- The assets, liabilities and the owner's equity at the end of the period under review.

After this initial development, a lot of changes have been witnessed in accounting. These changes were informed by sophistication and complexity of businesses, industrial and political environments which placed more responsibilities on management of business to disclose more information to owners and other interested parties.

3.2 Regulatory Framework

Due to the increasing changes in the economic and political environment, statutory and other regulations have been put in place to ensure the reliability, relevance and comprehensiveness of financial information, and to narrow areas of differences.

The main statutory document for the regulation of business in Nigeria is the Companies and Allied Matters Act **1990** (as amended in 2004). The company laws are enforceable in the court of law.

Other legislations relate directly to specific industry such as:

- Banks and Other Financial Institutions Act of 1991 (BOFIA 1991)

- Insurance Act 2003

Other regulations consist of the following accounting standards:

- Statements of Accounting Standards (SAS) issued by Nigerian Accounting Standards Board (NASB) now Financial Reporting Council (FRC) from time to time
- International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) issued by IASB from time to time.

SELF ASSESSMENT EXERCISE

Briefly explain the regulatory framework of accounting in Nigeria

3.3 Book keeping and Accounting

Bookkeeping is the recording phase of accounting. It is the classification and recording of business transactions in the books of account. The recording of the transactions is a routine task, therefore it tends to be repetitive. Accounting on the other hand includes not only the keeping of accounting records, but also the design of efficient accounting systems, the interpretation of accounts and the development of forecast. The processes involved in bookkeeping are as follows:

(a) The classification of business transactions using source documents;

(b) Recording of classified transactions in appropriate subsidiary books or books of prime entry;

(c) Posting of entries from subsidiary books to the ledger; and

(d) Extraction of the Trial Balance .

3.4 Scope of Accounting

The starting point in the study of accounting is financial accounting; others are cost accounting, management accounting, auditing, government accounting, and tax management.

3.4.1 Financial Accounting

Financial accounting involves an accounting process that starts with bookkeeping and ends with the preparation and interpretation of financial statements. The components of financial statements are the statement of financial position (the balance sheet), the statement of financial performance (the income statement) and the cash flow statement.

3.4.2 Cost Accounting

Cost accounting is the procedure for accumulating data to provide information for managerial action. Cost accumulation is the collection of cost data in some organized ways by means of an accounting system.

3.4.3 Management Accounting

Management accounting provides information to management of a business to help them take better decision and to improve upon the efficiency and effectiveness of existing operations (Drudry, 2004). It is concerned with providing accounting information to management for the purpose of planning, decision making and control.

3.4.4 Auditing

Only complete and reliable financial statements can be of any use to the creditors, investors, government agents and other interested parties. To guarantee these, the accounts must be audited by an independent person called *an Auditor*. Auditing is the independent examination of the books of accounts and records of the company

3.4.5 Government Accounting

Government accounting is the process of recognizing and reflecting in the appropriate books of accounts and records government generated revenue and disbursed expenditure in such a way as to extract with ease relevant financial information vital for appropriate decision making from time to time, and in compliance with the laws regulating government finances.

3.4.6 Accounting for Taxation

The accounting profits generated in the financial statements provide the basis for determining the taxable profits of a company. The taxable profits are different from the accounting profits because certain expenses and income are allowable for accounting purpose but disallowable for tax purpose. A good understanding of the knowledge of these taxable incomes and expenses and non-taxable incomes and expenses would help a business in its tax management.

3.5 The Need for Accounting Information

The need for accounting information can be summarized as follows:

- It provides information useful for making economic decisions.
- It provides information to users for predicting, comparing and evaluating the earnings power and financial strength of a business.
- It is used to judge the ability of management to utilize the entity's resources effectively in achieving the goal of the entity.

- It provides information to creditors for predicting and evaluating the cash flows of the entity.
- It provides management with detailed accounting data for use in planning and controlling the daily operations of the business.
- It provides information to government for determining the tax payable on the profit and/or other incomes of an individual or company and for formulating fiscal policies.
- It forms the basis of reporting on the activities of an enterprise as they affect the society.
- It serves as the basic instruments by which investors decide the securities in which to invest.

3.6 Qualities of good accounting information

Accounting information should possess the following qualities before users can rely on it:

(a) **Relevance:** The accounting information must include enough facts to satisfy the need of the user. For instance management accounting information should be relevant to the decision to be taken with it. Financial accounting information should disclose enough information to satisfy the various users.

(b) **Reliability:** The source of information must be verifiable and one source of evidence must corroborate the other.

(c) **Comparability:** There should be no change in the basis for the preparation of the accounting information from period to period so that it will be easy to compare the result of operations over some accounting periods.

(d) **Timeliness:** Accounting information must be made available early enough for its use. For instance management requires certain information on daily basis or weekly basis for effective running of the business; if it comes late it would be useless. Annual reports and accounts must be published not long after the year end.

(e) **Objectivity:** There must be no bias, window dressing or subjective judgments in the presentation of accounting information. Objectivity includes ability to trace transactions to documentary evidence and complying with required regulations in its presentation.

(f) **Comprehensiveness:** Accounting information must contain just enough details for good understanding. The detail must neither be too little nor too much.

4.0 CONCLUSION

Accounting as a discipline has been undergoing series of development. These increasing changes are due to the economic and political environment, statutory and other regulations have been put in place to ensure the reliability, relevance and comprehensiveness of financial information, and to narrow areas of differences.

5.0 SUMMARY

In this study, we examined the historical development of accounting, its relevant framework and the need for accounting information.

6.0 TUTOR-MARKED ASSIGNMENT

1. State four qualities of good accounting information
2. Differentiate between Bookkeeping and Accounting
3. Explain the scope of accounting
4. What are the qualities of good accounting information?
5. **Differentiate between the computerized accounting system and the manual accounting system**
6. **Identify the building blocks of accounting and explain each one**

6.0 REFERENCES/FURTHER READING

Aguolu, O. (2010). *Financial Accounting. A Practical Approach*. Institute for Development Studies, Enugu, Nigeria

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UNIT 2: METHODS OF RECORDING ACCOUNTING DATA: MANUAL AND COMPUTERIZED

CONTENTS

1.0 INTRODUCTION

The computer information age of the 21st century led to the use of computerized accounting system by different organizations. This is a departure from the manual system. However, most of the accounting source documents in Nigeria such as invoice, receipt are prepared manually by small businesses except few organizations whose accounting system is fully computerized to the extent of generating computer based invoices and receipts. This unit focuses of how accounting data are recorded using both manual and mechanical methods

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i. Explain manual accounting system.
ii. Discuss computerized/mechanical accounting system.
iii. Know the procedure for preparing accounting data using manual method
ii. Understand how accounting data can be prepared mechanically.

3.0 MAIN CONTENT

3.1 Manual Accounting System

The manual accounting system refers to the keeping of accounting record by hand written of relevant posting in the books of accounts. It means that electronic device such as computer is not used in posting.

The computerised information systems enable some companies to use different accounting software for the financial records, but some organisation still prefer the manual system for one reason or the other.

Some of the advantages of manual system over the computerised system are:

i. A manual system is cheaper to install in terms of cost when compared with a computerized system of maintaining financial records.

ii. Cost of acquiring computer, accounting software and training of account personnel in a computerised accounting system are not required for manual system.

iii. A manual system may be more secure because the possibility of computer crash and virus do not affect it.

Some of the disadvantages of manual system are:

i. It is highly prone to more mistakes and errors because humans factor do all the calculation without electronic assistant which a computer can generate with ease.

ii. The manual system takes longer time, efforts and paper to post.

iii. The security of the manual system is threatening because it is prone to destruction by flood and fire deface without any back-up.

iv. Auditing of manual accounting system is cumbersome because documents have to be checked and identified one after the other.

v. More space is required to keep manual accounting record because they are always voluminous.

vi. It takes more time to effect changes and correct mistakes in a manual system because it may require redoing a posting from the subsidiary books to the ledger.

3.2 Mechanical Accounting System

The word ‘mechanical’ means the use or adoption of electronic device in the posting and preparation of accounting records. This is achieved through the use of computer with relevant software as appropriate for each business. Computerised or mechanical accounting system makes the recording, processing and reporting of accounting data easier than the manual system.

The recording of accounting data in a computerised accounting system is different from the manual system of accounts. The recordings in mechanical accounting system are not the same for all accounting software, but there are common processes and procedures that are applicable to accounting software.

i. Accounting data are entered from the source documents to the computer through the key board and other input devices.

ii. The entry requires the classification of account or chart of account through the creation of ‘account code’ for each transaction head.

iii. It will be necessary in most computerised accounting system to specify the account to be debited and those to be credited while imputing accounting data.

iv. Information to prepare and generate the final accounts is in the data base from where the software automatically extracts the reports and accounts based on the user’s specification which can be modified.

3.2.1 Chart of Account

This is a set of numbers and codes that define each account head and also differentiate between classes of accounts e.g. The serial code for receipt differs from expenses

Account Types
Account types define how the account will be grouped in reports and financial statements. They also control what happens during financial year-end.

Typical Chart of Account

Code	Account Description	Account Type
10000	SALES	Income
10001	DONATION	Income
10002	INTEREST ON DEPOSIT	Income
80001	PURCHASES	Cost of Sales
80002	CARRIAGE INWARDS	Cost of Sales
20001	PRINTING AND STATIONERY	Expenses
20002	TELEPHONE	Expenses

20003	POSTAGE	Expenses
20004	RENT	Expenses
20005	SALARIES AND WAGES	Expenses
20008	ADVERTISEMENT	Expenses
30000	FURNITURE AND FITTINGS	Non-Current Assets
30001	OFFICE EQUIPMENT	Non-Current Assets
40000	RENT ADVANCE	Current Assets
40001	MAIN CASH	Cash
40002	DEBTORS	Account Receivable
50000	CAPITAL	Equity
50001	RETAINED EARNINGS	Equity-Retained Earnings
60000	LOAN – DC BANK PLC	Non-Current Liabilities
60001	LOAN – GF MORTGAGE BANK	Non-Current Liabilities
70000	LOAN – COOPERATIVE	Current Liabilities
70001	CREDITORS	Accounts Payable

Some advantages of computerised accounting system are:

i. The use of computer is an efficient way of keeping and recording accounting transactions because entry of data is faster than in manual system.

ii. With the use of computer for accounting records, it becomes easy to generate different reports and financial statement within a short period.

iii. It helps to communicate with customers and supplier better and faster because of email facility available in some accounting software,

iv. Accounting data and other information in accounting software are secure and safe because they can be back-up in different locations and folders such as internet, cloud, e-mail attachment and external drive.

v. The risk or loss of data is reduced to the barest minimum

vi. It helps to avoid the problem of duplication of same records which are found in manual system

vii. Quick and fast decision can be made by managers with timely report that are available in a computerised accounting system. This help in strategy formulation and realignment

viii. Up to date accounting records are made possible because accounting software update records automatically after they are posted.

Computerised accounting system has the following demerits

i. Computerised accounting system is prone to risk of computer virus and hard disk crash.

ii. Some software require the service of external consultants who have to be paid consultancy fee on annual basis in some cases

iii. The existence of computer hackers and identity theft are major challenge of computerised accounting system especially for those with internet and cloud back-up.

iv. Irregular power supply and other electrical faults can damage computer and other accessories used for computerised accounting system.

v. There is no limit to the effect of a single mistake in data entry. A mistake in data entry has negative effect on different reports, records and statements.

SELF ASSESSMENT EXERCISE

1. Define manual accounting system?

2. State the disadvantages of computerised accounting system?

4.0 CONCLUSION

Accounting data can be recorded, posted and processed manually and mechanically depending on what the business owner's desire. The manual system is hand written while the mechanical method uses computer system in data recording and processing. It is important for business organization to examine the merits and demerits of each system before deciding on the system of accounting record to use.

5.0 SUMMARY

In this unit we discussed manual accounting system and mechanical accounting system. It shed light on the advantages and the disadvantages of each system while a typical chart of account used in a computerized accounting system was given.

6.0 TUTOR-MARKED ASSIGNMENT

1: What are the merits of manual accounting system?
2: What do you understand by computerized accounting system?
3: What are the disadvantages of manual accounting system?
4: Prepare a typical chart of account for a trading organization.

7.0 REFERENCES/FURTHER READINGS

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UNIT 3: ACCOUNTING CONCEPTS

CONTENTS

1.0 INTRODUCTION

An appreciation of the conceptual and theoretical foundations of financial accounting is fundamental to the preparation, understanding and interpretation of financial statements. The conceptual and theoretical foundations can be described as a set of rules, principles, postulates, conventions and methods. This unit explains the nature of the underlying concepts of accounting. Some of the concepts are referred to specifically in the International Accounting Standard Committee's (IASC's) *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*) (IASC, 1989 quoted in Thomas and Ward, 2012).

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Define accounting concept;
- Explain the key accounting concepts;
- Describe the other accounting concept.

3.0 MAIN CONTENT

3.1 Key Accounting Concepts

Accounting concepts can be defined as broad basic assumptions that underlie the periodic financial statements of business enterprises. Two concepts have been specifically in the Framework and they are the going concern and the accruals concepts.

3.1.1 Going Concern Concept

The going concern concept is the assumption that an entity will continue in operational existence for the foreseeable future. Any user when looking at an entity's financial statements has the right to assume that the company is not going to liquidate or curtail materially the scale of its operations. Users should be able to look at the financial implications of prior activity as captured in the financial statements and use this as an indication of future activity.

The implication of the going concern assumption is that assets are valued at their historical cost (or fair value), not their scrap value. If there is reason to believe that the entity will not be able to continue in business, then the going concern principle no longer holds and the assets should be valued on a cessation basis; that is, at their net realizable value. For example a N10,000 machine, which can easily generate output for the next 10 years, would be recognized in the statement of financial position at cost price less depreciation, if the company is a going concern. However, if the company decides to go into voluntary liquidation, then this machine is not going to produce revenue for the next 10 years, hence should be written down to the value expected to be received on its sale (its net realizable value). This may be zero.

Self Assessment Exercise
Explain the nature of the going concern concept and its implications for the preparation of financial statements.

3.1.2 Accruals Concept
According to the *Framework* and IAS 1, to meet their objectives, financial statements should be prepared on the accruals basis of accounting.

The accruals concept is concerned with allocating expenses and income to the periods to which they relate (when the expenses were used by the entity, or when the income was earned, as distinctly different to when cash is paid out for expenses and when cash is received from a sale). The *Framework* states that the transactions should be 'recorded in the accounting records and reported in the financial statements in the periods to which they relate'. In most instances this refers to the accounting period in which the goods or services physically pass from the seller to the buyer.

The accruals concept also assumes that costs should be recognized when they occur, and not when money is paid: that is, goods and services are deemed to have been purchased on the date they are received and services consumed, for which no invoice has been received at the end of an accounting year (e.g. electricity, gas, telephone), are treated as a cost for that year. The amount due is treated as a liability. These are referred to as accrual expenses. In contrast, services paid for in advance (e.g. rent, insurance, road tax, local government taxes) that have not been received at the end of an accounting year are treated as a cost of the following accounting year, and thus carried forward as an asset at the end of the current year. These are referred to as prepaid expenses or prepayments.

Self Assessment Exercise
Explain the accrual concept and its implications for the preparation of financial statements.

3.2 Other Concepts
The fundamental concepts (going concern and accruals) are discussed above. There are a number of other concepts that are implicit in the preparation of financial statements and are so engrained in the process of accounting. To be comprehensive, a short explanation of each is given in this section.

3.2.1 Matching Concept
The matching concept/principle refers to the assumption that in the measurement of profit, costs should be set against the revenue that they generate at the time when they arise. A classic example of the application of the matching principle is inventory. Where goods are bought in

one accounting year but sold in the next, their cost is carried forward as inventory at the end of the year and set against the proceeds of sale in the accounting year in which it occurs.

3.2.2 Entity Concept

The entity concept, otherwise known as the accounting entity or the business entity concept. In simple terms this concept allows the user to look at a reporting entity's financial statements and to know that these represent the performance and financial position of the business unit and do not include any assets, liabilities, income or expenditure that are not related to the business. Therefore, when a sole trader uses the business cheque book to buy a car for personal use, this car will not form part of the business's assets; it will be treated as the owner withdrawing equity capital. This is called a 'drawing'.

3.2.3 Materiality Concept

The materiality concept affects every transaction and every set of financial statements. This concept affects two main areas: presentation and application of accounting standards. In respect of the first, this concept assumes that only material items should be disclosed in financial statements. This is important for achieving the objective of financial statements as attention being afforded to immaterial items can mislead the user. The user should be able to look at a set of financial statements and focus on the important figures, not see a mass of information, much of which is of no use for economic decision-making. For example, it is irrelevant to disclose a yearly spend on stationery of N100 and a yearly spend on coffee of N75, if the company has a turnover of N10 million and total expenditure of N8 million. The immaterial items need to be grouped together, or grouped into categories that are material. For example, the stationery and coffee could be combined into administration expenses that might have a total of N2.5 million.

3.2.4 Time Period Concept

Another concept, the time period concept, otherwise known as the time interval concept, refers to the practice of dividing the life of an entity into discrete periods for the purpose of preparing financial statements. The norm, as required by company law, is one year. Therefore, a user has the right to assume that the figures shown in a set of financial statements refer to a one-year period. When the period is different to one year, the financial statements need to make it clear that this is the case. Indeed, company law limits the ability of companies to change their accounting year-end date. Entities can of course elect to report for different time periods; however, to comply with law and the tax authorities they will also need to prepare financial statements every 12 months.

3.2.5 Historical Cost Concept/Fair Value

The historical cost concept allows a user to assume that all the transactions in an entity's financial statements reflect the actual cost price billed, or revenue charged, for items. In addition, it allows the reader to see the history of the management team's investment decision-making from the statement of financial position. This concept is becoming less relevant now as it is widely believed that historical cost information does not support financial statements in their aim of producing information that is useful for economic decision-making. In particular the impact of inflation means that many of items recorded at historic cost, do not reflect current value. Measuring items at fair value is deemed to provide more relevant information. Fair value is defined by the International Accounting Standards Board (IASB) as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in arm's length transaction.

3.2.6 Money Measurement Concept

The money measurement concept allows the user to assume that the performance and financial position of a reporting entity will be expressed in monetary amounts (usually in the currency of the country where the business is registered).

3.2.7 Duality Concept

The duality concept, otherwise known as the dual aspect concept or double entry, assumes that every transaction has two aspects. Every transaction affects two accounts in a set of financial statements in such a manner as to keep the accounting equation in balance (i.e. assets will always equal liabilities plus owners' capital).

3.2.8 Prudence Concept

The prudence concept, as the name implies, assumes that the financial statements have been prepared on a prudent basis. This allows the user to have confidence that no profits are included that are not earned and, if not yet received, are reasonably certain to be received. The user can also be confident that expenses are complete and are not understated, that assets are not overstated and liabilities are complete and are not understated. At one time this concept was deemed to be fundamental to the objective of financial statements (i.e. to provide relevant information to a wide range of users for economic decision-making). However, it was abused by some companies. When companies did well they tended to overstate expenses (by creating provisions for expenditure) and understate revenue. Then, in years when performance was not strong, the companies reversed the adjustments – reducing the provisions and the expenses in the year and increasing revenue. The result was that users could not quite work out how the company really performed. For this reason prudence was downgraded and provisions and manipulations that were based on the prudence concept are no longer allowed.

These transactions did not follow the spirit of this concept. They manipulated it for earnings management purposes. Earning management is where the preparers of financial statements use accounting adjustments to alter the reported performance of the reporting entity. They usually try to smooth profits, that is, to show steady profits. The concept still is applicable; however, it cannot be used as a defence for earnings management or earnings manipulation.

3.2.9 Substance Over Form Concept

This concept assumes that when accounting for transactions the preparer should look at the economic substance of a transaction, not its legal form. This was a reactive concept/standard that was introduced to try to stop the accounting practices that had emerged of creating complicated legal transactions which, because of their legal form, allowed transactions to be omitted from the financial statements. In particular, debts/ liabilities were arranged in such a manner as to enable them to be left off the statement of financial position. This would make the company look stronger, healthier and in general masked the real debt commitment that the entity had, from the users. This is no longer allowed. Regardless of the legal contract underlying a transaction, the preparer of the financial statements has to determine whether the transaction creates an asset or a liability as defined by the *Framework*. If the transaction does, then the preparer has to account for it as such.

3.2.10 Consistency Concept

The consistency concept allows the user to look at a set of financial statements over a number of years for an entity and to assume that the same methods, policies and estimation techniques have been used from year to year. This allows the user to compare the performance of the entity over time. Financial information should allow users to determine trends in the performance of an entity over time. If accounting policies, techniques and methods used were allowed to vary from year to year, this would make comparisons meaningless. Similarly, users should be able to look at the financial statements of several entities within the same industry and make informed comparisons in the performance and financial standing of each entity; relative to each other. If consistent accounting policies and practices are not adopted, this process would be very difficult. Consistency is one of the qualities that financial information should have, as detailed in the *Framework*.

3.2.11 Separate Determination Concept

This concept allows the user to look at the assets, liabilities, income and expenditure and to know that the reported figure is the total value for each of these elements. The entity should have a separate record of every asset held. The asset category in the financial statement should not be just a big bath that includes a whole host of untraceable past transactions. This concept also does not allow a company to net one element against another. This is important as netting can mislead users.

For example, if a company were able to net its debt against some assets so that less debt is shown in the statement of financial position, then the user would be unable to make a proper assessment of the entity's ability to pay back the debt as the user would assume the repayments required to clear it were less than they actually were.

4.0 CONCLUSION

The IASB's conceptual/theoretical *Framework* of accounting may be described as essentially being a set of accounting principles. These are said to comprise the objective of financial statements, the underlying assumptions of accounting (the concepts), the qualitative characteristics of financial information, the elements of financial statements, recognition in financial statements, measurement in financial statements and concepts of capital maintenance.

5.0 SUMMARY

In this unit, we have explained the nature of the going concern concept, the accruals concept, the matching concept, the entity concept, the materiality concept, the time period concept, the cost concept, the money measurement concept, the prudence concept, the duality concept, the substance over form concept, the consistency concept and the separate determination concept, including their implications for the preparation of financial statements;

6.0 TUTOR-MARKED ASSIGNMENT

In a paragraph each, explain the materiality, time period, historical cost, money measurement, duality, prudence, substance over form, consistency and the separate determination concept.

7.0 REFERENCES/FURTHER READINGS

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UNIT 4: THE ACCOUNTING EQUATION AND ITS COMPONENTS

CONTENTS

1.0 INTRODUCTION

In this unit we shall be considering the components of the accounting equation and how each component is affected when a transaction takes place.

2.0 OBJECTIVES

After reading this chapter you should be able to do the following:

- Explain the meaning of the key terms and concepts in the accounting equation.
- Explain the relevance of the accounting entity concept in financial accounting.
- Explain the nature of assets, liabilities and capital.
- Distinguish between revenue expenditure and capital expenditure, including their effects on the statement of financial position.

3.0 MAIN CONTENT

3.1 The Accounting Entity

The entity concept was introduced in the previous unit. Accounting for a reporting entity focuses on setting up a means of recording all accounting information in relation to that entity, as distinct from information that does not relate to the entity. The reporting entity may be, for example, a particular company, club or business partnership. We are used to hearing that a financial report relates to a specific organization, but now the organization is called an 'entity'. The use of the word 'entity' emphasizes the properties of being separate and discrete. Greater precision is demanded by accounting in deciding what is, and is not, part of the entity. Boundaries are created to separate out the accounting entity. Realizing that these boundaries are necessary, even though they may be artificial, is the key to the entity concept. It becomes possible to accept that a business may be separate from its sole proprietor.

Example: A trainee accountant is starting to prepare the financial statements for a sole proprietor who has a retail shop as his business. The following items appear in the list of cheques written by the businessman. The trainee accountant has been asked to state whether or not the items of expenditure below should be included in the financial statements of the retail shop.

1. Cheque paying the shop's rates.
2. Cheque paying the sole proprietor's house rates.
3. Cheque paying for new cash till.
4. Cheque paying for a new washing machine for the proprietor's wife's birthday.
5. Cheque for stationery (90 per cent is for the shop, 10 per cent is for his kids).
6. Cheque purchasing overalls for himself for cleaning the shop.
7. Cheque paying for a new outfit, which he can wear to work.

Required:
Complete a table detailing whether the items should enter the accounting system of the reporting entity or not.

		Yes	**No**
1.	Shop rates	√	
2.	House rates		√
3.	Till	√	
4.	Watching machine		√
5.	Stationery	√ (90%)	√ (100%)
6.	Overalls	√	
7.	New outfit		√

In sum, an accounting entity can be a legal entity, part of a legal entity, a combination of several legal entities, part of another accounting entity, or a combination of accounting entities.

The accounting/reporting entity concept is also sometimes referred to as the 'business entity' or simply the 'entity concept'.

3.2 The Statement of Financial Position as an Accounting Equation

An accounting entity may also be viewed as a set of assets and liabilities. Perhaps the most familiar form this takes is the *statement of financial position*. As an equation this would appear as follows:

Proprietor's *ownership interest* in the business = Net resources of the business
The ownership interest or claims are called owner's *equity* or owner's *capital*. The net resources are analyzed into assets and liabilities.

3.2.1 An *asset* can be defined as a tangible or intangible resource that is owned or controlled by an accounting entity, and which is expected to generate future economic benefits. Examples of assets include land and buildings, motor vehicles, plant and machinery, tools, office furniture, fixtures and fittings, office equipment, goods for resale (known as inventory), amounts owed to the accounting entity by its customers (i.e. trade receivables), money in a bank account, and cash in hand.

The use of the word 'net' to describe the resources possessed by the business recognizes that there are some amounts set against or to be deducted from the assets. There are two major types of such deduction*: liabilities and provisions*.

3.2.2 ***A liability*** can be defined as a legal obligation to transfer assets or provide services to another entity that arises from some past transaction or event. *Liabilities* represent claims by outsiders (compared to the owners, whose claims are equity or capital) and may include such items as loans made to the business and amounts owed for goods supplied (i.e. trade payables).

3.2.3 Provisions are amounts provided to allow for liabilities that are anticipated but not yet quantified precisely, or for reductions in asset values. Examples are bad debts and depreciation.

Given that liabilities can be regarded as being negative in relation to assets, the accounting equation can now be stated in the form:

Assets - Liabilities = Owners' capital

Or alternatively:

Assets = Owners' capital + Liabilities

This equation is based on what is sometimes referred to as the 'duality' or 'dual aspect concept’. This concept purports that every transaction has two aspects: one represented by an asset and the other a liability, or two changes in either the assets or the liabilities. For example, the purchase of an asset on credit will increase the assets and the liabilities by the same amount. The purchase of a vehicle for cash will increase the value of the vehicle asset but decrease the amount of the cash asset. These two aspects of each transaction are also reflected in the duality of double-entry bookkeeping.

The accounting equation is a fundamental equation and is a valuable basis from which to begin understanding the whole process of accounting. It sets out the financial position of the owners at any point in time, although in practice a complete and detailed statement of financial position may only be produced periodically, such as monthly or yearly. For now we will examine accounting simply in terms of statements of financial position. Let us trace how this approach reflects the setting-up of a plumbing business (see Example 1).

ILLUSTRATION

KEHINDE decided to start his business by opening a bank account for business transactions and depositing N200, 000 into it on 1 July 20X2: This transaction involves a flow of value from KEHINDE to his business and will affect two parts of the accounting equation: owner's capital and assets. Owner's capital will increase by N200, 000 as the business is now 'indebted to KEHINDE for the N200, 000 that he provided-to the business and cash at the business bank will have increased by N200, 000. There are several ways of presenting this. In practice companies usually adopt a vertical approach, placing capital vertically below net assets in the form:

KEHINDE (Plumber)	
Statement of financial position as at 1 July 20X2	
	N
Assets	
Cash at bank	200,000
Equity	
Owner's capital	200,000

However, a side-by-side or horizontal presentation may illustrate more clearly the accounting equation format.

KEHINDE (Plumber)
Statement of financial position as at 1 July 20X2

Assets	**N**	**Equity**	**N**
Cash at bank	200,000	Owner's capital	200,000

Following on from the example, if on 2 July 20X2 KEHINDE draws out N80,000cash and spends it all on purchasing tools, then cash at bank will be decreased by N80,000 and a new asset, tools, is introduced on the statement of financial position with a balance of N80,000.

KEHINDE (Plumber)
Statement of financial position as at 2 July 20X2

Assets	**N**	**Equity and liabilities**	**N**
Tools	80,000	Owner's capital	200,000
Cash at bank	120,000		
	200,000		200,000

In this case one asset is increased by exactly the same amount as another is decreased (N80,000), so that the accounting equation, assets equals capital plus liabilities, continues to balance.

Following on from the example, on 3 July KEHINDE buys a range of plumbing accessories for N30,000 from the local storekeeper, but arranges to pay in the next few days. The arrangement is described as 'on credit: The credit transaction with the storekeeper becomes a trade payable since he is now owes a debt of N30,000. There is no problem in maintaining the balance of the equation when including the effects of this transaction in the business statement of financial position, since the new liability of N30,000 owed to the store exactly complements the N30,000 increase in assets represented by the inventory of accessories:

KEHINDE (Plumber)
Statement of financial position as at 3 July 20X2

Assets	N	Equity and liabilities	N
Tools	80,000	Owner's capital	200,000
Inventory	30,000	**Liabilities**	
Cash at bank	120,000	Trade payable	30,000
	230,000		230,000

As mentioned, the horizontal approach adopted to portray the outcome of the last three transactions reflects the accounting equation (assets = liabilities + equity). However, in practice this is rarely utilized; therefore, the vertical approach is used throughout the remainder of this course material.

KEHINDE (Plumber)
Statement of financial position as at 4 July 20X2

		N
Assets		
Tools		80,000
Inventory		30,000
Cash at bank		90,000
		200,000
Equity and liabilities		
Owner's capital	200,000	200,000

3.3 The Accounting Period and Profit Reporting

The accounting period concept (sometimes called periodicity concept) is a means of dividing up the life of an accounting entity into discrete periods for the purpose of reporting performance for a period of time (in a statement of profit and loss) and showing its financial position at a point in time (in a statement of financial position). The period of time is usually one year and is often referred to as the accounting year, financial year or reporting period. Each accounting year of an entity's life normally ends on the anniversary of its formation, and therefore does not necessarily coincide with the calendar year. It could thus end on any day of the calendar year, but for convenience the accounting year is nearly always taken to be the end of a calendar month, and sometimes adjusted to the end of the calendar year or to the end of a particular month (e.g. for tax reasons). Some companies report on their financial position half-yearly or even quarterly. Thus, the accounting period can be less than one year.

3.4 Revenue Expenditure versus Capital Expenditure

The word 'capital' is associated with items that appear in the statement of financial position (e.g. owners' capital), whereas the word 'revenue' encapsulates items that appear in the statement of profit and loss (comprehensive income). Expenditure of the type that is to be matched against the period's revenue and is used up in the period is called revenue expenditure. Revenue expenditure will have no value at the end of the period to which it relates. Revenue expenditure is distinguished from capital expenditure - that which represents amounts which it is appropriate to carry forward as part of the next year's opening statement of financial position. Capital expenditure is carried forward because it will be used over a number of periods and contributes to several periods' revenues.

ILLUSTRATION

A trainee accountant who has been given the task of listing items of expenditure as being either capital or revenue expenditure approaches you for advice. She specifically wants to know whether the following expenditures (which relate to a builder's yard) should be classed as capital or revenue items:

1. rates charge for the year;
2. a new delivery van;
3. rent for the building;
4. sand that is not yet sold;
5. stationery;
6. telephone bills for the year;
7. a new telephone;
8. a new fence surrounding the yard (this is expected to reduce theft);
9. wages;
10. electricity bills;
11. timber in the yard that is not yet sold.

Required:

Complete a table detailing whether the items are capital or revenue in nature.

Solution

		Capital	Revenue
1.	Rates		√
2.	Delivery van (motor vehicle)	√	
3.	Rent		√
4.	Sand (inventory)	√	
5.	Stationery		√
6.	Telephone bill		√
7.	New telephone (office equipment)	√	
8.	Fence (fixtures and fittings)	√	
9.	Wages		√
10.	Electricity		√
11.	Timber (inventory)	√	

Capital expenditure typically includes the cost of purchasing a non-current asset (including the costs of getting the non-current asset operational at the begining) and the cost of improvements to a non- current asset that lead to increased revenue, or sustained revenue. Expenditure on tools, which represent the long-term equipment of the business, is capital expenditure and is carried forward from statement of financial position to statement of financial position. Rental expenditure on a building used during the year is revenue expenditure - what it provides is used up in the period. The purchase of the building, however, would be capital expenditure, as it is entirely appropriate to represent ownership being carried forward from period to period.

SELF ASSESSMENT EXERCISE

A trainee accountant who has been given the task of analysing items of expenditure in respect of the motor vehicles of the business in the year approaches you for advice. She specifically wants to know whether the following expenditures should be classed as capital or revenue items:

- repair of a lorry (the lorry is already included in the opening statement of financial position):
- purchase of a new truck;
- motor tax on the truck and lorry;
- cost of removing seats in the truck to create more room for transporting goods for the business;
- new tyres for the lorry;
- advertising painted on the side of both the lorry and the truck.

Required:

Complete a table detailing whether the items are capital or revenue in nature.

4.0 CONCLUSION

The accounting equation : Asset = Owner's equity + Liability is an explanation of the principle of double entry.

5.0 SUMMARY

In this unit we have discussed the accounting entity, the statement of financial position as an accounting equation, the accounting period and profit reporting, the difference between revenue expenditure and capital expenditure

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the relevance of the entity concept in accounting.
2. Define and distinguish between the following:
   a. assets and liabilities;
   b. capital and revenue expenditure.
3. State the accounting equation and explain its components.

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UNIT 5 : BASIC DOCUMENTATION AND PRIME BOOKS

CONTENTS

1.0 INTRODUCTION

No two businesses are exactly the same and the same can be said of the accounting systems used by firms. Most firms have their own particular ways of doing things. Some use manual record-keeping, others use off- the-shelf accounting software packages such as Grace, while others create their own accounting systems. However, there is a certain degree of similarity in keeping accounting records that is prevalent among the great majority of firms. This unit focuses on providing background information on the typical documentation and books of account that are used by most firms.

2.0 OBJECTIVES

After reading this chapter you should be able to do the following:

- Distinguish between cash transactions and credit transactions.
- Describe the nature of trade discount and cash discount.
- Give examples of source documents
- Explain the purpose of books of prime entry.
- List the books of prime entry and state what each is used to record.

3.0 MAIN CONTENT

3.1 Basic Documentation for Cash and Credit Transactions

In accounting, a cash transaction is one in which goods or services are paid for in cash or by cheque when they are received or delivered. A credit transaction is one where payment is made or received some time after delivery . This should not be confused with hire purchase or credit card transactions. Credit transactions are extremely common in many industries.
Credit transactions often involve trade discount.

3.1.1 Trade discount: This is a discount given by one trader to another. It is usually expressed as a percentage reduction of the recommended retail price of the goods, and is deducted in arriving at the amount the buyer is charged for the goods.

A large number of businesses also allow their customers cash discounts.

3.1.2 Cash discount: This is a reduction in the amount that the customer has to pay, provided payment is made within a given period stipulated by the seller at the time of sale (e.g. 5 per cent if paid within one week).
A cash transaction is recorded in the books of account from the receipt received if paid in cash, or from the cheque book stub if paid by cheque.

SELF-ASSESSMENT EXERCISE
Explain the difference between a cash transaction and a credit transaction.

3.2 Source documents
This is where original transaction information is to be found. Examples of source documents include the invoice, debit note, credit note, cheque and receipt.

3.2.1 The Invoice
The purpose of the invoice, which is sent by the seller, is primarily to inform the buyer how much is owed for the goods supplied. It is not demand for payment.
The information shown on an invoice typically consists of the following items:

- the name and address of the seller;
- the name and address of the buyer;
- the invoice and delivery note number of the seller (usually the same);
- the date of the invoice;
- the address to which the goods were delivered;
- the buyer's order number;
- the quantity of goods supplied;
- details/description of the goods supplied;

The buyer checks the invoice against the order and the delivery note (or more usually with a goods received note prepared by the receiving department). If correct, the invoice is then entered in the buyer's books. Similarly, a copy of the invoice would have been entered in the seller's books.

3.2.2 The debit note
A debit note is sent by the seller if the buyer has been undercharged on the invoice. It has basically the same layout and information as the invoice except that instead of details of the goods, it shows details of the undercharge. It is recorded in the books of the seller and buyer in the same way as an invoice.

3.2.3 The credit note
A credit note may be sent by the seller for a number of reasons. These include:

- The buyer has returned goods because they were not ordered, or they were the wrong type, quantity or quality, or are defective.
- The seller has overcharged the buyer on the invoice. This may be due to an error in the unit price or calculations.

A credit note has basically the same layout and information as an invoice, except that instead of the details of the goods, it will show the reason why it has been issued.

A credit note will be recorded in the books of the seller and buyer in a similar way as the invoice, except that the entries are the reverse. This document is called a credit note because it informs the buyer that the account in the books of the seller is being credited. Conversely, a debit note informs the buyer that the account in the seller's books is being debited.

3.2.4 The Cheque

This is the most common form of payment in business because of its convenience and safety. Most cheques are crossed and therefore have to be paid into a bank account. This makes it possible to trace the cheque if it is stolen and fraudulently passed on to someone else. A crossed cheque may be paid into anyone's bank account if the payee endorses (i.e. signs) the back of the cheque. However, if the words 'account payee only' are written between the crossings it must be paid into the account of the person named on the cheque.

The information that must be shown on a cheque consists of the following items:

- the date;
- the signature of the drawer (i.e. payer);
- the name of the drawee (i.e. the bank at which the drawer has the account);
- the name of the payee (i.e. who is to receive the money);
- the words 'Pay ..'. or 'Order the sum of ..;
- the amount of money in figures and in words.

The bank account number of the drawer, and the cheque and bank number are also shown on pre-printed cheques. Since there is only one copy of a cheque, it is essential to write on the cheque stub to whom the cheque was paid (i.e. the payee), the amount and what the payment was for. Without this information the books of account cannot be prepared..

3.2.5 The receipt

The law requires the seller to give the buyer a receipt for goods or services that have been paid for in cash. However, there is no legal requirement to do so in the case of payments by cheque.
A receipt must contain the following information:

- the name of the payer;
- the signature of the recipient;
- the amount of money in figures and in words;
- the date.

A receipt is only recorded in the books of account when it relates to cash receipts and payments.

SELF-ASSESSMENT EXERCISE

Give examples of source documents

3.3 Prime books

The main book of account in which all transactions are recorded is called the ledger (otherwise known as the general ledger, or the nominal ledger). However, before a transaction is recorded in the ledger, it must first be entered in a book of prime entry. These books are designed to show more detail relating to each transaction than appears in the ledger. They also facilitate making entries in the ledger, in that transactions of the same type can be posted periodically in total rather than one at a time. A business may make use of up to nine books of prime entry, which consist of the following:

3.3.1 The sales day book: records the sale on credit of goods bought specifically for resale. It is written up from copies of sales invoices and debit notes retained by the seller. The amount entered in the sales day book is after deducting trade discount (but before deducting cash discount).

3.3.2 The purchases day book: in which is recorded the purchase on credit of goods for resale. It is written up from the invoices and debit notes received from suppliers. The amount entered in the purchases day book is after deducting trade discount (but before deducting cash discount).

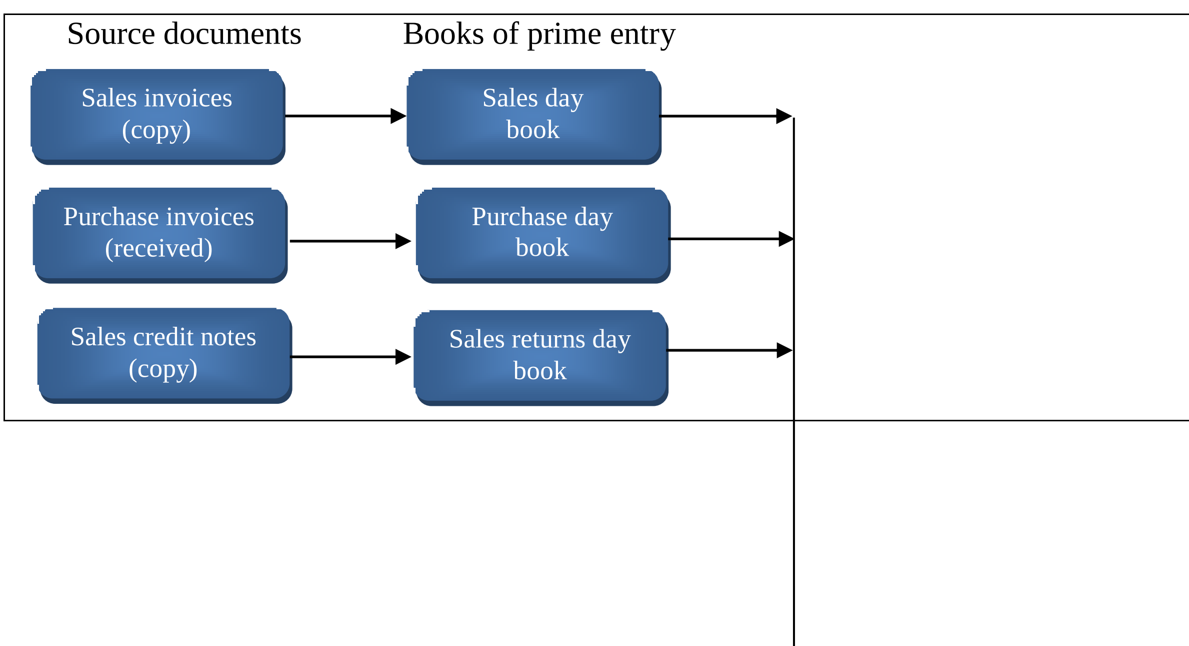
3.3.3 The sales returns day book: in which is recorded the goods sold on credit that are returned by customers. It is written up from copies of credit notes retained by the seller.

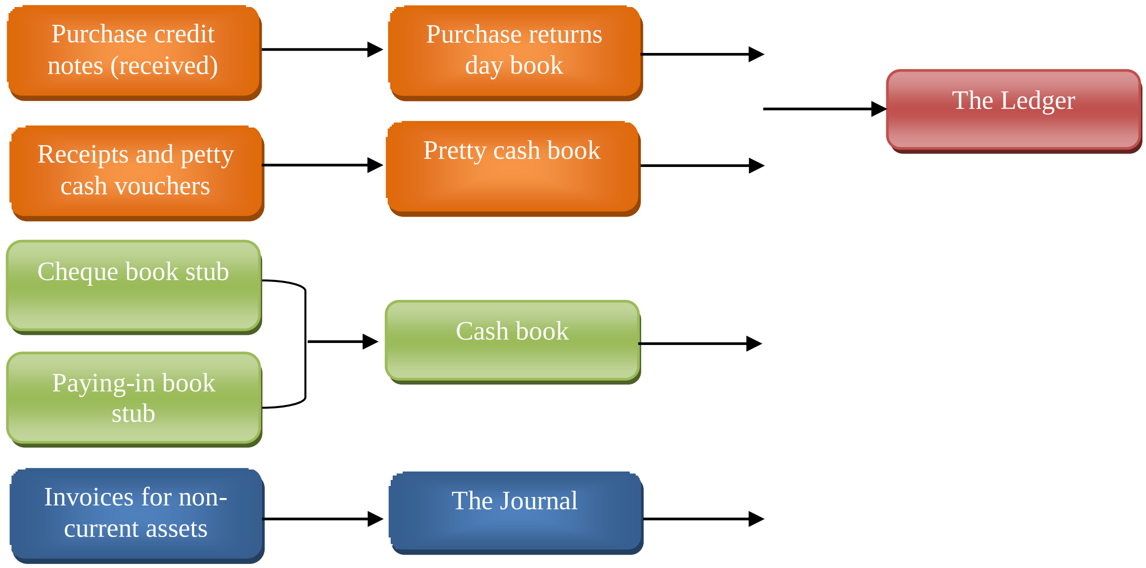
3.3.4 The purchases returns day book: in which is recorded the goods purchased on credit that are returned to suppliers. It is written up from the credit notes received from suppliers.

3.3.5 The petty cash book: in which is recorded cash received and cash paid. This is written up from receipts or petty cash vouchers where employees are reimbursed expenses.

3.3.6 The cash book: in which are recorded cheques received (and cash paid into the bank) and payments made by cheque (and cash withdrawn from the bank). This is written up from the bank paying-in book stub and cheque book stubs.

3.3.7 The Journal: in which are recorded any transactions that are not included in any of the other books of prime entry. At one time all entries passed through the journal, but now it is primarily used to record the purchase and sale of non-current assets on credit, the correction of errors, opening entries in a new set of books and any remaining transfers. Non-current assets are items not bought specifically for resale, such as land and buildings, machinery or vehicles. The journal is written up from copies of invoices and adjustments requested by the accountant.





Commonly used books of account and related source documents

Source: Thomas and Ward (2012)

4.0 CONCLUSION

In accounting a distinction is made between cash and credit transactions. A cash transaction is one where goods or services are paid for in cash or by cheque when they are received or delivered. A credit transaction is one where payment is made or received some time after delivery. Credit transactions often involve trade discounts and cash discounts.
receipts and payments are entered in a book of prime entry known as the 'petty cash book' Cheque receipts and payments are entered in the 'cash book:

Credit transactions involve a number of different documents, but those which are recorded in the books of account comprise invoices, debit notes and credit notes. These arise in connection with both purchases and sales, and are entered in a set of books of prime entry commonly known as 'day books'.

5.0 SUMMARY

In this unit we have discussed the accounting cycle making reference to the source documents, books of prime entry and the journal

6.0 TUTOR MARKED EXERCISE

1. You have just received a debit note for N10,000.
   a. What is a debit note?
   b. How should the N10,000 be accounted for?
2. List the four books of prime entry that are used to record inventory movements.
3. What do you have to do to a cheque to make it safe when sending it to a supplier using the postal system?

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UNIT 6 : PRIME BOOKS, GENERAL LEDGERS AND THE JOURNAL

CONTENTS

1.0 INTRODUCTION

Before a transaction is recorded in the general ledger, it must first be entered in a book of prime entry. These are intended to facilitate the posting of the general ledger, in that transactions of the same type are entered in the same book of prime entry, which is periodically posted to the general ledger in total (rather than one transaction at a time). These initial entries in the prime books do not form part of the double-entry bookkeeping.

There are several books of prime entry. This unit examines only those that are used to record credit transactions. These consist of: (1) the sales day book; (2) the purchases day book; (3) the sales returns day book; (4) the purchases returns day book; and (5) the journal. These prime books have been defined in unit 3. So, we shall be considering some illustrations.

2.0 OBJECTIVES

After reading this chapter you should be able to do the following:

- Describe the transactions and documents that are recorded in each of the prime books and the journal.
- Enter credit transactions in the appropriate day books or journal and post these to the relevant ledger accounts.

ILLUSTRATION 1

Big Dazzle is an electrical goods wholesaler. The transactions during June 20X3, which are all on credit, were as follows:

1 June Bought on credit from Power Ltd various bulbs with a retail price of N1,000,000 and received 20 per cent trade discount

4 June Sold goods on credit to Wire Reserves Ltd for N500,000 and allowed them 10 per cent trade discount on this amount

8 June	Sent Wire Reserves Ltd a credit note for goods returned that had a retail value of N300,000
10 June	Sold goods on credit to Wiggle Ltd for N600,000 after deducting 40 per cent trade discount
12 June	Purchased goods with a retail value of N1,000,000 from Switch Ltd who allowed 30 percent trade discount.
15June	Purchases on credit from Cables Ltd goods costing N550,000.
16 June	Sent Wiggle Ltd a credit note' for goods returned that had a retail value of N100,000.
18 June	Switch Ltd sent us a credit note for N300,000·in respect of goods returned
19 June	Received a credit note for goods returned to Power Ltd that had a retail value of N250,000
25 June	Sold goods to Grease Retails Ltd on credit for N250,000
27 June	Sent Grease Retails Ltd a credit note for N50,000 to rectify an overcharge on their invoice
28 June	Sold goods on credit to Wire Reserves Ltd at a price of N569,000.
29 June	Purchased on credit a motor van from Bobo Ltd that cost N800,000.
30 June	Sold on credit to Eko Trading Co. some fixtures and fittings no longer required in the shop for 350,000. (Prior. to this the business owned fixtures costing N1,000,000.)

Required

Make the necessary entries in the books of prime entry and general ledger.

Solution

Before starting to undertake double entry, the first step is to summarize the transactions in the day books. The first part of this solution deals with the transactions that do not impact on the journal.

3.1 Prime Books

Sales day book

Date	**Name of credit customer**	**Our invoice number**	**Folio**	**Amount**
20X3				**N'000**
4 June	Wire Reserves	100446	F34	450
10 June	Wiggle Ltd	100447	F8	600
25 June	Grease Retails Ltd	100448	F45	250
28 June	Wire Reserves	100449	F15	560
				1,860

Sales returns day book

Date	**Name of credit**	**Our credit**	**Folio**	**Amount**

	customer	note number		
20X3				**N'000**
8 June	Wire Reserves	CRN06	F34	270
16 June	Wiggle Ltd	CRN07	F8	60
27 June	Gross Retails	CRN08	F45	50
				380

Purchases day book

Date	**Name of credit customer**	**Our ref no for supplier's invoice**	**Folio**	**Amount**
20X3				**N'000**
1 June	Power Ltd	Inv460	T23	800
12 June	Switch Ltd	1000672	T5	700
15 June	Cables Ltd	S0056932	T10	550
				2,550

Purchase returns sales book

Date	**Name of credit suppliers**	**Our ref no for supplier's credit note**	**Folio**	**Amount**
20X3				**N'000**
18 June	Power Ltd	C00569	T5	300
19 June	Switch Ltd	SC452	T23	200
				500

3.2 Ledgers

The next step is to take the day books and to use them to enter the information into the main double-entry bookkeeping system (the general ledger, sales ledger and purchase ledger). These ledger accounts are shown in T account format.

The first two day books to be closed off and posted are those involving customers (sales day book and the sales return day book). Note the normal double-entry rules in respect of recording the flow of value are being applied.

General ledger entries

Sales account					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
			30 June	Total per sales day book	1,860

Sales returns account

20X3	Details	N'000	20X3	Details	N'000
30 June	Total per sales returns day book	380			

Sales ledger entries

Wire Reserves Ltd					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
4 June	Sales	450	8 June	Returns	270
28 June	Sales	560			
Wiggle Ltd					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
10 June	Sales	600	16 June	Returns	60

Grease Retails Ltd					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
25 June	Sales	250	27 June	Returns	50

Next, the two day books involving suppliers (purchases day book and the purchases return day book) are closed and posted.

General ledger entries

Purchase account					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
30June	Total purchases day book	2,050			

Purchase returns account					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
			30 June	Total per purchases returns day book	500

Purchase ledger entries					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
19 June	Returns	**200**	1 June	Purchases	800

Light Ltd					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
18 June	Returns	**300**	12 June	Purchases	700

Purchase account					
20X3	**Details**	**N'000**	**20X3**	**Details**	**N'000**
			15 June	Purchases	550

3.3 The Journal

The entries required to post the motor van on credit and the sale of fixtures and fittings are first recorded in the journal before they enter the general ledger bookkeeping system as follows:

Date	Details (account in which the ledger entry is to be made)	Folio	Debit Amount N’000	Credit amount N’000
20X3				
29 June	Motor vehicles	Dr	800	
	To Bobo Ltd	Cr		800
	Being purchase on credit of motor van reg no LAG 12			
29 June	Eko Trading Co	Dr	350	
	To fixtures and fittings	Cr		350
	Being sale on credit of shop fittings.			

Second, the journal is taken and its entries are posted to the individual ledger accounts in the general ledger as follows:

General ledger entries

Motor vehicles account

20X3	Details	N’000	20X3	Details	N’000
29 June	Bobo Ltd	800			

Bobo Ltd account (sundry payable)

20X3	Details	N’000	20X3	Details	N’000
			29 June	Motor vehicles	800

Fixtures and fittings account

20X3	Details	N’000	20X3	Details	N’000
1 June	Balance b/d	1,000	30 June	Eko Trading Co	350
			30 June	Balance c/d	650
		1,000			1,000
1 July	Balance b/d	650			

Eko Trading Co account (sundry receivable)

20X3	Details	N’000	20X3	Details	N’000
30 June	Fixtures and fittings	350			

Notes

1. The fixtures and fittings that were sold must obviously have already been owned by the business. Their cost is therefore included in the balance brought down on the debit side of the fixtures and fittings account along with the cost of other fixtures and fittings owned at that date.

2. The Eko Trading Co. is referred to as a sundry receivable and Bobo Ltd as a sundry payable.

SELF ASSESSMENT EXERCISE

Where possible, approach a local business or a family member who works in the administration function of a business and ask them about the books of account of the business. Ask them to explain the transactions that they record in each type of book. Different names to those used in this chapter may exist, however, they will typically perform the same function.

4.0 CONCLUSION

Before a transaction is recorded in the ledger, it must first be entered in a book of prime entry. These are intended to facilitate the posting of the general ledger, in that transactions of the same type are entered in the same book of prime entry, the totals of which are periodically posted to the general ledger rather than one transaction at a time.

Credit transactions not relating to goods for resale (or services), such as the purchase and sale of non- current assets, are recorded in another book of prime entry known as the 'journal. This is also used to record transactions that are not appropriate to any other book of prime entry, and various accounting adjustments that are not the subject of a transaction such as the correction of errors. The format of the journal includes a details column and two money columns labelled 'debit' and 'credit: The narrative in the details column and amounts in the money columns indicate the entries that will be made in the ledger in respect of a given transaction or item.

5.0 SUMMARY

In this unit we have considered how credit transactions pass through the prime books before postings are made to the ledgers using the double entry bookkeeping rules. We also considered the use of the journals for transactions that do not involve the use of prime books

6.0 TUTOR MARKED ASSIGNMENT

1. B. Jeje is in business as a builders' merchant. The following credit transactions took place during April 20X3:

1 Apr	Bought goods on credit from Bibi Ltd for N725,000
2 Apr	Sold goods on credit to Pool Ltd for N410,000
4 Apr	Bought goods costing N315,000 from Board Ltd on credit
7 Apr	Sold goods on credit to Bunch Ltd for N870,000
11 Apr	Bought goods costing N250,000 from Grace Ltd on credit
15 Apr	Sold goods to Lemon Ltd for N630,000 on credit
17 Apr	Bought goods on credit from Bibi Ltd for N290,000

19 Apr	Received a credit note for N120,000 from Bibi Ltd
22 Apr	Sent Pool Ltd a credit note for N220,000
24 Apr	Board Ltd sent us a credit note for N75,000 in respect of goods returned
27 Apr	Sent Bunch Ltd a credit note for N360,000
28 Apr	Bought a delivery truck on credit from Coscharis motors for N5,000,000.

Required:

You are required to make the necessary entries in the books of prime entry and the general ledger.

7.0 REFERENCES/FURTHER READINGS

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UNIT 7: INVENTORY VALUATION

CONTENTS

1.0 INTRODUCTION

Merchandising organisations have goods they sell in order to generate revenue and ultimately profit. It is naturally inappropriate for these entities to wait for customers to demand their products before the order for inventory, otherwise, the attendant delays will lead to potential loss of customers arising from customers' dissatisfaction. In order to avoid this negative eventuality, entities usually hold inventory as a buffer prior to when customers demand for them. However, the need to place a value on the unsold inventories at the end of the year and the cost of those sold in order to know the portion of the relevant cost to charge against revenue and the one to carry forward as an asset in the financial positionis usually not that simple. This Unit therefore examines the nature of inventory, the methods of valuing inventory and the effects of inventory valueson profit and asset.

2.0 OBJECTIVES

After studying this Unit, the student should be able to:

- define what inventory is and identify when assets can be regarded as inventories;
- explain the nature of periodic inventory model or system;
- identify and compute the common methods of valuing inventory;
- describe the effects of inventory on the profit or loss and financial position.

3.0 MAIN CONTENT

3.1 Inventory and Simple Inventory Valuation

3.2 Meaning and Nature of Inventory

Inventories are generally referred to as the unsold portion of goods held for resale. What constitutes inventories depends on the nature of the business of an entity. Purchases give rise to inventories when the goods purchased are not fully sold in the period. However, non-current assets such as motor vehicle, plant and equipment, land and building, for example, might equally be regarded as purchases and ultimately inventories by firms that deal on buying and selling them. For example, estate developer will regard buildings acquired for the purpose of resale as purchases and ultimately inventories if not sold in the particular accounting period. Students should not be confused about this. What constitutes a non-current asset to a firm depends on what it does with that asset. This is also true of purchases as what constitutes purchases is a function of the nature of the business of an entity or simply what the entity does with the particular assets. There are three basic types of inventories namely, raw materials, work-in-progress (or semi-finished goods) and finished goods. Whereas a manufacturing firm will obviously have these three types of inventories, a merchandising firm (i.e., a firm that buys and sells) which does not engage in manufacturing will only have finished goods inventories.

A major concern to entities in respect of inventory involves the value to be placed on the inventory at the end of the accounting year or at such time when a physical count of inventory is taken, which will also have implications for the amount to be allocated to cost of sales in that period. For the purpose of inventory valuation, a periodic or perpetual/continuous inventory valuation could be applied. We shall discuss periodic inventory in this Unit and defer perpetual inventory model to Unit 13. A periodic inventory valuation occurs where an entity takes inventory count and determines the value at the end of the accounting year as a basis for preparing the financial statement. The entity using periodic inventory model will be unable to determine the value of its closing inventory and cost of sales until stock-taking is done at the end of the financial year or at such time when inventory count is undertaken.

3.3 Methods of Inventory valuation

Generally, inventories are valued at lower of cost and net realisable or fair value. However, the value/cost is only ascertained after applying a particular method of valuation. It is worth mentioning here that different valuation methods yield different values of inventory and ultimately cost of sales. An entity's accounting policy (see Unit 15) determines the method the entity would adopt for valuing its inventory. The common methods of valuing inventory are: First In First Out (FIFO), Last In First Out (LIFO), Average (simple and weighted) and standard cost. We shall now discuss them in turn.

3.3.1 First In First Out (FIFO)

The underlying assumption of this method of valuing inventory is that earlier purchases of goods for resale are considered sold prior to subsequent purchases. This means that if an entity has three batches of purchases in a period: A = 300 units (at ₦10 each), B = 500 (at ₦11) and C = 600 (at ₦15), what would be the value of closing inventory and cost of sales if 1,000 units were sold in the period.

Units of closing inventory = Total units purchased less units sold

Inventory = 1,400 – 1,000 = 400.

The order of sales following the FIFO assumption would be: Batch A, followed by Batch B and then Batch C. So the closing inventory of 400 units would come from Batch C. The value of the closing stock would then be ₦6,000 (i.e., 400 units x ₦15). By implication, cost of sales would be determined as follows:

(300 x ₦10) + (500 x ₦11) + (200 x ₦15)

₦3,000 + ₦5,500 + ₦3,000 = ₦11,500.

3.3.2 Last In First Out (LIFO)

The assumption is that the last batches of goods are considered to be sold first prior to earlier purchases. This means that later batches are assumed to be sold before earlier ones. Using our FIFO data above, LIFO will produce the following values of closing inventory and cost of sales:

Closing inventory = (300 x ₦10) + (100 x ₦11)

₦3,000 + ₦1,100 = ₦4,100

Cost of sales = (600 x ₦15) + (400 x ₦11)

₦9,000 + ₦4,400 = ₦13,400

3.3.3 Simple Average Method (SAM)

This applies a simple average of the unit costs/prices to the goods sold to determine the cost of goods sold and average of the unit costs to the units of closing inventory to get the value of closing inventory. If we use our example above, the values of closing inventory and cost of sales would be as follows:

First, we compute the average price, which is the aggregate of the prices of the three batches divided by 3.

$$\text{Average price} = \frac{₦10 + ₦11 + ₦15}{3}$$

$$\frac{₦36}{3} = ₦12$$

Closing inventory = 400 x ₦12 = ₦4,800

Cost of sales = 1,000 x ₦12 = ₦12,000

Because the average computation ignores the units purchased that would eventually absorb the average price as inventory and cost of sales, the total of the computed cost of sales and inventory is not equal to the total cost of purchasing the three batches. We learnt from FIFO and LIFO examples above that the total cost of purchases (inventory and cost of sales) is ₦17,500 but the simple average produced a different result because of the averaging of the prices independent of the corresponding units purchased.

3.3.4Weighted Average Method (WAM)

Unlike the simple average method that ignores the units of goods purchased in determining the average cost, this method uses the weighting of the unit prices of all the batches purchased before dividing by the total units purchased. The average cost then becomes the unit cost for computing both the values of cost of sales and closing inventory. Using our example above, the value of inventory and cost of sales would be as follows:

$$\text{Weighted average} = \frac{(300 \, x \, ₦10) + (500 \, x \, ₦11) + (600 \, x \, ₦15)}{300 + 500 + 600}$$

$$= \frac{₦3{,}000 + ₦5{,}500 + ₦9{,}000}{1{,}400}$$

$$= \frac{₦17{,}500}{1{,}400} = ₦12.50$$

Therefore, the value of closing inventory and cost of sales are:

Closing inventory = 400 units x ₦12.50 = ₦5,000

Cost of sales = 1,000 units x ₦12.50 = ₦12,500

3.3.5 Standard cost

This method uses a predetermined rate set by the entity's management for the purpose of calculating the cost of sales and inventory. While this method is easy and convenient to apply, it does not utilise actual cost used in purchasing the batches of goods. However, the entity does not set the standard cost per unit arbitrarily but probably based on experience and other prevailing circumstances. Following our previous example, if we assume that the management sets a standard cost of ₦13.50/unit, the closing inventory and cost of sales would respectively be: ₦5,400 (400 units x ₦13.50) and ₦13,500 (1,000 units x ₦13.50).

3.4 Inventory and Its Effect on Profit and Financial Position

The value of inventory will equally affect the reported profit and the value of current asset. The higher the value placed on the closing inventory, the higher the profit of the period would be. Remember that closing inventory is deducted from the cost of goods available for sale to get the cost of sales, which is invariably similar to adding it to sales. Closing inventory also affects the value of current assets: the higher the closing inventory the higher the value of current assets.

Nevertheless, after valuing inventory using any of the inventory valuation methods and the entity compares that value with a potential market value the inventory would sell for, the lower of the cost-based value and net realisable value would be used as the value of closing inventory for the purpose of computing profit in the statement of comprehensive income and current asset in the statement of financial position. After making this comparison, the estimated loss in value is charged as an expense to the profit or loss for the year.

3.5 Illustrative Examples

Example 1

From the information below relating to five business entities, determine the (i) basis of valuing the inventory (cost or net realisable value) at the end of the year (ii) value of closing inventory that would appear in their financial statements, and (iii) amount to be written off to profit or loss as inventory loss and how this will be treated in the ledger account.

Entities	**Inventory at Cost** **₦**	**Inventory at NRV** **₦**
Chip-Chip Enterprises	561,000	673,400
Omede Shop	675,000	526,700
Akin Carpet	988,000	1,060,000
Adamu Merchandising	350,000	344,100
Bisi Toiletries	674,300	550,000

Example 2

Adesuwa Toy Shop orders and sells toys at Ikoyi High Street in Lagos. On 1st January, the Shop had 800 units of toys which were purchased at N100 each. During the year, Adesuwa Toy Shop made four batches of purchases of toys as follows:

Batches	**Units**	**Unit price**	**Total cost**

		₦	₦
February	1,000	105	105,000
May	1,200	110	132,000
September	1,300	120	156,000
November	1,600	122	195,200

The Shop sold 4,700 units during the year.

Required:

(a) Compute the quantity of closing inventory

(b) Compute the cost of sales and closing inventory using the following methods: (i) FIFO (ii) LIFO (iii) SAM, and (iv) WAM

(c) Determine the value of closing inventory if the net realisable value of inventory held at the end of the year is: (i) N95 (ii) N112

SOLUTION

Solution to Example 1

The important thing the student should note here is that inventory is recognised in the financial statements at lower of cost and net realisable value. If the cost is less than the NRV, the value to be recognised in the financial statements will be cost; if NRV is less than the cost, then the NRV will be the recognisable value of inventory in the financial statements. However, when the cost is greater than the NRV (i.e., NRV less than cost), a potential loss occurs and that loss has to be charged to the profit or loss for the year.

Entities	**Inventory at Cost** **₦** **(A)**	**Inventory at NRV** **₦**	**Basis of valuation**	**Closing inventory** **₦** **(B)**	**Inventory loss** **₦** **(A - B)**
Chip-Chip Enterprises	561,000	673,400	Cost	561,000	Nil
Omede Shop	675,000	526,700	NRV	526,700	148,300
Akin Carpet	988,000	1,060,000	Cost	988,000	Nil
Adamu Merchandising	350,000	344,100	NRV	344,100	5,900
Bisi Toiletries	674,300	550,000	NRV	550,000	124,300

The treatment of the losses in the ledger accounts are as follows:

Generally, the accounting entries for the inventory loss in value are: Dr Profit or loss and Cr Inventory.

Omede Shop

Inventory A/c

	₦		₦
		Profit or Loss	148,300

Bal. b/f	675,000	Bal. c/f	526,700
	675,000		675,000
Bal. b/f	526,700		

Adamu Merchandising

Inventory A/c

	₦		₦
		Profit or Loss	5,900
Bal. b/f	350,000	Bal. c/f	344,100
	350,000		350,000
Bal.b/f	344,100		

Bisi Toiletries

Inventory A/c

	₦		₦
		Profit or Loss	124,300
Bal. b/f	674,300	Bal. c/f	550,000
	674,300		674,300
Bal. b/f	550,000		

Solution to Example 2

(a)

Computation of quantity of closing inventory

Batches

Opening	800
February	1,000
May	1,200
September	1,300
December	1,600
Goods available for sale	5,900
Less: Goods sold	(4,700)
Units of closing inventory	1,200

(a) i

FIFO

Computation of Cost of sales

Batches	**Units Purchased**	**Units sold from batch**	**Unit price** **₦**	**Cost of sales** **₦**
Opening	800	800	100	80,000

February	1,000	1,000	105	105,000
May	1,200	1,200	110	132,000
September	1,300	1,300	120	156,000
November	1,600	400	122	48,800
TOTAL		**4,700**		**521,800**

Computation of Cost of Closing Inventory (FIFO)

Since the first batches are deemed to be sold first, it means that the closing inventory of 1,200 units will come from the November batch.

Value of closing inventory = 1,200 x N122 = **N146,400**

*NB: If you were to compute the cost of goods available for sale, that would simply be the value of the closing inventory plus the cost of sales and this will give us N668,200.

(b)ii

LIFO

Computation of Cost of sales

Batches	**Units Purchased**	**Units sold from batch**	**Unit price** **₦**	**Cost of sales** **₦**
Opening	800	0	100	0
February	1,000	600	105	63,000
May	1,200	1,200	110	132,000
September	1,300	1,300	120	156,000
November	1,600	1,600	122	195,200
TOTAL		**4,700**		**546,200**

Computation of Cost of Closing Inventory (LIFO)

Since the first batches are deemed to be sold last, it means that the closing inventory of 1,200 units will come from the opening and February batches.

Value of closing inventory = Opening batch 800 units x N100 = N80,000

February batch 400 units x N105 = N42,000

Closing inventory cost	**N122,000**

(b)iii

Simple Average Method (SAM)

Computation of Cost of sales and Closing Inventory

Batches	**Unit price** **₦**
Opening	100
February	105
May	110
September	120
November	122
TOTAL	**557**

Average Cost $= \frac{\text{Total unit price}}{\text{Number of batches}}$, where the number of batches is 5 (i.e, Opening, February, May, September, November)

$= \frac{₦557}{5}$ = ₦111.40

Cost of sales = 4,700 units x ₦111.40 = **₦523,580**

Value of closing inventory = 1,200 x ₦111.40 = **₦133,680**

(b) iv

(Periodic) Weighted Average Method (WAM)

Computation of Cost of sales and Closing Inventory

Batches	**Units purchased**	**Unit price** **₦**	**Weighted cost** **₦**
Opening	800	100	80,000
February	1,000	105	105,000
May	1,200	110	132,000
September	1,300	120	156,000
November	1,600	122	195,200
TOTAL	**5,900**		**668,200**

Weighted Average Cost = $\frac{Weighted\ Cost}{Total\ Units\ Purchased\ \ or\ Available\ \ for\ Sale}$

= $\frac{₦668,200}{5,900}$ = ₦113.25 (approximated/rounded to 2 decimal places)

Cost of sales = 4,700 units x ₦113.25 = ₦532,275

Value of closing inventory = 1,200 x ₦113.25 = ₦135,900

(c)

Determination of value of closing inventory @ N95 NRV

Method of Valuation	**Units of Inventory**	**Cost**	**NRV @ ₦95/unit**	**Inventory Value ₦**
FIFO	1,200	146,400	114,000	114,000
LIFO	1,200	122,000	114,000	114,000
SAM	1,200	133,680	114,000	114,000
WAW	1,200	135,900	114,000	114,000

Determination of value of closing inventory @ N112 NRV

Method of Valuation	**Units of Inventory**	**Cost**	**NRV @ ₦112/unit**	**Inventory Value ₦**
FIFO	1,200	146,400	134,400	134,400
LIFO	1,200	122,000	134,400	122,000
SAM	1,200	133,680	134,400	133,680
WAW	1,200	135,900	134,400	134,400

4.0 CONCLUSION

We have examined inventory and its valuation and how it affects the cost of sales and reported profit.

5.0 SUMMARY

In this Unit we studied the nature of inventory and the different inventory valuation methods such as FIFO, LIFO, SAM, WAM, and standard cost. Moreover, this Unit equally looked at how inventory valuation methods affect the cost of sales and profit as well as the carrying value of closing inventory in the statement of financial position.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain what you understand by periodic inventory system.
2. What is the rationale for applying the notion of lower of cost or net realisable value? What accounting concept do you think underpins this rule?
3. The following data for the month of January relate to the records of Mimido Enterprises which deals on 'I love mummy' branded baby nappies. On 1st January, the shop had 800 units of nappies which were purchased at N10 each:

Dates	**Units Purchased**	**Units Sold**	**Purchase price/unit ₦**	**Sales price/unit ₦**
Jan. 3	1,000		10.50	
Jan. 5		1,200		25

Jan. 10	500		11	
Jan. 12	800		12	
Jan. 15		1,600		29
Jan. 20	1,000		12.75	
Jan. 25		600		30
Jan. 29	400		12.45	

Required:

a. Compute the cost of sales and closing inventory following the periodic inventory model assumption: (i) FIFO (ii) LIFO (iii) SAM, and (iv) WAM

b. If the firm's pre-determined unit price of valuing inventory is N12.65, compute the cost of sales and closing inventory for the month.

4. The following costs and net realisable valueswere drawn from the books of Apo Paints Merchants which deals on five product lines of paints:

Product Line	**Inventory at Cost** **₦**	**Inventory at NRV** **₦**
Chiplex	800,000	873,400
Delux	675,000	582,700
Dumaplux	988,000	982,000

Sweetex	380,000	404,100
Lunaplex	645,300	650,000

Required:

(i) Identify the basis of valuing the inventory of each product line for the period (Hints: state whether it is cost or net realisable value)

(ii) Determine the value of closing inventory of each of the product lines asit would appear in the financial statements and the total inventory value that would appear in the financial statements.

(iii) Determine the amount to be written off to profit or loss as inventory loss and how this will be treated in the ledger account.

7.0 REFERENCES/FURTHER READING

Hindmarch, A. and Simpson, M. (1991): Financial Accounting: an introduction, London: Macmillan

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UNIT 8: TRIAL BALANCE

CONTENTS

1.0 INTRODUCTION

The trial balance helps to ascertain the arithmetical accuracy of all the postings made. In this unit, we will be looking at the uses of the trial balance, errors affecting the trial balance and errors that does not affect the trial balance.

2.0 OBJECTIVES

After studying this unit, you should be able to;

- explain the uses of trial balance
- describe the purpose of trial balance
- determine the errors affecting the trial balance
- identify errors not affecting the trial balance

3.0 MAIN CONTENT

3.1 Definition of Trial Balance

A trial balance is a list of ledger account balances within a ledger, at a particular instance. If we balance all the ledger accounts at a particular instance and then prepare a statement of balances we get the "Trial Balance".

3.2 Uses of Trial Balance

The first step in the preparation of the final accounts is the compilation of a Trial Balance, with a view to:

(a) Proving the arithmetical accuracy of the postings, and

(b) Providing in one statement a concise summary of the items, which are to be included in the comprehensive Income statement and the Statement of financial position. Debit balances recorded in the trial balance normally represent either assets, or losses and expenses. The assets are entered in the Statement of financial position, while losses and expenses are debited to the

Income statement. Likewise, the credit balances represent liabilities, provisions, reserves, or revenues and gains. The liabilities are entered in the statement of financial position as deductions from assets of the firm, while income and gains are credited to the Income statement.

3.3 Purpose of a trial balance

A trial balance is prepared to check the mathematical/arithmetic accuracy of postings. This is the only (main) purpose of the "Trial Balance". Since it is anyhow prepared for a purpose, it is put to some other uses like for the preparation of final accounts.

3.4 Format of a Trial Balance

The most common format in which we find a trial balance is as below.

Trial Balance of MYZ _____ as on _____

Particulars	L/F	Debit Amount (in Naira)	Credit Amount (in Naira)
Account Head 1 Account Head 2 Account Head 3	— — — —	– – –	– – –
Total		Xxxx	Xxxx

Illustration 1

On 1 April 2012, K. Obinna sets up a business with a capital of ₦150,000, made up of Plant and Machinery ₦100,000, Furniture and Fittings ₦20,000 and the rest in cash which he banked, except ₦2,500. The following transactions were recorded during the month:

April 2 Bought goods for resale on credit from R. Samson, valued ₦5,650

April 5 Paid rates ₦1,500, electricity GHC350, all by cheque

April 9 Bought materials for use in making up goods for resale, by cheque ₦12,500

April 15 Sold in cash ₦ 4,800, Sold on credit to K. Michael ₦1,500.

April 17 Paid for postage ₦550 cash, travelling expenses ₦420 cash, and

bought goods for resale, ₦ 27,500 on credit from R. Jones.

April 28 Sent invoice to B. Morison for goods sold to him on credit ₦5,000.

Receives invoice from D. Mowe for goods supplied by him for resale ₦4,500.

You are required to:

Open necessary accounts, record the transactions and extract a Trial Balance on 30 April 2012.

SELF ASSESSMENT EXERCISE

1. What is a Trial balance?

3.5 Correction of Errors

Due to the imperfection of human beings, it is inevitable that errors made in recording transactions would exist in the accounting records. Errors cannot be eliminated completely; they can only be reduced to the barest minimum by, among other measures, engaging the services of well trained personnel to maintain accounting records.

3.6 Types of Errors

Errors are of two kinds:

- Those that do not affect the trial balance
- Those that affect the trial balance

3.6.1 Errors not affecting the Trial balance

Despite the existence of these errors, the trial balance still balances i.e. the debit and credit sides are the same. These errors are not easily identifiable.

3.6.1.1 Error of Original Entry `

This error occurs when a transaction is recorded with the wrong amount at the beginning of the recording process i.e errors that are made when the source document is being raised or when the source document is being posted to the appropriate subsidiary book.

3.6.1.2 Error of Omission

This is an error involving failure to post a transaction into the accounts i.e. no debit entry, no credit entry.

3.6.1.3 Error of Principle

This is an error whereby a transaction is posted to the wrong class of accounts. For example, the cost of an office air-conditioner may be wrongly debited to office expense account (an account belonging to the class of nominal accounts) instead of the office equipment account (an account belonging to the class of real accounts).

3.6.1.4 Error of Commission

This is an error involving the posting of a transaction of the correct class of accounts but the wrong account within that class. This could also happen where a correct figure is recorded in the correct side of a wrong person's account. This type of error takes place where the bookkeeper is not used to the names of customers that are common in the locality.

3.6.1.5 Error of complete reversal of entry

This is an error involving the complete reversal of the normal double-entry for a transaction. For example, the payment by cheque for stationery may be wrongly debited to bank account and credited to stationery account. The trial balance will still balance because the debit and credit sides have been affected with the same amount.

3.6.1.6 Compensating Errors

This is a situation in which errors cancel each other out. For example, the erroneous adding up of the debit side of cash book by, say ₦20,000 would be cancelled out if, later taken from sales day book and credited to sales account is understated by ₦20,000.

3.6.2 Errors affecting Trial Balance

These are errors the existence of which would cause the Trial balance not to agree. They consist of the following:

3.6.2.1 Casting Error

This is an error involving wrong addition of figures.

3.6.2.2 Error of partial reversal of entry

This is an error involving reversal of one leg of the double-entry for a transaction.

3.6.2.3 Omission or misstatement of account balance

This is the omission or misstatement of account(s)' balances while drawing up a Trial balance.

3.6.2.4 Posting only one side of a transaction

This is an error whereby one aspect of the double-entry for a transaction is posted without posting the corresponding opposite entry.

3.7 Suspense Account

When a trial balance does not balance and there is no time or it is inconvenient to immediately locate and correct the errors because the final accounts are urgently required, the Trial balance can be made to balance by inserting the balance figure and describing it as Suspense account.

4.0 CONCLUSION

The trial balance contains the list of balances from the ledger and it provides the platform for the preparation of the final accounts.

5.0 SUMMARY

In this unit, we looked at the meaning of trial balance, the uses of trial balance and the errors that affect and do not affect the trial balance.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the errors that affect the trial balance

2. State the uses of Trial Balance

3. What are the errors that do not affect the trial balance?

4. Define the suspense account.

7.0 REFERENCES/FURTHER READING

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UNIT 9: FINAL ACCOUNTS OF A SOLE TRADER 1: STATEMENT OF PROFIT OR LOSS

CONTENTS

1.0 INTRODUCTION

The preparations of accounting records from the subsidiary books of accounts, to the ledger and the extraction of trial balance are the processes involved in the preparation of final accounts. The final accounts are the end points of books of accounts which are used to determine the income, profit, loss, assets and liabilities of a business concern. The final accounts of a sole trader consist of statement of profit or loss and statement of financial position. However, the statement of profit or loss for traders who deals in the buying and selling of goods are discussed in this unit while their statement of financial position is considered in the next unit.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- i Define final accounts
- ii. Understand the components of final accounts
- iii. Prepare statement of profit or loss for a sole trader
- iv. Discuss the importance of final accounts

3.0 MAIN CONTENT

3.1 STATEMENT OF PROFIT OR LOSS

The final accounts represent the presentation of financial information for a particular period or year to the users of financial report. The final accounts of a sole trader basically consist of statement of profit or loss and statement of financial position. Our focus in this study unit is the statement of profit or loss without end of year adjustment.

The preparation of statement of profit or loss will enable the business owner to ascertain the profit or loss from the business for a particular period, month or year. Statement of profit or loss is technically divided into two sections to show the gross profit or loss and the net profit or loss for a particular period.

3.2 DEFINITION OF TECHNICAL TERMS

Let us look at some basic words that will come up regularly under the final accounts of a sole trader in this unit and the next two units namely units 18 and 19.

3.2.1 Sales

Sales represent total of all credit and cash sales made to a third party. This excludes good taken by the owner for personal use and sales of non-current assets.

3.2.2 Returns Inwards

They are goods previously sold to customers but were later returned either in whole or in part probably as a result of:

i. Wrong specification, model, colour etc.
ii. Deficiency
iii. Disagreement between the buyer and seller that can be traced to either pricing, discount, payment terms etc.
iv. Shortage in quantity, weight and other measuring discrepancies.
v. Government policy.

The total amount of returns inwards will be deducted from sales value.

3.2.3 Opening Stocks

These are the value of stock of goods meant for sale that are available with the business at the beginning of the accounting year or period.

3.2.4 Purchases

Purchases represent total value of goods that are bought for cash and on credit for resale. This does not include the purchases of non-current assets.

3.2.5 Carriage Inward

This represents the cost of transporting goods meant for resale into the organisation. Carriage inward is added to purchases because it is an additional cost incurred as goods are bough for resale by the business which enables the goods to get to where buyers can come for them.

3.2.6 Returns Outwards

These are goods previously bought for resale but later returned to the supplier due to one reason or the other such as late delivery and wrong specification. The total value of returns outwards should be deducted from the purchases of the same accounting period.

3.2.7 Closing Stocks

The closing stocks represent the value of stock of goods that are meant for sale which a business has at the end of the accounting year or a stated period or date.

3.2.8 Cost of Goods Sold

This is the cost price of goods sold for a particular period and it can be derived in a simple way by adding the purchases to opening stock then deducting the closing stock. There could be other things that will form part of the cost of goods sold like purchase return, carriage inward, goods withdrawn by the owner, etc., depending on the question. Cost of goods sold is also referred to as cost of sales.

3.2.9 Gross Profit

This is the profit realised on trading activities alone without other expenses incurred in the business. It is derived by deducting cost of goods sold from the sales value.

3.2.10 Other Income

They are revenues that are generated outside the sales of goods or services that the firm regularly deals with. It includes bank interest, rent received, discount received etc.

3.2.11 Expenses

These are cost of goods (other than those related to goods to be sold) and services consumed or used during the period covered by the account, and such goods and services are meant for the business. These expenses include: transport, rent and rates, electricity, depreciation, salaries etc., and they are charged against the profit in the statement of profit or loss.

3.2.12 Carriage Outwards

This represents the cost of transporting goods meant for resale to the buyer. Carriage outwards are expenses that relate to sales and they are included among the other running cost of an enterprise to determine the net profit.

3.2.13 Net Profit

Net profit is the profit derived after all expenses and cost of sales have been deducted from the net income including sales of goods and other income. Where all expenses are higher than the income, it will be a net loss.

3.3 PREPARATION OF STATEMENT OF PROFIT OR LOSS

When preparing the statement of profit or loss, it should be done in a way to reveal the income generated, cost of sales, gross profit, other income, expenses and the net profit. A typical statement of profit or loss is presented below as a guide.

3.3.1 Format of Statement of Profit or Loss

Statement of profit or loss

For the year ended 31st December 20XX

	₦	₦
Sales		XXXX
Less returns inwards		(XXX)
Net sales		XXXX
Opening stock	XXXX	
Add purchases	XXXXX	
Add carriage inwards	XXX	
	XXXXX	
Less returns outwards	XXX	
Less closing stock	XXXX	
Cost of gods sold		XXX
Gross profit		XXXX

Other income:		
Discount received		XXX
Commission received		XXX
Dividend received		XXX
Fixed deposit interest		XXX
		XXXXX
Expenses:		
Lighting and heating	XXX	
Discount allowed	XX	
Office rent	XXX	
Advertising	XX	
Travelling expenses	XXX	
Rates	XXX	
Fire insurance	XXX	
Postages	XX	
Office salaries	XXX	
Repairs	XXX	
Carriage outwards	XXX	
Depreciation	XXX	
Bank charges	XXX	
Stationery	XX	
General expenses	XXX	XXXX
Net profit		XXXX

Example 1: From the trial balance below, prepare statement of profit or loss of Treasure Gold Ventures for the year ended December 31, 2015.

	₦	₦
Capital		24,800
Furniture	24,000	
Stock at start	12,480	
Purchases	37,600	
Returns outwards		4,600
Transport expenses	4,500	
Discount received		300
Returns inwards	1,700	
Travelling expenses	2,000	
Carriage inward	1,500	
Carriage outward	2,500	

Salaries	3,200	
Debtors	12,260	
Creditors		14,520
Cash in hand	1,200	
Drawings	5,000	
Sales		64,000
Discount allowed	280	
	108,220	108,220

The stock at close is ₦7,400

SUGGESTED SOLUTION TO EXAMPLE 1

Treasure Gold Ventures
Statement of Profit or Loss
For the year ended December 31, 2015

	₦	₦	₦
Sales			64,000
Less returns inwards			1,700
			62,300
Opening stock		12,480	
Add purchases	37,600		
Add carriage inwards	1,500		
	39,100		
Less returns outwards	4,600	34,500	
		46,980	
Less closing stock		7,400	
Cost of goods sold			39,580
Gross profit			22,720
Add discount received			300
	23,020		
Transport		4,500	
Traveling		2,000	
Carriage outwards		2,500	
Salaries		3,200	
Discount allowed		280	
			12,480

Net profit for the year	<u>10,540</u>

Note carefully the treatment of closing stock which is normally written outside of the trial balance. Closing stock is deducted from the addition of opening stock and purchases in the statement of profit or loss.

Example 2: The trial balance below is drawn from the books of Greater Grace Concepts for the year ended 30thJune 2016.

	DR.	CR.
	₦	₦
Capital account		17,000
Drawing account	8,400	
Purchases	38,000	
Sales		60,000
Discounts	2,400	1,900
Office rent	1,080	
Travelling expenses	960	
Warehouse rent	1,320	
Fire insurance	180	
Insurance on purchases	240	
Office salaries	5,520	
Carriage inwards	160	
Carriage outwards	140	
Furniture & fittings	3,600	
Opening stock	4,000	
Trade debtors	17,400	
Sundry creditors		15,020
Cash at bank	10,224	
Cash in hand	110	
Bank charges	36	
General expenses	150	
	93,920	93,920

Note the following:

i. Closing stock was ₦4,800

ii. You are to prepare statement of profit or loss for the year.

SUGGESTED SOLUTION TO EXAMPLE 2

Greater Grace Concepts
Statement of Profit or Loss
For the year ended 30th June 2016

	₦		₦
Sales			60,000
Opening stock	4,000		
Purchases	38,000		
Carriage inwards	160		
	42,160		
Less closing stock	4,800		
Goods available for sale	37,360		
Purchases insurance	240		
Warehouse rent	1,320		
Cost of gods sold			38,920
Gross profit			21,080
Other income			
Discount received			1,900
			22,980
Discount allowed	2,400		
Office rent	1,080		
Travelling expenses	960		
Fire insurance	180		
Office salaries	5,520		
Carriage outwards	140		
Bank charges	36		
General expenses	150	10,466	
Net profit			12,514

4.0 CONCLUSION

The final accounts represent the presentation of financial information for a particular period or year to the users of financial report. The final accounts of a sole trader consist of statement of profit or loss and statement of financial position.The preparation of statement of profit or loss for sole traders enables the business owner to ascertain the profit or loss from the business for a particular period, month or year. Statement of profit or loss is technically divided into two sections to show the gross profit or loss and the net profit or loss for a particular period.

SELF ASSESSMENT EXERCISE

1. Differentiate between a statement of profit or loss and a trial balance.
2. The following Trial Balance was extracted from the books of Promise Global Investments on 31st December, 2013

	₦	₦
Premises	150,000	
Motor Vans	27,810	
Capital 1st January, 2013		483,720
Advertising	3,810	
Postage	4,140	
Purchases	2,054,550	
Electricity	2,730	
Salaries	85,110	
Tenement Rate	3,030	
Telephone	1,020	
Furniture	33,120	
Sales		2,204,940
Returns	1,680	11,760
Bad Debts	780	
Insurance	5,760	
Commission received		52,500
Debtors	146,460	
Creditors		252,150
Cash in hand	10,560	
Bank	113,760	
Stock 1st Jan. 2013	360,750	
	3,005,070	3,005,070

Additional information is as follows:

i. The stock at 31st December2013 was ₦323,610
ii. Prepare the statement of profit or loss for the year.

5.0 SUMMARY

This study unit was used to define final accounts, explain the components of final accounts, define technical terms relating to statement of profit or loss such as opening stocks, purchases, carriage inward, returns outwards, closing stocks, cost of goods sold, gross profit, other income, expenses, carriage outwards and net profit. Statement of profit or loss for sole trader was also prepared in this unit.

6.0 TUTOR-MARKED ASSIGNMENT

Question 1: The trial balance of Adekanmbi, a sole proprietor for the year ended 31/12/2015 was as follows:

		DR		CR
		₦		₦
Stock 1/1/2015		7,500		
Cash	10,200			
Capital 1/1/2015				199,750
Drawings		1,300		
Bank	85,000			
Land and Building		90,000		
Furniture		1,500		
Rent		500		
Rates		350		
Debtors/Creditors		5,600		15,000
Electricity	300			
Cleaning		50		
Carriage on purchases		150		
Carriage on sales		210		
Motor Vehicles		45,000		
Purchases	40,500			
Returns Outwards			1,200	
Returns Inwards		400		
Sales				85,000
Interest received				970
Stationery	1,000			
Salaries		12,000		
Insurance	360			
		301,920		301,920

Closing stock, 31/12/2015 ₦5,300. Prepare for Adekanmbi, statement of profit or loss for the year ended 31/12/2015.

Question 2: T. Addo'sbusiness affairs on 1st December 2015 stood as follows:

	₦
Cash in Hand	440
Cash at Bank	2,440
Stock	3,500
Furniture and Fittings	1,200

You are required to:

(a) Enter the above, by means of the journal, into his ledgers, and post thereto the following transactions which took place during the month of December 2015. (Use a two column cash book for cash transactions)

		₦
Dec. 2	Bought goods from V. Bojon & Sons on credit	1,200
Dec. 3	Paid insurance premium in cash	150
Dec. 5	Paid V. Bojon by cheque the amount due	
Dec. 8	Bought goods – gave a cheque for	840
Dec. 12	Sold goods to Badu &Co. on credit	1,560
Dec. 17	Sold goods to L. Aliyi on credit	2,000
Dec. 22	Sold goods to Badu &Co. on credit	730
Dec. 27	Received a cheque from Badu & Co.	1,290
Dec. 28	Paid salaries by cheque	450
Dec. 31	Drew cheque for personal use	500

(b) Extract a Trial Balance

(c) Prepare a statement of profit or loss for the month ended 31st December 2015, Stock on hand was valued at ₦3,200

7.0 REFERENCES/FURTHER READINGS

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UNIT 10: FINAL ACCOUNTS OF A SOLE TRADER 2: STATEMENT OF FINANCIAL POSITION

1.0 INTRODUCTION

The statement of financial position is part of the final accounts which are prepared from the subsidiary books of accounts, to the ledger and the extraction of trial balance to the statement of profit or loss. The final accounts are the end points of books of accounts which are used to determine the income, profit, loss, assets and liabilities of a business concern. The statement of financial position for sole traders who deal in the buying and selling of goods are discussed in this unit.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i Define statement of financial position
ii. Explain the components of statement of financial position
iii. Understand the technical terms in statement of financial position
iv. Prepare statement of financial position for a sole trader
iv. Know the difference between statement of profit or loss and statement of financial position.

3.0 MAIN CONTENT

3.1 STATEMENT OF FINANCIAL POSITION

Statement of financial position is a statement (not an account) that contains the list of assets and liabilities with owner's capital at the end of a particular period, month or year, and arranged in an orderly manner. Like the trial balance, it is expected that both assets and liabilities figure in a statement of financial position should be equal in total.

3.2 COMPONENTS OF FINANCIAL POSITION

Let us look at the components of financial position which are terms that are unique in accounting.

3.2.1 Assets

These are valuables, claims, possessions and properties belonging to the business. Assets are normally arranged in order of liquidity in the statement of financial position. There are different types of assets, namely:

3.2.1.1 Non-current assets

These are company's tangible assets that are expected to be used in, and for the organisation for many years e.g. furniture, fittings, land, building, equipment, motor vehicle, etc.

3.2.1.2 Current assets

This class of assets are those whose value fluctuate during the year depending on the level of business activities e.g. debtors, stock, bank balance, cash in hand, prepayments etc.

3.2.1.3 Intangible assets

These are assets that add value to the organisation but they cannot be seen by their nature e.g. goodwill, copyrights, patent rights, trade mark etc.

3.2.1.4 Fictitious assets

These are expenditure incurred to cover a long period of time as a result of which some portions are capitalised or deferred pending the time it is written off against the profit (in statement of profit or loss) for subsequent years e.g. preliminary expenses, research and development expenses, discount on shares etc.

3.2.1.5 Investments

These are ownership interests a company has in another organisation. It could be in shares or debentures. This investment may be quoted (marketable) or unquoted, and it can be of short term or long term in nature.

3.2.2 Liabilities

These are financial obligations the business has in favour of outsiders. They are amount owed to individuals and/or organisations. Liabilities can be grouped into:

3.2.2.1 Non-current liabilities

These are financial obligations against the company that are not due for repayment within one year e.g. bank loan, mortgage loan, deferred tax etc.

3.2.2.2 Current liabilities

They are debts that are due for payment within one year and do change regularly from one period to another within one accounting year e.g. creditors, accruals, bank overdraft etc.

3.2.3 Capital or owner's equity

This is the initial investment of the business owner in the company. It represents the value of money, properties and other resources brought in by the owner to start the business and other additions after the commencement of the business.

As business progresses, profits not taken out of the business are added into capitalwhile drawings reduce owner's interest in the business. Usually, capital is equivalent to total assets minus total liabilities. CAPITAL = Total assets – Total liabilities.

3.3 PREPARATION OF STATEMENT OF FINANCIAL POSITION

3.3.1 Format of Statement of Financial Position

ABC Business Ventures
Statement of financial position
As at 31st December 2014

	₦	₦

ASSETS

Non-current assets		
Land	XXXX	
Less depreciation	XX	XXXX
Furniture	XXXX	
Less depreciation	XX	XXXX
Motor vehicle	XXXX	
Less depreciation	XX	XXXX
Plant and machinery	XXXX	
Less depreciation	XX	XXXX
Office equipment	XXXX	
Less depreciation	XX	XXXX
		XXXX
Current assets		
Debtors	XXXX	
Stock	XXXX	
Payment in advance	XXXX	
Cash at bank	XXXX	
Cash in hand	XXXX	XXXX
Total Assets		XXXXX

EQUITY AND LIABILITIES

Equity		
Capital		XXXX
Add net profit		XXXX
		XXXX
Less drawings		XXXX
Owner's equity		XXXX
Current liabilities		
Creditors	XXXX	
Bank overdraft	XXXX	
Accrued expenses	XXXX	XXXX
Total equity and liabilities		XXXXX

Example 1: From the balances below, prepare statement of financial position for ABC Businessas at December 31, 2015.

	₦
Furniture	24,000
Stock at start	12,480
Capital	24,800
Debtors	12,260
Creditors	14,520
Cash in hand	1,200
Drawings	5,000
Closing stock	7,400
Net profit	10,540

SUGGESTED SOLUTION TO EXAMPLE 1

ABC Business

Statement of Financial Position
As at December 31, 2015

	₦	₦
Non-current asset		
Furniture		24,000
Current assets		
Stock	7,400	
Debtors	12,260	
Cash	1,200	20,860
Total Assets		44,860
Equity and Liability		
Equity		
Capital		24,800

Add net profit	10,540
	35,340
Less drawings	5,000
Owner's equity	30,340
Current liability	
Creditors	14,520
Total equity and liability	44,860

Example 2 The trial balance below is drawn from the books of Palace Ventures for the year ended 30thJune 2016.

	DR.	CR.
	₦	₦
Capital account		17,000
Drawing account	8,400	
Furniture & fittings	3,600	
Trade debtors	18,000	
Sundry creditors		15,020
Cash at bank	10,200	
Cash in hand	110	
Opening stock	4,412	
Net profit		12,702
	44,722	44,722

Note the following as at June 30th.

i. Prepaid expenses ₦12
ii. Closing stock was ₦4,800
iii. Accrued expenses ₦400
iv. Depreciation on furniture is 10%

You are to prepare statement of financial position for the year.

SUGGESTED SOLUTION TO EXAMPLE 2

Palace Venture

Statement of Financial Position

As at 30thJune 2016

	₦	₦

Assets

Non-current asset		
Furniture & fittings		3,600
Less depreciation		360
		3,240
Current assets		
Debtors	18,000	
Stock	5,160	
Prepaid expenses	12	
Cash at bank	10,200	
Cash in hand	110	33,482
Total Assets		36,722

Equity and Liabilities

Equity		
Capital		17,000
Net profit		12,702
		29,702
Less drawings		8,400
Owner's equity		21,302
Current liabilities		
Creditors	15,020	
Accrued expenses	400	15,420
Total equity and liabilities		36,722

SELF ASSESSMENT EXERCISE

1. Differentiate between a statement of financial position and a statement of profit or loss.

2. The trial balance of Umaru Blessing, a sole proprietor for the year ended 31/12/2015 was as follows:

	DR	CR
	₦	₦
Stock 1/1/2015	7,500	
Cash	10,200	
Capital 1/1/2015		199,750

Drawings		1,300		
Bank	85,000			
Land and Building		90,000		
Furniture		1,500		
Rent		500		
Rates		350		
Debtors/Creditors		5,600		15,000
Electricity	300			
Cleaning		50		
Carriage on purchases		150		
Carriage on sales		210		
Motor Vehicles		45,000		
Purchases	40,500			
Returns Outwards			1,200	
Returns Inwards		400		
Sales				85,000
Interest received				970
Stationery	1,000			
Salaries		12,000		
Insurance	360			
		301,920		301,920

Closing stock, 31/12/2015 ₦5,300. Prepare the business statement of profit or loss and statement of financial position.

4.0 CONCLUSION

The statement of financial position is part of the final accounts and it serves as the end points of books of accounts for sole traders. The statement of financial position consists of the assets and liabilities of the business, and owner's equity or capital. The asset is divided into non-current assets, current assets, intangible assets, fictitious assets, and investments while the liabilities consists of non-current liabilities and current liabilities.

5.0 SUMMARY

The statement of financial position was defined while the components of the financial position namely non-current assets, current assets, intangible assets, fictitious assets, investments non-current liabilities, current liabilities and owner's equity or capital were explained in this unit. Relevant examples were used to prepare typical statement of financial position.

6.0 TUTOR-MARKED ASSIGNMENT

Question 1: List and explain six components of statement of financial position.

Question 2: What are the similarities between a trial balance and a statement of financial position?

Question 3: The following trial balance was extracted from the books of Olowolayemo Omooba on 31st December, 2013

	₦	₦
Premises	150,000	
Motor Vans	27,810	
Capital 1st January, 2013		483,720
Advertising	3,810	
Postage	4,140	
Purchases	2,054,550	
Electricity	2,730	
Salaries	85,110	
Tenement Rate	3,030	
Telephone	1,020	
Furniture	33,120	
Sales		2,204,940
Returns	1,680	11,760
Bad Debts	780	
Insurance	5,760	
Commission received		52,500
Debtors	146,460	
Creditors		252,150
Cash in hand	10,560	
Bank	113,760	
Stock 1st Jan. 2013	360,750	
	3,005,070	3,005,070

Additional information is as follows:

i. The stock at 31st December 2013 was ₦323,610

ii. Depreciation is as follows:
 Premises at 5 per cent
 Motor vans at 10% per annum
 Furniture at 10% per annum

Prepare statement of profit or loss for the year ended 31st December 2013, and statement of financial position as at that date.

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UNIT 11: END OF YEAR ADJUSTMENTS IN FINAL ACCOUNTS

1.0 INTRODUCTION

A business is a legal entity whose operations and financial transactions are continuous in nature from one year to another. As a result, there are financial transactions in business organisations that cannot be fully completed within a year and more importantly at the end of the accounting year. Furthermore, the accounting year of organisations vary from one company to another; as a result some transactions will not fall within the same accounting year for two or more companies. Events like this lead to adjustments in the final accounts at the end of the accounting period.

Business involves the giving and taking of credits, while all expenditure and income for a particular year may not be fully paid and received as at the year end. However, those incomes due but not yet received and expenses due for settlement but not yet paid as at the year-end should be brought into the final accounts to show a true and fair position of the company through proper adjustment. This unit focuses on end of year adjustments which include prepayments, accruals, reserves and provisions.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i. Explain entries on accruals
ii. Discuss entries for prepayments

iii. Understand the concept of bad debts
iv. Explain the entries for provisions
v. Recognise and treat increase and decrease in provisions
vi. Explain reserves
vii. Prepare final accounts with end of year adjustments

3.0 MAIN CONTENT

3.1 Accruals

These are services and goods that have been consumed or enjoyed during the year but which payment has not been made either in full on in part at the end of that financial year. e.g. Government water uGrace of ₦15,000 for December 2015, but bill was received in January 2016. It means that the amount was owed as at December 31, 2015 and form part of the accruals to be adjusted for in the final accounts. Accrual can also be called owing or due. Any amount owing on expenses is added to that expense in the statement of profit or loss and reflected under current liabilities in the statement of financial position. Accruals are necessary in order to allocate all expenses relating to an accounting period to that period.

Example 1: Big Success Limited paid the following expenses by cash amongst others during the accounting year ended 31st December 2015.

Office rent	₦72,080
Office salaries	₦45,800

A further examination of the company's records shows that:
i. Office salaries of ₦4,000 was due as at 31st December 2015..
iv. Office rent of N32,600 owed has not been paid by 31st December 2015.

You are required to show how the accruals will be treated in the final accounts.

SUGGESTED SOLUTION TO EXAMPLE 1

Method 1: This entails the preparation of an account for items affected by the accruals. Accrued expenses are credit balance in the ledger as depicted in the account below. With this method, the total of expenses paid and those owed will be posted to the statement of profit or loss and statement of financial position.

Office rent account

Cash	72,080		

Balance c/d	32,600	Statement of profit or loss	104,680
	104,680		104,680
		Balance b/d	32,600

Office salaries account

Cash	45,800		
Balance c/d	4,000	Statement of profit or loss	49,800
	49,800		49,800
		Balance b/d	4,000

Big Success Limited
Statement of Profit or Loss (Extract)

	₦
Office rent	104,680
Office salaries	49,800

Big Success Limited
Statement of Financial Position (Extract)
Current liabilities:

Office rent due	32,600
Office salaries owed	4,000

Method 2: This method does not require the preparation of an account for items affected by the accruals. The amount paid and the accrual will be posted to the statement of profit or loss separately while the accrued expenses will be reflected in the statement of financial position under the current liabilities.

Big Success Limited
Statement of Profit or Loss (Extract)

		₦
Office rent	72,080	
Add accrual	32,600	104,680
Office salaries	45,800	
Add owing	4,000	49,800

Big Success Limited
Statement of Financial Position (Extract)
Current liabilities

Office rent due	32,600
Office salaries owed	4,000

3.2 Prepayments

These are goods and services that have been paid for, but the benefit is yet to be enjoyed or consumed either in full or in part. A good example is payment of rent in advance. Prepayment or payment in advance or amount prepaid is deducted from the total payment in respect of the expense in statement of profit or loss and the prepayment is recorded under current assets in the statement of financial position. Prepayment is to enable the organisation not to understate the profits for the accounting period in which the prepayment occurs.

Example 2: No Loss Enterprises paid the following expenses by cheque during the accounting year ended 31st December 2014.

Office rent	₦156,650
Water rate	₦50,000

The information below was provided as at 31st December 2014

i. Three months office rent of ₦26,650 for January to March 2015 are included in the ₦156,650 paid.

iv. ₦5,000 was paid in advance to the water board as water rate.

You are required to show how the above transactions will be treated in the final accounts.

SUGGESTED SOLUTION TO EXAMPLE 2

Method 1: This entails the preparation of accounts for items affected by the prepayments.

Office rent account

Bank	156,650	Statement of profit or loss	130,000
	______	Balance c/d	26,650
	156,650		156,650
Balance b/d	26,650		

Water rate account

Bank	50,000	Statement of profit or loss	45,000
		Balance c/d	5,000
	50,000		50,000
Balance b/d	5,000		

No Loss Enterprises
Statement of Profit or Loss (Extract)

	₦
Office rent	130,000
Water rate	45,000

No Loss Enterprises
Statement of Financial Position (Extract)
Current assets:

Office rent prepaid	26,500
Water rate in advance	4,000

Method 2: This method does not require the preparation of an account for items affected by the prepayments.

No Loss Enterprises
Statement of Profit or Loss (Extract)

	₦	₦
Office rent	156,650	
Less prepayment	26,500	130,000
Water rate	50,000	
Less payment in advance	5,000	50,000

No Loss Enterprises
Statement of Financial Position (Extract)
Current assets:

Office rent prepaid	26,500
Water rate in advance	4,000

3.3 Provisions

Provisions are important because most business transactions are done on credit. As long as organisations relate with their suppliers and customers on credit basis, bad debts and other provisions are inevitable.

3.3.1 Bad Debts

Bad debts are debts that have gone bad and there are no chances of the debt being recovered. Bad debts could be as a result of death of the debtor, bankruptcy of a debtor, mental illness of a debtor, lack of good credit control procedures, disagreement as to amount due between the debtor and the creditor and closure or permanent negative disruption of the debtors business.

Bad debt is an expense to be charged against the profit for the year it occurred. This is done by debiting the bad debt account and credit the debtors account to reduce the value of the debtors after the bad debt. It is the net debtors figure after adjusting for bad debts that will reflect in the statement of financial position.

Example 3: Goodness Limited decided to write off ₦4,000 and ₦3,000 as bad debts for two customers namely Lola and Doyin respectively for year 2014. The balances on these account for year 2013 are Lola ₦48,400 and Doyin ₦11,500.

Show the journal, ledgers, statement of profit or loss and statement of financial position to record the above.

SUGGESTED SOLUTION TO EXAMPLE 3

Journal

	Dr.	Cr.
Bad debts	4,000	
Debtors - Lolade		4,000
Being debt written off a debtor account		
Bad debts	3,000	
Debtors – Doyin		3,000

Being bad debt on a debtor account

Statement of profit or loss	7,000	
Bad debts		7,000

Being bad debts for the year written off

Ledgers

Bad debts Account

Debtors – Lolade	4,000		
Debtors – Doyin	3,000	Statement of profit or loss	7,000
7,0007,000			

Debtors Account – Lolade

Bal b/d	48,400	Bad debt	4,000
		Bal c/d	44,400
	48,400		48,400
Bal b/d	44,400		

Debtors Account – Doyin

Bal b/d	11,500	Bad debt	3,000
		Bal c/d	8,500
11,50011,500			
Bal b/d	8,500		

Statement of Profit or Loss

Expenses:	₦
Bad debts	7,000

Statement of Financial Position

Current assets:		₦
Debtors	59,900	
Less bad debts	7,000	52,900

3.3.2 Provision for Bad or Doubtful Debts

Doubtful debts are those debts which in the opinion of management of an organisation may not be fully recovered. The provision for such debt is largely subjective.It is an estimation of debts of which their probability of recovery is below hundred percent. To avoid sudden bad debts, business organisations have devised a way of guarding against this by creating provision for bad or doubtful debt in their records for debts that they are not sure of being able to collect.

Provision for doubtful or bad debts will be charged on the debtors after the deduction of the bad debts for the period or after the bad debts have been written off.

Example 4:A company provide 5% as provision for bad debts. As at year 2015, the debtors balance was ₦60,000 and bad debt to be written off was ₦6,000. What is the doubtful debt provision for the year?

SUGGESTED SOLUTION TO EXAMPLE 4

	₦
Debtors	60,000
Less bad debt	(6,000)
	54,000

Provision for doubtful debt is ₦54,000 x 5% = ₦2,700

The accounting entry for provision for doubtful debt is a function of the time the provision occurs. It can take two forms namely, the first year and subsequent years.

Where the provision is for the first year, the amount will be charged against the profit by:

Debiting	-	Statement of profit or loss
Crediting	-	Provision for doubtful debts account

The provision will be deducted from the debtors after deducting bad debts in the statement of financial position.

Example 5: Oluwaseyi Investment decided to provide 7% as provision for bad debt on his debtors figure of ₦88,200. Show this in form of a journal, ledger and statement of financial position extract.

SUGGESTED SOLUTION TO EXAMPLE 5

Journal

	Dr.	Cr.
Statement of profit or loss	6,174	
Provision for bad debt account		6,174

Being 7% provision for bad debt on debtors

Ledgers

Provision for bad debt account

		Statement of profit or loss	6,174

Statement of profit or loss

Expenses

Provision for bad debt	6,174

Oluwaseyi Investment

Statement of Financial Position (extract)

Current asset:	₦
Debtors	88,200
Less provision for bad debt	6,174
	82,026

Where the provision is for subsequent years, it can either be an increase over what was provided for in previous year (which is an expenses) or a decrease over previous year provision (which is an income). Increase can occur if the closing provision is higher than the opening provision for doubtful debts.

Example 6: The bad debt provision for a company in 2014 and 2015 are ₦2,000 and ₦2,800 respectively. Show the above entries using ledgers and statement of profit or loss as at 2015.

SUGGESTED SOLUTION TO EXAMPLE 6

Provision for bad debt Account

		Bal b/d	2,000
Bal c/d	2,800	Statement of profit or loss	800
	2,800		2,800
		Bal b/d	2,800

Statement of profit or loss

Expenses

Provision for bad debt - increase	800

Decrease in provision can occur if the closing provision is lower than the opening provision for doubtful debts. This could be a result of improved payment habits of the customers and/or reduction in credits granted to customers.

Example 7: Provision for doubtful debts of a company was ₦1,550 and ₦1,300 for year 2010 and 2011 respectively. By means of ledger and statement of profit or loss, show how this will appear in the books.

SUGGESTED SOLUTION TO EXAMPLE 7

Provision for Doubtful Debts Account

Statement of profit or loss	250	Bal b/d	1,550
Bal c/d	1,300		
1,5501,550			
Bal b/d			1,300

Statement of Profit or Loss

Other income:

Provision for doubtful debts - decrease	250

3.4 Reserves

These are amounts set aside out of profit earned by a company and constitute part of shareholders fund. Reserves may be voluntarily created by the directors or statutorily created. We have revenue, capital and general reserves. Reserves are posted to the statement of changes in equity and statement of financial position as appropriate for limited liability company.

3.4.1 Revenue Reserve

This type of reserve is distributed to the shareholder and other capital providers in form of debenture interest, retained profit etc.

3.4.2 Capital Reserves

They are non-distributable reserves that are retained to comply with certain laws or for accounting requirement. e.g. capital redemption reserve fund, share premium, revaluation reserve etc.

3.4.3 General Reserves

They are reserves not set aside for a specific purpose.

Example 8: The trial balance below is drawn from the books of Palace Ventures for the year ended 31st March 2016.

	DR.	CR.
	₦	₦
Capital account		17,000
Drawing account	8,400	
Purchases	38,000	
Sales		60,000
Discounts	2,400	1,900
Office rent	1,080	
Travelling expenses	960	
Warehouse rent	1,320	
Fire insurance	180	
Insurance on purchases	240	
Office salaries	4,800	
Wages	720	
Carriage inwards	160	
Carriage outwards	140	
Furniture & fittings	3,600	
Opening stock	4,000	
Trade debtors	17,400	
Sundry creditors		15,020
Cash at bank	10,224	
Cash in hand	110	
Bank charges	36	
General expenses	150	
	93,920	93,920

Note the following:

i. Office salaries of ₦40 due as at 31st March 2016.
ii. Closing stock was ₦4,800
iii. Sales of ₦600 made on credit during the period were omitted in the record keeping process
iv. Office rent of ₦360 owed has not been paid by 31st March 2016
v. Bank charges of ₦12 were not entered in the books
vi. You are to prepare statement of profit or loss and statement of financial position for the year.

SUGGESTED SOLUTION TO EXAMPLE 8

Palace Ventures

Statement of profit or loss

For the year ended 31st March 2016

		₦	₦	
Sales			60,000	
Omitted sales			600	
Total sales			60,600	
Opening stock		4,000		
Purchases		38,000		
Carriage inwards		160		
		42,160		
Less closing stock		4,800		
Goods available for sale		37,360		
Wages		720		
Purchases insurance		240		
Warehouse rent		1,320		
Cost of gods sold				39,640
Gross profit				20,960
Other income				
Discount received				1,900
				22,860
Discount allowed		2,400		
Office rent	1,080			
Add accrual	360	1,440		
Travelling expenses		960		
Fire insurance		180		
Office salaries	4,800			
Add owing	40	4,840		
Carriage outwards		140		
Bank charges	36			
Add omission	12	48		
General expenses		150	10,158	
Net profit				12,702

SELF ASSESSMENT EXERCISE

1. (a) Define bad debts.
   (b) What is the objective of making provision for bad debt?

2. Babafidau Bim is the owner of Babafem Enterprises. The trading concerns sells on credit to a sizeable number of the well-known customers. The company has been experiencing bad debts and commenced providing for suchdebts from the last financial year (1989). On 1st January, 1990 the provision for bad debts was ₦2,570. During the year ₦680 of these debts actually proved uncollectible and the sum of ₦1,409 proved collectable. The sum of ₦315 debts that became bad were not provided for. At the end of the year a new provision of ₦3,498 is required.

Show the treatment of provision for bad debts and bad debts in the ledger and statement of profit or loss.

4.0 CONCLUSION

End of year adjustments in the final accounts are necessary to show the true and fair position of the financial statements. As such, the end of the year adjustment in the statement of profit or loss and the statement of financial position include how entries are passed in both statements for accruals, prepayments, bad debts, reserves and provisions for doubtful debts - including the recognition and treatment of increase and decrease in provisions.

5.0 SUMMARY

This unit has discussed in details the end of year adjustments in final accounts. It specifically examined bad debts, provisions for doubtful debts, reserve, prepayments and accruals with relevant discussion and question, and how they are treated in the statement of profit or loss and the statement of financial position.

6.0 TUTOR-MARKED ASSIGNMENT

Question 1: Madam Florence provide the following information

Year	Debtors	Bad debts
2000	120,000	-
2001	155,000	14,000
2002	62,500	2,500

The debtors' figures are before bad debts, while provision for bad debts is estimated at 10 percent for each year. Prepare the following:

(a) Bad debt account.

(b) Provision for bad debts account

(c) Statement of profit or loss

(d) Statement of financial position extract for the three years.

Question 2: The following were extracted from the books of Orelope and Co. on 31st December 2003.

	₦
Debtors – without any adjustment	58,500
Provision for bad debts	5,460
Bad debts	1,560

The company's provide for 10% as doubtful debts.
You are required to prepare
(a) Provision for doubtful debts account.
(b) Statement of profit or loss.
(c) Statement of financial position.

Question 3: Emaka is a sole trader, who has no knowledge of accounting. However, some of his business transactions are recorded in a personal diary. Financial records as at 1st January 2015 are as follows:

	₦
Rent owing to landlord	500
Stock	31,000
Amount owing by Emaka to suppliers	11,500
Debtors	7,500
Capital	47,100
Non-current assets	30,000
Bank	3,100
Depreciation to date	12,500

During the year, an analysis of his bank statement revealed:
Cheques drawn:

To suppliers	48,650
Rent	3,500
Other expenses	10,250
Drawings	11,000
Electric oven	13,000

Lodgement:

From customers	75,900
Amount inherited	5,500

A further look at his diary showed that before banking the cash and cheques received from customers, ₦5,000 was paid out for purchases and ₦1,000 for personal drawings. Rent is ₦5,000 a year.

As at 31st December 2015 the following figures were computed.

Debtors	₦11,500
Stock	₦39,000
Creditors	₦19,750

Depreciation is at 15% on the reducing balance method.

Required:

(a) Statement of profit or loss for the year ended 31st December 2015.

(b) Statement of financial position as at that date.

Show all workings

7.0 REFERENCES/FURTHER READINGS

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UNIT 12: ACCOUNTING TREATMENT OF CONTROL ACCOUNTS

1.0 INTRODUCTION

As businesses keep growing, the number of accounts kept will be on the increase and this will of necessity require more personnel to work on the preparation of such accounts. When the various accounts are prepared, there will be need to harmonise these accounts into one at a particular period to check the arithmetical accuracy of what has been posted to individual accounts. The process of harmonising all individual accounts in the same class will give rise to a control account which serves as the total or summary of what happens within that period for those accounts in the same class.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i. Define Control Account
ii. Explain Types of Control Accounts
iii. Discuss Merits of Control Accounts
iv. Prepare Debtors Control Account:
v. Prepare Creditors Control Account
vi. Prepare Debtor’s Statement of Account
vii. Prepare Creditor’s Statement of Account

3.0 MAIN CONTENT

3.1 Control Account System

Control account is a summary of customers or suppliers ledger in total. The balance on the control account under normal circumstance must equal the addition of individual customers or suppliers account at a particular date or period.Another name for control accounts is total account, because the account is maintained on total basis.

Due to mistakes and errors in the completion of the control account and/or individual customers or suppliers account, the control account may not agree with the addition of all the individual customers or suppliers balances, and this will lead to reconciliation. It should be noted that any entry on the debit side of an account will also be on the debit side of the control for such an account, likewise the credit side.

There are two major types of control accounts namely

i. Sales ledger control or Debtors control account
ii. Purchases ledger control or Creditors control account

3.2 Merits of Control Account

The following are the merits of control accounts

i. It allows homogeneous accounts to be grouped together.
ii. Useful in detecting fraud and errors relating to debtors and creditors.
iii. It can be used to detect missing figure.
iv. Allows for quick preparation of draft annual account.
v. It also helps to localise errors in a trial balance because such errors can be easily traced to a set of account(s).

3.3 Working of Control Account

With simple illustration about customers, readers will grasp the working of control account systems.

Assuming there is a company with over two thousand customers located all over Nigeria and neighbouring countries. A separate account will be maintained or kept for these customers individually where their transactions with the company are recorded. At the end of the month, the account will be closed for the month to know what each customer owes.

The control account to be prepared will only record the total of each transaction as it affects all the customers for the month and the balance on the control account should be equal to the sum of the balance on the individual customers account.

3.4 Debtors Control Account

Any transactions that will increase the customers' indebtedness to the organisation are debited to the debtors control account while those that will reduce the debts are credited to the same account. At the end of the period, the sales ledger control account or debtors control account will have a debit balance to show how much is due from all the credit customers. Debtors control account is not used for cash customers. The format for debtors control account is as prepared below.

3.4.1 Format of Debtors Control Account

Sales Ledger Control Account

Bal. b/d	xx	Receipts from customers	xx
Credit sales	xx	Discount allowed	xx
Dishonoured cheque	xx	Returns inward	xx
Bills receivable dishonoured	xx	Bad debts	xx
Cash refund to debtors	xx	Creditor control contra	xx
Interest charge to customer	xx		
Bad debt written off recovered	xx	Bal. c/d	xx
	xxx		xxx
Bal. b/d	xx		

3.5 Creditors Control Account

The transactions that will increase the financial obligation to the supplier will be credited to the creditors control account. Same account will be debited with those transactions that will reduce the obligation like discount received, returns outwards and payments to creditors.

3.4.1 Format of Creditors Control Account

Purchases Ledger Control Account

Cash paid	xx	Bal. b/d	xx
Returns outward	xx	Credit purchases	xx
Discount received	xx	Dishonoured cheque	xx
Cheque paid	xx	Bills payable dishonoured	xx
Debtors control contra	xx	Interest charge by supplier	xx
Bal c/d	xx		
	xxx		xxx
		Bal. b/d	xx

Example 1: Ascertain by means of control accounts, the amount of 'purchases' and 'sales' for the year ended 31st, December 2015

Total for the year:

	₦
Returns outwards	95
Cash payment to creditors for good supplied	5,625
Returns inwards	205
Cash received from debtors for sales	8,892
Bills receivable	1,200
Discount received	527
Bills payable	1,702
Discount allowed	546
Bad debts	253
Amount due from debtors set off by contra against amount due to him for supplies	340
At January 1, 2015	
Sundry creditors for goods supplied	1,226
Sundry debtors for sales	2,130
At 31st December 2015	
Sundry creditors for goods supplied	1,339
Sundry debtors for sales	2,860

SUGGESTED SOLUTION TO EXAMPLE 1

Debtors Control Account

Bal. b/d	2,130	Returns inwards	205
Credit sales (bal figure)	12,166	Cash from debtors	8,892
		Bills receivable	1,200
		Discount allowed	546
		Bad debts	253
		Set-off	340
		Bal. c/d	2,860
	14,296		14,296
Bal. b/d	2,860		

Creditors Control Account

Returns outwards	95	Bal. b/d	1, 226
Payment to creditors	5, 625	Credit purchase(bal figure)	8, 402
Discount received	527		
Bills payable	1, 702		
Set-off	340		
Bal. c/d	1, 339		
	9, 628		9, 628
		Bal. b/d	1, 339

The credit sales and credit purchases are balancing figures.

Example 2: The following balances were extracted from the books of Top Performers International Limited as at 31st December 2015.

		₦
Opening balance: Debtors		4,000
	Creditors	3,300
Purchases:	on credit	16,500
	in cash	7,400
Sales:	on credit	25,500
	for cash	10,200
Payment to creditors		15,000
Receipt from debtors		23,600
Cash discount allowed		540
Cash discount received		400
Trade discount allowed		12,000
Returns inwards		760
Returns outwards		215
Contra settlements		500
Bad debts written off		85
Provision for bad debts		120
Bills receivable		600
Cheques dishonoured		45
Bills payable		1, 020

You are required to prepare:

i. Sales Ledger Control Account:

ii. Purchases Ledger Control Account

SUGGESTED SOLUTION TO EXAMPLE 2

Top Performers International Limited
Sales Ledger Control Account
As at 31st December, 2015

Bal. b/d	4,000	Receipt from debtors	23,600
Sales on credit	25,500	Discount allowed	540
Cheque dishonoured	45	Returns inwards	760
		Contra settlement	500
		Bad debt written off	85
		Bills receivable	600
		Balance c/d	3,460
	29,545		29,545
Bal. b/d	3,460		

Top Performers International Limited
Purchases Ledger Control Account
As at 31st December, 2015

Payment to creditors	15,000	Bal. b/d	3,300
Discount received	400	Purchases on credit	16,500
Returns outwards	215		
Contra Settlement	500		
Bills payable	1,020		
Bal. c/d	2,665		
	19, 800		19,800
		Bal. b/d	2,665

Trade discount is given at the point of sales and the amount is deducted before arriving at the sales figure to be recorded in the books of account. Hence it is not posted in the control account.

Example 3: Sani Dongo Ventures maintains self-balancing ledgers. From the details given below you are required to prepare the control accounts for purchases and sales ledgers for the year ended 31st, December 2015

	₦
Purchases	153,270
Bad debts written off	2,200
Bills payable accepted	21,700
Bills receivable drawn	50,200

Interest charged to customers		70
Purchases returns	890	
Payment to creditors		125,380
Receipts from debtors		143,080
Bills receivable dishonoured		5,750
Discount allowed		5,280
Discount receivable		3,270
Sales returns		3,010
Cash refund to debtors		750
Cheques from debtors returned unpaid		250
Sales and Purchases ledger contra		10,170
Bills receivable discounted		47,850
Bills payable retired for non-payment		1,500
Sales		200,510
Bad debts recovered (included in cash from debtors)		80
Creditors ledger balance at 31st December, 2015		50,860
Debtors ledger balance at 31st December, 2015		68,180
Purchases ledger control balance at 1st January, 2015		57,500
Sales ledger control balance at 1st January, 2015		74,710

SUGGESTED SOLUTION TO EXAMPLE 3

Sani Dongo Ventures
Purchases Ledger Control Account
As at 31st December, 2015

Bills payable	21,700	Bal. b/d	57,500
Purchases returns	890	Purchases	153,270
Payment	125,380	Bills repayable retired	1,500
Discount receivable	3,270		
Sales ledger contra	10,170		
Bal. c/d	50,860		
	212,270		212,270
		Bal. b/d	50,860

Sani Dongo Ventures
Sales Ledger Control Account
As at 31st December, 2015

Bal. b/d	74,710	Bad debts	2,200

Dishonoured bills	5,750	Bills receivable	50,200
Cash refund	750	Receipts	143,080
Returned cheques	250	Discount allowed	5,280
Sales	200,510	Sales returns	3,010
Bad debt recovered	80	Purchases ledger contra	10,170
Interest charge	70	Bal. c/d	68,180
	282,120		282,120
Bal. b/d	68,180		

Bills receivable discounted has nothing to do with the control account because the company can as well wait till the bill is matured for payment instead of discounting it.

3.6 Debtor's Statement of Account

It is a statement sent periodically, usually once a month by a seller to his customers, showing the position of their accounts up to a certain date. It shows the particulars of invoices, debit notes and credit notes originated from the seller to the buyer during a given period.It also includes payments made and how much the customer owes. At times, the age of the debt may be revealed in the statement. The statement is kept by the buyer for reference and settlement purpose.

A debtor's statement can also be regarded as a memorandum statement showing the details of unpaid invoices for each debtor, which is supposed to agree with the total amount outstanding against the customer in the general ledger. It is also expected to give some information about the customer and analyse the amount outstanding at the end of the month according to their age.

Example 4: You have been engaged as Account Officer of Efiong Enterprises. Your immediate assignment is the preparation of monthly Statements of Account. From the following information, you are required to prepare the statement of account of B. Dabir, a supplier.

Type of Document	**Date 2016**	**Number**	**Particulars**	**Amount ₦**
Invoice	Jan. 2	024	Goods Supplied	4,820
Invoice	Jan. 3	027	Goods Supplied	8,240
Debit Note	Jan. 4	018	Goods Returned	360
Receipt	Jan. 5		A2845	10,820
Invoice	Jan. 6	058	Goods Supplied	6,452
Invoice	Jan. 12	086	Goods Supplied	5,462
Invoice	Jan. 18	098	Goods Supplied	6,325
Debit Note	Jan. 21	021	Goods Returned	2,132
Invoice	Jan. 28	0123	Goods Supplied	3,256

Receipt	Jan. 29	A3451	15,584

Additional information:

i The last statement sent to B. Dabir showed that Efiong Enterprises owed him ₦7,215 at 1st Jan. 2016

ii A cheque for ₦3,500 in favour of B. Dabir dated January 30, 2016 has just been dispatched.

SUGGESTED SOLUTION TO EXAMPLE 4

Efiong Enterprises

To:

B. Dabir No. A807

Address ………………….. Date……………….

……………………………..

Statement of Accounts

Date	Particulars	Ref:	Debit	Credit	Balance
Jan. 2016			₦	₦	₦
1	Balance b/f				7,215 (cr)
2	Goods Invoice	024		4,820	12,035 (cr)
3	Goods Invoice	027		8,240	20,2759 (cr)
4	Returns Invoice	018	360		19,915 (cr)
5.	Receipt No	A2845	10,820		9,095 (cr)
6.	Goods – Invoice	058		6,452	15,547 (cr)
12.	Goods – Invoice	086	5,462	21,009 (cr)	
18	Goods - Invoice	098		6,325	27, 334 (cr)
21	Returns D/Note	021	2,132		25, 202 (cr)
28	Goods – Invoice	0123		3,256	28,458 (cr)
29	Receipt No	A3451	15,584		12,874 (cr)
30	Cheque No		3,500		9,374 (cr)

Prepared by ……………… Approved by ……………

Date ………………………. Date ……………………..

3.7 Creditor's Statement of Account

It is a statement sent periodically usually once a month by a buyer to his suppliers, showing the position of their accounts up to a certain date. The statement gives particulars of invoices, debit notes and credit notes received from the supplier during a given period. Details of payments made to the supplier and how much is outstanding to the supplier are also shown. The creditor's statement is very useful for reconciliation purposes.

Example 5: Mr. Favour is a supplier to whom we owed a balance of ₦4,075 on March 1, 2012

March 2. We paid the outstanding balance by cheque, less ₦204 discount

March 13. Mr. Favour supplied goods value at ₦8,500

March 17. He supplied more goods valued at ₦1,650

March 18. We returned goods to Mr. Favour valued at ₦575

March 19. He gave an allowance on goods that needed repackaging because of damage in transit ₦840

March 27 He supplied goods valued ₦13,250 and also charged insurance on goods in transit ₦ 50

You are required to

i Prepare creditors statement of account of Mr. Favour as at 31 March 2012.

ii Post the above transactions from the month into his ledger account.

SUGGESTED SOLUTION TO EXAMPLE 5

Creditor's Statement

Mr. Favour

Statement of Account

Date: March 31, 2012 Account No:

Date	Description	Ref	Debit	Credit	Balance
			₦	₦	₦
Mar. 1	Balance b/f				4,075
Mar. 2	Bank Cheq No		3,871		204
Mar. 2	Discount		204		0
Mar. 13	Invoice Inv. No			8,500	8,500
Mar. 17	Invoice			1,650	10,150
Mar. 18	Debit note – returns		575		9,575
Mar. 19	Debit not – allowance		840		8,735
Mar. 27	Invoice			13,250	21,985
Mar. 27	Insurance of goods in transit			150	22,135

Prepared by ……………………….   Checked by …………………………..

Mr. Favour Account

Date	Particulars	Amount	Date	Particulars	Amount
Mar. 2	Bank	3,871	Mar.1	Bal. b/d	4,075
2	Discount received	204	13	Purchases	8,500
18	Purchases return	575	17	Purchases	1,650
19	Purchase returns (Allowance)	840	27	Purchases	13,250
31	Bal. c/d	22,135			
		27,625			27,625
			1	Bal. b/d	22,135

SELF ASSESSMENT EXERCISE

1. On January 1, 2011 the Sales Ledger balance of Ola was ₦2,400 debit while the bought Ledger balance was ₦970 credit. The following transactions took place in the month of January 2011.

	₦
Credit sales	35,180
Bad debts	845
Dishonoured cheques	1,250
Credit purchases	18,060
Returns inwards	1,570
Bills receivable	4,500
Cash received from debtors	15,600
Cash paid to creditors	11,400
Discount allowed	450
Discount received	945
Cheques from debtors	7,500
Bills payable	2,150
Debit balance in bought ledger transferred to sales ledger	260
Discount allowed but subsequently disallowed	150
Discount received but subsequently withdrawn	145

Prepare:

a. Total Debtors Account

b. Total Creditors Account

2. The net total balances extracted from Tipper’s purchase ledger on 31st March 2007 amounted to ₦12,560, which did not agree with the balance on the purchase ledger control account. The audit revealed the following errors and, when the appropriate adjustments had been made for these, the books balanced.

1. A debit balance of ₦40 in the purchase ledger had been listed as a credit balance.
2. Hector had been debited for goods returned to him, £90, and no other entry had been made.
3. The purchase day book had been overcast by ₦100
4. Credit balances on the purchase ledger amounting to ₦480 and debit balances amounting to ₦24 had been omitted from the list of balances.
5. A payment of ₦8 to Tiger for a cash purchase of goods had been recorded inthepetty cash book and posted to his account in the purchase ledger, no other entry having been made.
6. The transfer of ₦120 from Harrow’s account in the sales ledger to the credit of his account in the purchase ledger had not been entered in the control account.

You are required to prepare:

(a) A statement reconciling the original net balances extracted from the purchase ledger with the corrected balance on purchase ledger control account, and

(b) The purchase ledger control account showing the balance before the correction of the errors and the necessary adjustments thereon.

3. The following balances have been extracted from the books of Jola Ade a sole trader for the year ended 31st December, 2011.

		₦
Sales ledger balance, 1/1/11		4,936
Purchases ledger balance, 1/1/11		3,676
Sales	49,916	
Returns inwards	1,139	
Cheques and Cash received from customers		46,490
Bad debts written off		99
Purchases	42,257	
Returns outwards	1,098	
Cheques paid to suppliers	38,765	
Discount received		887
Cash paid twice in error to a supplier now refunded		188
Interest charged to a customer in respect of an overdue account		50

You are required to prepare the Sales Ledger and Purchases Ledger Control Accounts for the year ended 31st December, 2011.

4. From the following particulars which relate to the month of January 1998, prepare a Sales Ledger Control Account:

	₦
Sales	1,200,000
Returns Inward	12,500
Cash received from customers	1,152,000
Discount allowed	25,000
Bad debt written off	50,000
Interest charged on overdue accounts	2,000
Balance 1st January	514,100

(b) The balance in this control account does not agree with the schedule of debtors extracted from the personal ledgers which amounted to ₦407,400.00 An investigation revealed the following:

i. The sales day book had been overcast by ₦10,000.00 on one occasion and ₦5,000.00 on another.
ii. Discount of ₦1,000.00 shown in the sales ledger has been omitted from the Cash Book
iii. Balance totalling ₦8,800.00 have been left off the list of debtors as at 31st January
iv. The credit side of one ledger account is ₦5,000.00 too much.
v. Bad debt of ₦12,200.00 has been written off in sales ledger but no entry has been made in the General ledger.
vi. ₦22,400.00 in the Purchases Ledger has been set off against a contra account in the Sales Ledger but this is not recorded in both Control Account.
vii. Discount allowed of ₦600.00 entered in the cash book has not been carried to the customer's account.
viii. An item of ₦9, 300.00 in the Sales Day Book has been posted as ₦39, 000.00 in the customer's account.

Show the adjustments necessary for:

(a) The balance in the Sales Ledger Control Account
(b) The Schedule of Debtors

4.0 CONCLUSION

Control account is a summary of customers or suppliers ledger in total. The balance on the control account under normal circumstance must equal the addition of individual customers or suppliers account at a particular date or period. Some of the merits of control accounts are: it saves time, it helps to prevent fraud, it allows homogeneous accounts to be grouped together and it can be used to detect missing figure.

5.0 SUMMARY

This unit focused on control accounts, and it was used to define control accounts, explain types of control accounts, discussedthe merits of control accounts. In addition, debtors control account, creditors control account, debtor’s statement of account and creditor’s statement of account were prepared.

6.0 TUTOR-MARKED ASSIGNMENT

Question 1: The following balances were extracted from the books of Usen Stores on 31st December, 2006.

	₦
Returns outwards	190
Cash payment to creditors for goods supplied	11,250
Returns inwards	410
Cash received from debtors for sales	17,784
Bills payable	3,404
Discount received	1,054
Bills receivable	2,400
Discount allowed	1,092
Bad debts	506
Balance of creditors for goods supplied as at 1/1/2006	2,678
Balance of debtors for sales as at 1/1/2006	4,260
Balance of creditors for goods supplied as at 31/12/2006	2,678
Balance of debtors for sales as at 31/12/2006	5,720

You are required to determine by Control Accounts, the amount of

(a) Purchases as at 31st December 2006

(b) Sales as at that date

Question 2: The net total balances extracted from Starling’s purchase ledger on 31st March 2014 amounted to ₦5,676, which did not agree with the balance on the purchase ledger control account. The audit revealed the following errors and, when the appropriate adjustments had been made for these, the books balanced.

1. An item of ₦20, purchase from A. Brown. had been posted from the purchase day book to the credit of B. Brown’s account.

2. On 31st January 2014, Charles had been debited for good returned to him, ₦84, and no other entry had been made.
3. Credit balances on the purchase ledger amounting to ₦562 and debit balances amounting to ₦12 had been omitted from the list of balances.
4. Returns of ₦60 allowed by Austin had been correctly recorded and posted in Starling's books. This item was later disallowed, entered in the sales return book, and credited to Austin's account in the sales ledger.
5. The transfer of ₦90 from the debit of Cook's account in the sales ledger to the credit of his account in the purchase ledger had not been entered in the journal.
6. The purchase day book had been undercast by₦100
7. A payment to Brook of ₦3 for a cash purchase of goods had been recorded in the cash book and posted to his account in the purchase ledger, no other entry having been made.

You are required to set out:

(a) Journal entries, where necessary, to correct these errors, and

(b) The purchase ledger control account showing the balance before the correction of the errors and the necessary adjustments thereon.

Question 3: The following transactions relate to a sales ledger for the year ended 31st December 2015

	₦
Balance on sales ledger control 1 January 2015	8,952
Sales as per positing summaries	74,753
Receipts from debtors	69,471
Discounts allowed	1,817

The clerk in charge had prepared from the ledger cards a list of balances outstanding on 31st December 2015 amounting to ₦9,663 but this did not agree with the balance of the sales ledger control account. There were no credit balances on the ledger cards.

Investigation of the differences revealed:

i. The bank statement showed credit transfers of ₦198 which had been completely overlooked

ii. Journal entries correctly posted to the ledger cards had been overlooked whenpositing control account: debts settled by set off against creditors' account ₦2,896, bad debts ₦640.

iii. When listing the debtors balances three ledger cards with debit balances of £191 had been incorrectly filed and consequently had not been included in the list of balances.

iv. The machine operator when posting a ledger card had incorrectly picked up an old balance of ₦213.50 as ₦13.50 and had failed to check her total balance.

v. ₦1,173 entered in the cash book as a receipt from J. Spruce had not been posted as no account under that name could be traced. Later it was discovered that it was in payment for a car which had been used by the sales department and sold to him second-hand.

Required:
(a) Prepare the sales ledger control account for the year ended 31st December 2015 taking into account the above adjustments.
(b) Reconcile the clerk's balance of ₦9,663 with the corrected balance on the sales ledger account.
(c) Explain the benefits that accrue from operating control accounts.

7.0 REFERENCES/FURTHER READINGS

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UNIT 13: BANK RECONCILIATIONS

1.0 INTRODUCTION

Two column cash book was considered in unit 10 which shows how both cash and bank accounts of an organisation are treated in the account. The bank column records the transactions carried out in the company's bank account. However, the balance of the bank column in the cash book may not be the same with the bank statement provided by the bank to the company. This unit examines how the bank column of the cash book and the bank statement balances can be reconciled including the factors responsible for differences in both balances that necessitate the preparation of bank reconciliation statement.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- i Define and explain bank reconciliation statement
- ii. Understand why cheques are dishonoured by the banks.
- iii. Prepare adjusted cash book
- iv. prepare a Bank reconciliation statement

3.0 MAIN CONTENT

3.1 BANK RECONCILIATION STATEMENT

Bank reconciliation is the process of making the balance on the bank column of a cash book to agree with the balance on the bank statement received from the bank. Put differently, bank reconciliation statement is a report prepared to show the process of agreeing entries in the bank statement with those in the cash book with a view to arriving at a reconciled balance.

The reconciliation becomes necessary as a result of differences between the cash book prepared by an account holder and the bank statement prepared by the bank. These differences are corrected using adjusted cash book and bank reconciliation statement.

Most of the time, the differences do not occur deliberately, but could be as a result of:

i. Errors – These are mistake either by the bank and/or the customer.
ii. Timing differences – These are due to unpresented cheques and uncredited lodgements.
iii. Entries not brought to the notice of the company by the bank e.g. bank charges, interests, transfers, commission on turnover etc.

3.1.1 Unpresented cheques

These are cheques which have been issued for payment by a bank account holder but have not been presented for payment at the bank as at the date the bank prepared the bank statement.Unpresented cheques will appear on the credit side of the cash book but will not be seen on the debit column of the bank statement.

3.1.2 Uncredited lodgements

These are cheques deposited into the bank, but which have not been credited to the customer's account by the bank as at the date of preparing the bank statement. This delay may be due to the cheque being banked other than at the customer's branch of the bank or delay in cheque clearing system which may take up to three working days for local cheques to clear or even more for up-country cheques.

3.1.3 Direct transfers or Standing orders

These are payments made directly by the bank as a result of previous instructions given by the customer to the bank. They include an order to pay annual insurance premium, professional membership subscription etc.

3.1.4 Others

These include bank charges, account maintenance fee, interest on loan and overdraft account, dishonoured cheque etc. not brought to the notice of the account holder by the bank except through the bank statement.

3.1.5 Reasons for Dishonoured Cheques

A cheque may be dishonoured for the following reasons:

i. If the cheque is not dated.
ii. If the amount in words does not correspond to the amount written in figure on the cheque.
iii. If the balance on the drawer's account is not sufficient to accommodate the amount to be drawn with the cheque.
iv. Cheque mutilations (i.e. unsigned alteration).
v. Stale cheques: The date on the cheque is more than six months beforeit is presented to the bank for payment.
vi. Irregular signature from the issuer
vii. Unsigned cheques.
viii. Cheque post-dated: Presenting cheque at the bank before the date written on it.
ix. Notice of death of customer received by the bank.

3.2 MERITS OF BANK RECONCILIATION STATEMENT

i. It aids the bank customer to monitor unpresented cheques, uncredited lodgements etc.
ii. It assists in detecting errors that might have occurred in the cash book or in the bank statement.
iii. It is useful in detecting fraud either from the bank or office
iv. Where the bank reconciliation statement is prepared regularly, it helps to prevent fraud.

3.3 PREPARATION OF BANK RECONCILIATION STATEMENT

i. Ensure that both cash book and bank statement are prepared up to the same date
ii. Check off items in the cash book against the bank statement
iii. Update the cash book by preparing adjusted cash book which will be credited with bank charges, commission on turnover, interest on overdraft and loans, dishonoured cheques, direct transfers, standing orders etc. Debit the adjusted cash book with direct payment to the bank like dividend received, interest on deposit account etc.
iv. Check for errors which occur in the cash book and bank statement for corrections, and correct cash book errors. But include bank errors in the reconciliation statement for notification to the bank.
v. Prepare the bank reconciliation statement using any of these two formats.

3.3.1 Format of Bank Reconciliation Statement Starting with Cash Book Balance

Big Life Ventures
Bank Reconciliation Statement
As at 31st December 2015
₦

Balance as per adjusted cash book	x x
Add unpresented cheques	x x
	x x
Less uncredited lodgements/cheques	(x)
	x x
Add or deduct bank error(s)	x
Balance as per bank statement	x x

3.3.2 Format of Bank Reconciliation Statement Starting with Bank Statement Balance

Unlimited Grace& Company
Bank Reconciliation Statement
As at 30th April 2016

	₦
Balance as per bank statement	x x
Add uncredited cheques/lodgements	x x
	x x
Less unpresented cheques	(x)
	x x
Add or less bank error(s)	x
Balance as per cash book	x x

Where the balance from the bank statement or adjusted cash book is an overdraft, it does not change the formats above. Overdraft should be indicated in bracket to show that it is a negative balance.

A bank reconciliation statement will only contain those entries that are necessary for the bank to make correction in future bank statements. Adjusted cash book should take care of all necessary entries to be made by the company.

Example 1: Joy Investment Company has the following transactions in its cash book and bank statement for July 2015.

Cash Book

Lodgement into bank			Payment ordered		
Chq.	6789	14,000	Chq.	123456	4,000
Chq.	4591	12,000	Chq.	123457	6,000
Chq.	4826	9,500	Chq.	123458	7,500

Chq.	4725	19,000	Chq.	123459		12,500
Chq.	4228	9,000	Chq.	123460		8,000
Cash		66,000	Chq.	123461		1,500
				Bal. c/d	90,000	
	129,500			129,500		
Bal. b/d		90,000				

Bank Statement

	Debit	Credit	Balance
Chq. 123459	12,500		(12,500)
Chq. 123458	7,500		(20,000)
Chq. 4826		9,500	(10,500)
Chq. 6789		14,000	3,500
Chq. 123460	8,000		(4,500)
Chq. 4826 contra	9,500		(14,000)
ICAN- Standing order	250		(14,250)
Account maintenance fee	500		(14,750)
Commission	1,750		(16,500)
Chq. 4228		9,000	(7,500)
Chq. 123457	6,000		(13,500)
Cash		66,000	52,500

You are required to

1. Prepare an adjusted cash book
2. Reconcile the adjusted cash book balance with bank statement.

Adapted from Institute of Chartered Accountants of Nigeria

SUGGESTED SOLUTION TO EXAMPLE 1

Joy Investment Company

Adjusted Cash Book

Bal. b/d	90,000	ICAN – Standing order		250
		Account maintenance fee	500	
		Commission	1,750	
		Bal. c/d	87,500	
	90,000		90,000	
Bal. b/d	87,500			

Joy Investment Company
Bank Reconciliation Statement

As at 31st July 2015

	₦		₦
Balance as per bank statement			52,500
Add uncredited lodgements:			
Chq. 4591	12,000		
Chq. 4826	9,500		
Chq. 4725	19,000		40,500
		93,000	
Less unpresented cheques:			
Chq. 123456	4,000		
Chq. 123461	1,500	5,500	
Balance as per cash book			87,500

Example 2: Okoro's cash book showed a debit balance of ₦3,344 on 31st January, 2016. His bank statement for January, 2016 however showed a credit balance of ₦3,424. On investigation it was discovered that.

i. The opening balance on the cash book for the month had been wrongly brought down as ₦1,505 instead of₦1,550.
ii. Payment for rent ₦250 had been debited in the cash book
iii. A customer had paid ₦600 direct into the bank
iv. The bank had paid, on a standing order, ₦300 to an insurance company
v. A cheque for ₦870 deposited in the bank on 25th January, was not credited until 3rd February, 2016.
vi. Cheques paid to suppliers totalling ₦1,875, had not been presented for payment.
vii. Cost of cheque book and other charges by bank totalling ₦90 had not been entered in the Cash Book.
viii. The bank had paid a cheque of N680 in error from Okoro's Account.

You are required to prepare:
a. Adjusted Cash Book
b. Bank Reconciliation Statement as at 31st January, 2016.

SUGGESTED SOLUTION TO EXAMPLE 2

Mr. Okoro

Adjusted Cash Book

Balance. b/d	3,344	Rent	500
Opening Bal. difference	45	Standing order	300
Direct payment	600	Bank charges	90
	____	Bal. c/d	3,099
	3,989		3,989
Bal. b/d	3,099		

Mr. Okoro
Bank Reconciliation Statement
As at 31st January 2016

	₦
Balance as per bank statement	3,424
Add uncredited cheque	870
	4,294
Less unpresented cheque	1,875
	2,419
Add Bank error	680
Balance as per cash book	3,099

The adjusted cash book was credited with rent of ₦500 because the account ought to have been credited initially with ₦250, but was debited, hence the need to credit the cash book with ₦500 to correct the error and also reflect ₦250 in rent account after the error.

SELF ASSESSMENT EXERCISE

1. T. Emeka maintains a business bank account with Second Bank Nigeria Limited. The bank statement received for the month of March 1999 showed a balance of ₦14,265 to his credit while according to his Cash Book; he should have ₦13,380. Subsequent investigation revealed the following:

(a) Two cheques A000111 for ₦3,400 and X222419 for ₦6,000 deposited to the bank on 28th March, 1999 were not credited by the bank until 2nd April, 1999.
(b) A cheque for ₦6,500 issued to Jango Ltd. had not been presented for payment.
(c) A cheque for ₦3,000 received from a customer in full settlement of a debt of ₦3,300 had been entered in the Cash Book at the full value of the debt.
(d) Dividend of ₦650 from PZ Ltd. had been paid direct to the bank.
(e) The bank deducted a total of ₦125 as its charges.
(f) The bank had credited a cheque of ₦3,560 of V. Amaka in error to T. Emeka Account.

You are required to prepare:
(i) Adjusted Cash Book; and

(ii) A Bank Reconciliation Statement for the month of March, 1999.

2. Define the bank reconciliation statement.

3. On 31st July 2016 the bank statement of Ene Nyong showed a credit balance of ₦140,163. The Cash Book has a debit balance of ₦55,750 as at 31st July 2016. Cheques drawn prior to 31st July 2016 but not presented until after that date:-

		₦
Abe Auto Works		2,920
Early Childhood School	80,117	
UCT Stores		574
Abu Momoh	13,232	

Cheques paid into the bank on 31st July 2016 but not credited until 4thAugust 2016 ₦11,619. Bank charges and interest to 31st July 2016 not entered in the Cash Book ₦811.

Required:
Prepare the Bank Reconciliation Statement

4. Discuss the process of preparing bank reconciliation statement.

4.0 CONCLUSION

Usually the balance of the bank column in the cash book may not be the same with the bank statement provided by the bank to the company. When this occurs, the two balances from the bank column of the cash book and the bank statement can be agreed by preparing a bank reconciliation statement.

5.0 SUMMARY

The importance to agree bank column of the cash book with the bank statement balance and the reasons for differences between the cash book and bank statement balances were considered in this unit. Adjusted cash book and bank reconciliation statement were also prepared.

6.0 TUTOR-MARKED ASSIGNMENT

Question 1: Below is an extract of the Bank Statement of Messrs. Jackson & Co for April, 1987.

Date	Details	Dr.	Cr.		Balance
		₦	₦	₦	
1/4/87	Balance				176,000Cr
4/4/87	Dasco Engineering		40,000		216,000Cr
5/4/87	Adebayo Builders		60,000		276,000Cr
7/4/87	Bisi Motors Cheque 011201	32,000			244,000Cr
9/4/87	Jide Foods Cheque 011202	57,000			187,000Cr
13/4/87	Okin Oloja & Co. Cheque 011204	32,800			154,200Cr
14/4/87	Bank Charges	7,280			146,920Cr
15/4/87	Interest on Fixed Deposit		4,000		150,920Cr
16/4/87	Tolu Adeolu & Co. Cheque 011205	8,000			142,920Cr
30/4/87	Kingsway Stores Cheque 011206	19,200			123,720Cr

You are given the following additional information:

(a) Cheque No 011203 issued in favour of Tayo Ajao and Associates for ₦24,800 was presented to the Bank on 2nd May, 1987.

(b) Advice in respect of Bank charges was received by Messrs. Jackson & Co. on 6th May, 1987.

(c) Cheque issued in favour of Jide Foods is for supplies to the Directors.

You are required to prepare:

i. The Cash Book of Messrs. Jackson & Co. for April, 1987 and
ii. A Bank Reconciliation Statement as at 30th April, 1987.

Question 2: On 30th June 2016, Olisa's cash book showed that he had an overdraft of ₦12,000 on his current account at the bank. On checking the cash book with the bank statement you find the following.

(a) Cheque drawn amounting to ₦20,000 had been entered in the cash book but had not been presented.

(b)Cheques received amounting to₦16,000 had been entered in the cash book but had not been credited to the bank.

(c) On instructions from Olisa, the bank had transferred interest of ₦2,400 from his deposit account to his current account, recording the transfer on 5th July 2016. This amount had however, been credited in the cash book as on 30th June 2016.

(d) Bank charges of ₦1,400, shown in the bank statement had not been entered in the cash book.

(e) The payment side of the cash book had been under cast by₦400;

(f) Dividends amounting to ₦8,000 had been paid direct to the bank, and not entered in the cash book.
(g) A cheque of ₦2,000, drawn on deposit account had been shown in the cash book as drawn on current account.
(h) A cheque issued to Jolayemi for ₦1,000 was replaced when out of date. It was entered again in the cash book, no other entry being made. Both cheques were included in the total of unpresented cheque shown above.

You are required to indicate the appropriate adjustment in the cash book, and prepare a statement reconciling the amended balance with that shown in the bank statement.

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UNIT 14: COST ACCOUNTING

CONTENTS

1.0 INTRODUCTION

The unit introduces you to the concept of cost accounting, its definition, the range of information that could be supplied by the system, usefulness of accounting information and cost build-up.

2.0 OBJECTIVES

At the end of this you unit, you should be able to:

(i) define cost accounting;
(ii) itemize the range of information that could be supplied by the cost accounting system;
(iii) explain the various concepts associated with cost
(iv) describe the build up of cost

3.0 MAIN CONTENT

3.1 Cost Accounting Information

The cost accounting system of any organization is the foundation of the internal financial information system. Management needs a variety of information to plan, to control and to make decisions. Information regarding the financial aspects of performance is provided by the cost accounting system. The table below shows the examples of cost accounting information and their uses.

S/N	Information provided by Cost Accounting System	Possible Uses by Management
1.	Cost per unit of production or service or for a process.	As a factor in pricing decisions, production planning and cost control.
2.	Cost of running a section, department or factory.	Organisational planning cost control.
3.	Wage costs for a unit of production or per period of production.	Production planning, decisions on alternative methods, wages cost control.
4.	Scrap/Rectification costs.	Material cost control, production planning.
5.	Cost behaviour with varying levels of activity.	Profit planning, make or buy decisions, cost control.

3.2 Cost Accounting – Definition

Cost accounting (traditionally termed 'costing') may be defined as:

> "*Gathering of cost information and its attachment to cost objects, the establishment of budgets, standard costs and actual costs of operations, processes, activities or products; and the analysis of variances, profitability or the social use of funds*".

An important part of the managerial task is to ensure that operations, departments, processes and costs are under control and that the organization and its constituent parts are working efficiently towards agreed objectives. Although there are numerous other control systems within a typical organization, for example, Production Control, Quality Control, and Inventory Control, the Cost Accounting system is the key financial control system and monitors the results of all activities and all other control systems. The detailed analysis and location of all expenditure, the calculation of job and product costs, the analysis of losses and scrap, the monitoring of labour and departmental efficiency and the other outputs of the Cost Accounting system provide a sound basis of information for financial control.

Decision making is concerned with making a choice between alternatives and frequently an important factor in making that choice is the financial implications of the various alternatives.

Correctly presented cost information can be of great value to management in decision making and accordingly material on short and long term decision making shall be included later in this unit.

The analysis and recording of past costs and activities is but one element of cost accounting. Management is also concerned to know what costs will be in the future so that appropriate plans and decisions can be made in good time. Also, having some standard or target against which to compare actual costs greatly assists the control function.

Pricing decisions are complex and many interacting factors need to be considered including: the type of market in which the firm operates, the degree of competition, demand and the elasticity of demand, the cost structure of the product and firm, the state of the economy and numerous other factors. Pricing is not simply a cost based decision although past costs and expected future costs are factors to be considered in pricing decisions.

3.3 Usefulness of Cost Accounting

It cannot be emphasised too strongly that if the information produced by the cost accounting system is not useful for managerial decision making, for control or for planning, then it has no value and should not be prepared. To ensure its usefulness, the following questions should be considered:

(a) Is the cost accounting system appropriate to the organization the way services are provided or goods manufactured?
(b) Do the reports, statements and analyses produced by the cost accounting system contain the relevant information for the intended purpose?
(c) Are the reports and statements produced at appropriate intervals and early enough to be effective?
(d) Are they addressed to the person responsible for planning/decision making/control?
(e) Is the information produced in a relevant form and to a sufficient degree of accuracy for the intended purpose?

It follows from the above that every cost accounting system will, in certain respects, be unique, because it must be designed to suit the particular organization, products and processes and personalities involved.

SELF ASSESSMENT EXERCISE

1. Describe the information provided by cost accounting system
2. Explain the usefulness of cost accounting

3.4 Conceptual clarification of cost

3.4.1 Cost may be defined as:

Cost *as a noun – The amount of cash or cash equivalent or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction* (IAS 16).

The word 'cost' may also be used as a verb, in which case, it can be defined thus:

To ascertain the cost of a specified thing or activity. The word cost can rarely stand alone and should be qualified as to its nature and limitations.

It will be clear from a study of these definitions that they relate to past costs which are the basis of cost ascertainment. At the simplest level, cost includes two components, quantity used and price, i.e.

cost = quantity used x price

3.4.2 Cost Object

A cost object is any item, process or activity for which a separate measurement of cost is required.

Examples include: the cost of manufacturing a component or product, the cost of operating a department, the cost of dealing with an enquiry at a call centre, the cost of an operation at a hospital or indeed the cost of running the whole hospital. When an individual unit cost is required it is normal to refer to *cost units*.

3.4.3 Cost Units

Costs are always related to some object or function or service. For example, the cost of a car, a haircut, a ton of coal etc. Such units are known as *cost units* and can be formally defined as:

A unit of product or service in relation to which costs are ascertained.

The cost unit to be used in any given situation is that which is most relevant to the purpose of the cost ascertainment exercise. This means that in any one organization numerous cost units may be used for particular parts of the organization or for differing purposes. For example, in a factory manufacturing typewriters the following cost units might be used for different purposes in the cost accounting system.

Cost Unit	Used
A typewriter	production cost ascertainment
Kilowatt-hours	electricity cost ascertainment
Computer minutes of operation	computer running cost ascertainment
Tonne-miles	transport cost ascertainment
Canteen meals	catering cost ascertainment

Cost units may be *units of production*, e.g. tones of cement, typewriters, gallons of beer, or *units of service*, e.g. consulting hours, number of invoices processed, patient nights, kilowatt-hours etc.

They may be *identical* units as in the above examples, or they may be dissimilar as in a jobbing engineering factory where the cost unit will be the job or batch, each of which will be costed individually.

3.4.4 Direct Costs

Costs may be classified in numerous ways, but a fundamental and important method of classification is into *direct* and *indirect costs*.

Direct costs (comprising direct material costs, direct wages cost and direct expenses) are those costs which can be directly identified with a job, batch, product or service. Typical examples are:

Direct materials	The raw materials used in a product, bought in parts and assemblies incorporated into the finished products.
Direct wages or Direct labour cost	The remuneration paid to production workers for work directly related to production, the salaries directly attributable to a saleable service (audit clerks' salaries for example).
Direct expenses	Expenses incurred specifically for a particular product, job, batch or service; royalties paid per unit for a copyright design, plant or tool hire charges for a particular job or batch.

It follow therefore that direct costs do not have to be spread between various categories because the whole cost can be attributed directly to a production unit or saleable service.

The total of direct costs is known as *prime cost*, i.e.:

direct material + direct labour + direct expenses = prime cost

Invariably when direct costs are mentioned, the costing of production cost units is involved. Technically, this need not be so, but unless the context of the question clearly points to some other conclusion, any reference to direct costs should be taken to refer to product costs units.

3.4.5 Indirect Costs

All material, labour and expense costs which cannot be identified s direct costs are termed *indirect costs*. The three elements of indirect costs: indirect materials, indirect labour and indirect expenses are collectively known as **overheads**. Typical examples of indirect costs in the production area are the following:

INDIRECT MATERIALS:	Lubricating oil, stationery, consumable materials, maintenance materials, spare parts for machinery, etc.
INDIRECT LABOUR:	Factory supervision, maintenance wages, storemen's wages, etc.
INDIRECT EXPENSES:	Rent and rates for the factory, plant insurance, etc.

INDIRECT MATERIAL + INDIRECT LABOUR + INDIRECT EXPENSES = OVERHEADS

Note:
In practice, overheads are usually separated in categories such as Production Overheads, Administration Overheads, Selling Overheads. The above are examples of Production Overheads.

It must be emphasised that the choice of cost object determines what can be classified as a direct or indirect cost. For example, in a manufacturing firm, the cost object may be to find the cost of running the Inspection Department; in which case the salaries of the inspectors would be a direct cost. However, if the cost object was to find a unit component cost then the inspector's salaries would be an indirect cost because they cannot be directly identified with an individual component. The more costs that can be classified as direct; the more accurate will be the cost assignment.

3.5 Cost Build-up

Having defined direct and indirect costs, the framework of cost build-up can be shown thus:

DIRECT MATERIAL	INDIRECT MATERIAL
+	+
DIRECT LABOUR	INDIRECT LABOUR
+	+
DIRECT EXPENSE	INDIRECT EXPENSE

PRIME COST + OVERHEADS = TOTAL COSTS

4.0 CONCLUSION

Cost and financial information is not the only information required for management decision-making, but it is usually an important if not a crucial factor. Decision-making is concerned with the future and with future costs and revenues. Cost accounting, which is based on historical data, can nevertheless provide some guide to future costs and is frequently a critical part of the information upon which a decision is made. The word cost is rarely used on its own. It is invariably qualified in some way, e.g. Prime Cost, Factory Cost, Indirect Cost, etc.

5.0 SUMMARY

In this unit, we have learnt that: Cost accounting is concerned with the ascertainment and control of costs; The purpose of cost accounting is to provide detailed information for control, planning and decision-making; To be of use, cost accounting information must be appropriate, relevant, timely, well presented and sufficiently accurate for the purpose intended. Also, in this unit we have treated various concepts such as: cost object; direct cost; indirect cost, etc.

6.0 TUTOR-MARKED ASSIGNMENT

1. Define cost accounting with reference to its scope and uses
2. Differentiate between Direct and Indirect cost

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UNIT 15: ELEMENTARY BREAK-EVEN ANALYSIS

CONTENTS

1.0 INTRODUCTION

Break-Even analysis can be used to give answers to business questions such as "what is the minimum level of sales that can be made wherein a company will not experience loss" or "by how much can sales be reduced and the company still continues to be profitable". Break-even analysis is the analysis of the level of sales at which a company (or a project) would make zero profit. As its name implies, this approach determines the sales needed to break-even.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

i. Explain break-even analysis

ii. Calculate the break-even point for any product using formulars

iii. Present the break-even point in a diagram

iv. Mention the major assumptions behind the C-V-P analysis

v. Describe restrictions surrounding the break-even point analysis

3.0 MAIN CONTENT

3.1 BREAK-EVEN POINT

Break-Even point (B.E.P.) is determined as the point where total income from sales is equal to total expenses (both fixed and variable). In other words, any point under this point indicates that the company is operating at a loss. If all the company's expenses were variable, break-even analysis would not be relevant. But, in practice, total costs can be significantly affected by long-term investments that produce fixed costs. Therefore, a company–in its effort to produce gains for its shareholders has to estimate the level of goods (or services) sold that covers both fixed and variable costs.

3.2 BREAK-EVEN ANALYSIS

Break-even analysis is based on categorizing production costs between those which are variable (costs that change when the production output changes) and those that are fixed (costs not directly related to the volume of production). The distinction between fixed costs (for example administrative costs, rent, overheads, and depreciation) and variable costs (for example production wages raw materials, sellers' commissions) can easily be made, even though in some cases, such as plant maintenance, costs of utilities and insurance associated with the factory and production manager's wages, need special treatment. Total variable and fixed costs are compared with the sales and revenue in order to determine the level of sales volume, sales value or production at which the business makes neither a profit nor a loss.

SELF-ASSESSMENT EXERCISE

Explain in details the break-even analysis with reference to the break-even point.

3.3 SIMPLE BREAK-EVEN POINT APPLICATION

B.E.P is explained in the following example, the case of Eleganza Ltd. This company produces and sells quality pens.

Fixed costs = N400,000

Cost per pen = N12

Selling price per pen = N20

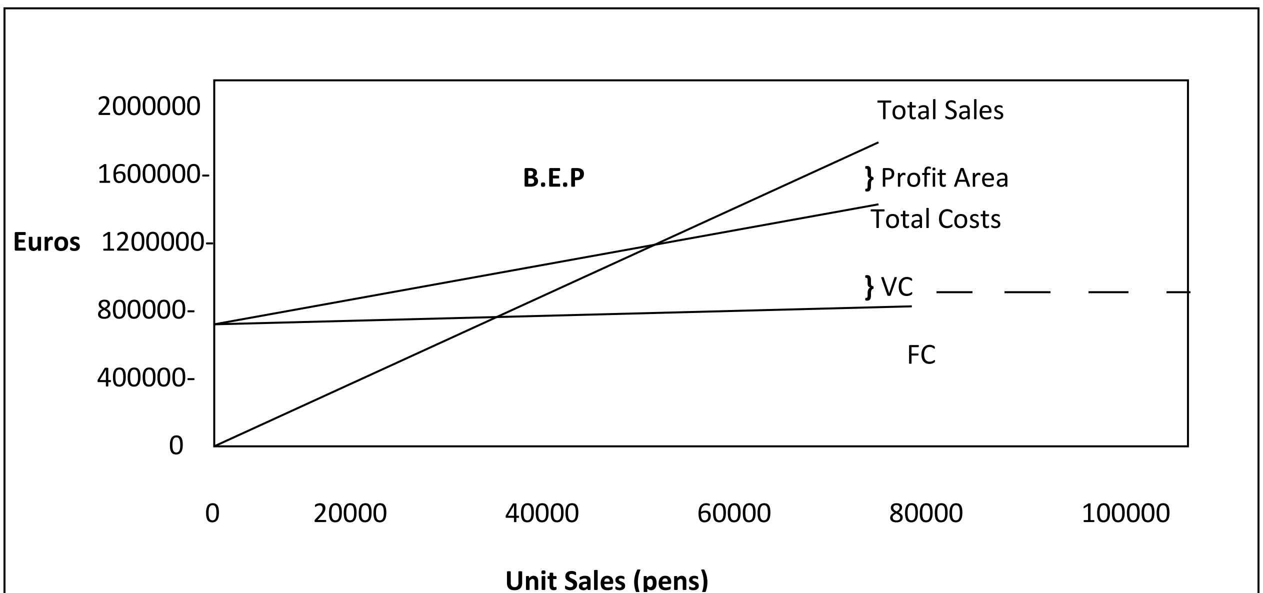
The following table shows the outcome for different quantities of pens sold (Diagram1):

Number of Pens Sold (Q)	20,000	50,000	80,000

Total Sales (S)	N400,000	N1,000,000	N1,600,000
Variable Costs (VC)	N240,000	N600,000	N960,000
Contribution Margin (C.M.)	N160,000	N400,000	N640,000
Fixed Costs (FC)	N400,000	N400,000	N400,000
Profit/(Loss)	(N240,000)	0	N240,000

Diagram 1: Different quantities of pens sold

The break-even point can easily be calculated. Since the sales price is N20 per pen and the variable cost is N12 per pen, the difference per item is N8. This difference is called the contribution margin per unit because it is the amount that each additional pen contributes to profit, in other words, each pen sold offers N8 in order to cover the fixed expenses. In our examples, fixed cost incurred by the firm is N400,000 regardless of the number of sales. As each pen contributes N8, sales must reach the following level to offset the above costs (Diagram 2):



$$\frac{\text{Fixed Costs}}{\text{SP- VC (u)}} = \frac{\text{Fixed Costs}}{\text{Contribution Margin}} = \frac{\text{N400,000}}{\text{N8}} = 50000\text{pens (B.E.P)}$$

Thus, 50,000 pens is the B.E.P required for an accounting profit.

Break-even analysis is a useful tool because it helps managers to estimate the outcome of their plans. This analysis calculates the sales figure at which the company (or a single project) breaks even. Therefore, a company uses it during the preparation of annual budget or in cases of new product development. The B.E.P formula can be also used in the case of new product development. The various formulas relevant for BEP analysis are shown below:

1. Break-even point (in units) = $\frac{\text{Fixed cost}}{\text{Contribution margin/unit}}$
2. Break-even point (N sales) = $\frac{\text{Fixed cost}}{\text{Contribution/unit}}$ x Selling price/unit
3. Contribution/unit = Selling price/unit – Cost price/unit
4. Number of units for target profit = $\frac{\text{Fixed cost + Target profit}}{\text{Contribution/unit}}$
5. Sales value for target profit = Number of unit for target profit x Selling price/unit

The B.E.P formula can be also used in the case where a company wants to specify the exact volume of sold items required to produce a certain level of profit. This is depicted in ILLUSTRATION 2.

ILLUSTRATION 2

Honey PLC produces bottles of honey with a Selling price of N1,000 and a variable cost of N600. Fixed cost is N6,000,000 per annum. Calculate:

i. Number of units to break-even
ii. Sales at break-even point
iii. The number of units to be sold to achieve a profit of N2,000,000
iv. The sales value for target profit of N2,000,000

SOLUTION

Contribution/unit = N1,000-N600
= N400

i. BEP (units) = $\frac{\text{N6,000,000}}{\text{N400}}$ = 15,000 bottles of honey

ii. BEP (N sales) = $\frac{\text{N6,000,000}}{\text{N400}}$ x N1000 = N15,000,000
iii. Number of units for target profit = $\frac{\text{N6,000,000 + N2,000,000}}{\text{N400}}$ = 20,000 bottles
iv. Sales for target profit = 20,000 bottles of honey x N1,000 = N20,000,000

From Illustration 2 it is clear that BEP is not only concerned with the level of activity that produces neither profit or loss but also considers the behavior of costs and profits at other levels which is of much greater significance. As a result of this consideration, the B-E-P is alternatively referred to as cost-volume-profit analysis or C-V-P analysis

3.4 C-V-P Analysis Assumptions

a) All costs can be resolved into fixed and variable elements

b) Fixed costs will remain constant and variable costs vary proportionately with activity

c) Over the activity range being considered, costs and revenues behave in a linear fashion

d) The only factor affecting costs and revenues is volume

e) Technology, production methods and efficiency remain unchanged

f) Particularly for graphical methods, the analysis relates to one product only or to a constant product mix

g) There are no stock level changes or that stocks are valued at marginal or variable cost only.

3.5 RESTRICTIONS OF B-E-P

Beside its useful applications, break-even analysis is subject to some restrictions.

1. In every single estimation of the break-even level, we use a certain value to the “selling price”. Therefore, if we want to find out the level that produces profits under different selling prices, many calculations and diagrams are required.
2. A second drawback has to do with the variable “total costs”, since in practice these costs are difficult to calculate due to the fact that there are many things that can go wrong and mistakes that can occur in production.
3. Another effect that is not algebraically measured is that changes in costs may alter products’ quality. Also, the break-even point is not easily estimated in the ‘real world’, because there is no in mathematical calculation that allows for the “competitive environment”. This refers to the fact that the competition may cause prices to drop or increase according to demand.

4.0 CONCLUSION

The Break-even analysis, or more descriptively, cost-volume-profit analysis studies the relationship between costs, volume, sales and profit. The main purpose of this analysis is to have some idea of how much to sell, before a profit will be made. Break-even analysis is extremely important before starting a new business or to early stage business because it gives answers to crucial questions such as how sensitive is the profit of the business to decreases or increases in costs.

5.0 SUMMARY

In this unit, we have discussed the meaning of Break-even analysis and shown how to make use of formular and graph to calculate the Break-even point. The cost-volume-profit analysis is also described as more encompassing than the B-E-P in studying the behavior of costs and profit at varying level of activity. This unit also discussed the assumptions behind C-V-P analysis and restrictions of B-E-P.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the major assumptions behind C-V-P analysis?
2. A company makes a single product with a selling price of N40 and a variable cost of N24. Fixed cost is N240,000 per annum. Calculate the following and present in a graph:
    a. Number of units to break even
    b. Sales at break-even point
    c. What is the number of sales that is needed to achieve a profit of N80,000
    d. What is the level of sales that will achieve a profit of N80,000

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