PRC - 4

INTRODUCTION TO ACCOUNTING

The Institute of
Chartered Accountants
of Pakistan

CA PAKISTAN

First edition published by
The Institute of Chartered Accountants of Pakistan
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ACCOUNTING FUNDAMENTALS

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Book-keeping and accounting are two different but inter-connected functions which are integral part of business reporting. Book-keeping is concerned with only recording financial transactions of the business whereas Accounting is a broader term that includes summarising, analysing and reporting these transactions in the financial statements.

A business transaction is an economic event, involving a business entity and other parties, and must be recorded by an accounting system. One important classification of business transactions is capital vs revenue transactions which differentiate long term impacts from short term impacts of transactions, respectively.

Financial statements are the concise reports based on financial transactions over an accounting period of an entity which reflect its financial performance and financial position. Statement of financial position has three elements namely assets, liabilities and equity. Statement of comprehensive income is made up from two elements i.e. income and expenses.

The main objective of financial statements is to provide investors, lenders, creditors and other users with relevant and reliable information to help them make decisions regarding the business entity. The preparation and presentation of financial statements is regulated by Generally Accepted Accounting Principles which, in Pakistan, are mainly Companies Act, 2017 and International Financial Reporting Standards.

Every business transaction has dual aspect and these aspects are recorded as debit and credit. The double entry book-keeping makes it possible to process large volume of transactions and maintains the accounting equation.

1. BOOK-KEEPING AND ACCOUNTING

BOOK-KEEPING

Book-keeping is the process of recording financial transactions in the accounting records (the 'books') of an entity. All transactions are analysed into different types and are then recorded in a series of individual records called accounts. There is a separate account for each different type of transaction, or that is to say, for each type of asset, liability, income, expense and owners' capital.

Double entry book-keeping is used to record dual aspect of transactions in systems designed to allow the management of the business to monitor its progress and produce periodic financial statements and performance reports.

ACCOUNTING

Accounting is the process of recording, classifying, summarising the information of financial nature and interpreting the results thereof. There are two kinds of accounting: financial accounting and managerial accounting.

Financial accounting (and reporting) is a term that describes:

- maintaining a system of accounting records for business transactions and other items of financial nature; and
- reporting the financial position and the financial performance (profit or loss) of an entity in a set of financial statements to the stakeholders.

Cost and Management Accounting (covered at CAF Level) is the recording and communication of economic information to management for planning, control and decision making.

Accounting Cycle (or Accounting process)

- **Transactions:** An event that has a monetary impact and needs to be recorded in books of accounts is called transaction. A business usually has thousands of transactions in an accounting period.
- **Books of prime entry:** This is the first place where transactions are recorded according to the type of transactions.
- **Ledgers:** Transactions (or transactions totals) are entered into the appropriate accounts in ledgers.
- **Trial balance:** A list of balances can be extracted from the ledgers and this list is called trial balance.
- **Financial statements:** The figures in trial balance are adjusted for period-end adjustments and financial statements are prepared.

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2. BUSINESS TRANSACTIONS

A **transaction** is an action or activity involving two parties or things that reciprocally affect or influence each other. A business transaction is an interaction between a business and customer, supplier or any other party with whom they do business. It is an economic event that must be recorded by the accounting system.

Any transaction that has a monetary impact on the business' accounts is a **financial transaction**. A financial transaction has an effect on the business' assets and liabilities, etc. A business must record and account for all financial transactions.

Few examples of financial business transactions are:

- Cash sales of goods or services.
- Credit sales of goods or services.
- Receipt of cash from a customer to whom credit sales was made.
- Cash purchase of raw materials or goods.
- Credit purchase of raw materials or goods.
- Payment of cash to a supplier from whom we had purchased on credit.
- Receipt of loan proceeds.
- Repayment of a loan.
- Payments made to employees.
- Payments made to the government (for example taxes).
- Purchase of non-current assets.
- Drawings (i.e. cash or goods taken by owner from the business)

CLASSIFICATION OF BUSINESS TRANSACTIONS

The business transactions may be classified in following ways:

Simple transactions and Complex transactions

Transactions can be very simple like buying and selling items on cash. Transactions may also be complex involving long time and various parties, for example, selling an item through agent involving series of instalment payment including interest.

One-off transactions and Ongoing transactions

Transactions might occur on single occasion, for example, buying land and building for setting up a factory. Transactions may also occur on regular basis, for example, payment of monthly rent or electricity bill.

Capital transactions and Revenue transactions

Items of a long-term nature, such as property, plant and equipment used to carry out the operating activities of the business, are 'capital items'. Items of a short-term nature, particularly items that are used or occur in the normal cycle of business operations, are 'revenue items'.

Capital expenditure and Revenue expenditure

Capital expenditure is expenditure made to acquire or improve long term assets that are used by the business. Revenue expenditure is expenditure on day-to-day operating expenses.

The term 'capitalisation' means recognising a cost as an asset or part of the cost of an expenditure as an asset. So, when an item of cost is 'capitalised' it is treated as an asset rather than as an 'expense.'

Capital receipts and Revenue receipts

Capital receipts are receipts of 'long term' nature, such as money from a bank loan, or new money invested by the business owner (which is called 'capital'). Revenue income is income arising from the normal operations of a business from its investments, for example, revenue from sale of goods or interest received.

- *Example 01:*

Classify the following transactions as either 'capital' or 'revenue'.

Sr. #	Transaction	Capital /Revenue
(i)	Vehicle A engine is repaired	Revenue expenditure
(ii)	Vehicle B engine is replaced	Capital expenditure
(iii)	Loan borrowed from bank for five years	Capital receipt
(iv)	Interest paid on loan	Revenue expenditure
(v)	Cash received from customer	Revenue receipt
(vi)	Cash paid to employees for their wages	Revenue expenditure
(vii)	Wages paid by a building contractor to his own staff for construction of an office room	Capital expenditure
(viii)	The purchase of machinery for use in the business	Capital expenditure
(ix)	Carriage paid to bring the above-mentioned machinery to the factory	Capital expenditure
(x)	Monthly electricity bill paid	Revenue expenditure
(xi)	The purchase of a soft drinks vending machine for the canteen	Capital expenditure
(xii)	The stock of soft drinks purchased for resale, along with above-mentioned vending machine	Revenue expenditure
(xiii)	Annual motor vehicle tax paid for existing car	Revenue expenditure
(xiv)	Annual motor vehicle tax paid for new car	Revenue expenditure
(xv)	Cost of alteration in office van to increase carrying capacity	Capital expenditure
(xvi)	Small but expensive alterations to a manufacturing machine which increased the output of that machine by 15%	Capital expenditure

3. FINANCIAL STATEMENTS

Financial statements are reports of an entity to provide its stakeholders with necessary information for their decision making needs. The term entity is used to describe any type of organisation for which we do accounting e.g. a business, a company, a bank, a charity organisation.

The business entity concept

Financial reports are constructed as if the business entity is separate from its owners. In other words, the business entity and its owners are differentiated.

This concept has legal substance in case of companies i.e. a company by law is a legal person separate from its owners (the shareholders). However, the concept is also applied to sole traders and partnership in accounting.

▶ *Example 02:*

Discuss whether you would consider the following events as business transactions.

(i)	A businessman purchased a vehicle for his private use by drawing cash from business. However, he also uses it for coming to the office.
(ii)	ABC & Company has paid the electricity bill of one of its partners. However, the amount is recoverable from that partner.
(iii)	Furniture and fixtures lying in the office were destroyed by fire. Furniture was owned by one of the partner and it was not in the use of business.
(iv)	The proprietor provides a generator to the office. The generator is presently not working and it would have to be repaired before it can be used. Previously the generator was lying in the proprietor’s house.
(v)	Balance recoverable from an employee was written off after his death.

▶ *ANSWER:*

(i)	Purchase of a vehicle is not a business transaction. However, the cash withdrawal is a business transaction.
(ii)	Payment on behalf of the partner is recoverable by the business. Hence this is a business transaction.
(iii)	It is not a business transaction as the ownership of furniture does not belong to the business entity but to one of the partners.
(iv)	It is a business transaction and it is required to be recorded as capital invested in business in the form of generator.
(v)	This is a business transaction as the employee was working for the business and such waiver is a form of benefit to the employee.

Accounting period

Financial statements relate to given period of time, known as the ‘financial year’, ‘accounting period’ or ‘reporting period’.

COMPONENTS OF FINANCIAL STATEMENTS

A complete set of financial statements usually comprises:

- A statement of financial position;
- A statement of comprehensive income;
- A statement of changes in equity (not examinable at this level);
- A statement of cash flows (not examinable at this level); and
- Notes to the financial statements (not examinable at this level).

Statement of financial position

A statement of financial position (also called balance sheet) reports the financial position of an entity as at a particular date, usually the end of a financial year. The financial position of an entity is shown by its assets, liabilities and equity (owner's capital).

Statement of Comprehensive income

This statement provides information about the performance of an entity in a period. It consists of two parts:

- A statement of profit or loss – a list of income and expenses which result in a profit or loss for the period; and
- a statement of other comprehensive income – a list of other gains and losses that have arisen in the period (not in syllabus).

ELEMENTS OF FINANCIAL STATEMENTS

The statement of financial position consists of three elements i.e. assets, liabilities and equity. These three elements form an accounting equation i.e. Assets = Liabilities + Equity

The statement of comprehensive income consists of two elements i.e. income and expenses. The difference of these two elements determines the profit or loss for an accounting period.

Assets

An asset is defined as:

- a present economic resource
- controlled by the entity
- as a result of past events.

The definition clarifies that the potential economic benefits no longer need to be 'expected' to flow to the entity and they do not need to be certain or even likely. An economic resource is a right that has the potential to produce economic benefits.

In simple words, an asset is something the business owns or controls and is available or will be available for use in the business.

The assets are classified into current assets and non-current assets:

- **Current assets:** assets that provide economic benefits in the short term (usually one year). For example, cash and trade receivables.
- **Non-current assets:** assets that have a long useful life and provide future economic benefits for an entity over a period of several years. For example, buildings and plant & machinery.

Liabilities

A liability is:

- a present obligation of the entity
- to transfer an economic resource
- as a result of past events.

The definition clarifies that a liability is the obligation to transfer an economic resource and not the ultimate outflow of economic benefits. The outflow also no longer needs to be 'expected'.

In simple words, a liability is something owed by the business to someone else.

The liabilities are classified into current and non-current, as well:

- **Current liabilities:** amounts payable by the entity within 12 months. For example, trade payables and utilities bills payable.
- **Non-current liabilities:** amounts payable more than 12 months after the reporting date. For example, long term bank loan.

▶ *Example 03:*

Identify the following items as either an asset or a liability.

Sr.#	Item	Element
(i)	Loan to another business	Asset
(ii)	Bank overdraft	Liability
(iii)	Fixture and fittings	Asset
(iv)	Computers	Asset
(v)	We owe a supplier for inventory bought	Liability
(vi)	Warehouse we own and control	Asset
(vii)	Motor vehicles	Asset
(viii)	Premises	Asset
(ix)	Accounts receivables	Asset
(x)	Inventory	Asset
(xi)	Accounts payable for inventory	Liability
(xii)	Owing to bank	Liability
(xiii)	Cash in hand	Asset
(xiv)	Loan from a friend for business use	Liability
(xv)	Machinery	Asset

▶ *Example 04:*

Identify the following items as elements of financial statements and classify them as either current or non-current.

Sr. #	Item	Element	Classification
(i)	Land and buildings	Asset	Non-current asset
(ii)	Receivables (Trade debts)	Asset	Current asset
(iii)	Cash	Asset	Current asset
(iv)	Loan repayable in two years' time	Liability	Non-current liability
(v)	Payables (Trade creditors)	Liability	Current liability
(vi)	Delivery trucks	Asset	Non-current asset

Equity (owner's capital)

Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Equity claims are claims against the entity that do not meet the definition of a liability i.e. the entity has no obligation to pay or distribute its profits to its shareholders but most of the profitable companies distribute it as to gain the investor confidence. Equity is often referred as owner's capital in sole trader businesses.

Income and investing further capital increases the equity while expenses and drawings decrease the equity.

Equity is sometimes referred to as the 'net assets' of the business. This is represented by accounting equation i.e. Equity (net assets) = Assets – Liabilities

▶ *Example 05:*

Complete the gaps in following table using accounting equation.

Sr. #	Assets	Liabilities	Owner's Capital
	Rs.	***Rs.***	***Rs.***
(i)	60,000	15,000	?
(ii)	80,000	?	56,000
(iii)	?	18,000	58,000
(iv)	120,000	27,000	?
(v)	150,000	?	97,000
(vi)	?	36,000	95,000

▶ *ANSWER*

(i)	Owner's Capital = 60,000 – 15,000 = Rs. 45,000
(ii)	Liabilities = 80,000 – 56,000 = Rs. 24,000
(iii)	Assets = 18,000 + 58,000 = Rs. 76,000
(iv)	Owner's Capital = 120,000 – 27,000 = Rs. 93,000
(v)	Liabilities = 150,000 – 97,000 = Rs. 53,000
(vi)	Assets = 36,000 + 95,000 = Rs. 131,000

Income

Income arise from:

- increase in assets or decrease in a liability, resulting in increase in equity
- other than contribution from owners (more capital invested in the business).

Income is usually classified into revenue and other items of income:

- **Revenue:** it is income arising in the course of the ordinary activities of the entity. For example, revenue from sale of goods and fee for providing services.
- **Other income:** income arising other than in the course of ordinary activities. For example, interest received on bank deposits and gain from disposal of non-current assets.

Expenses

Expenses arise from:

- decrease in assets or increase in liability, resulting in decrease in equity
- other than distributions (drawings or dividends) to owners.

Expenses arise in the normal course of activities, such as the cost of goods sold, salaries, rent and other operational costs. Expenses also include losses such as the loss on disposal of a non-current asset, and losses arising from damage caused by fire or flooding.

FORMAT OF FINANCIAL STATEMENTS

Name of Entity

Statement of Comprehensive Income for the year ended 30 June 2021

	Rs'000
Revenue	950
Cost of Sales	(750)
Gross Profit	200
Other income: Gain on disposal	100
	300
Operating expenses	
Salaries and wages	(140)
Repair and maintenance	(60)
Depreciation	(20)
Other expenses	(10)
	(230)
Net profit	70

Name of Entity

Statement of Financial Position as at 30 June 2021

	Rs'000
Non-current assets	
Land and building	200
Plant and machinery/equipment	100
Furniture and fixture	50
Motor vehicles	50
	400
Current assets	
Inventories	110
Trade Receivables	40
Cash and bank balances	50
	200
	600

Capital	**Rs'000**
Balance at beginning	100
Add: additional capital invested	50
Add: net profit	70
Less: drawings	(20)
	200
Non-current liabilities	
Bank loan	100
Loan from friend	100
	200
Current liabilities	
Trade payables	100
Salaries payables	100
	200
	600

Relationship between above financial statements

- The statement of financial position shows the equity of a business at a point in time.
- The statement of comprehensive income ends with a figure showing net profit for the period.
- Profit belongs to the owner (or owners) of the business. It is, therefore, added to equity.

ACCOUNTING TERMS

Recognition

This refers to putting an item into the bookkeeping system (performing double entry on it).

Cost

The amount of cash or cash equivalents paid, or the value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Gross amount

This is presenting an asset, liability, income or expense without deducting any related amount.

Illustration:

	Rs. '000
Sales	580,000
Trade receivables	63,000

Net amount

This refers to the result of adding a positive and negative number together. The result might be a net asset, net liability, net income or net expense.

Illustration:

	Rs. '000
Sales	580,000
Less: Sales return	(46,000)
Less: Settlement discount allowed	(3,000)
Net sales	531,000
Trade debts	63,000
Less: Allowance for doubtful debts	(3,500)
Net trade debts	59,500

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4. FINANCIAL REPORTING

The objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

The information explains the financial position of an entity at the end of a period (usually a year) and the financial performance of the entity over that period.

RESPONSIBILITY FOR PREPARING FINANCIAL STATEMENTS

Sole trader and partnership businesses

There may be no obligation to prepare financial statements, other than for tax purposes or obtaining loan from bank, for which the owner/partners are responsible. They might employ a person or persons to maintain the accounting records and prepare financial statements.

Companies

Companies must prepare financial statements for shareholders and for filing with relevant regulatory bodies. It is the responsibility of the directors to ensure that this is done. Usually the work is delegated to employees.

REGULATION FOR PREPARING FINANCIAL STATEMENTS

Sole trader and partnership businesses

The financial statements are private and do not have to be disclosed, except to the tax authorities (and possibly also to a lending bank). These must be prepared according to accepted accounting principles and practices but need not conform to all the requirements of accounting standards.

Companies

The financial statements of a company are prepared for the shareholders of the company and are usually subject to audit. Audit is the examination of the financial statements by an independent expert who expresses an opinion as to whether they are fairly presented (show a true and fair view).

Company law requires that financial statements are filed with a government agency, where they can be accessed and read by any member of the general public. Listed companies are even required to make their financial statements available on their websites.

The concepts, principles, conventions, laws, rules and regulations that are used to prepare and present financial statements are known as Generally Accepted Accounting Principles (GAAPs).

GAAP AND IFRS

The main sources of GAAPs in Pakistani jurisdiction are:

- Companies Act, 2017; and
- International Financial Reporting Standards (IFRSs)

The accountancy profession has developed a large number of regulations and codes of practice that professional accountants are required to use when preparing financial statements. These regulations are accounting standards. Many countries and companies whose shares are traded on the world's stock markets have adopted IFRSs issued by the International Accounting Standards Board (IASB).

INFORMATIONAL NEEDS OF USERS OF FINANCIAL STATEMENTS

Financial statements are drafted to provide information that should be useful to most users but will not necessarily satisfy all of their needs.

Investors

They need information to assess whether to buy, hold or sell investment in the business. Financial statements also give some indication of the ability of a company to pay dividends to its shareholders out of profits.

Lenders

Financial statements can help lenders to assess the continuing ability of the borrower to pay interest, and its ability to repay the loan principal at maturity.

Suppliers

They can use the financial statements to assess how much credit they might safely allow to the entity.

Government

They might use this information for the purpose of business regulation or deciding taxation policies.

The public

In some cases, members of the general public might have an interest in the financial statements of a company. The IASB Framework comments: 'For example, entities may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers.'

Employees

Employees need information about the financial stability and profitability of their employer. An assessment of profitability can help employees to reach a view on the ability of the employer to pay higher wages, or provide more job opportunities in the future.

Customers

Customers might be interested in the financial strength of an entity, especially if they rely on that entity for the long-term supply of key goods or services.

Managers

Management should have access to all the financial information they need, and in much more detail than financial statements provide. However, management is responsible for producing the financial statements and might be interested in the information they contain.

5. DOUBLE ENTRY BOOK-KEEPING

Every transaction that affects assets, liabilities, capital, income or expenses must have an offsetting effect to maintain the accounting equation. Every transaction must be recorded (entered) in at least two places. The process of doing this is called double entry book-keeping.

RULES OF DEBIT AND CREDIT

Each business transaction has two aspects which are named as debit and credit by norm in accounting. By convention, the terms 'debit' and 'credit' are shortened to 'Dr' and 'Cr' respectively. Total debit entries and total credit entries must always be equal, this maintains the accounting equation.

An account is a record of an individual type of asset, liability, income, expense or equity. For example, a record of amounts owed by an individual customer (an asset) or a record of utility bills (an expense).

Account type	Increase	Decrease
Assets, Expenses and Drawings	Debit	Credit
Liabilities, Income and Capital	Credit	Debit

► *Example 06:*

Identify the accounts to be debited and credited for the following transactions:

(i)	Bought motor vehicle for cash.
(ii)	Paid creditor, Nawabshah Traders, by cash.
(iii)	Repaid Bank loan by cheque.
(iv)	Sold Motor vehicle for cash.
(v)	Paid office rent by cheque.
(vi)	A debtor, Multan Traders, pays us by cash.
(vii)	Paid electricity bill for the month by cash.
(viii)	Proprietor puts a further amount into the business by cheque.
(ix)	A loan in cash is received from Sahiwal Bank.
(x)	Paid a creditor, Peshawar Enterprise, by cash.
(xi)	Bought office machinery on credit from Lahore Limited
(xii)	The proprietor paid a creditor, Layyah Enterprises, from his private funds.
(xiii)	A debtor, Islamabad Limited, paid us in cash.
(xiv)	Repaid part of loan from Quetta Bank by cheque.
(xv)	Returned some of office machinery to Lahore Limited.
(xvi)	A debtor, Karachi Port, pays us by cheque.
(xvii)	Interest on bank deposit received in bank account.
(xviii)	Bought goods on credit from Arslan Traders
(xix)	Returned good to supplier Amjad Enterprises
(xx)	Sold goods to Habib Mall on credit
(xxi)	Customer Rizwan Stores returned goods to us
(xxii)	Owner took cash for his personal use

► *ANSWER:*

Sr. #	Account	Element	Effect	Debit / Credit
(i)	Motor vehicle Cash	Asset Asset	Increase Decrease	Debit Credit
(ii)	Nawabshah Traders: payables Cash	Liability Asset	Decrease Decrease	Debit Credit
(iii)	Bank Loan Bank	Liability Asset	Decrease Decrease	Debit Credit
(iv)	Cash Motor vehicle	Asset Asset	Increase Decrease	Debit Credit
(v)	Office rent expense Bank	Expense Asset	Increase Decrease	Debit Credit
(vi)	Cash Multan Traders: receivables	Asset Asset	Increase Decrease	Debit Credit
(vii)	Electricity expenses Cash	Expense Asset	Increase Decrease	Debit Credit
(viii)	Bank Capital	Asset Equity	Increase Increase	Debit Credit
(ix)	Cash Loan from Sahiwal Bank	Asset Liability	Increase Increase	Debit Credit
(x)	Peshawar Enterprises: payables Cash	Liability Asset	Decrease Decrease	Debit Credit
(xi)	Office machinery Payable to Lahore Limited	Asset Liability	Increase Increase	Debit Credit
(xii)	Layyah Enterprises: payables Capital	Liability Equity	Decrease Increase	Debit Credit
(xiii)	Cash Islamabad Limited: receivables	Asset Asset	Increase Decrease	Debit Credit
(xiv)	Loan from Quetta Bank Bank	Liability Asset	Decrease Decrease	Debit Credit
(xv)	Payable to Lahore Limited Office machinery	Liability Asset	Decrease Decrease	Debit Credit
(xvi)	Bank Karachi Port: receivables	Asset Asset	Increase Decrease	Debit Credit
(xvii)	Bank Interest income (other income)	Asset Income	Increase Increase	Debit Credit
(xviii)	Purchases Arslan Traders: payables	Expense Liability	Increase Increase	Debit Credit
(xix)	Amjad Enterprises: payables Purchases return	Liability Expense	Decrease Decrease	Debit Credit
(xx)	Habib Mall: receivables Sales	Asset Income	Increase Increase	Debit Credit
(xxi)	Sales return Rizwan Stores: receivables	Income Asset	Decrease Decrease	Debit Credit
(xxii)	Drawings Cash	Equity Asset	Decrease Decrease	Debit Credit

- *Example 07:*

In respect of each of the following, give example of a transaction which would result in:

(i)	Decrease in a liability and increase in another liability
(ii)	Increase in an asset and decrease in another asset
(iii)	Decrease in an asset and decrease in a liability
(iv)	Decrease in capital and decrease in asset

- *ANSWER:*

(i)	Payment of creditors by using bank overdraft / loan.
(ii)	Purchase of a machine against cash.
(iii)	Payment of creditors through bank balance.
(iv)	Cash withdrawal by owner of the business.

6. COMPREHENSIVE EXAMPLES

- *Example 08:*

Identify the accounts to be debited and credited for the following transactions:

(i)	We pay a creditor in cash.
(ii)	Bought fixtures paying by cheque.
(iii)	Bought goods on credit.
(iv)	The proprietor introduces further cash into the business.
(v)	A bank lends us in cash.
(vi)	A debtor pays us by cheque.
(vii)	We return goods costing to a supplier whose bill we had not paid.
(viii)	Bought additional shop fixtures paying by cheque.
(ix)	Bought a van on credit.
(x)	Repaid by cash a loan owed to Bank.

- *ANSWER:*

Sr. #	Account	Element	Effect	Debit / Credit
(i)	Trade creditors (payables) Cash	Liability Asset	Decrease Decrease	Debit Credit
(ii)	Fixtures Bank	Asset Asset	Increase Decrease	Debit Credit
(iii)	Purchases Trade creditors (payables)	Expense Liability	Increase Increase	Debit Credit
(iv)	Cash Capital	Asset Equity	Increase Increase	Debit Credit
(v)	Cash Bank Loan	Asset Liability	Increase Increase	Debit Credit
(vi)	Bank Trade debtors (receivables)	Asset Asset	Increase Decrease	Debit Credit
(vii)	Trade creditors (payables) Purchase return	Liability Expense	Decrease Decrease	Debit Credit
(viii)	Fixtures Bank	Asset Asset	Increase Decrease	Debit Credit
(ix)	Van Payable for Van	Asset Liability	Increase Increase	Debit Credit
(x)	Bank Loan Cash	Liability Asset	Decrease Decrease	Debit Credit

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- *Example 09:*

Identify the accounts to be debited and credited for the following transactions:

(i)	Bought goods paying by cheque.
(ii)	The owner puts further cash into the business.
(iii)	Sold goods on cash.
(iv)	Sold goods on credit.
(v)	A debtor returns to us some goods. We agree to make an allowance for them.
(vi)	Bought goods on credit.
(vii)	The owner takes out cash for his personal use.
(viii)	We pay a creditor by cheque.

- *ANSWER:*

Sr. #	Account	Element	Effect	Debit / Credit
(i)	Purchases Bank	Expense Asset	Increase Decrease	Debit Credit
(ii)	Cash Capital	Asset Equity	Increase Increase	Debit Credit
(iii)	Cash Sales	Asset Income	Increase Increase	Debit Credit
(iv)	Trade debtors (receivables) Sales	Asset Income	Increase Increase	Debit Credit
(v)	Sales return Trade debtors (receivables)	Income Asset	Decrease Decrease	Debit Credit
(vi)	Purchases Trade creditors (payables)	Expense Liability	Increase Increase	Debit Credit
(vii)	Drawings Cash	Equity Asset	Decrease Decrease	Debit Credit
(viii)	Trade creditors (payables) Bank	Liability Asset	Decrease Decrease	Debit Credit

- *Example 10:*

Identify the accounts to be debited and credited along with amounts for the following transactions:

(i)	Started business with Rs. 75,000 cash and Rs. 900,000 in the bank.
(ii)	Received a loan of Rs. 200,000 from KLM Bank by cheque.
(iii)	Bought a computer for cash Rs. 30,000.
(iv)	Bought display equipment on credit from Clear Count Ltd Rs. 42,000.
(v)	Took Rs. 20,000 out of the bank and put it in the cash till.
(vi)	Repaid part of KLM Bank loan by cheque Rs. 50,000.
(vii)	Paid amount owing to Clear Count Ltd Rs. 42,000 by cheque.
(viii)	Repaid part of KLM Bank loan by cash Rs. 25,000.
(ix)	Bought a printer on credit from Image Traders for Rs. 20,000.
(x)	Bought goods on credit from ABC for Rs. 10,000
(xi)	Sold goods on credit to XYZ for Rs. 12,000
(xii)	Owner took cash from bank of Rs. 7,000 for his personal use.

- *ANSWER:*

Sr. #	Account	Rs.	Element	Effect	Debit / Credit
(i)	Cash	75,000	Asset	Increase	Debit
	Bank	900,000	Asset	Increase	Debit
	Capital	975,000	Equity	Increase	Credit
(ii)	Bank	200,000	Asset	Increase	Debit
	Bank Loan	200,000	Liability	Increase	Credit
(iii)	Computer	30,000	Asset	Increase	Debit
	Cash	30,000	Asset	Decrease	Credit
(iv)	Display Equipment	42,000	Asset	Increase	Debit
	Payable to Clear Count	42,000	Liability	Increase	Credit
(v)	Cash (in hand)	20,000	Asset	Increase	Debit
	(Cash at) Bank	20,000	Asset	Decrease	Credit
(vi)	Bank Loan	50,000	Liability	Decrease	Debit
	Bank	50,000	Asset	Decrease	Credit
(vii)	Payable to Clear Count	42,000	Liability	Decrease	Debit
	Bank	42,000	Asset	Decrease	Credit
(viii)	Bank Loan	25,000	Liability	Decrease	Debit
	Cash	25,000	Asset	Decrease	Credit
(ix)	Printer	20,000	Asset	Increase	Debit
	Image Traders	20,000	Liability	Increase	Credit
(x)	Purchases	10,000	Expense	Increase	Debit
	Trade payables	10,000	Liability	Increase	Credit
(xi)	Trade receivables	12,000	Asset	Increase	Debit
	Sales	12,000	Income	Increase	Credit
(xii)	Drawings	7,000	Equity	Decrease	Debit
	Bank	7,000	Asset	Decrease	Credit

7. OBJECTIVE BASED Q&A

01. Which of the following statements are true?

1. Accounting can be described as the recording and summarizing of transactions

2. Financial accounting describes the production of a statement of financial position and Statement of Profit or Loss for internal use

(a) 1 only

(b) 2 only

(c) 1 and 2 both

(d) Neither 1 nor 2

02. The terms accounting and book keeping are classified as

(a) Same

(b) Different

(c) Opposite

(d) None of these

03. The main aim of financial accounting is to:

(a) Record all transactions in the books of account.

(b) Provide management with detailed analyses of costs.

(c) Present the financial results of an organization by mean of financial statements.

(d) Calculate profit.

04. Which of the following is least likely to be expected from a book-keeping and accounting system?

(a) Systematic recording of transactions

(b) Ascertaining profit or loss

(c) Ascertainment of financial position

(d) Solving tax disputes with tax authorities

05. A business has incurred following costs for the year ended 31 December 2018:

	Rs. million
Extension in building	1.5
Repairs to building	0.5
Overhaul to machinery that increased production capacity	1.2

What is the amount of capital expenditure incurred during the year?

Rs. _________

06. A business has incurred following costs for the year ended 31 December 2018:

	Rs. million
Extension in building	1.5
Repairs to building	0.5
Overhaul to machinery that increased production capacity	1.2

What is the amount of revenue expenditure incurred during the year?

Rs. _________

07. A business has incurred following information for the year ended 31 December 2018:

	Rs. million
Cost of building – Opening	15.5
Cost of machinery – Opening	10.2
Extension in building – during the year	1.5
Repairs to building – during the year	0.5
Overhaul to machinery that increased production capacity	1.2

What is the cost of building after incorporating the above costs?

Rs. _________

08. A business has incurred following information for the year ended 31 December 2018:

	Rs. million
Cost of building – Opening	15.5
Cost of machinery – Opening	10.2
Extension in building – during the year	1.5
Repairs to building – during the year	0.5
Overhaul to machinery that increased production capacity	1.2

What is the cost of machinery after incorporating the above costs?

Rs. _________

09. A business has incurred following costs for the year ended 31 December 2018:

	Rs. million
Extension in building	1.5
Repairs to building	0.5
Overhaul to machinery that increased production capacity	1.2

Profit for the year before incorporating the above adjustments is Rs. 5.6 million.
What will be the profit for year after charging the above repairs?

Rs. _________

10. Which of the following is not a business transaction?

(a) Incurring interest on a business loan

(b) Hiring a new employee

(c) Purchasing office supplies

(d) Receiving fees for services

11. Expenditures which provide benefits in future period are called:

(a) Revenue expenditure

(b) Outstanding expenditure

(c) Current expenditure

(d) Capital expenditure

12. Which one is a capital transaction?

(a) Purchase of goods

(b) Payment of wages

(c) Sale of goods

(d) Purchase of machinery

13. The capital of a business would change as a result of:

(a) A supplier being paid by cheque

(b) Non-current assets being purchased on cash

(c) Non-current assets being purchased on credit

(d) Wages being paid in cash

14. Cash invested in the business by the owner is called

(a) Current asset

(b) Non-current asset

(c) Liabilities

(d) Capital

15. Cash or goods taken away by the proprietor is called

(a) Drawings

(b) Sales

(c) Charity

(d) Expense

16. Which of the following is an element of the statement of financial position?

(a) Income

(b) Expense

(c) Gains

(d) Liabilities

17. Which from the following is not a current asset?

(a) Equipment

(b) Inventory

(c) Cash

(d) Trade receivables

18. Which from the following is not a non-current asset?

(a) Intangibles

(b) Property

(c) Inventory

(d) Equipment

19. The IASB's Conceptual Framework for Financial Reporting defines an asset as:

(a) A resource controlled by an entity which is capable of generating independent cash flows.

(b) A present economic resource controlled by the entity as a result of past events.

(c) A resource owned/controlled by an entity as a result of past events, from which future economic benefits are expected.

(d) A resource capable of generating income for the entity.

20. The basic accounting equation is given by the formula:

Equity + Long term liabilities = ______________ + Current assets – Current liabilities.

21. Economic resources controlled by a business are called its _______.

22. According to the _______ concept, the business is regarded as separate from the personal affairs of its owners.

23. A business has capital of Rs.10,000.

Which of the following asset and liability figures could appear in this business's statement of financial position?

	Assets (Rs.)	Liabilities (Rs.)
(a)	6,000	16,000
(b)	6,000	4,000
(c)	10,000	10,000
(d)	14,000	4,000

24. Which of the following is incorrect?

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

25. The correct form of accounting equation is

(a) Assets + Liabilities = Equity

(b) Assets – Liabilities = Equity

(c) Assets – Trade payables= Equity

(d) Assets + Receivable = Equity

26. Which of the following is not true:

(a) Revenue – Expenses = profit

(b) Revenue – Profit = Expenses

(c) Sales + Gross Profit = Revenue

(d) Revenue = Profit + Expenses

27. Expenses paid by a business decrease:

(a) Cash

(b) Capital

(c) Cash and capital

(d) Capital and Accounts payable

28. If during the accounting period the assets increased by Rs.7 million, and the owner's equity decreased by Rs.3 million, then the liabilities must have;

(a) Increased by Rs.10 million

(b) Increased by Rs.4 million

(c) Decreased by Rs.4 million

(d) Decreases by Rs.10 million

29. At 31 October 2016 Zahid's trial balance included the following balances:

	Rs.
Machinery	12,890
Inventory	5,754
Trade receivables	11,745
Trade payables	7,830
Bank overdraft	1,675
Cash at bank	150

What is the value of Zahid's current assets at 31 October 2016?

(a) Rs. 17,649

(b) Rs. 17,499

(c) Rs. 15,974

(d) Rs. 13,734

30. A business has provided following information in the trial balance;

	Rs.
Machinery	150,000
Equipment	120,220
Trade receivables	35,150
Trade payables	40,220
Bank overdraft	18,997
Cash at bank	32,112

What is the amount of non – current assets to be shown in the financial position?

(a) Rs. 337,482

(b) Rs. 270,220

(c) Rs. 356,479

(d) Rs. 318,485

AT A GLANCE
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- **(a)** To compare the business with its competitors in order to decide whether to seek employment with one of those competitors.
- **(b)** To assess the effect of the business on the local economy, community and environment.
- **(c)** To assess whether the business will continue into the foreseeable future.
- **(d)** To assess the profitability of the business in order to decide whether to invest in it.

32. Which of the following user groups require the most detailed financial information from financial statements?

- **(a)** The management
- **(b)** Investors and potential investors
- **(c)** Government agencies
- **(d)** Employees

33. Which of the following explains why lenders are interested in financial statements of a business?

- **(a)** Lenders need information about financial stability of business
- **(b)** Lenders need information about profitability of business
- **(c)** Lenders want to assess the entity's capacity to pay interest and repay loan on time
- **(d)** All of the above

34. Who is responsible to prepare financial statements in a company?

- **(a)** Shareholders
- **(b)** Managers
- **(c)** Directors
- **(d)** All of the above

35. Who is responsible to prepare financial statements of a partnership?

- **(a)** Partner (for public disclosure)
- **(b)** There may be no obligation to prepare financial statements of a partnership (other than for tax purpose)
- **(c)** Manager
- **(d)** Accountant

36. Which one of the following not an external user of financial statements?

- **(a)** Lender
- **(b)** Investor
- **(c)** Customer
- **(d)** Management

37. Which one of the following not an internal user of financial statements?

- **(a)** Employees
- **(b)** Management
- **(c)** Supplier
- **(d)** Executive Director

38. The main source(s) of Generally Accepted Accounting Principles (GAAP) is/are:

- **(a)** Company Law
- **(b)** International Finance Reporting Standards (IFRSs)
- **(c)** Tax law
- **(d)** Sales Tax Act

39. An entity (with 31 December year-end) has bought the machine for Rs. 1,000,000 with the down payment of Rs. 200,000and remaining payment Rs. 800,000 would be made after a month. The transaction happened on 15 December 2011.

What would be the effect on the of transaction?

- **(a)** Machine increased by Rs.800,000 and liabilities decreased by Rs.800,000
- **(b)** Machine decreased by Rs.800,000 and liabilities increased by Rs.800,000
- **(c)** Machine increased by Rs.1,000,000 and liabilities increased by Rs.800,000 while cash is decreased by Rs.200,000
- **(d)** Machine increased by Rs.800,000 and liabilities increased by Rs.800,000 while cash is decreased by Rs.200,000

40. Purchase of machinery for cash

- **(a)** Increases total assets
- **(b)** Decreases total assets
- **(c)** Increases assets and liabilities
- **(d)** Keeps total assets unchanged

41. The investment of cash into the business results in a/an

- **(a)** Increase in cash and a decrease in capital
- **(b)** Increase in cash and an increase in capital
- **(c)** Decrease in cash and an increase in capital
- **(d)** Increase in fees earned and an increase in capital

42. Services rendered for cash will result in a/an

- **(a)** Increase in cash and a decrease in capital
- **(b)** Increase in cash and an increase in fees earned
- **(c)** Decrease in cash and an increase in fees earned
- **(d)** Increase in fees earned and an decrease in capital

AT A GLANCE
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43. One of the local fast-food outlets hired a first-year accounting student to oversee the cash-collection procedures.

When the firm pays the student his weekly wage, the transaction will

- **(a)** Increase an asset, increase a liability
- **(b)** Decrease an asset, decrease a liability
- **(c)** Increase an asset, increase owner's equity
- **(d)** Decrease an asset, decrease owner's equity

44. QK Company records the transaction as a debit to Consultant Expense for Rs. 500,000 and an equivalent credit to Accounts Payable.

What would be impact on elements of financial statements?

- **(a)** Increase a liability, increase owner's equity
- **(b)** Decrease an asset, decrease a liability
- **(c)** Increase a liability, decrease owner's equity
- **(d)** Decrease an asset, decrease owner's equity

45. Which of the following will cause owner's equity to increase?

- **(a)** Revenue
- **(b)** Expense
- **(c)** Drawings
- **(d)** Asset's depreciation

46. The owner contributes his personal car to the business

- **(a)** Increase an asset, increase a liability
- **(b)** Decrease an asset, decrease a liability
- **(c)** Increase an asset, increase owner's equity
- **(d)** Decrease an asset, decrease owner's equity

47. The company purchases a significant amount of office supplies on credit

- **(a)** Decrease an asset, decrease a liability
- **(b)** Increase an asset, increase owner's equity
- **(c)** Decrease an asset, decrease owner's equity
- **(d)** Increase an asset, increase a liability

48. What double entry would be made to record the purchase of an item of machinery on credit?

- **(a)** Debit machinery, credit cash
- **(b)** Debit machinery, credit accounts payables
- **(c)** Debit purchases, credit trade payables
- **(d)** Debit trade payables, credit machinery

49. What transaction is presented by the entries: debit bank, credit Receivables?

(a) Sale of goods for cash

(b) Purchase of goods for cash

(c) Receipt of cheque from receivables

(d) Payment of cheque to payables

50. A debit entry usually represents increase in:

(a) Assets and Income

(b) Liabilities and Income

(c) Assets and Expenses

(d) Liabilities and Expenses

51. The double entry to record the withdrawal of cash from a business bank account by the owner is?

(a)	Debit: drawings	Credit: bank
(b)	Debit: drawings	Credit: capital
(c)	Debit: liability	Credit cash
(d)	Debit: capital	Credit: drawings

52. A business sells Rs. 100,000 worth of goods to a customer, the customer pays Rs. 50,000 in cash immediately and will pay the remaining Rs. 50,000 in 30 days' time.

What is the double entry to record the purchase in the customer's accounting records?

(a) Dr. cash Rs. 50,000; Cr. payables Rs. 50,000; Cr. purchases Rs. 50,000

(b) Dr. payables Rs. 50,000; Dr. cash Rs. 50,000 ;Cr. purchases Rs. 100,000

(c) Dr. purchases Rs. 100,000; Cr. payables Rs. 50,000; Cr. cash Rs. 50,000

(d) Debit purchases Rs. 100,000; credit cash Rs. 100,000

53. Mariam has the following transactions:

(i) Receipt of cash from Nauman in respect of an invoice for goods sold three weeks ago

(ii) Receipt of cash from Amjad for cash sales

What are the entries required to record the above transactions?

(a) Dr Cash; Cr Sales

(b) Dr Cash; Cr Sales; Cr Trade Receivables

(c) Dr Sales; Cr Cash

(d) Dr Trade Receivables; Dr Sales; Cr Cash

54. A business has purchased machinery on credit. Which of the accounts mentioned below are affected by the transactions?

- **(a)** Trade payables
- **(b)** Purchases
- **(c)** Machinery
- **(d)** Capital

55. Payment of insurance through the bank involves entries in which of the two accounts

- **(a)** Insurance account (Debit) and petty cash account (Credit)
- **(b)** Insurance account (Debit) and bank account (Credit)
- **(c)** Insurance account (Debit) and rent account (Credit)
- **(d)** Insurance account (Debit) and capital account (Credit)

56. X Ltd. purchases a vehicle for Rs. 1.5 million for business use, paying by cheque, what is the double entry:

- **(a)** Purchases account (debit) and bank account (credit)
- **(b)** Vehicle account (debit) and bank account (credit)
- **(c)** Vehicle account (credit) and bank account (debit)
- **(d)** Debit vehicle account (debit) and petty cash account (credit)

57. The double entry for return of goods purchased from Khan Limited on account is:

- **(a)** Cash (debit) and purchases (credit)
- **(b)** Accounts payable (debit) and purchases (credit)
- **(c)** Accounts payable (debit) and purchases return (credit)
- **(d)** None of the above

58. The double entry for payment of a telephone bill is;

- **(a)** Telephone expense (debit) and cash (credit)
- **(b)** Office equipment (debit) and cash (credit)
- **(c)** Office supplies (debit) and cash (credit)
- **(d)** Cash (debit) and utilities (credit)

59. Khalid is a dealer in electronic goods (refrigerator, washing machine, air conditioners, televisions, etc.). He purchased two air conditioners and installed in his showroom. In the books of Khalid, the cost two air conditioners will be debited to

- **(a)** Drawing account
- **(b)** Capital Account
- **(c)** Fixed assets (non-current assets)
- **(d)** Purchases account

60. An asset was purchased for Rs. 1,000,000 with the down payment of Rs. 200,000 and bills accepted for Rs. 800,000/-.

What would be the effect on the total asset and total liabilities in the statement of financial position?

(a) Assets increased by Rs.800,000 and liabilities decreased by Rs.800,000

(b) Assets decreased by Rs.800,000 and liabilities increased by Rs.800,000

(c) Assets increased by Rs.1,000,000 and liabilities increased by Rs.800,000

(d) Assets increased by Rs.800,000 and liabilities increased by Rs.800,000

ANSWERS

01.	**(a)**	Financial statements are not only for internal use.
02.	**(b)**	Book-keeping is only recording transaction, accounting is wider term which includes summarising, analysing and reporting financial statements.
03.	**(c)**	(a) is book-keeping task (b) is concerned with management accounting (d) is part of the process but not main aim of financial accounting
04.	**(d)**	Solving tax disputes is not expected from a book-keeper or accountant. Usually this service is performed by tax consultants.
05.	**Rs. 2.7 million**	= Rs. 1.5+1.2 = Rs. 2.7
06.	**Rs. 0.5 million**	Repairs to building
07.	**Rs. 17 million**	= Rs. 15.5 + 1.5 = 17
08.	**Rs. 11.4 million**	= Rs. 10.2 +1.2 = Rs. 11.4 million
09.	**Rs. 5.1 million**	Profit = Rs. 5.6 – 0.5 = Rs. 5.1
10.	**(b)**	Hiring an employee has no financial impact. Salary being paid or becoming due is a business transaction.
11.	**(d)**	Capital expenditures provide benefits in long term future.
12.	**(d)**	Machinery is asset to be used for long term.
13.	**(d)**	Expense decreases the equity. All other transaction have same effect on asset and liabilities.
14.	**(d)**	Claims of outsiders on business are liabilities and claim of owner is capital.
15.	**(a)**	Drawings.
16.	**(d)**	Income, expense and gains are recognised in statement of comprehensive income.
17.	**(a)**	Equipment is non-current asset.
18.	**(c)**	Inventory is current asset as it is usually sold in short term.
19.	**(b)**	All other definitions include some part of the correct answer but are incomplete.
20.	**Non-current assets**	Non-current assets

21.	**Assets**	Asset is present economic resource controlled by an entity as a result of past events.
22.	**Business Entity**	A business and its owner are differentiated in accounting.
23.	**(d)**	Capital = Assets – liabilities 10,000 = 14,000 – 4,000
24.	**(c)**	Rs. 9,550 – 1,150 = 8,400
25.	**(b)**	Equity = Assets – Liabilities
26.	**(c)**	Sales + Gross profit ≠ Revenue
27.	**(c)**	Cash and Capital both would decrease.
28.	**(a)**	Rs. 7 million + Rs. 3 million = Rs. 10 million
29.	**(a)**	5,754 + 11,745 + 150 = Rs. 17,649
30.	**(b)**	150,000 + 120,220 = Rs. 270,220
31.	**(a) & (c)**	The public and environmental groups are interested in (b). The investors are interested in (d).
32.	**(b)**	The management also has access to even more detailed information from internal sources. Government agencies and employees are interested in selective relevant information and not detailed one.
33.	**(c)**	Interested in loan repayments and ability to pay interest.
34.	**(c)**	The directors
35.	**(b)**	The public disclosure of partnership accounts is not required.
36.	**(d)**	Management is internal user.
37.	**(c)**	Supplier is external user.
38.	**(a) & (b)**	Company Law and IFRSs
39.	**(c)**	Machine increased by Rs. 1,000,000 - Debit Cash decreased by Rs. 200,000 - Credit Liabilities increased by Rs. 800,000 - Credit
40.	**(d)**	Unchanged, one asset increased and another decreased by same amount.
41.	**(b)**	Increase in cash and an increase in capital
42.	**(b)**	Increase in cash and an increase in income

43.	**(d)**	Decrease in an asset (Cash) Decrease in equity (due to wages expense)
44.	**(c)**	Increase in liability (Accounts payable) Decrease in equity (due to consultant expense)
45.	**(a)**	Revenue (income) increases the equity.
46.	**(c)**	Increase an asset (Car) Increase in equity (capital)
47.	**(d)**	Increase in asset (office supplies) Increase in liability (payable)
48.	**(b)**	Machinery (asset increased) debit Accounts payable (liability increased) credit
49.	**(c)**	Receipt of cheque from receivables
50.	**(c)**	Increase in asset and expenses is debit.
51.	**(a)**	Drawings Debit (Decrease in equity / increase in drawings) Bank Credit (Decrease in asset)
52.	**(c)**	Purchases (Increase in expense) Debit Rs. 100,000 Cash (Decrease in asset) Credit Rs. 50,000 Payables (Increase in liability) Rs. 50,000
53.	**(b)**	Debit Cash (asset increased) Credit Sales (income increased) Credit Trade receivable (asset decreased)
54.	**(c)**	Machinery and payable for machinery. Trade payables are related to purchases of inventory only.
55.	**(b)**	Insurance (expense increased) Debit Bank (asset decreased) Credit
56.	**(b)**	Vehicle (asset increased) Debit Bank (asset decreased) Credit

57.	**(c)**	Account payable (liability decreased) Debit Purchase return (expense decreased) Credit
58.	**(a)**	Telephone charges (expense increased) Debit Cash (asset decreased) Credit
59.	**(c)**	Non-current assets as used in showroom for long term use. Inventory is for resale.
60.	**(d)**	Assets increased 1,000,000 – 200,000 = 800,000 Liabilities increased 800,000

AT A GLANCE

SPOTLIGHT

STICKY NOTES

STICKY NOTES

Book-keeping is recording double entry on business transactions and accounting is summarising and classifying these transactions to produce financial statements.

Classifcation of Business Transactions

Simple vs Complex

One-off vs Ongoing

Capital (long term) vs Revenue (Short term)

Financial Statements

Statement of financial position (asset, liability and equity)

Statement of comprehensive income (income and expenses)

Elements of Financial Statements

Asset: a present economic resource controlled by the entity as a result of past events.

Liability: a present obligation to transfer an economic resource as a result of past events.

Equity: the residual interst in the assets of an entity after deducting all of its liabilities. Equity = Assets – Liabilities

Income: increases in assets or decreases in liabilities, that result in increases in equity, other than those relating to contributions from owners.

Expenses: decreases in assets or increases in liabilities, that result in decreases in equity, other than those relating to distributions to owners.

The preparation of financial statement is regulated by GAAPs which mainly consist of Companies Act, 2017 and IFRSs.

External users: Investors, Lenders, suppliers, Customers, Government and Public

Internal users: Management and employees

Increase in assets, expenses and drawings ➔ Debit

Increase in liability, equity and income ➔ Credit

The rule ➔ Total debits = Total credits

AT A GLANCE SPOTLIGHT STICKY NOTES

CHAPTER 2

BOOKS OF PRIME ENTRY

IN THIS CHAPTER:

AT A GLANCE

Books for prime entry (also known as books of original entry) is an efficient book-keeping system which sorts the different type of transactions at initial recording stage.

The main books of prime entry are;

1. Sales day book (for sales invoices to credit customers)
2. Purchase day book (for purchase invoices from credit suppliers)
3. Sales returns day book (for credit notes issued to customers)
4. Purchases returns day book (for credit notes received from suppliers)
5. Cash book (all cash transactions); additionally, a Petty cash book may be prepared for small cash transactions.
6. General Journal (for all other transactions)

In practice, many entities use different types of vouchers to initially record the transactions in an accounting system.

1. INTRODUCTION

Books of prime entry are a useful means of summarising large numbers of similar transactions like credit sales, credit purchases, cash and bank receipts and payments.

Books of prime entry OR books of original entry are books where transactions are first recorded. Instead of recording all transactions at one place, transactions are sorted and recorded in different books of prime entry at initial stage. This allows efficient processing of transactions in an accounting system.

There are six main books of prime entry:

Book of prime entry		Transactions type	Source document
1.	Sales day book (Sales journal)	Records sales of inventory items on credit to customers.	Sales invoices issued to customers.
2.	Sales return day book (Return inwards journal)	Records items returned by credit customers.	Credit notes issued to customers.
3.	Purchases day book (Purchase journal)	Records purchases of inventory items on credit from suppliers.	Purchase invoices from suppliers.
4.	Purchases return day book (Return outwards journal)	Records items returned to credit suppliers.	Credit notes received (or debit notes issued).
5.	Cash book + Petty cash book	All cash transactions including cash sales and cash purchases and payment of expenses and cash transactions with credit customers and suppliers.	Cheques, counterfoils, bank statements, receipts, etc.
6.	General Journal	Records transactions that are not recorded in any of the other books of original entry, e.g. non-current asset bought on credit.	Invoice, bill or another authorised document.

► *Example 01:*

The following details relate to a carpet retailer *Adeel Traders* for the month of November. Each transaction can be related to relevant book of prime entry as follow:

Nov	Transaction	Book
1	Started the business with Rs. 15,000,000 in the bank.	Cash book
3	Bought goods on credit from: Jamal Rs. 290,000; Faisal Rs. 1,200,000; Talal Rs. 610,000; Rashid (List price Rs. 550,000, trade discount Rs. 20,000)	Purchase day book
5	Cash sales Rs. 610,000.	Cash book
6	Paid rent by cheque Rs. 175,000.	Cash book
7	Paid business rates by cheque Rs. 130,000.	Cash book
17	Withdrew cash Rs. 290,000 for personal use.	Cash book
18	We returned goods to: Jamal Rs. 18,000; Rashid Rs. 27,000.	Purchase return day book
19	Bought goods on credit from: Rashid Rs. 110,000; Talal Rs. 320,000; Fahad Rs. 165,000.	Purchase day book

Nov	Transaction	Book
19	Sold goods on credit to: Taseer Rs. 885,000; Jawad Rs. 848,000; Touseef Rs. 1,640,000.	Sales day book
20	Goods were returned to us by: Jawad Rs. 6,000; Taseer Rs. 14,000	Sales return day book
21	Bought Delivery Vehicle on credit from Turnkey Motors Rs. 4,950,000.	General Journal
23	We paid the following by cheque: Jamal Rs. 265,000 (after settlement discount of Rs. 7,000); Faisal Rs. 1,200,000; Talal Rs. 480,000 (after discount of Rs. 20,000)	Cash book
25	Bought another Vehicle, paying by cheque immediately Rs. 6,200,000.	Cash book
26	Received a loan of Rs. 750,000 cash from BB Bank.	Cash book
28	Received cheques from: Taseer Rs. 65,000 (after cash discount of Rs. 6,000); Jawad Rs. 40,000 (after cash discount of Rs. 2,000).	Cash book
30	Proprietor brings a further Rs. 900,000 into the business, by a payment into the business bank account.	Cash book

2. ACCOUNTING FOR SALES

A business tries to make profit by selling goods or services to customers. This creates revenue or income for the business. Sales might be for cash or on credit.

The following documents might be used in a system designed to account for sales.

Document		Purpose	Impact on double entry?
1.	**Sales Quotation**	Before ordering, customers often require a sales quotation for review in their company. It is created as a proposal of your goods and services to a customer.	No
2.	**Sales order**	From the customer placing an order.	No
3.	**Goods dispatched note**	A notice to the customer to inform them that the goods have been dispatched.	No
4.	**Delivery note**	A note that accompanies the goods. (A customer will check this to make sure that it agrees with his order and that it is consistent with what has actually been delivered.	No
5.	**Sales invoice**	A request for payment from the customer for goods delivered. Invoices normally show a date, details of transaction and payment terms.	Yes
6.	**Statement**	A document to show the customer the amount still owed at a point in time. It will be the net amount of all invoices issued less cash received by the business up to a point in time.	No
7.	**Credit note issued**	Issued when a customer returns goods and the business agrees to this. The business issues a credit note to acknowledge that the amount specified is no longer owed to them by the customer.	Yes

FORMAT: SALES DAY BOOK

Date	Customer name	Invoice #	Rs.
	TOTAL		

FORMAT: SALES RETURNS DAY BOOK

Date	Customer	Credit note #	Rs.
	TOTAL		

DISCOUNT ALLOWED

This is the discount given by a business to its customers.

Trade discount

This is a definite price reduction given to a customer at the time of sales transaction. The invoice is issued at the reduced amount so there are no double entry problems caused by this type of discount. The sales revenue is simply recorded at net (of trade discount) amount.

For example, an entity sells an item with list price of Rs. 100 to a credit customer who negotiates 5% discount at the time of transaction, the sales invoice of Rs. 95 shall be issued and sales revenue of Rs. 95 will be recorded.

Cash discount / Settlement discount / Prompt payment discount

A settlement discount might be offered in order to persuade credit customers to pay earlier. For example, a cash discount of 4% may be offered to a customer if pays within 10 days, otherwise he will pay full amount within 30 days that is normal credit term of the business.

It is for the customer to decide whether to take advantage of paying discounted (reduced) amount by paying early or to take advantage of longer credit period, however, paying the full amount.

Although offering this discount encourages earlier receipt of cash from credit customers, there is still loss of revenue to the entity (seller's business).

When a business makes a sale, it does not know whether the customer will take advantage of the settlement discount or not, therefore, this is dealt in following ways:

(a) Record the revenue for the full amount if the customer is not expected to pay early:

- (i) If customer does not pay early as expected, the full amount is due as recorded already.
- (ii) If customer pays early and is entitled to discount, recognise the reduction in revenue by the amount of discount. Reduction in revenue may be recorded by debiting the 'revenue' account directly or by debiting 'discount allowed' account which is eventually deducted from sales revenue (similar to sales returns).

(b) Record the revenue for reduced (net of discount) amount if the customer is expected to pay early:

- (i) If customer pays early as expected, the net amount is due as recorded already.
- (ii) If customer does not pay early as expected, treat the additional amount received as revenue from original sales transaction.

The following example illustrate above scenarios relating to cash discount allowed to customers.

► *Example 02:*

Maria Enterprises (ME) sold goods of Rs. 10,000 to Zahra Traders (ZT) on 8th August 2021 to be paid on 31st August 2021. However, if ZT pays within 10 days, it will be entitled to 4% cash discount and will have to pay only Rs. 9,600.

How the above transactions along with following independent scenarios will be treated in the books of ME on 8th August and on the date of payment:

(a) ME expected that ZT will not pay within 10 days and ZT actually paid on 31st August.

(b) ME expected that ZT will not pay within 10 days but ZT actually paid on 17th August.

(c) ME expected that ZT will pay within 10 days and ZT actually paid on 17th August.

(d) ME expected that ZT will pay within 10 days but ZT actually paid on 31st August.

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ANSWER:

Part (a)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	ZT: receivables Revenue	Asset Income	Increase Increase	Debit Credit	10,000 10,000
31st August	Cash/Bank ZT: receivables	Asset Asset	Increase Decrease	Debit Credit	10,000 10,000

Part (b)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	ZT: receivables Revenue	Asset Income	Increase Increase	Debit Credit	10,000 10,000
17th August	Cash/Bank Revenue* ZT: receivables	Asset Income Asset	Increase Decrease Decrease	Debit Debit Credit	9,600 400 10,000

*Alternatively, discount allowed account may be debited and subsequently deducted from revenue.

Part (c)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	ZT: receivables Revenue	Asset Income	Increase Increase	Debit Credit	9,600 9,600
17th August	Cash/Bank ZT: receivables	Asset Asset	Increase Decrease	Debit Credit	9,600 9,600

Part (d)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	ZT: receivables Revenue	Asset Income	Increase Increase	Debit Credit	9,600 9,600
31st August	Cash/Bank Revenue ZT: receivables	Asset Income Asset	Increase Increase Decrease	Debit Credit Credit	10,000 400 9,600

DISHONOURED CHEQUES

These are cheques received from customers where subsequently the bank refuses to make payment.

When a business receives a cheque from a customer it recognises that as an amount paid. If the business presents the cheque to the bank for payment and the bank refuses to accept it (perhaps because of insufficient funds in the customer's account) the business is still owed the money and must reverse the original entry.

The double entry for this reversal is (debit Receivables, credit Bank).

- *Example 03:*

Using the information in Example 01, prepare sales day book and sales return day book. Assume that none of the customer was expected to avail the cash discount.

SALES DAY BOOK

Date	Customer	Inv. #	Rs.
19 Nov	Taseer		885,000
19 Nov	Jawad		848,000
19 Nov	Touseef		1,640,000
30 Nov	**TOTAL**		**3,373,000**

SALES RETURNS DAY BOOK

Date	Customer	CN #	Rs.
20 Nov	Jawad		6,000
20 Nov	Taseer		14,000
30 Nov	**TOTAL**		**20,000**

3. ACCOUNTING FOR PURCHASES

Businesses make purchases from suppliers. Purchases are similar in many respects to sales, except that the business is buying from a supplier rather than selling to a customer.

The following documents might be used in a system designed to account for purchases.

Document		Purpose	Impact on double entry?
1.	**Purchase requisition**	An item should be requisitioned first if not lying in the stock.	No
2.	**Quotation and approval**	Where value of goods exceeds certain limit, quotations are usually obtained from at least three suppliers. Purchase order is then initiated after evaluating quotations.	No
3.	**Purchase order**	A document sent by the business to place an order.	No
4.	**Goods received note**	A document produced when goods are received. It is produced after the goods have been checked against the delivery note and what has actually been received. The GRN is sent to accounts staff who will check that what has been received is what was ordered and that the invoice agrees with what was received.	No
5.	**Purchase invoice**	A request for payment from the supplier for goods delivered.	Yes
6.	**Statement**	A document from the supplier to show the amount still owed at a point in time.	No
7.	**Credit note received**	Issued by supplier when we return goods or get credit because of damaged goods.	Yes

FORMAT: PURCHASES DAY BOOK

Date	Supplier	Invoice #	Rs.
	TOTAL		

FORMAT: PURCHASES RETURNS DAY BOOK

Date	Supplier	Credit note #	Rs.
	TOTAL		

DISCOUNT RECEIVED

This is the discount given by a supplier to the business.

Trade discount

This is definite price reduction given by a supplier. The invoice is issued at the reduced amount so there are no double entry problems caused by this type of discount. The purchase is simply recorded at net (of trade discount) amount.

Cash discount / Settlement discount / Prompt payment discount

A settlement discount might be offered by a supplier to persuade earlier payment. For example, a cash discount of 4% may be offered by a supplier if the business pays within 10 days, otherwise full amount will be paid within 30 days as per normal credit terms.

The purchase and related liability (trade payables) are usually recorded at full cost of the goods. This is in line with prudence concept, which requires that expenses and liabilities must not be understated.

Then, the purchaser will decide whether or not to take advantage of settlement discount considering his cash flow position. The subsequent treatment is as follows:

(a) If advantage of settlement discount is not taken, the gross amount is payable to supplier as already recorded.

(b) If advantage of settlement discount is taken, the differential is recognised as reduction of cost of purchases. Alternatively, 'discount received' may be credited. The 'discount received' is netted off against the cost of purchase of inventory (in accordance with IAS 2).

The following example explains the above scenarios relating to cash discount received from suppliers.

► *Example 04:*

Maria Enterprises (ME) sold goods of Rs. 10,000 to Zahra Traders (ZT) on 8th August 2021 to be paid on 31st August 2021. However, if ZT pays within 10 days, it will be entitled to 4% cash discount and will have to pay only Rs. 9,600.

How the above transactions along with following independent scenarios will be treated in the books of ZT on 8th August and on the date of payment:

(a) ZT did not take advantage of settlement discount terms and paid on 31st August.

(b) ZT took advantage of settlement discount and paid on 17th August.

► *ANSWER:*

Part (a)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	Purchases ME: payables	Expense Liability	Increase Increase	Debit Credit	10,000 10,000
31st August	ME: payables Cash / Bank	Liability Asset	Decrease Decrease	Debit Credit	10,000 10,000

Part (b)

Date	Account	Element	Effect	Debit / Credit	Rs.
8th August	Purchases	Expense	Increase	Debit	10,000
	ME: payables	Liability	Increase	Credit	10,000
17th August	ME: payables	Asset	Increase	Debit	10,000
	Purchases	Expense	Decrease	Credit	400
	Cash / Bank	Asset	Decrease	Credit	9,600

*Alternatively, discount received account may be credited and subsequently deducted from cost of purchases just like purchase returns.

CONTRA SETTLEMENT

A business might sell goods or services to another business, and also buy goods or services from the same business. The other business is both a customer and a supplier and might therefore be a receivable and a trade payable at the same time. When this happens, the two businesses might agree to offset the amounts that they owe each other, leaving a net amount payable by the business with the higher debt.

The double entry for this offset is (debit Trade payables, credit Trade receivables).

- *Example 05:*

Using the information in *Example 01*, prepare purchases day book and purchases return day book.

PURCHASES DAY BOOK

Date	Supplier	Inv. #	Rs.
03 Nov	Jamal		290,000
03 Nov	Faisal		1,200,000
03 Nov	Talal		610,000
03 Nov	Rashid		530,000
19 Nov	Rashid		110,000
19 Nov	Talal		320,000
19 Nov	Fahad		165,000
30 Nov	**TOTAL**		**3,225,000**

PURCHASES RETURNS DAY BOOK

Date	Supplier	CN #	Rs.
18 Nov	Jamal		18,000
18 Nov	Rashid		27,000
30 Nov	**TOTAL**		**45,000**

4. ACCOUNTING FOR CASH

The cash book is a book of prime entry and is used to record the receipts of and payments from the business bank account.

The cash book has two sides, a side for receipts of money (debit) and a side for payments (credit). Both sides have a number of columns so that cash receipts and payments can be analysed to make it easier to construct journals for double entry.

A business can analyse the amounts received and paid in any way it chooses.

TYPES OF CASH BOOK

There are four basic types of a cash book.

- Single column cash book
- Two column cash book
- Three column cash book
- Petty cash book

Single column cash book

A simple cash book or a single column cash book is just like an ordinary account that carries one amount column on each side. The left hand side is for recording receipts of cash and the right hand side is for recording payments of cash. It is balanced just like any other ledger account.

► *Example 06:*

Following data has been extracted from Sara Shah's records for the month of June 2016.

June 2016		Rs.
1	Opening balance of cash	12,000
2	Received cash from Akhtar	3,800
5	Paid rent by cash	4,000
9	Made sales on cash	3,000
14	Paid to Bilal	1,760
18	Purchased Furniture on cash	3,000
23	Paid salaries	3,600
26	Rent due, yet not paid for June	2,700

Enter the above transactions in the single column cash book of Sara.

► *ANSWER*

Sara Shah					
Cash Book					
Date	**Details**	**Cash (Rs.)**	**Date**	**Details**	**Cash (Rs.)**
June 1	Balance b/d	12,000	June 5	Rent	4,000
2	Akhtar	3,800	14	Bilal	1,760
9	Sales	3,000	18	Furniture	3,000
			23	Salaries	3,600
			30	Balance c/d	6,440
		18,800			**18,800**
Aug 1	Balance b/d	6,440			

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Two column cash book

The double column cash book has two columns i.e. the cash column and the bank column on both the sides of the cash book. All the cash receipts and cash payments are recorded in the cash columns and all the deposits in and withdrawals from the bank are entered in the bank columns accordingly.

- *Example 07:*

July 2016	
1	Naeem Traders started business with a capital of Rs.40,000. The amount was paid into the business's bank account.
2	Paid rent of Office premises Rs.1,700 by cheque.
5	Purchased goods worth Rs.12,000 on credit from Shahzaib Traders.
9	Withdrew Rs.1,000 from the bank account for office use.
14	Paid advertising expenses, Rs.700 in cash.
18	Sold goods, Rs.8120 to Niazi Trading and received cheque.
23	Paid Shahzaib Traders by cheque.
26	Purchased Motor Vehicle Rs.30,000 and paid by cheque.
28	Naeem took Rs.2,000 from the business through cheque for personal use.

Enter the above transactions in the cash book of Naeem Traders. The cash and bank accounts should be shown in a two columnar cash book.

- *ANSWER*

Naeem Traders

Cash Book

Date	Details	Cash	Bank	Date	Details	Cash	Bank
		Rupees				**Rupees**	
July 1	Capital		40,000	July 2	Rent		1,700
9	Bank	1,000		9	Cash		1,000
18	Sales		8,120	14	Advertising	700	
				23	Shahzaib Traders		12,000
				26	Motor vehicles		30,000
				28	Drawings		2,000
				31	c/d	300	1,420
		1,000	**48,120**			**1,000**	**48,120**
Aug 1	b/d	300	1,420				

Three column cash book

Many businesses maintain a Three-column cash book instead of the Two-column cash book. The only difference is the **extra memorandum columns** that is meant to record **cash discounts**. It may further be split into cash receipt book and cash payment book.

- *Example 08:*

Using the information in *Example 01*, prepare cash receipt book and cash payment day book. Assume that revenue was recognised at gross amount without expecting that any customer would avail the settlement discount terms.

Cash Receipt Book

Date	Receipts / Particulars	Discount allowed	Cash	Bank
1 Nov	Capital			15,000,000
5	Sales		610,000	
26	BB Bank Loan		750,000	
28	Taseer	6,000		65,000
28	Jawad	2,000		40,000
30	Capital			900,000
		8,000	**1,360,000**	**16,005,000**

Cash Payment Book

Date	Payments / Particulars	Discount received	Cash	Bank
6 Nov	Rent			175,000
7	Business rates			130,000
17	Drawings		290,000	
23	Jamal	7,000		265,000
23	Faisal			1,200,000
23	Talal	20,000		480,000
25	Motor Vehicle			6,200,000
30	Balance c/d		1,070,000	7,555,000
		27,000	**1,360,000**	**16,005,000**

Petty cash Book

Petty cash is cash (notes and coins) held by a business to pay for small items of expense, in situations where it is more convenient to pay in notes and coin than to pay through the bank account. Petty cash might be used, for example, to pay for bus fares, taxi fares, tea and coffee for the office, and so on.

When petty cash transactions take place, for example petty cash is spent on tea and coffee for the office, the entity needs to record both an expense, and a reduction in the asset "petty cash".

Imprest system: A very common petty cash system is called the imprest system. Under this system a set amount is established (say Rs.10,000). This set amount is called the imprest. At any moment in time, the petty cash balance plus the amounts on invoices and notes should sum to the imprest. Periodically the invoices are removed and replaced by cash to re-establish the imprest in cash.

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- *Example 09:*

A business uses an impress system to control its petty cash.The impress is set at Rs. 10,000.

At the start of the month there is Rs. 10,000 cash in the petty cash tin. An amount of Rs. 600 is paid to Laila to compensate her for a payment she made out of her own pocket on behalf of the business.

After this transaction the petty cash tin will contain Rs.9,400 cash and an invoice from Laila for Rs.600. These two amounts add back to the impress.

- *Example 10:*

Shanzay Industries keeps an analysed petty cash book using the imprest system. The imprest amount is Rs. 2,000. The following information is available for the month of June 2016.

2016 June		Rs.	Voucher Number
1	Balance	2,000	
6	Paid window cleaner	200	1
8	Bought pens and pencils	100	2
11	Paid for bus fare	60	3
16	Paid for printer cartridge	400	4
18	Purchased envelopes	270	5
20	Paid for coffee and milk for office staff	70	6
22	Bought printing papers	80	7
23	Paid taxi fare	200	8
24	Paid office cleaner	170	9
26	Paid for biscuits and tea	100	10
28	Purchased paper pins	40	11
29	Paid for petrol	70	12

Write up the petty cash book for the month of June 2016 for Shanzay Industries. Balance the petty cash book and carry down the balance. Show the restoration of imprest as on July 1, 2016.

▶ *ANSWER*

Date	Details	Total Received	Date	Details	V#	Total Paid	Cleaning	Stationary	Travel	Postage	Food
Jun 1	Bal b/d	**2,000**	Jun 6	Window cleaner	1	200	200				
			8	Pens & pencils	2	100		100			
			11	Bus fare	3	60			60		
			16	Printer cartridge	4	400		400			
			18	Envelopes	5	270				270	
			20	Coffee & milk	6	70					70
			22	Printing paper	7	80		80			
			23	Taxi fare	8	200			200		
			24	Office cleaner	9	170	170				
			26	Biscuits & tea	10	100					100
			28	Paper pins	11	40		40			
			29	Petrol	12	70			70		
						1,760	**370**	**620**	**330**	**270**	**170**
			30	Balance c/d		**240**					
						2,000					
Jul 1	Bal b/d	**240**									
	Cash	**1,760**									

5. GENERAL JOURNAL

The general journal (journal for short) is a book of prime entry that is used to record transactions that are not recorded in any other book of original entry.

The journal might be used to provide a record and explanation of:

- year-end adjustments;
- settlement discounts;
- contra settlement;
- correction of errors; or
- any other adjustment.

In practice, not all entries are recorded in a journal or journalised but of course it is possible to write a journal for any transaction.

FORMAT: GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
31 Aug	*Account debited*		XXX	
	Account credited			XXX
	(brief narration)			

Ledger Folio (LF) is the page number of the ledger account on which the relevant account appears and it enables quick access to relevant ledger accounts.

▸ *Example 11:*

Using the information in *Example 01*, prepare General Journal for relevant transactions only.

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
21 Nov	*Motor Vehicle*		4,950,000	
	Turnkey Motors			4,950,000
	(Vehicle bought on credit)			
23 Nov	*Discount allowed (revenue)*		8,000	
	Receivable: Taseer			2,000
	Receivable: Jawad			6,000
	(Settlement discount allowed)			
28 Nov	*Payable: Jamal*		7,000	
	Payable: Talal		20,000	
	Discount received			27,000
	(Settlement discount received)			

▸ *Example 12:*

In July 2014, Abdullah established a business for providing van service to private schools in the city of Gujarat. The transactions during the month are listed below:

1 July	A bank account was opened with a cash deposit of Rs. 20,000,000.
3 July	A property was purchased at a cost of Rs. 10,000,000, of which Rs. 7,200,000 was considered as applicable to the land and Rs. 2,800,000 to the building. The transaction involved a cash payment of Rs. 3,000,000 and the balance was agreed to paid after six months.

5 July	10 new vans were purchased for at Rs. 300,000 each from City Showroom, Lahore. Abdullah paid Rs. 600,000 in cash and agreed to pay Rs. 1,000,000 by 31 July and the remaining balance by 15 August.
7 July	Upon inspection, a van was found to be defective and was returned to City Showroom, Lahore.
8 July	Office equipment was purchased against cash payment by cheque of Rs. 24,400.
15 July	Abdullah signed an agreement with a petrol pump for supply of CNG on credit. As per agreement, he issued a cheque for Rs. 15,000 as security deposit.
30 July	25% of the property acquired on 3 July was rented out from 1 August 2014 at a monthly rent of Rs. 30,000. A three month advance was received from the tenant.
31 July	Cheque for Rs. 1,000,000 was issued to City Showroom, Lahore.

Required: Journal entries of all the above transactions for the month of July 2014.

▶ *ANSWER*

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
1 Jul 14	Bank		20,000,000	
	Abdullah's Capital			20,000,000
3 Jul 14	Land		7,200,000	
	Building		2,800,000	
	Bank			3,000,000
	Payable – for property			7,000,000
5 Jul 14	Vans		3,000,000	
	Bank			600,000
	Payable – City Showroom			2,400,000
7 Jul 14	Payable – City Showroom		300,000	
	Vans			300,000
8 Jul 14	Office equipment		24,400	
	Bank			24,400
15 Jul 14	Security Deposit		15,000	
	Bank			15,000
30 Jul 14	Bank		90,000	
	Advances received			90,000
31 Jul 14	Payable – City Showroom		1,000,000	
	Bank			1,000,000

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6. VOUCHERS AS AN ALTERNATIVE TO DAY BOOKS

Voucher is an internal document prepared as proof that a monetary transaction has occurred between two parties and it is often supported by bill, invoice, copy of cheque, etc. In business, a voucher can be used for a variety of purposes, sometimes for payment of cash in a transaction, acting as a receipt, or indicating that an invoice has been approved for payment.

In practice, especially in computerised accounting systems, voucher system replaces (or supports) the books of prime entry. Every transaction is recorded on relevant vouchers as input to accounting system, which produces ledgers, trial balances and other reports through using automated processes. The voucher systems do vary across different entities. A practical system might operate as follows to replace the books of prime entry:

Book of prime entry		Transactions type	Voucher type
1.	Sales day book	Records sales of inventory items on credit to customers.	Sales voucher (or simply a sales invoice).
2.	Sales return day book	Records items returned by credit customers.	Sales Return Voucher (or credit notes issued).
3.	Purchases day book	Records purchases of inventory items on credit from suppliers.	Purchase voucher (or purchase invoices).
4.	Purchases return day book	Records items returned to credit suppliers.	Purchase return voucher (or credit notes received).
5.	Cash book	All cash transactions including cash sales and cash purchases and payment of expenses and cash transactions with credit customers and suppliers.	Payment vouchers and Receipt vouchers
6.	General Journal	Records transactions that are not recorded in any of the other books of original entry, e.g. non-current asset bought on credit.	Journal Voucher

Payment voucher: Payment can be made after approval of payment voucher supported with bills or other relevant supporting documents.

Business Entity Name

Payment Voucher

Sr. #_________ Date:____________

Paid to:________________________________ Mode of payment: Cash / Cheque

On account of: ___________________________ Cheque #: __________________

Amount in words: ________________________ Amount Rs. ______________

Prepared by **Approved by** **Received by**

Receipt voucher: Receipt vouchers are prepared to record the cash and cheque receipts and collections in bank accounts.

Business Entity Name

Receipt Voucher

Sr. #__________ Date:______________

Received from:____________________________________ Mode: Cash / Cheque

On account of: ____________________________________ Cheque #: ______________________

Amount in words: ________________________________ Amount Rs. _________________

Received by **Checked by**

Journal voucher (JV): JV is prepared to evidence the authorization to record non-cash transactions.

Business Entity Name

Journal Voucher

Sr. #__________ Date:______________

Code	Account Description	Debit (Rupees)	Credit (Rupees)

Details: ____

____

Prepared by **Checked by** **Authorised by**

7. COMPREHENSIVE EXAMPLES

- *Example 13:*

Following information pertains to Alpha Traders (AT):

Balances as at 1 August 2017:

	Rupees
Cash in hand	178,000
Bank overdraft	769,000

Transactions for the month of August 2017:

Date	Transactions
02-Aug	Office furniture purchased from RABBIT for cash and on credit for Rs. 38,000 and Rs. 129,000 respectively.
03-Aug	Goods purchased for cash from Bena & Co. for Rs. 85,000.
05-Aug	Goods purchased on credit in bulk (net of 5% trade discount) from Moon & Co. and Shan Traders for Rs. 475,000 and Rs. 513,000 respectively.
08-Aug	Goods sold on credit for Rs. 236,000 and Rs. 198,000 to A-Z Super Store and Apollo Centre, respectively. The settlement discount terms are usually offered but it is highly probable that customers will not avail that offer.
10-Aug	Goods costing Rs. 68,000 were returned to Moon & Co.
12-Aug	Cash sales to Danish & Sons for Rs. 40,000.
16-Aug	Cheques (net of 5% discount) amounting to Rs. 194,750 and Rs. 243,200 were received from A-Z Super Store and Bright & Co. respectively.
20-Aug	It was agreed with Columbus Traders to adjust Rs. 200,000 payable to AT against receivables from AT.
25-Aug	Payment of Rs. 225,000 (net of 10% discount) to Al-Shams.

Required: Record the above transactions in relevant books of prime entry in a proper format. AT prepares two Column cash book.

- *ANSWER*

Alpha Traders

Purchases day Book

Date	Supplier	Inv. #	Rs.
05 Aug 2017	Moon & Co		475,000
05 Aug 2017	Shan Traders		513,000
	TOTAL		**988,000**

Purchases returns day Book

Date	Supplier	Credit note#	Rs.
10 Aug 2017	Moon & Co		68,000
	TOTAL		**68,000**

Sales day Book

Date	Customer	Inv. #	Rs.
10 Aug 2017	A-Z Super Store		236,000
10 Aug 2017	Apollo Centre		198,000
	TOTAL		**434,000**

Cash Book

Date	Details	Cash	Bank	Date	Details	Cash	Bank
		Rupees				Rupees	
Aug 1	b/d	178,000		Aug 1	b/d		769,000
12	Sales	40,000		2	Furniture	38,000	
16	AZ Super		194,750	3	Purchases	85,000	
16	Bright & Co		243,200	25	Al-Shams		225,000
31	c/d		556,050	31	c/d	95,000	
		218,000	**994,000**			**218,000**	**994,000**

General Journal

Date	Particulars	LF	Debit Rs.	Credit Rs.
02 Aug	*Office furniture*		129,000	
	RABBIT (Other liabilities)			129,000
	(Purchased office furniture on credit)			
16 Aug	*Revenue / Discount allowed*		23,050	
	AZ Super (194,750 x 5/95)			10,250
	Bright & Co (243,200 x 5/95)			12,800
	(Settlement discount allowed)			
20 Aug	*Payable: Columbus Traders*		200,000	
	Receivable: Columbus Traders			200,000
	(Contra – Columbus Traders)			
25 Aug	*Al-shams (225,000 x 10 /90)*		25,000	
	Discount received			25,000
	(Settlement discount received)			

- *Example 14:*

Henry Brothers (HB) is engaged in trading of textile products. As at 1 July 2018, HB had cash and bank balances of Rs. 76,000 and Rs. 286,000 respectively. Following transactions pertain to the month of July 2018:

4 July	Purchased goods on credit amounting to Rs. 250,000 and Rs. 180,000 from Alpha Enterprises (AE) and Bravo Traders, respectively. AE offered 3% discount if payment was made within 15 days.
6 July	Purchased office furniture costing Rs. 90,000 from Lavish Designs and paid Rs. 50,000 through cheque. Rs. 40,000 had already been paid in June 2018 and debited to Advances.
8 July	Sold goods to HRS Garments and received a cheque of Rs. 300,000. Also sold goods on cash to Shan Garments having list price of Rs. 250,000 and offered discount of 2%.
14 July	20% goods sold to Shan Garments on 8 July were returned and the amount was refunded in cash. These goods were sold on mark-up of 25% of cost.
16 July	Sold old office furniture at its book value on cash for Rs. 12,000.
17 July	Goods costing Rs. 35,000 were returned to AE and the remaining amount was paid through cheque.
23 July	Sold goods on cash to Salim Sons for Rs. 236,500.
26 July	Saleh & Co. offered discount of 5% on list price of Rs. 500 per unit if at least 250 units are purchased. HB purchased 300 units to avail the discount and paid through cheque.
28 July	Paid loan instalment of Rs. 150,000 including interest of Rs. 35,000 in cash.
30 July	Deposited cash into bank Rs. 200,000.

Required:

Record the above transactions in the relevant books of prime entry in a proper format.

(Narrations are not required)

- *ANSWER*

PURCHASES DAY BOOK

Date	Supplier	Inv. #	Rs.
4-Jul-18	Alpha Enterprises		250,000
4-Jul-18	Bravo Traders		180,000
	TOTAL		**430,000**

PURCHASES RETURNS DAY BOOK

Date	Supplier	CN #	Rs.
17-Jul-18	Alpha Enterprises		35,000
	TOTAL		**35,000**

CASH BOOK (Two column)

Date	Receipts	Cash	Bank	Date	Payments	Cash	Bank
01 Jul	Balance b/d	76,000	286,000	06 Jul	Office furniture		50,000
08 Jul	Sales		300,000	14 Jul	Return in 20%	49,000	
08 Jul	Sales 98%	245,000		17 Jul	Alpha Ent. 97%		208,550

Date	Receipts	Cash	Bank	Date	Payments	Cash	Bank
16 Jul	Disposal	12,000		26 Jul	Purchases 95%		142,500
23 Jul	Sales	236,500		28 Jul	Loan	115,000	
30 Jul	Cash		200,000	28 Jul	Interest	35,000	
				30 Jul	Bank	200,000	
				31 Jul	Balance c/d	170,500	384,950
		569,500	**786,000**			**569,500**	**786,000**

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
6 Jul 18	*Office furniture*		40,000	
	Advances			40,000
17 Jul 18	*Trade payables (Alpha Enterprises)*		6,450	
	Discount received 3%			6,450

- *Example 15:*

Following transactions pertain to Gul Brothers (GB) for the month of February 2017:

3-Feb	Bought goods on credit from QT Stores for Rs. 295,000.
3-Feb	Purchased goods in bulk on 15 days' credit from Bana & Co. at a price of Rs. 190,000 (net of 5% trade discount).
8-Feb	Sold goods on cash for Rs. 300,000.
15-Feb	Issued a cheque of Rs. 90,000 to XYZ in full and final settlement of an old outstanding balance of Rs. 100,000.
18-Feb	Sold goods on 15 days' credit to Qavi for Rs. 275,000. Qavi would be entitled to 2% discount if payment is made on the due date. It is highly probable that Qavi would be able to claim this discount.
18-Feb	Sold goods on credit to Child Care Centre at a concessional price of cost plus 10%. The cost of goods was Rs. 158,000.
25-Feb	Received cheques from debtors – Chenab Rs. 68,000 and Ameen Stores Rs. 32,000.

Required:

Enter the above transactions in the related books of prime entry except general journal.

- *ANSWER*

Purchases day Book

Date	Supplier	Inv. #	Rs.
03 Feb	QT Stores		295,000
03 Feb	Bana & Co		190,000
	TOTAL		**485,000**

Sales day Book

Date	Customer	Inv. #	Rs.
18 Feb	Qavi (275,000 x 98%)		269,500
18 Feb	Child Care Centre [158,000 x 110%]		173,800
	TOTAL		**443,300**

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Cash Book

Date	Receipts	Disc.	Cash	Bank	Date	Payments	Disc.	Cash	Bank
8 Feb	Sales		300,000		15 Feb	XYZ	10,000		90,000
25 Feb	Chenab			68,000					
25 Feb	Ameen			32,000					

- *Example 16:*

In August 2015, Ali established a stationery store named as Ali Baba Stationers. The transactions during the month are listed below:

Date	Transactions
3 August	A bank account was opened with cash Rs. 5,000,000.
3 August	Purchase shop furniture worth Rs. 170,000 on credit.
3 August	Bought stationery on credit from The Pen Store: Rs. 450,000 less trade discount of Rs. 25,000, The School Shop: Rs. 200,000, Galaxy Stationers: Rs. 350,000, The Stationery Store: Rs. 400,000, The Office Store: Rs. 800,000.
5 August	Supplied stationery on credit to Murjeena Traders: Rs. 200,000, Qasim and Company: Rs. 550,000 less trade discount of Rs. 50,000, Chiragh Limited: Rs. 250,000, Sameer Enterprises: Rs. 400,000, Hamid and Company: Rs. 800,000.
6 August	Purchase returns to Galaxy Stationers: Rs. 10,000 and The Stationery Store: Rs. 40,000.
7 August	Paid shop rent amounting to Rs. 300,000.
7 August	Recovered Rs. 150,000 from Murjeena Traders, Rs. 250,000 from Qasim and Company, Rs. 200,000 from Chiragh Limited, Rs. 300,000 from Sameer Enterprises, Rs. 400,000 from Hamid and Company.
10 August	Paid Rs. 300,000 to The Stationery Store, Rs. 290,000 to The Office Store and Rs. 250,000 to The Pen Store after availing early payment discount of Rs. 25,000.
11 August	Paid Rs. 60,000 for shop repairs.
12 August	Sold stationery on cash amounting to Rs. 250,000.
15 August	Sales return from Murjeena Traders: Rs. 25,000 and Chiragh Limited: Rs. 30,000.
18 August	Bought stationery for cash Rs. 150,000
21 August	Supplied stationery on credit to Murjeena Traders: Rs. 300,000, Qasim and Company: Rs. 200,000, Chiragh Limited: Rs. 550,000, Sameer Enterprises: Rs. 200,000.
25 August	Following amounts were received from debtors: Murjeena Traders: Rs. 150,000, Qasim and Company: Rs. 150,000 after allowing early payment discount of Rs. 25,000, Chiragh Limited: Rs. 300,000 after allowing early payment discount of Rs. 50,000.

Required: Enter the transactions in the related books of prime entry assuming that all receipts and payments are made through bank account. Also assume that it was not expected that any customer will avail early payment discount.

► *ANSWER*

Ali Baba Stationers

PURCHASE DAY BOOK

Date	Supplier	Invoice #	Rs.
3 Aug 15	The pen store		425,000
3 Aug 15	The School Shop		200,000
3 Aug 15	Galaxy Stationers		350,000
3 Aug 15	The Stationary Store		400,000
3 Aug 15	The Office Store		800,000
	TOTAL		**2,175,000**

SALES DAY BOOK

Date	Customer	Invoice #	Rs.
5 Aug 15	Murjeena Traders		200,000
5 Aug 15	Qasim and Company		500,000
5 Aug 15	Chiragh Limited		250,000
5 Aug 15	Sameer Enterprises		400,000
5 Aug 15	Hamid and Company		800,000
21 Aug 15	Murjeena Traders		300,000
21 Aug 15	Qasim and Company		200,000
21 Aug 15	Chiragh Limited		550,000
21 Aug 15	Sameer Enterprises		200,000
	TOTAL		**3,400,000**

PURCHASE RETURN DAY BOOK

Date	Supplier	Credit note	Rs.
6 Aug 15	Galaxy Stationers		10,000
6 Aug 15	Stationary Store		40,000
	TOTAL		**50,000**

SALES RETURN DAY BOOK

Date	Customer	Credit note	Rs.
15 Aug 15	Murjeena Traders		25,000
15 Aug 15	Chiragh Limited		30,000
	TOTAL		**55,000**

CASH BOOK

Date	Receipts	Bank	Date	Payments	Bank
3 Aug	**Capital**	**5,000,000**	**7 Aug**	**Shop rent**	**300,000**
7 Aug	Receivables	1,300,000	10 Aug	Payables	840,000
12 Aug	Sales	250,000	11 Aug	Shop repairs	60,000
25 Aug	Receivables	600,000	18 Aug	Purchases	150,000
			31 Aug	Balance c/d	5,800,000
		7,150,000			**7,150,000**

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
3 Aug	Shop furniture		170,000	
	Payable for furniture			170,000
10 Aug	Payables: The Pen Store		25,000	
	Discount received / Purchases			25,000
25 Aug	Revenue / Discount allowed		75,000	
	Receivable: Qasim & Company			25,000
	Receivable: Chiragh Limited			50,000

8. OBJECTIVE BASED Q&A

01. Which of the following is not a book of prime entry?

(a) Sales day book

(b) Petty cash book

(c) Journal

(d) Trial balance

02. The sales day book is a book of prime entry:

(a) For recording all sales

(b) For recording credit sales

(c) In which cash sales are first recorded

(d) In which credit sales are first recorded

03. The purchases day book is a book of prime entry:

(a) For recording all purchases

(b) For recording credit purchases

(c) In which cash purchases are first recorded

(d) In which credit purchases are first recorded

04. In which book of prime entry credit notes issued to customers are initially recorded?

(a) Sales Journal

(b) Sales Return Journal

(c) Purchase Journal

(d) Purchase return Journal

05. In which book of prime entry debit notes issued are initially recorded?

(a) Sales Journal

(b) Sales Return Journal

(c) Purchase Journal

(d) Purchase return Journal

06. In which book of prime entry credit notes received are initially recorded?

(a) Sales Journal

(b) Sales Return Journal

(c) Purchase Journal

(d) Purchase return Journal

07. Which of the following transactions shall be recorded in sales day book of an Electronics Trader?

(a) Cash sales of office furniture

(b) Cash sales of electronics items

(c) Credit sales of office furniture

(d) Credit sales of electronics items

08. Which of the following transactions shall be recorded in cash book of an Electronics Trader?

(a) Cash sales of office furniture

(b) Cash sales of electronics items

(c) Credit sales of office furniture

(d) Credit sales of electronics items

09. Which of the following transactions must be recorded in general journal of an Electronics Trader?

(a) Cash sales of office furniture

(b) Cash sales of electronics items

(c) Credit sales of office furniture

(d) Credit sales of electronics items

10. A business has made following sales:

- Credit sales Rs. 1,500
- Cash sales Rs. 1,200

Which statement is correct for recording of sales transactions?

(a) Sales day book Rs. 1,500, Cash receipt book Rs. 1,200

(b) Cash receipt book Rs. 2,700

(c) Sales day book Rs. 1,500, Petty cash book Rs. 1,200

(d) Sales day book Rs. 2,700

11. Usuf made following transactions during a certain month:

- Credit sales 15,000 out of which Rs. 3,000 were returned by the customers subsequently
- Cash sales amounting Rs. 8,000
- Cash received from customers Rs. 4,000

What is the total of sales day book for the month?

(a) Rs. 15,000

(b) Rs. 12,000

(c) Rs. 23,000

(d) Rs. 20,000

12. In which of the following book returns inwards are recorded?

(a) Sales returns book

(b) Purchase returns books

(c) Cash receipts book

(d) Cash payment book

13. Hussain runs a business of purchase and sales of furniture. During a particular period, Hussain made following transactions:

- Sales to A Rs. 12,000
- Sales to B Rs. 10,000 list price and trade discount 2%
- Sales returns from A Rs. 3,000

What is the total of sales day book for the period?

(a) Rs. 22,000

(b) Rs. 21,800

(c) Rs. 19,000

(d) Rs. 18,800

14. A Credit Note is issued to a:

(a) Customer for return of goods

(b) Supplier for return of goods

(c) Customer to accept the goods

(d) Supplier to accept the goods

15. In which book of prime entry does debit notes received worth Rs.100,000 would be recorded?

(a) Accounts payable book

(b) Purchase journal

(c) Return inwards journal

(d) Returns outward journal

16. In which book of prime entry does sales on account of Rs. 700,000 would be recorded?

(a) Sales journal

(b) Accounts receivable journal

(c) Cash book

(d) Return inwards journal

17. Which of the following documents serves as a notice to the customer to inform them that the goods have been dispatched?

(a) Quotation

(b) Sales order / order confirmation

(c) Goods dispatched note

(d) Delivery note

18. On 20th July, goods with list price of Rs. 80,000 were sold. The customer has been offered 2% trade discount and 3% (of list price) further discount if he pays within 15 days. It is reasonably expected that customer will pay within 15 days. At which amount sales should be recognised on 20th July?

(a) Rs. 80,000

(b) Rs. 78,400

(c) Rs. 76,048

(d) Rs. 76,000

19. What is correct double entry for dishonour of cheque that was given by a customer?

(a) DEBIT Sales return; CREDIT Receivables

(b) DEBIT Bank; CREDIT Receivables

(c) DEBIT Receivables; CREDIT Bank

(d) DEBIT Sales return; CREDIT Bank

20. In which book of prime entry the transaction of cheque dishonoured is recorded?

(a) Sales day book

(b) Petty cash book

(c) Cash book

(d) General journal

21. In the books of Faizan; Sarmad has a debit balance of Rs. 3,000 and credit balance of Rs. 1,500. Sarmad has requested to adjust debit balance with credit.
What is the contra entry to be passed to adjust the balance?

(a) Dr Accounts receivable a/c Rs. 3,000 Cr Accounts payable a/c Rs. 3,000

(b) Dr Accounts payable a/c Rs. 3,000 Cr Accounts receivable a/c Rs. 3,000

(c) Dr Accounts receivable a/c Rs. 1,500 Cr Accounts payable a/c Rs. 1,500

(d) Dr Accounts payable a/c Rs. 1,500Cr Accounts receivable a/c Rs. 1,500

22. Which of the following document is prepared by the business's store keeper on receiving goods in store?

- **(a)** Goods dispatched note
- **(b)** Goods received note
- **(c)** Remittance advice
- **(d)** Debit note

23. Gross amount of purchases must be equal to:

- **(a)** Total of all invoices issued to customers
- **(b)** Total of all credit notes issued to customers
- **(c)** Total of all debit notes sent by customers
- **(d)** Total of all invoices received from suppliers

24. A debit note is issued to a:

- **(a)** Customer for return of goods
- **(b)** Supplier for return of goods
- **(c)** Customer to accept the goods
- **(d)** Supplier to accept the goods

25. In which book of prime entry does purchases on account of Rs. 500,000 would be recorded?

- **(a)** Cash book
- **(b)** Accounts payable book
- **(c)** Purchase day book
- **(d)** None of the above

26. In which book of prime entry does credit note received worth Rs.150,000 would be recorded?

- **(a)** Accounts receivable book
- **(b)** Sales day book
- **(c)** Return inwards journal
- **(d)** Returns outward journal

27. Which of the following document is prepared when an item is needed in the business but it is not available in stock?

- **(a)** Purchase requisition
- **(b)** Quotation and approval
- **(c)** Purchase order
- **(d)** Goods received note

28. Which of the following statements is correct with reference to settlement discount received from suppliers?

(a) It is recognised as reduction of revenue.

(b) It is recognised and presented as other income

(c) It is recognised as reduction in cost of purchases

(d) It is recognised as operating expenses of the business

29. In which book of prime entry, entry for contra settlement is initially recorded?

(a) Purchase day book

(b) Purchase day book and sales day book

(c) Cash Book

(d) General Journal

30. Cash discount received is recorded:

(a) As deduction in purchase day book

(b) In purchase return journal

(c) As deduction from cost of purchase in general journal

(d) None of above

31. Samreen has made following transactions during current week:

- Sales Rs. 15,000 out of which Rs. 4,000 are on cash
- A customer paid 800 after availing discount of 2%
- Rent paid Rs. 100

What is the total of receipt column of cash book?

(a) Rs. 15,800

(b) Rs. 4,800

(c) Rs. 4,700

(d) Rs. 15,700

32. Sufyan has purchased certain goods on credit from Aliyan. List price of the goods was Rs. 10,000. Trade discount of 2% was allowed. Aliyan also offered a discount of 1% on amount due if the amount due is paid within 10 days. Sufyan availed the discount.

For recording the above transactions by Sufyan; which books of prime entry are involved and at what amount?

(a) Purchase day book Rs. 10,000, Cash book discount column Rs. 298 and payment column Rs. 9,702

(b) Purchase day book Rs. 9,702, Cash book Rs. 9,702

(c) Purchase day book Rs. 9,800, Cash book discount column Rs. 98 and payment column Rs. 9,702

(d) Sales day book Rs. 9,800, Cash book discount column Rs. 98 and receipt column Rs. 9,702

33. A businessman maintains petty cash book under imprest system. The imprest amount is Rs. 500. During a month, payments totalling Rs. 300 were made.

How much amount will be reimbursed at the end of the month to restore the petty cash to the imprest amount?

(a)	Rs. 200	**(c)**	Rs. 500
(b)	Rs. 300	**(d)**	Rs. 800

34. Which of the following statement describes the nature of weekly imprest system for petty cash?

(a) Maximum amount of weekly petty cash expense is defined

(b) For maintaining a fixed float; an amount equal to weekly expenses incurred is reimbursed

(c) Proper authorization is required for all expense

(d) Business transfers an equal amount to petty cash balance at regular intervals

35. A business made following transactions during a certain period:

Credit purchases Rs. 12,000; out of which Rs. 2,000 were rejected and subsequently returned to the supplier. Supplier allowed a discount of 1% on settlement of amount.

What is the net amount of cash paid to the supplier and amount of net purchases to be reported in financial statements?

(a) Rs. 10,000 amount paid and Rs. 10,000 net purchases.

(b) Rs. 10,000 amount paid and Rs. 10,000 net purchases

(c) Rs. 9,900 amount paid and Rs. 9,900 net purchases

(d) Rs. 9,900 amount paid and Rs. 11,880 net purchases

36. Sadia maintains an imprest system of petty cash. Float is maintained at Rs. 1,000. During February 2019 Sadia has made payments of Rs. 650. At end of February it is decided to increase float by Rs. 100.

What amount is needed to achieve the required float?

Rs. __________

37. In which book of prime entry does receipt from a debtor worth Rs.200,000 may be recorded?

(a) Petty cash book

(b) Cash book

(c) Receivable ledger

(d) Debtor book

38. In which book of prime entry does payment to supplier worth Rs.300,000 may be recorded?

(a) Petty cash book

(b) Accounts payable journal

(c) Cash payment journal / Cash book

(d) None of the above

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39. In which book of prime entry does payment of entertainment expense worth Rs.150 is usually recorded?

(a) Petty cash book

(b) Cash payment journal

(c) Bank book

(d) None of the above

40. In which book of prime entry does cash purchases worth Rs. 500,000 would be recorded?

(a) Petty cash book

(b) Cash book

(c) Purchase day book

(d) Accounts payable book

41. In which book of prime entry does cash sales worth Rs. 250,000 would be recorded?

(a) Petty cash book

(b) Cash book

(c) Sales day book

(d) Accounts receivable book

42. Which of the following items will be debited to payable account in journal entry?

(a) Payment to credit supplier

(b) Cash purchases

(c) Refunds from a credit supplier

(d) Balance due

43. Any transaction, which cannot be recorded in any other book of prime entry, is recorded in?

(a) Cash book

(b) Petty cash book

(c) General journal

(d) Day books

44. In which book of prime entry correction of errors would usually be recorded?

(a) Cash book

(b) Petty cash book

(c) Error correction book

(d) General Journal

45. In which book of prime entry, year-end adjustments would usually be recorded?

(a) Cash book

(b) Petty cash book

(c) Error correction book

(d) General Journal

46. A voucher is:

(a) An internal document of a business entity

(b) An external document received by a business entity

(c) A book of prime entry

(d) None of above

47. Vouchers may be used:

(a) In replacement of books of prime entry

(b) In support of books of prime entry

(c) Both of above

(d) None of above

48. Which voucher is used to for payment of cheques?

(a) Journal voucher

(b) Receipt voucher

(c) Payment voucher

(d) None of above

49. Which voucher is used to for receipt of cheques/cash?

(a) Journal voucher

(b) Receipt voucher

(c) Payment voucher

(d) None of above

50. Which voucher is prepared for non-cash transactions?

(a) Journal voucher

(b) Receipt voucher

(c) Payment voucher

(d) None of above

ANSWERS

01.	**(d)**	Trial balance is not a book of prime entry.
02.	**(b)**	Only credit sales is recorded in sales day book, cash sales is recorded in cash book.
03.	**(b)**	Only credit purchases are recorded in purchases day book, cash purchases are recorded in cash book.
04.	**(b)**	Sales return journal
05.	**(d)**	Purchase return journal
06.	**(d)**	Purchase return journal
07.	**(d)**	Inventory item on credit
08.	**(a)&(b)**	All cash transactions
09.	**(c)**	Non-current asset sold on credit
10.	**(a)**	Credit sales are recorded in sales day book and cash sales are recorded in cash receipt book
11.	**(a)**	Credit sales are entered in the sales day books; sales returns are entered in sales returns day book (not deducted from sales day book total); cash sales and cash received from customers are entered in cash receipt book
12.	**(a)**	Sales returns day book
13.	**(b)**	Total sales = Rs. 12,000+ (Rs. 10,000x0.98) = Rs. 21,800
14.	**(a)**	Customer as an evidence of return of goods
15.	**(c)**	Return inwards (we issued credit note and received debit note)
16.	**(a)**	Sales journal
17.	**(c)**	Goods dispatched note
18.	**(d)**	Rs. 80,000 less 2% of Rs. 80,000 less 3% of Rs. 80,000 = Rs. 76,000
19.	**(c)**	DEBIT Receivables; CREDIT Bank
20.	**(c)**	Cash book (as reversal of receipt)
21.	**(d)**	Payables (Liabilities) decreased, resulting in debit Receivables (assets) decreased, resulting in credit Only lower amount may be offset.
22.	**(b)**	Goods received note
23.	**(d)**	Total of all invoices received from suppliers
24.	**(b)**	Supplier for return of goods
25.	**(c)**	Purchase day book
26.	**(d)**	Return outwards journal
27.	**(a)**	Purchase requisition
28.	**(c)**	It is recognised as reduction in cost of purchases.
29.	**(d)**	General Journal (a non-cash transaction)
30.	**(c)**	In general journal, as reduction in cost of purchases.

31.	**(b)**	Cash sales Rs. 4,000 + cash received from customer 800 = Rs. 4,800
32.	**(c)**	Purchase day book: Rs. 10,000 x 98% = 9,800 Discount received column in Cash book: Rs. 9,800x1%=Rs. 98 Cash payment column in cash book = Rs. 9,800 – Rs. 98 = Rs. 9,702
33.	**(b)**	The amount spent is reimbursed so that imprest amount becomes available again.
34.	**(b)**	For maintaining a fixed float; an amount equal to weekly expenses incurred is reimbursed
35.	**(c)**	Net amount payable = Rs. 12,000-Rs. 2,000 = Rs. 10,000 Cash paid = Rs. 10,000 x 99%= Rs. 9,900 The same amount will be recorded as cost of purchases (net).
36.	**Rs. 750**	New float = Rs. 1,000+100 = Rs. 1,100 Amount required to restore and increase = Rs. 100+Rs. 650 = Rs. 750
37.	**(b)**	Cash transaction (not a small amount)
38.	**(c)**	Cash transaction of payment (not a small amount)
39.	**(a)**	Cash transaction (small amount)
40.	**(b)**	Cash transaction
41.	**(b)**	Cash transaction
42.	**(a)**	Payment to credit supplier
43.	**(c)**	General journal
44.	**(d)**	General Journal
45.	**(d)**	General Journal
46.	**(a)**	An internal document of a business entity
47.	**(c)**	Voucher system may be used along with books of prime entry or in its replacement.
48.	**(c)**	Payment voucher
49.	**(b)**	Receipt voucher
50.	**(a)**	Journal voucher

STICKY NOTES

Sales day book
Transaction type: Credit sales (of inventory)
Source document: Invoices issued to customer

Sales returns day book
Transaction type: Return of goods sold on credit
Source document: Credit notes issued

Purchases day book
Transaction type: Credit purchases (of inventory)
Source document: Invoices received from suppliers

Purchases returns day book
Transaction type: Return of goods bought on credit
Source document: Credit notes received (or debit notes issued)

Cash Book
Transaction type: All cash and bank transactions (small cash transactions may be recorded in petty cash book)
Source document: Payment approvals, counterfoils, cheques and vouchers

General Journal
Transaction type: All other transactions
Source document: Bills, approval documents and journal vouchers

Vouchers
Different vouchers may be used to record transactions initially rather than using day books of prime entry.
These may include receipt vouchers, payment vouchersand journal vouchers.

CHAPTER 3

LEDGERS AND TRIAL BALANCE

IN THIS CHAPTER:

AT A GLANCE

The transactions recorded in books of prime entry are posted in ledger accounts which may have T account form or statement form with running balance calculated after each transaction.

Individual customer accounts are usually maintained in receivables' ledger, individual supplier accounts in payables ledger and all other accounts in general ledger.

Every ledger account must be separately identifiable. It is often quicker and more convenient to give accounts their own unique code number. The design and arrangement of such codes is called chart of accounts.

From ledgers a trial balance is prepared to check arithmetical accuracy of double entry book-keeping and it is also starting point to prepare financial statements.

Income, expense and drawings accounts are transferred / closed to Capital account at the end of accounting period once financial statements have been prepared. The next period starts with balances of assets, liabilities and equity only.

1. LEDGERS

The sorted record from books of prime entry is posted to ledger accounts.

Accounts are kept together in a ledger. A ledger is a collection of related accounts. The two most common format for ledger accounts are 'T account' and 'running balance account'.

The process of classifying amounts from books of prime entry to ledgers is called '**posting**'.

T account

A simplified form of an account and is widely used in studies, exams and workings. Debit transactions are posted on **left** side with reference to account of credit entry. Credit transactions are posted on **right** side with reference to account of debit entry.

Receivable – Quality Traders					
Date	**Particulars**	**Dr. (Rs.)**	**Date**	**Particulars**	**Cr. (Rs.)**
01 Feb	Balance b/d	5,000	08 Feb	Sales return	2,000
06 Feb	Sales	15,000	18 Feb	Bank	10,000
20 Feb	Sales	8,000	24 Feb	Bank	9,000
			29 Feb	Balance c/d	7,000
		28,000			**28,000**
01 Mar	Balance b/d	7,000			

Balancing a T account ledger

Once the transactions for a period have been recorded, it will be necessary to find the balance on the ledger account:

- Total both sides of the T account and find the larger total.
- Put the larger total in the total box on the debit and credit side.
- Insert a balancing figure to the side of the T account which does not currently add up to the amount in the total box. Call this balancing figure 'balance c/f' (carried forward) or 'balance c/d' (carried down).
- Carry the balance down diagonally and call it 'balance b/f' (brought forward) or 'balance b/d' (brought down).

Running account balance

This is an alternative to T account and is widely used in practice. This provides with updated balance after each transactions.

Receivable – Quality Traders				
Date	**Particulars**	**Dr. (Rs.)**	**Cr. (Rs.)**	**Balance Rs.**
01 Feb	Balance b/d			5,000 Dr
06 Feb	Sales	15,000		20,000 Dr
08 Feb	Sales return		2,000	18,000 Dr
18 Feb	Bank		10,000	8,000 Dr
20 Feb	Sales	8,000		16,000 Dr
24 Feb	Bank		9,000	7,000 Dr

TYPE OF LEDGERS

1.	**Receivables Ledger**	It contains all individual customers' accounts (to whom we sell inventory on credit) in it. It is also called sales ledger or customer ledger.
2.	**Payables Ledger**	It contains all individual suppliers' accounts (from whom we purchase inventory on credit) in it. It is also called purchase ledger or supplier ledger.
3.	**General (Main) Ledger**	It contains all the other accounts of assets, liabilities, income, expenses, capital and drawings. It is also called nominal ledger.

POSTING RULES

Books of Prime entry		Amount	Posted in	Account(s)
1.	**Sales day book**	Each invoice	Receivables Ledger	On debit side of individual customers' accounts.
		Total sales	General Ledger	On credit side of Sales Account.
2.	**Sales return day book**	Total returns	General Ledger	On debit side of Sales Return Account.
		Each return	Receivables Ledger	On credit side of individual customers' accounts.
3.	**Purchase day book**	Total purchases	General Ledger	On debit side of Purchase Account.
		Each invoice	Payables Ledger	On credit side of individual suppliers' accounts.
4.	**Purchase return day book**	Each return	Payables Ledger	On debit side of individual suppliers' accounts.
		Total returns	General Ledger	On credit side of Purchase Return Account.
5.	**Cash Book**	Each payment to supplier	Payables Ledger	On debit side of individual suppliers' accounts.
		Other payments	General Ledger	On debit side of relevant Account.
		Discount from each supplier	Payables Ledger	On debit side of individual suppliers' accounts.
		Total of discount received column	General Ledger	On credit side of 'Discount Received' or 'Purchases' Account
		Each receipt from customers	Receivables Ledger	On credit side of individual customers' accounts.
		Other receipts	General Ledger	On credit side of relevant Account.
		Discount to each customer	Receivables Ledger	On credit side of individual customers' accounts.
		Total of discount allowed column	General Ledger	On debit side of 'Discount Allowed' or 'Revenue' Account
6.	**General Journal**	Account debited	General Ledger	On debit side of relevant account
		Account credited	General Ledger	On credit side of relevant account

AT A GLANCE
SPOTLIGHT
STICKY NOTES

Tutorial note: The above posting rules are in accordance with an accounting system, where control accounts are not maintained.

- *Example 01:*

The following books of prime entry relate to a carpet retailer *Adeel Traders* for the month of November.

SALES DAY BOOK

Date	Customer	Inv. #	Rs.
19 Nov	Taseer		885,000
19 Nov	Jawad		848,000
19 Nov	Touseef		1,640,000
30 Nov	**TOTAL**		**3,373,000**

SALES RETURNS DAY BOOK

Date	Customer	CN #	Rs.
20 Nov	Jawad		6,000
20 Nov	Taseer		14,000
30 Nov	**TOTAL**		**20,000**

PURCHASES DAY BOOK

Date	Supplier	Inv. #	Rs.
03 Nov	Jamal		290,000
03 Nov	Faisal		1,200,000
03 Nov	Talal		610,000
03 Nov	Rashid		530,000
19 Nov	Rashid		110,000
19 Nov	Talal		320,000
19 Nov	Fahad		165,000
30 Nov	**TOTAL**		**3,225,000**

PURCHASES RETURNS DAY BOOK

Date	Supplier	CN #	Rs.
18 Nov	Jamal		18,000
18 Nov	Rashid		27,000
30 Nov	**TOTAL**		**45,000**

CASH RECEIPT BOOK

Date	Receipts / Particulars	Discount allowed	Cash	Bank
1 Nov	Capital			15,000,000
5	Sales		610,000	
26	BB Bank Loan		750,000	
28	Taseer	6,000		65,000
28	Jawad	2,000		40,000
30	Capital			900,000
		8,000	**1,360,000**	**16,005,000**

CASH PAYMENT BOOK

Date	Payments / Particulars	Discount received	Cash	Bank
6 Nov	Rent			175,000
7	Business rates			130,000
17	Drawings		290,000	
23	Jamal	7,000		265,000
23	Faisal			1,200,000
23	Talal	20,000		480,000
25	Motor Vehicle			6,200,000
30	Balance c/d		1,070,000	7,555,000
		27,000	**1,360,000**	**16,005,000**

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
21 Nov	*Motor Vehicle*		4,950,000	
	Turnkey Motors			4,950,000
	(Vehicle bought on credit)			

Required: Prepare relevant ledger accounts assuming that *Adeel Traders* maintains separate accounts for settlement discounts and deduct the discounts from Revenue and Purchases in the financial statements.

▶ *ANSWER*

RECEIVABLES' LEDGER

Taseer (RL 1)

19 Nov	Sales	885,000	20 Nov	Sales return	14,000
			28 Nov	Bank	65,000
			28 Nov	Discount	6,000
			30 Nov	Balance c/d	800,000
		885,000			**885,000**
1 Dec	Balance b/d	800,000			

Jawad (RL 2)

19 Nov	Sales	848,000	20 Nov	Sales return	6,000
			28 Nov	Bank	40,000
			28 Nov	Discount	2,000
			30 Nov	Balance c/d	800,000
		848,000			**848,000**
1 Dec	Balance b/d	800,000			

Touseef (RL 3)

19 Nov	Sales	1,640,000	30 Nov	Balance c/d	1,640,000
		1,640,000			**1,640,000**
1 Dec	Balance b/d	1,640,000			

PAYABLES' LEDGER

Jamal (PL 1)					
18 Nov	Purchases returns	18,000	03 Nov	Purchases	290,000
23 Nov	Bank	265,000			
23 Nov	Discount received	7,000			
		290,000			**290,000**

Faisal (PL 2)					
23 Nov	Bank	1,200,000	03 Nov	Purchases	1,200,000
		1,200,000			**1,200,000**

Talal (PL 3)					
23 Nov	Bank	20,000	03 Nov	Purchases	610,000
23 Nov	Discount received	480,000	19 Nov	Purchases	320,000
30 Nov	Balance c/d	430,000			
		930,000			**930,000**
			1 Dec	Balance b/d	430,000

Rashid (PL 4)					
18 Nov	Purchases returns	27,000	03 Nov	Purchases	530,000
30 Nov	Balance c/d	613,000	19 Nov	Purchases	110,000
		640,000			**640,000**
			1 Dec	Balance b/d	613,000

Fahad (PL 5)					
30 Nov	Balance c/d	165,000	19 Nov	Purchases	165,000
		165,000			**165,000**
			1 Dec	Balance b/d	165,000

GENERAL LEDGER

Sales (GL 1)					
			30 Nov	RA (SDB TOTAL)	3,373,000
30 Nov	Balance c/d	3,983,000	5 Nov	Cash	610,000
		3,983,000			**3,983,000**
			1 Dec	Balance b/d	3,983,000

Sales Returns (GL 2)					
30 Nov	RA (SRDB TOTAL)	20,000	30 Nov	Balance c/d	20,000
		20,000			**20,000**
1 Dec	Balance b/d	20,000			

Purchases (GL 3)					
30 Nov	PA (PDB TOTAL)	3,225,000	30 Nov	Balance c/d	3,225,000
		3,225,000			**3,225,000**
1 Dec	Balance b/d	3,225,000			

Purchases Return (GL 4)					
30 Nov	Balance c/d	45,000	30 Nov	PA (PRDB TOTAL)	45,000
		45,000			**45,000**
			1 Dec	Balance b/d	45,000

Owner's Capital (GL 5)					
			1 Nov	Bank	15,000,000
30 Nov	Balance c/d	15,900,000	30 Nov	Bank	900,000
		15,900,000			**15,900,000**
			1 Dec	Balance b/d	15,900,000

BB Bank Loan (GL 6)					
30 Nov	Balance c/d	750,000	26 Nov	Cash	750,000
		750,000			**750,000**
			1 Dec	Balance b/d	750,000

Discount allowed (GL 7)					
30 Nov	CB TOTAL	8,000	30 Nov	Balance c/d	8,000
		8,000			**8,000**
1 Dec	Balance b/d	8,000			

Rent (GL 8)					
6 Nov	Bank	175,000	30 Nov	Balance c/d	175,000
		175,000			**175,000**
1 Dec	Balance b/d	175,000			

Business Rates (GL 9)					
7 Nov	Bank	130,000	30 Nov	Balance c/d	130,000
		130,000			**130,000**
1 Dec	Balance b/d	130,000			

Drawings (GL 10)					
17 Nov	Cash	290,000	30 Nov	Balance c/d	290,000
		290,000			**290,000**
1 Dec	Balance b/d	290,000			

Discount Received (GL 11)					
30 Nov	Balance c/d	27,000	30 Nov	CB TOTAL	27,000
		27,000			**27,000**
			1 Dec	Balance b/d	27,000

Motor Vehicles (GL 12)					
25 Nov	Bank	6,200,000			
21 Nov	Turnkey Motors	4,950,000	30 Nov	Balance c/d	11,150,000
		11,150,000			**11,150,000**
1 Dec	Balance b/d	11,150,000			

Turnkey Motors (GL 13)					
			21 Nov	Motor Vehicles	4,950,000
30 Nov	Balance c/d	4,950,000			
		4,950,000			**4,950,000**
			1 Dec	Balance b/d	4,950,000

2. CHART OF ACCOUNTS

This is a list of accounts created by a business to be used to organise its financial transactions into identified categories of assets, liabilities, income and expenses.

Unique coding and arrangement

Each general ledger account is identified by a unique code and heading. This allows a business to generate instructions and policies to be followed by those members of staff responsible for recording information.

The list is typically arranged in the order of the customary appearance of accounts in the financial statements, statement of financial position general ledger accounts followed by statement of comprehensive income general ledger accounts. The structure and headings in the list aim to result in consistent posting of transactions.

Design and future changes

A company might have complete freedom in designing its chart of accounts (within the boundaries set by the rules of accounting). In some countries, the government might issue a generic chart of accounts from which a business selects those codes that are appropriate to its needs.

In order to keep a vigilant control over accounting framework of the organization, no accounting personnel is allowed to make amendment (including opening a new head of account) in the chart of accounts unless specific written approval thereof is duly sanctioned by the head of finance function.

Objective of using chart of accounts

The aim of the chart is to ensure that all transactions are recognised in accordance with the requirements of the business. The organisation aims to maintain appropriate chart of accounts in order to cater the present and future monetary transactions with an objective of coming up with timely, accurate and meaningful financial reporting. The chart of accounts will act as a guiding and referring tool to the finance personnel while they post accounting entries to their respective head of accounts.

Specimen

Each major heading in the financial statements might be given a range of codes from which codes can be selected for individual general ledger accounts:

	Code range
Non-current assets	**100 – 199**
Land	110-119
Office buildings	120-129
Warehouses	130-139
Factories	140-149
Motor vehicles	150-159
Current assets	**200 – 299**
Inventory	210-219
Receivable	220-269
Cash	270-279
Non-current liabilities	**300 – 399**
Current liabilities	**400 – 499**
Equity	**500 – 599**
Income	**600 – 699**
Expenses	**700 – 799**

3. TRIAL BALANCE

Trial balance is a memorandum listing of all account balances as an internal check on mathematical accuracy of double entry book-keeping. It has two columns, debit and credit, and these two columns should be equal to each other indicating there is no arithmetical error.

List of balances are made from 'Receivables Ledger' and 'Payables Ledger' in order to determine total receivables and total payables amounts for inclusion in trial balance.

Source data for preparing trial balance

The source of balances for preparing trial balance consists of:

- Cash and bank balance from cash book
- Receivable balance from list of balances (receivables ledger, or general ledger if separate receivables ledger is not maintained)
- Payables balance from list of balances (payables ledger, or general ledger if separate payables ledger is not maintained)
- All other balances from general ledger

Purposes of a trial balance

- It is a starting point for producing a statement of comprehensive income and a statement of financial position at the end of an accounting period.
- It is a useful means of checking for errors in the accounting system. Errors must have occurred if the total of debit balances and total of credit balances on the ledger accounts are not equal.

Limitation of a trial balance

Trial balance is taken as test of arithmetical accuracy. If both the debit and credit columns of trial balance are equal to each other, we assume that there is no mistake in the posting of journal and subsidiary books to ledger accounts, in carrying forward balances of ledger accounts to trial balance and even in the balancing of ledger accounts.

This assumption is correct but should never be taken as conclusive proof of accuracy. It means that there are certain errors which remain undetected by trial balance. Both the debit and credit columns of the trial balance may be equal in spite of certain mistakes of omissions and principles. These errors may be mentioned as under:

- Errors of omission in the books of original record
- Errors of principle (posting on right side of wrong account nature wise)
- Compensating errors (same amount effect on debit and credit side)
- Incorrect account in the original books (on both sides)
- Posting to wrong account (but on right side)

- *Example 02:*

Using the information in *Example 01*, prepare list of balances (receivables), list of balances (payables) and trial balance.

LIST OF BALANCES - RECEIVABLES
As at 30 November 2017

Sr. #	Item	Ref.	Debit Rs. '000	Credit Rs. '000
1	Taseer	RL 1	800	
2	Jawad	RL 2	800	
3	Touseef	RL 3	1,640	
	TOTAL		**3,240**	

LIST OF BALANCES - PAYABLES
As at 30 November 2017

Sr. #	Item	Ref.	Debit Rs. '000	Credit Rs. '000
1	Jamal	PL 1		0
2	Faisal	PL 2		0
3	Talal	PL 3		430
4	Rashid	PL 4		613
5	Fahad	PL 5		165
	TOTAL			**1,208**

Adeel Traders
TRIAL BALANCE
As at 30 November 2017

Sr. #	Item	Ref.	Debit Rs. '000	Credit Rs. '000
1	Cash in hand	CB	1,070	
2	Cash at Bank	CB	7,555	
3	Receivables	RL	3,240	
4	Payables	PL		1,208
5	Sales	GL 1		3,983
6	Sales returns	GL 2	20	
7	Purchases	GL 3	3,225	
8	Purchases returns	GL 4		45
9	Capital	GL 5		15,900
10	BB Bank Loan	GL 6		750
11	Discount allowed	GL 7	8	
12	Rent	GL 8	175	
13	Business Rates	GL 9	130	
14	Drawings	GL 10	290	
15	Discount received	GL 11		27
16	Motor Vehicles	GL 12	11,150	
17	Turnkey Motors	GL 13		4,950
	TOTAL		**26,863**	**26,863**

AT A GLANCE
SPOTLIGHT
STICKY NOTES

4. TRANSITION TO NEXT ACCOUNTING PERIOD

CLOSING ENTRIES

Although in above example, all account balances have been carried forward, however, income, expenses and drawings are closed at the end of each reporting period.

This is because profit or loss belongs to owner and drawings reduce owner's capital. Therefore, the accounts related to income, expenses and drawings are not carried forward to next year. These accounts are directly or indirectly transferred to owner's capital by passing following closing (transferring) entries at the end of reporting period:

Transfer of all income

Debit Income accounts

Credit Statement of comprehensive income (profit or loss)

Transfer of all expenses accounts

Debit Statement of comprehensive income (profit or loss)

Credit Expense accounts

Transfer of profit to capital (reverse in case of loss)

Debit Statement of comprehensive income (profit or loss)

Credit Owner's capital

Transfer of drawings to capital

Debit Owner's capital

Credit Drawings

BALANCING OFF

Balances on the asset, liability and capital accounts are carried forward as closing balances at the end of the period and become opening balances at the beginning of the next period, usually an opening trial balance is prepared as well and accounting for the next period is started.

► *Example 03:*

Using the information in *Example 02*, show closing entries and opening trial balance afterwards.

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.	Credit Rs.
30 Nov	Sales		3,983,000	
	Purchase return		45,000	
	Discount received		27,000	
	Profit or loss			4,055,000
	(Transferred all credit items)			
30 Nov	Profit or loss		3,558,000	
	Sales return			20,000
	Purchases			3,225,000
	Rent			175,000
	Discount allowed			8,000
	Business rates			130,000
	(Transferred all debit items)			

Date	Particulars	LF	Debit Rs.	Credit Rs.
30 Nov	Profit or loss [4,055,000 – 3,558,000]		497,000	
	Owner's capital			497,000
	(Transferred profit to capital)			
30 Nov	Owner's capital		290,000	
	Drawings			290,000
	(Transferred drawings to capital)			

Trial Balance (Opening)
As at 01 December 2017

Sr. #	Item	Ref.	Debit Rs. '000	Credit Rs. '000
1	Cash in hand	CB	1,070	
2	Cash at Bank	CB	7,555	
3	Receivables	RL	3,240	
4	Payables	PL		1,208
5	Capital **(15,900 + 497 – 290)**			16,107
6	BB Bank Loan			750
7	Motor Vehicles		11,150	
8	Turnkey Motors			4,950
	TOTAL		**23,015**	**23,015**

5. COMPREHENSIVE EXAMPLES

- *Example 04:*

The following information relates to Hamza & Co., a retailer of television sets for the month of December 2010:

Date	Transaction	Rs. 000
1	Started business with a capital:	
	(i) in cash	870
	(ii) at bank	1,330
3	Bought television sets from Amin & Co., on credit.	2,200
3	Paid to Fast Motors for purchase of delivery van through cheque.	540
4	Televisions sold to Ahmed Brothers on credit.	1,880
8	Paid shop's rent in advance for six months to June 2011 to Mrs. Ali through cheque.	680
11	Payment received from Ahmed Brothers and deposited in the bank.	1,340
12	Paid cheque to Amin & Co.	784
18	Paid carriage by cash on purchases.	38
19	Defected televisions returned by Ahmed Brothers.	220
22	Bought LCD televisions on credit from Amin & Co.	1,230
28	Sold LCD televisions to Ahmed Brothers on credit.	810
30	The owner withdraws one television set for his personal use.	25

Required:

(a) Prepare journal entries of the above transactions.

(b) Post the information in the ledger accounts.

(c) Extract a trial balance as at December 31, 2010.

- *ANSWER*

Part (a)

GENERAL JOURNAL

Date	Particulars	LF	Debit Rs.000	Credit Rs.000
01 Dec	Cash		870	
	Bank		1,330	
	Capital			2,200
03 Dec	Purchases		2,200	
	Amin & Co (Payables)			2,200
03 Dec	Delivery van		540	
	Bank			540
04 Dec	Ahmed Brothers (Receivables)		1,880	
	Sales			1,880

Date	Particulars	LF	Debit Rs.000	Credit Rs.000
08 Dec	Advance rent		680	
	Bank			680
11 Dec	Bank		1,340	
	Ahmed Brothers (RA)			1,340
12 Dec	Amin & Co (PA)		784	
	Bank			784
18 Dec	Carriage inward		38	
	Cash			38
19 Dec	Sales return		220	
	Ahmed Brothers (RA)			220
22 Dec	Purchases		1,230	
	Amin & Co (PA)			1,230
28 Dec	Ahmed Brothers (RA)		810	
	Sales			810
30 Dec	Drawings		25	
	Purchases			25

Part (b) Ledger Accounts

Cash

Date	Particulars	Rs.	Date	Particulars	Rs.
1 Dec	Capital	870,000	18 Dec	Carriage inward	38,000
			31 Dec	Balance c/d	832,000
		870,000			**870,000**

Bank

Date	Particulars	Rs.	Date	Particulars	Rs.
1 Dec	Capital	1,330,000	3 Dec	Van	540,000
11 Dec	Ahmed Brothers	1,340,000	8 Dec	Prepaid rent	680,000
			12 Dec	Amin & Co.	784,000
			31 Dec	Balance c/d	666,000
		2,670,000			**2,670,000**

Capital

Date	Particulars	Rs.	Date	Particulars	Rs.
			1 Dec	Cash	870,000
31 Dec	Balance c/d	2,200,000	1 Dec	Bank	1,330,000
		2,200,000			**2,200,000**

Purchases of Television					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
3 Dec	Amin & Co.	2,200,000	30 Dec	Drawings	25,000
22 Dec	Amin & Co.	1,230,000	31 Dec	Balance c/d	3,405,000
		3,430,000			**3,430,000**

Amin & Co (payables)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
12 Dec	Bank	784,000	3 Dec	Purchases	2,200,000
31 Dec	Balance c/d	2,646,000	22 Dec	Purchases	1,230,000
		3,430,000			**3,430,000**

Van					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
3 Dec	Bank	540,000	31 Dec	Balance c/d	540,000
		540,000			**540,000**

Ahmed Brothers (receivables)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
4 Dec	Sales	1,880,000	11 Dec	Bank	1,340,000
28 Dec	Sales	810,000	19 Dec	Sales return	220,000
			31 Dec	Balance c/d	1,130,000
		2,690,000			**2,690,000**

Sales of Television					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
			4 Dec	Ahmad Bros.	1,880,000
31 Dec	Balance c/d	2,690,000	28 Dec	Ahmad Bros.	810,000
		2,690,000			**2,690,000**

Prepaid rent					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
8 Dec	Bank	680,000	31 Dec	Balance c/d	680,000
		680,000			**680,000**

Carriage inwards					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
18 Dec	Cash	38,000	31 Dec	Balance c/d	38,000
		38,000			**38,000**

Sales return					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
19 Dec	Ahmed Brothers	220,000	31 Dec	Balance c/d	220,000
		220,000			**220,000**

Drawings					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
30 Dec	Drawings	25,000	31 Dec	Balance c/d	25,000
		25,000			**25,000**

(Part c)

Trial balance
As at 31 December 2010

Sr. #	Particulars	Dr Rs.	Cr Rs.
1	Cash	832,000	
2	Bank	666,000	
3	Capital		2,200,000
4	Purchases	3,405,000	
5	Amin & Co (Payables)		2,646,000
6	Van	540,000	
7	Ahmed Brothers (Receivables)	1,130,000	
8	Sales		2,690,000
9	Prepaid rent	680,000	
10	Carriage inwards	38,000	
11	Sales return	220,000	
12	Drawings	25,000	
		7,536,000	**7,536,000**

- *Example 05:*

The following transactions in May 2013 are those of a new business entity, Home Oak Garden Traders.

Date	
1	Set up the entity with capital in cash Rs. 2,500,000.
2	Bought goods on credit from the following suppliers: The Bushes Company Rs. 540,000, Flower City Rs. 870,000, D Gibson Rs. 250,000, Wild Weed Rs. 760,000, T Greenery Rs. 640,000.
4	Sold goods on credit to: The Office Company Rs. 430,000, V Cork Rs. 640,000, Texas Chain Stores Rs. 1,760,000.
6	Paid rent Rs. 120,000.
9	The Office Company paid the Rs. 430,000 that it owed.
10	Texas Chain Stores paid Rs. 1,500,000.

Date	
12	The following payments were made to D Gibson Rs. 250,000 and to The Bushes Company Rs. 540,000.
15	Advertising costs of Rs. 230,000 were paid to the local newspaper publisher.
18	Bought goods on credit from the following suppliers: The Bushes Company Rs. 430,000, Landscape Rs. 1,100,000.
21	Sold goods on credit to Public Parks Rs. 670,000
31	Paid rent Rs. 180,000.

Required:

(a) Use T accounts to show how these transactions should be recorded in the main ledger accounts of the entity. The accounting system maintains separate accounts for each individual payable and receivable in the main ledger.

(b) Prepare a trial balance as at 31 May 2013.

▸ *ANSWER*

Part (a)

Capital					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
31	Balance c/d	2,500	1	Cash	2,500
		2,500			**2,500**

Cash					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
1	Capital	2,500	6	Rent	120
9	The office co.	430	12	D Gibson	250
10	Texas chain store	1,500	12	The Bushes Co.	540
			15	Advertising cost	230
			31	Rent	180
			31	Balance c/d	3,110
		4,430			**4,430**

Purchases					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
2	The bushes co.	540			
2	Flower city	870			
2	D Gibson	250			
2	Wild Weed	760			
2	T Greenery	640			
18	The bushes co.	430			
18	Landscape	1,100	31	Balance c/d	4,590
		4,590			**4,590**

Payables – The Bushes Company

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
12	Cash	540	2	Purchases	540
31	Balance c/d	430	18	Purchases	430
		970			**970**

Payables – Flower city

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
31	Balance c/d	870	2	Purchases	870
		870			**870**

Payables – D Gibson

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
12	Cash	250	2	Purchases	250
		250			**250**

Payables – Wild Weed

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
31	Balance c/d	760	2	Purchases	760
		760			**760**

Payables – T Greenery

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
31	Balance c/d	640	2	Purchases	640
		640			**640**

Payables – Landscape

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
31	Balance c/d	1,100	18	Purchases	1,100
		1,100			**1,100**

Receivables – The Office company

Date	Particulars	Rs.000	Date	Particulars	Rs.000
May			May		
4	Sales	430	9	Cash	430
		430			**430**

Receivables – V Cork					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
4	Sales	640	31	Balance c/d	640
		640			**640**

Receivables – Texas Chain Stores					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
4	Sales	1,760	10	Cash	1,500
			31	Balance c/d	260
		1,760			**1,760**

Receivables – Public Parks					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
21	Sales	670		Balance c/d	670
		670			**670**

Sales					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
			4	The office company	430
			4	V Cork	640
			4	Texas chain stores	1,760
31	Balance c/d	3,500	21	Public Parks	670
		3,500			**3,500**

Rent					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
6	Cash	120			
31	Cash	180	31	Balance c/d	300
		300			**300**

Advertising					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
May			May		
15	Cash	230	31	Balance c/d	230
		230			**230**

Part (b)

HOME OAK GARDEN TRADERS
Trial Balance
As at 31st May 2013

Sr.	Description	Dr. Rs. 000	Cr. Rs. 000
1	Capital		2,500
2	Cash	3,110	
3	Purchases	4,590	
4	Payables:		
5	The Bushes Company		430
6	Flower city		870
7	Wild Weed		760
8	T Greenery		640
9	Landscape		1,100
10	Receivables:		
11	V Cork	640	
12	Texas Chain Stores	260	
13	Public Parks	670	
14	Sales		3,500
15	Rent	300	
16	Advertising	230	
		9,800	**9,800**

- *Example 06:*

March 2013 Date	Transactions
1	Started business with Rs. 80,000 in the bank
2	Bought goods on credit from: KH Supplies Rs. 7,600; Hatts Rs. 2,700; Toby Traders Rs. 5,600
5	Cash sales Rs. 8,700. The cash was kept in a safe in Lee's office.
6	Paid wages Rs. 1,400 by cheque.
7	Sold goods on credit to: Elliott Rs. 3,500; L. Lane Rs. 4,200; Carton Leisure Rs. 7,200
9	Bought goods for cash Rs. 4,600 using cash from Lee's safe.
10	Bought goods on credit from: KH Supplies Rs. 5,700; Toby Traders Rs.9,800
12	Paid wages Rs. 1,400 by cheque.
13	Sold goods on credit to: L. Lane Rs. 3,200; Carton Leisure Rs. 2,300
15	Bought shop fixtures on credit from Beta Fittings Rs. 5,000
17	Paid K H Supplies Rs. 8,400
18	Goods returned to Toby Traders Rs. 2,000
21	Paid Beta Fittings Rs. 5,000

March 2013 Date	Transactions
24	Payment received from Carton Leisure Rs. 9,500
27	Goods returned to KH Supplies Rs. 2,400
30	King Bank provides a loan of Rs. 6,000
31	Bought a motor van, paying by cheque Rs. 40,000

Required:

Enter the above transactions in the main ledger accounts of Lee, and extract a trial balance as at 31 March 2013. Assume that all receipts and payments are by cheque unless told otherwise.

▶ *ANSWER*

Capital

Date	Particulars	Rs.	Date	Particulars	Rs.
Mar			Mar		
31	Balance c/d	80,000	1	Bank	80,000
		80,000			**80,000**

Bank

Date	Particulars	Rs.	Date	Particulars	Rs.
Mar			Mar		
1	Capital	80,000	6	Wages	1,400
24	Carton Leisure	9,500	12	Wages	1,400
30	King Bank Loan	6,000	17	KH Supplies	8,400
			21	Beta Fittings	5,000
			31	Motor Van	40,000
			31	Balance c/d	39,300
		95,500			**95,500**

Cash

Date	Particulars	Rs.	Date	Particulars	Rs.
Mar			Mar		
5	Sales	8,700	9	Purchases	4,600
			31	Balance c/d	4,100
		8,700			**8,700**

Purchases

Date	Particulars	Rs.	Date	Particulars	Rs.
Mar			Mar		
2	KH Supplies	7,600			
2	Hatts	2,700			
2	Toby Traders	5,600			
9	Cash	4,600			
10	KH Supplies	5,700			
10	Toby Traders	9,800	31	Balance c/d	36,000
		36,000			**36,000**

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Payables – KH Supplies					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
17	Bank	8,400	2	Purchases	7,600
27	Purchase returns	2,400	10	Purchases	5,700
31	Balance c/d	2,500			
		13,300			**13,300**

Payables – Hatts					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
31	Balance c/d	2,700	2	Purchases	2,700
		2,700			**2,700**

Payables – Toby Traders					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
18	Purchase returns	2,000	2	Purchases	5,600
31	Balance c/d	13,400	10	Purchases	9,800
		15,400			**15,400**

Payables – Beta Fittings					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
21	Bank	5,000	15	Fixtures and fittings	5,000
		5,000			**5,000**

Receivables – Elliot's					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
7	Sales	3,500	31	Balance c/d	3,500
		3,500			**3,500**

Receivables – L Lane					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
7	Sales	4,200			
13	Sales	3,200	31	Balance c/d	7,400
		7,400			**7,400**

Receivables – Carton Leisure					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
7	Sales	7,200	24	Bank	9,500
13	Sales	2,300			
		9,500			**9,500**

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Sales					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
			5	Cash	8,700
			7	Elliott	3,500
			7	L Lane	4,200
			7	Carton Leisure	7,200
			13	L Lane	3,200
31	Balance c/d	29,100	13	Carton Leisure	2,300
		29,100			**29,100**

Wages					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
6	Bank	1,400			
12	Bank	1,400	31	Balance c/d	2,800
		2,800			**2,800**

Fixture and Fittings					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
15	Beta Fittings	5,000	31	Balance c/d	5,000
		5,000			**5,000**

Motor Van					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
31	Bank	40,000	31	Balance c/d	40,000
		40,000			**40,000**

Purchase returns					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
			18	Toby Traders	2,000
31	Balance c/d	4,400	27	KH Supplies	2,400
		4,400			**4,400**

Loan					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
Mar			Mar		
31	Balance c/d	6,000	30	Bank	6,000
		6,000			**6,000**

Part (b)

LEE
Trial Balance
As at 31st March 2013

Description	Dr. Rs	Cr. Rs
Capital		80,000
Bank	39,300	
Cash	4,100	
Purchases	36,000	
Payables:		
KH Supplies		2,500
Hatts		2,700
Toby Traders		13,400
Receivables:		
Elliott	3,500	
L Lane	7,400	
Sales		29,100
Wages	2,800	
Fixture and Fittings	5,000	
Motor Van	40,000	
Purchase returns		4,400
Loan		6,000
	138,100	**138,100**

- *Example 07:*

Ravi Traders (RT) commenced its business on 1 January 2018. The books of prime entry as maintained by RT for the month of January 2018 are reproduced below:

CASH BOOK - RECEIPTS

Date	Description	Discount	Cash	Bank
		------------- Rupees -------------		
1-Jan	Capital	-	1,000	8,000
10-Jan	Return outward	-	50	-
11-Jan	Trade debtors - Quality Traders	150	–	6,100
14-Jan	Sales	-	-	1,250
20-Jan	Trade debtors - Himalaya Super Store	90	300	1,410
26-Jan	Bank	–	500	-
		240	1,850	16,760

CASH BOOK - PAYMENTS

Date	Description	Discount	Cash	Bank
		------------- Rupees -------------		
4-Jan	Office rent	-	200	300
5-Jan	Fixed assets (Office equipment)	-	-	1,500
7-Jan	Purchases	–	-	650
14-Jan	Trade debtors - Quality Traders	-	-	6,100
15-Jan	Trade creditors - Zee Traders	100	500	3,400
20-Jan	Return inward	-	60	-
21-Jan	Fixed assets (Computers)	–	250	-
24-Jan	Drawings	-	100	180
25-Jan	Utility bills	–	120	140
26-Jan	Cash	-	-	500
		100	1,230	12,770

PURCHASES DAY BOOK

Date	Suppliers' name	Rupees
2-Jan	ABC & Co.	4,500
10-Jan	Zee Traders	6,000
28-Jan	Unity Enterprises	7,500
		18,000

PURCHASES RETURNS DAY BOOK

Date	Suppliers' name	Rupees
12-Jan	Zee Traders	900

SALES DAY BOOK

Date	Customers' name	Rupees
8-Jan	Quality Traders	6,250
19-Jan	Himalaya Super Store	2,350
24-Jan	ABC & Co.	8,000
		16,600

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Date	Particulars	Debit	Credit
		-------- Rupees --------	
1-Jan	Fixed assets (Furniture)	300	
	Capital		300
14-Jan	Drawings	100	
	Purchases		100
14-Jan	Trade debtors - Quality Traders	150	
	Discount allowed (Reversed)		150
31-Jan	Drawings	50	
	Fixed assets (Computers)		50
31-Jan	Trade creditors - ABC & Co.	4,500	
	Trade debtors - ABC & Co.		4,500

Required: Prepare trial balance for the month ended 31 January 2018. (Preparation of ledger accounts is not necessary). Discount received and Discount allowed accounts are not maintained by RT.

► *ANSWER*

Ravi Traders
Trial balance for the month of January 2018

Description	Workings / Calculation	Debit	Credit
		Rupees	
Capital	+1,000 + 8,000 CB + 300 GJ		9,300
Purchase return	+50 CB + 900 PRDB		950
Trade debtors –QT	-150 – 6,100 + 6,100 CB + 6,250 SDB +150 GJ	6,250	
Sales	+1,250 CB + 16,600 SDB – (240 CB – 150 GJ)		17,760
Trade debtors – HSS	-90 – 300 – 1,410 CB + 2,350 SDB	550	
Cash in hand	+ 1,850 – 1,230 CB	620	
Cash at Bank	+ 16,760 – 12,770 CB	3,990	
Office rent	+200 + 300 CB	500	
Fixed assets	+1500 + 250 CB + 300 – 50 GJ	2,000	
Purchases	+ 650 CB + 18,000 PDB – 100 GJ – (100 CB)	18,450	
Trade creditors - ZT	-100 – 500 – 3,400 CB + 6,000 PDB – 900 PRDB		1,100
Sales return	+60 CB	60	
Drawings	+100 + 180 CB + 100 + 50 GJ	430	
Utility bills	+120 + 140 CB	260	
Trade creditors - ABC	+4500 PDB – 4,500 GJ		0
Trade creditors – Unity	+7,500		7,500
Trade debtors - ABC	+8,000 SDB – 4,500 GJ	3,500	
		36,610	**36,610**

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6. OBJECTIVE BASED Q&A

01. The process of transferring transaction from journal to ledgers is called?

- **(a)** Journalizing
- **(b)** Summarizing
- **(c)** Posting
- **(d)** Analysing

02. The total of debit side of an account is Rs. 16,000 and total of credit side is Rs. 22,000. The balance carried forward shall be written:

- **(a)** On left side Rs. 6,000
- **(b)** On right side Rs. 6,000
- **(c)** On left side Rs. 38,000
- **(d)** On right side Rs. 38,000

03. How different formats of ledgers are balanced?

- **(a)** T account: periodically & Running balance account: periodically
- **(b)** T account: after each transaction & Running balance account: after each transaction
- **(c)** T account: periodically & Running balance account: after each transaction
- **(d)** T account: after each transaction & Running balance account: periodically

04. The total of debit side of an account is Rs. 16,000 and total of credit side is Rs. 22,000. The balance brought forward shall be written after balancing the account:

- **(a)** On left side Rs. 6,000
- **(b)** On right side Rs. 6,000
- **(c)** On left side Rs. 38,000
- **(d)** On right side Rs. 38,000

05. The total of debit side of an account is Rs. 60,000 and total of credit side is Rs. 22,000. The balance brought forward shall be written after balancing the account:

- **(a)** On left side Rs. 6,000
- **(b)** On right side Rs. 6,000
- **(c)** On left side Rs. 38,000
- **(d)** On right side Rs. 38,000

06. The total of debit side of an account is Rs. 60,000 and total of credit side is Rs. 22,000. The balance carried forward shall be written:

- **(a)** On left side Rs. 6,000
- **(b)** On right side Rs. 6,000
- **(c)** On left side Rs. 38,000
- **(d)** On right side Rs. 38,000

07. An entity maintains running balance account ledger. A customer had balance of Rs. 18,000 debit. A further sale of Rs. 10,000 was made to him and he paid Rs. 15,000 by cheque. What would be his account balance after posting all transactions?

(a) Rs. 13,000 credit

(b) Rs. 13,000 debit

(c) Rs. 18,000 debit (unchanged)

(d) Rs. 3,000 debit

08. The Return Inwards account would be found in

(a) The Sales ledger

(b) The Nominal ledger

(c) The Purchases Returns ledger

(d) The Purchases ledger

09. The sales account is part of:

(a) General ledger

(b) Sales ledger

(c) Receivables ledger

(d) Payables ledger

10. The purchases account is part of:

(a) General ledger

(b) Sales ledger

(c) Purchases ledger

(d) Payables ledger

11. Each invoice value from sales journal is posted to:

(a) credit side of individual customer account in Receivables Ledger.

(b) debit side of individual customer account in Receivables Ledger.

(c) credit side of sales account in General Ledger.

(d) debit side of sales account in General Ledger.

12. The periodic total from sales journal is posted to:

(a) credit side of individual customer account in Receivables Ledger.

(b) debit side of individual customer account in Receivables Ledger.

(c) credit side of sales account in General Ledger.

(d) debit side of sales account in General Ledger.

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13. Each return inward (credit note issued) from sales return journal is posted to:

(a) credit side of individual customer account in Receivables Ledger.

(b) debit side of individual customer account in Receivables Ledger.

(c) credit side of sales return account in General Ledger.

(d) debit side of sales return account in General Ledger.

14. The periodic total from sales return journal is posted to:

(a) credit side of individual customer account in Receivables Ledger.

(b) debit side of individual customer account in Receivables Ledger.

(c) credit side of sales return account in General Ledger.

(d) debit side of sales return account in General Ledger.

15. Each purchase invoice value from purchases journal is posted to:

(a) credit side of individual supplier account in Payables Ledger.

(b) debit side of individual supplier account in Payables Ledger.

(c) credit side of purchases account in General Ledger.

(d) debit side of Purchases account in General Ledger.

16. The periodic total from purchases journal is posted to:

(a) credit side of individual supplier account in Payables Ledger.

(b) debit side of individual supplier account in Payables Ledger.

(c) credit side of purchases account in General Ledger.

(d) debit side of Purchases account in General Ledger.

17. Each return outwards from purchase return journal is posted to:

(a) credit side of individual supplier account in Payables Ledger.

(b) debit side of individual supplier account in Payables Ledger.

(c) credit side of purchase return account in General Ledger.

(d) debit side of purchase return account in General Ledger.

18. The period total of purchase return journal is posted to:

(a) credit side of individual supplier account in Payables Ledger.

(b) debit side of individual supplier account in Payables Ledger.

(c) credit side of purchase return account in General Ledger.

(d) debit side of purchase return account in General Ledger.

19. Each payment to supplier as recorded in Cash Book is posted to:

(a) debit side of individual suppliers' account in Payables Ledger

(b) debit side of relevant account in General Ledger

(c) credit side of individual suppliers' account in Payables Ledger

(d) credit side of discount received account in General Ledger

20. Each payment, other than those to suppliers, as recorded in Cash Book is posted to:

(a) debit side of individual suppliers' account in Payables Ledger

(b) debit side of relevant account in General Ledger

(c) credit side of individual suppliers' account in Payables Ledger

(d) credit side of discount received account in General Ledger

21. Discount received from each supplier as recorded in Cash Book is posted to:

(a) debit side of individual suppliers' account in Payables Ledger

(b) debit side of relevant account in General Ledger

(c) credit side of individual suppliers' account in Payables Ledger

(d) credit side of discount received account in General Ledger

22. Total of discount received column as recorded in Cash Book is posted to:

(a) debit side of individual suppliers' account in Payables Ledger

(b) debit side of relevant account in General Ledger

(c) credit side of individual suppliers' account in Payables Ledger

(d) credit side of discount received account or Purchases account in General Ledger

23. Each receipt from customer as recorded in Cash Book is posted to:

(a) credit side of individual customers' account in Receivables Ledger

(b) credit side of relevant account in General Ledger

(c) debit side of individual customers' account in Receivables Ledger

(d) debit side of discount allowed account in General Ledger

24. Each receipt (other than from customers) as recorded in Cash Book is posted to:

(a) credit side of individual customers' account in Receivables Ledger

(b) credit side of relevant account in General Ledger

(c) debit side of individual customers' account in Receivables Ledger

(d) debit side of discount allowed account in General Ledger

25. Discount allowed to each customer as recorded in Cash Book is posted to:

(a) credit side of individual customers' account in Receivables Ledger

(b) credit side of relevant account in General Ledger

(c) debit side of individual customers' account in Receivables Ledger

(d) debit side of discount allowed account or sales account in General Ledger

26. Total of discount allowed column as recorded in Cash Book is posted to:

(a) credit side of individual customers' account in Receivables Ledger

(b) credit side of relevant account in General Ledger

(c) debit side of individual customers' account in Receivables Ledger

(d) debit side of discount allowed account or sales account in General Ledger

27. An entity recorded the following journal entry in its General Journal:

Furniture	Rs. 500,000	
Interwood (supplier)		Rs. 500,000

How this would be posted in the ledger account of "Furniture"?

(a) On debit side with description "Furniture" and amount Rs. 500,000

(b) On credit side with description "Furniture" and amount Rs. 500,000

(c) On debit side with description "Interwood" and amount Rs. 500,000

(d) On credit side with description "Interwood" and amount Rs. 500,000

28. An entity recorded the following journal entry in its General Journal:

Furniture	Rs. 500,000	
Interwood (supplier)		Rs. 500,000

How this would be posted in the ledger account of "Interwood"?

(a) On debit side with description "Furniture" and amount Rs. 500,000

(b) On credit side with description "Furniture" and amount Rs. 500,000

(c) On debit side with description "Interwood" and amount Rs. 500,000

(d) On credit side with description "Interwood" and amount Rs. 500,000

29. Which of the following would normally be a credit balance in the trial balance?

(i) Loan
(ii) Owner's capital
(iii) Drawings
(iv) Purchases

(a) (i) and (ii)

(b) (i) and (iii)

(c) (ii) and (iii)

(d) (ii) and (iv)

30. A debit balance would be expected to arise when the accounts are balanced at the period end on which of the following accounts?

(a) Capital

(b) Sales

(c) Electricity

(d) Loan

31. A business buys machinery costing Rs. 120,000 and sells machinery costing Rs. 18,000 in the year. The opening balance of the machinery account is Rs. 80,000.

What will be the balance brought down in the next period?

Rs. ________

32. A company had a cash balance of Rs. 18,000 at the start of the month. During the month, the following transactions occurred.

(i) Sales on credit Rs. 72,000

(ii) Cash from trade receivables Rs. 49,000

(iii) Purchases on credit Rs. 33,000

(iv) Payments to trade payables Rs. 35,000

What was the cash balance at the end of the month?

Rs. ________

33. An accountant has inserted all the relevant figures into the trade payables account, but has not yet balanced off the account.

Accounts payable a/c

Particulars	Rs.	Particulars	Rs.
Bank a/c	100,750	b/d	250,225
		Purchases	325,010

Assuming there are no other entries to be made, other than to balance off the account, what is the closing balance on the trade payables account?

Rs. ________

34. You are given the following information:

	Rs.
Receivables at 1 January 2018	10,000
Receivables at 31 December 2018	9,000
Total receipts during 2018 (including cash sales of Rs.5,000)	85,000

What are sales on credit during 2018?

Rs. ________

35. Following information is available about Saim:

	Rs.
Receivable as on January 1, 2018	70,000
Receivable as on December 31, 2018	25,000
Cash received from customers during the year	250,000
Settlement discount allowed to customers	4,000

There are no return inwards or cash sales. Saim recorded all sales expecting that customers will not claim early payment discount.

At what amount Sales Revenue shall be reported in financial statements?

(a) Rs. 291,000

(b) Rs. 250,000

(c) Rs. 205,000

(d) Rs. 209,000

36. Alia's Account payable ledger has a balance of Rs. 95,000 credit as on January 1, 2018. During the month, following transactions were performed:

	Rs.
Credit purchases	221,000
Cash purchases	85,000
Cheques issued to credit suppliers (after receiving discount of Rs. 2,000)	148,000
Credit purchases return	8,000

What is the amount shown in Account payable ledger as on January 31, 2018?

(a) Rs. 158,000

(b) Rs. 160,000

(c) Rs. 243,000

(d) Rs. 245,000

37. Following information relates to Sales transaction of Sabir during March 2019

- Receivables as at 1 March Rs. 35,000
- Receivables as at 31 March Rs. 42,000
- Receipts during the period (after allowing discount of Rs. 4,000) Rs. 29,000

What is the amount of credit sales (net) during March?

Rs. ________

38. A payable account contains the following relevant entries for the year ended 31 December 2018:

	Rs.
Payment through bank	160,000
Credit purchases during the year	185,000
Discount received	16,000
Contra with receivable account	7,000
Balance c/d as on Dec 31, 2018	22,000

There are no other transactions related to account payable.

What is the amount of balance b/d of account payable account as on 1 January 2018?

Rs. __________

39. A receivable ledger account at 1 June 2017 had balances of Rs. 32,850 debit.

During the year, sales (net of trade discount) of Rs. 245,000 were made on credit.

Receipts from customers amounted to Rs. 210,200 and cash discounts of Rs. 700 were allowed. Refunds of Rs. 1,300 were made to customers.

What should be the closing balance at 31 May 2018 of account receivable account?

Rs. __________

40. Which of the following statement(s) is/are true?

(i) The chart of accounts is a listing of the accounts presently having balances in the general ledger.

(ii) The digits of the account numbers assigned to general ledger accounts often have significance. For example, an account number beginning with a "1" might signify that the account is an asset account, a "6" might signify an operating expense, etc.

(a) (i) only

(b) (ii) only

(c) (i) and (ii) both

(d) Neither (i) nor (ii)

41. Which of the following is/are characteristics of a good chart of accounts?

(a) Each account is identified by unique code and heading

(b) The design allows future changes and additions after due approvals

(c) It ensures that all transactions are recorded according to business requirement

(d) All of above

42. The list of chart of accounts (with unique codes) is usually arranged in:

(a) Chronological order

(b) Random order

(c) Order of appearance of accounts in financial statements

(d) Sorted order (higher amounts first)

43. A trial balance is made up of a list of debit balances and credit balances.
Which of the following statements is correct?

(a) Every debit balance represents an expense

(b) Assets are represented by debit balances

(c) Liabilities are represented by debit balances

(d) Income is included in the list of debit balances

44. Basheer has extracted the following list of balances from his general ledger at 31 October 2015:

	Rs.
Sales	258,542
Purchases	142,958
Expenses	34,835
Non-current assets (carrying amount)	63,960
Receivables	31,746
Payables	13,864
Cash at bank	1,783
Capital	12,525

What is the total of the debit balances in Basheer's trial balance at 31 October 2015?

(a) Rs. 267,049

(b) Rs. 275,282

(c) Rs. 283,148

(d) Rs. 284,931

45. Which of the following are true with reference to a trial balance?

(a) Trial balance is taken as a test of arithmetical accuracy

(b) It is starting point for producing financial statements

(c) It is conclusive proof that double entry book-keeping is free from errors

(d) (a) and (b) only

46. At the end of accounting period, all credit items of income and expenses are transferred to:

(a) Debit side of Capital account

(b) Credit side of Capital account

(c) Debit side of profit or loss

(d) Credit side of profit or loss

47. At the end of accounting period, all debit items of income and expenses are transferred to:

(a) Debit side of Capital account

(b) Credit side of Capital account

(c) Debit side of profit or loss

(d) Credit side of profit or loss

48. At the end of accounting period, an entity incurred net loss of Rs. 15,000 it shall be transferred to:

(a) Debit side of Capital account

(b) Credit side of Capital account

(c) Debit side of profit or loss

(d) Credit side of profit or loss

49. At the end of accounting period, drawings account has balance of Rs. 8,000, it shall be transferred to:

(a) Debit side of Capital account

(b) Credit side of Capital account

(c) Debit side of profit or loss

(d) Credit side of profit or loss

50. Which statement is true?

(a) The debit balance accounts are closed at the end of accounting period while the credit balance accounts are carried forward to next year

(b) The credit balance accounts are closed at the end of accounting period while the debit balance accounts are carried forward to next year

(c) Income, expenses and drawings accounts are closed at the end of accounting period while assets, liabilities and capital accounts are carried forward to next year

(d) Income, expenses and capital accounts are closed at the end of accounting period while assets, liabilities and drawings accounts are carried forward to next year

ANSWER

01.	**(c)**	The process of classifying amounts from books of prime entry to ledgers is called 'posting'.
02.	**(a)**	On left side Rs. 6,000
03.	**(c)**	T account: periodically & Running balance account: after each transaction
04.	**(b)**	On right side Rs. 6,000
05.	**(c)**	On left side Rs. 38,000
06.	**(d)**	On right side Rs. 38,000
07.	**(b)**	Rs. 18,000 + 10,000 – 15,000 = Rs. 13,000 debit
08.	**(b)**	General (nominal) ledger
09.	**(a)**	General ledger
10.	**(a)**	General ledger
11.	**(b)**	debit side of individual customer account in Receivables Ledger.
12.	**(c)**	credit side of sales account in General Ledger.
13.	**(a)**	credit side of individual customer account in Receivables Ledger.
14.	**(d)**	debit side of sales return account in General Ledger.
15.	**(a)**	credit side of individual supplier account in Payables Ledger.
16.	**(d)**	debit side of Purchases account in General Ledger.
17.	**(b)**	debit side of individual supplier account in Payables Ledger.
18.	**(c)**	credit side of purchase return account in General Ledger.
19.	**(a)**	debit side of individual suppliers' account in Payables Ledger
20.	**(b)**	debit side of relevant account in General Ledger
21.	**(a)**	debit side of individual suppliers' account in Payables Ledger
22.	**(d)**	credit side of discount received account or Purchases account in General Ledger
23.	**(a)**	credit side of individual customers' account in Receivables Ledger
24.	**(b)**	credit side of relevant account in General Ledger
25.	**(a)**	credit side of individual customers' account in Receivables Ledger
26.	**(d)**	debit side of discount allowed account or sales account in General Ledger
27.	**(c)**	On debit side with description "Interwood" and amount Rs. 500,000
28.	**(b)**	On credit side with description "Furniture" and amount Rs. 500,000
29.	**(a)**	Loan (owed) and owner's capital
30.	**(c)**	Electricity (expense)

31. **Rs. 282,000**

Machinery a/c

Particulars	Rs.	Particulars	Rs.
b/d	80,000	Disposal	18,000
Purchases	120,000	c/d	282,000
	300,000		300,000

32. **Rs. 32,000**

Cash a/c

Particulars	Rs.	Particulars	Rs.
b/d	18,000	Payables	35,000
Receivables	49,000	c/d	32,000
	67,000		67,000

33. **Rs. 474,485**

Accounts payable

Particulars	Rs.	Particulars	Rs.
Bank a/c	100,750	b/d	250,225
c/d	474,485	Purchases	325,010
	575,235		575,235

34. **Rs. 79,000**

Accounts receivables

Particulars	Rs.	Particulars	Rs.
b/d	10,000	Cash	80,000
Sales	79,000	c/d	9,000
	89,000		89,000

35. **(c)**

Accounts receivables

Particulars	Rs.	Particulars	Rs.
b/d	70,000	Cash	250,000
Sales (balancing)	209,000	Discount allowed	4,000
		c/d	25,000
	279,000		279,000

Sales revenue to be reported in financial statements

Rs. 209,000 as originally recorded – Rs. 4,000 revenue reversal due to discount adjustment = Rs. 205,000

<table>
<tr><td>36.</td><td>(a)</td><td>
Accounts Payable
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>Cash/Bank</td><td>148,000</td><td>b/d</td><td>95,000</td></tr>
<tr><td>Discount received</td><td>2,000</td><td>Purchases (credit)</td><td>221,000</td></tr>
<tr><td>Purchase returns</td><td>8,000</td><td></td><td></td></tr>
<tr><td>c/d</td><td>158,000</td><td></td><td></td></tr>
<tr><td></td><td>316,000</td><td></td><td>316,000</td></tr>
</table>
Cash purchases have no effect on payables.
</td></tr>
<tr><td>37.</td><td>Rs. 36,000</td><td>
Accounts receivables
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>b/d</td><td>35,000</td><td>Cash</td><td>29,000</td></tr>
<tr><td>Sales (balancing)</td><td>40,000</td><td>Discount allowed</td><td>4,000</td></tr>
<tr><td></td><td></td><td>c/d</td><td>42,000</td></tr>
<tr><td></td><td>75,000</td><td></td><td>75,000</td></tr>
</table>
Rs. 40,000 as recorded – 4,000 discount = Rs. 36,000 net sales
</td></tr>
<tr><td>38.</td><td>Rs. 20,000</td><td>
Accounts Payable
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>Bank</td><td>160,000</td><td>b/d</td><td>20,000</td></tr>
<tr><td>Discount received</td><td>16,000</td><td>Purchases</td><td>185,000</td></tr>
<tr><td>Receivable (contra)</td><td>7,000</td><td></td><td></td></tr>
<tr><td>c/d</td><td>22,000</td><td></td><td></td></tr>
<tr><td></td><td>205,000</td><td></td><td>205,000</td></tr>
</table>
</td></tr>
<tr><td>39.</td><td>Rs. 68, 250</td><td>
Accounts receivables
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>b/d</td><td>32,850</td><td>Cash</td><td>210,200</td></tr>
<tr><td>Sales</td><td>245,000</td><td>Discount allowed</td><td>700</td></tr>
<tr><td>Cash (refunds)</td><td>1,300</td><td>c/d</td><td>68,250</td></tr>
<tr><td></td><td>279,150</td><td></td><td>279,150</td></tr>
</table>
</td></tr>
<tr><td>40.</td><td>(b)</td><td>Some accounts in chart of accounts may not have any balance or even transactions posted yet.</td></tr>
<tr><td>41.</td><td>(d)</td><td>All of these are good attributes of chart of account.</td></tr>
<tr><td>42.</td><td>(c)</td><td>Order of appearance of accounts in financial statements</td></tr>
</table>

43.	**(b)**	Assets are represented by debit balances Option (a) is incorrect as a debit may represent expenses, assets and drawings.
44.	**(b)**	Purchases 142,958 + Expenses Rs. 34,835 + non-current assets Rs. 63,960 + Receivables 31,746 + Cash at bank Rs. 1,783 = Total debits Rs. 275,282
45.	**(d)**	Trial balance is not conclusive proof of accuracy. It may be equal in spite of certain omissions and errors.
46.	**(d)**	Credit side of profit or loss
47.	**(c)**	Debit side of profit or loss
48.	**(a)**	Debit side of Capital account
49.	**(a)**	Debit side of Capital account
50.	**(c)**	Income, expenses and drawings accounts are closed at the end of accounting period while assets, liabilities and capital accounts are carried forward to next year

STICKY NOTES

Posting from Sales day book / Sales Return day book:
Individual transactions to Individual customer accounts in Receivables Ledger
Totals to Sales and Sales Return Account in General Ledger

Posting from Purchase day book / Purchase Return day book:
Individual transactions to Individual supplier accounts in Payables Ledger
Totals to Purchase and Purchase Return Account in General Ledger

Posting from cash book:
Receipts to credit side of relevant ledger account
Payments to debit side of relevant ledger account

Posting from General Journal:
Amount debited to debit side of relevant ledger account
Amount credited to credit side of relevant ledger account

Chart of accounts is useful as:

A code number is usually quicker to write than an account name.

Using unique codes can reduce risk of errors

It is easier to process code numbers than account names in compture softwares.

Trial Balance

Sources: Cash book, lists of balances and ledger balances.

Purpose: arithmetical accuracy and preparation of financial statements

Limitation: Trial balance may be equal in spite of certain mistakes of omissions and principles. It is not conclusive proof of accuracy.

Closing entries

Income are closed to profit or loss account

Expenses are closed to profit or loss account

Profit or loss account is closed to Capital account

Drawings is closed to Capital account

Assets, liabilities and capital accounts are not closed, rather their balances are carried forward.

CHAPTER 4

ACCRUALS AND PREPAYMENTS

IN THIS CHAPTER:

AT A GLANCE

Financial statements are prepared on an accrual basis of accounting. Therefore, accrued income and expenses, unearned income and prepaid expenses are important concepts that need to be understood and accounted for in the financial statements.

Accrued expenses are expenses incurred but not yet paid and accrued income are income earned but not yet received.

Prepaid expenses and unearned income is defined as the expense paid or income received in advance but which has not yet been incurred or earned.

The period-end adjustment of accruals and prepayments is important to calculate profit by matching income and expenses of the same period. These adjustment result in recognition of assets (income receivable or prepaid expenses) and liabilities (unearned income or expenses payables).

AT A GLANCE
SPOTLIGHT
STICKY NOTES

1. ACCRUED AND PREPAID EXPENSES

ACCRUAL (MATCHING) CONCEPT

Accrual concept is the most fundamental principle of accounting which requires recording income when they are earned and not when they are received in cash, and recording expenses when they are incurred and not when they are paid.

Cash basis vs. Accrual basis

Under the cash basis of accounting, income and expenses are reported in financial statements when the cash is received or paid. Under the accrual basis of accounting, expenses are matched with the related income and are reported when the expense is incurred, not when the cash is paid.

The accrual basis of accounting gives a better measurement of profitability than does the cash basis because accrual basis matches revenue with expenses that an entity incurred to earn it.

ACCRUED EXPENSES

These are expenses incurred but not paid by the end of an accounting period. The expense must be recorded, even if it has not been paid yet, as it relates to the period in which it was incurred and the amount unpaid should be recorded as a liability (Expenses Payable).

The related journal entries (two account system) are as follows:

On payment of expense during accounting period

Debit	Expense account	
Credit		Cash / Bank

Period end adjustment for expenses incurred but not yet paid

Debit	Expense account	
Credit		Accrued expenses (a liability)

At start of next accounting period, reversal of period end adjustment is needed

Debit	Accrued expenses	
	Credit	Expense account

An alternative and time-saving method, called single account system, is to prepare a memorandum (not part of double entry book-keeping) T account to represent expense and liability both.

EXPENSES					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
				Bal. b/d (opening payable)	**XX**
	Cash paid	**XX**		**Expense (balancing figure)**	**XX**
	Bal. c/d (closing payable)	**XX**			
		XX			**XX**

- *Example 01:*

Asif sets up a business on 1 January 2016. The business has a 31 December year end.

The business acquired telephone system on 1 February 2016. Telephone charges are to be paid every three months in arrears and telephone invoice received are as follows:

Bill and payment date	Bill related to	Rs.
YEAR 1		
30 Apr 2016	Feb 2016 to Apr 2016	5,000
31 Jul 2016	May 2016 to Jul 2016	7,500
31 Oct 2016	Aug 2016 to Oct 2016	8,500

At 31 December 2016, the quarterly bill is expected to be Rs. 9,000 for period from Nov 2016 to

YEAR 2		
31 Jan 2017	Nov 2016 to Jan 2017	9,500
30 Apr 2017	Feb 2017 to Apr 2017	9,500
31 Jul 2017	May 2017 to Jul 2017	10,000
31 Oct 2017	Aug 2017 to Oct 2017	10,000

At 31 December 2017, the quarterly bill is expected to be Rs. 10,500 for period from Nov 2017 to Jan 2018.

Required: Prepare relevant ledger accounts to calculate telephone expense and related liability under two account system and single account system.

- *ANSWER*

TWO ACCOUNT SYSTEM

Telephone expense

Date	Particulars	Rs.	Date	Particulars	Rs.
2016	Cash (5,000+7,500+8,500)	21,000			
	Telephone payable	6,000		**Expense in PL**	**27,000**
		27,000			27,000
2017	Cash (9,500+9,500+10,000 +10000)	39,000		Telephone payable	6,000
	Telephone payable	7,000		**Expense in PL**	**40,000**
		46,000			46,000

Telephone payable

Date	Particulars	Rs.	Date	Particulars	Rs.
2016				Telephone expense	6,000
	Balance c/d	6,000			
		6,000			6,000
2017	Telephone expense	6,000		Balance b/d	6,000
	Balance c/d	7,000		Telephone expense	7,000
		13,000			13,000

SINGLE ACCOUNT SYSTEM

Telephone (Memorandum account)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	Cash (5,000+7,500+8,500)	21,000			
	Bal. c/d (9,000 x 2/3)	6,000		**Expense in PL**	**27,000**
		27,000			27,000
2017	Cash (9,500+9,500+10,000 +10000)	39,000		Bal. b/d	6,000
	Bal. c/d (10,500 x 2/3)	7,000		**Expense in PL**	**40,000**
		46,000			46,000

PREPAID EXPENSES

This is cash paid in advance for expenses to be incurred after the end of an accounting period. The amount that relates to next accounting period is not an expense for this period and must be presented as an asset (Prepayments).

The related journal entries (two account system) are as follows:

On payment of expense during accounting period

Debit Expense account

Credit Cash / Bank

Period end adjustment for expenses not yet incurred and paid in advance

Debit Prepaid expenses (an asset)

Credit Expense account

At start of next accounting period, reversal of period end adjustment is needed

Debit Expense account

Credit Prepaid expenses

Under single account system, memorandum T account is prepared to represent expense and asset both.

EXPENSES					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Bal. b/d (opening prepaid)	**XX**			
	Cash paid	**XX**		**Expense (balancing figure)**	**XX**
				Bal. c/d (closing prepaid)	**XX**
		XX			**XX**

- *Example 02:*

Aqib sets up a business on 1 January 2016. The business has a 31 December year end.

The business acquired insurance policy on 1 March 2016 and paid amount of Rs. 24,000 in advance for risk coverage for one year.

The business continued the insurance policy for next one year on 1 March 2017 and paid amount of Rs. 30,000 in advance for annual risk coverage.

Required:

Prepare relevant ledger accounts to calculate Insurance expense and related asset under two account system and single account system.

- *ANSWER*

TWO ACCOUNT SYSTEM

Insurance expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	Cash	24,000		**Expense PL**	**20,000**
				Prepaid insurance	4,000
		24,000			24,000
2017	Prepaid insurance	4,000		**Expense PL**	**29,000**
	Cash	30,000		Prepaid insurance	5,000
		34,000			34,000

Prepaid insurance					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	Insurance expense	4,000			
				Balance c/d	4,000
		4,000			4,000
2017	Balance b/d	4,000		Insurance expense	4,000
	Insurance expense	5,000		Balance c/d	5,000
		9,000			9,000

SINGLE ACCOUNT SYSTEM

Insurance (Memorandum account)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	Cash	24,000		**Expense PL**	**20,000**
				Bal. c/d (24,000 x 2/12)	4,000
		24,000			24,000
2017	Balance b/d	4,000		**Expense PL**	**29,000**
	Cash	30,000		Bal. c/d (30,000 x 2/12)	5,000
		34,000			34,000

ACCRUAL AND PREPAYMENT COMBINED

It is possible that some of the bills are due while some are paid in advance at the end of an accounting period. The accounting treatment is not any different.

Under the two account system journal entries are passed as mentioned above.

Under the single account system, one memorandum T account is prepared to represent expense, liability and asset.

EXPENSES					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Bal. b/d (opening prepaid)	**XX**		Bal. b/d (opening payable)	**XX**
	Cash paid	**XX**		**Expense (balancing figure)**	**XX**
	Bal. c/d (closing payable)	**XX**		Bal. c/d (closing prepaid)	**XX**
		XX			**XX**

► *Example 03:*

Adeel Engineering has two motor vehicles that are used within the business. The expenses of running these vehicles and insuring these vehicles are recorded in the "Vehicle running expenses". At May 1, 2003 there are repair bills accrued of Rs. 4,780, petrol bills accrued of Rs. 12,000 and insurance that had been prepaid of Rs. 2,900.

During the year ended April 30, 2004 following transactions took place:

Date	Description	Rs.
30 June 2003	Paid repair bills to workshop	6,980
1 September 2003	Paid insurance for one of motor vehicles for the year to Aug 31, 2004	34,800
1 December 2003	Paid insurance for other motor vehicle for year to November 30, 2004	39,000
30 April 2004	Paid petrol bills	130,000

At April 30, 2004 there were repair bills unpaid totalling Rs. 3,560 and no petrol bill was outstanding.

Required:

Write up ledger accounts under two account system and single account system for the year ended April 30, 2004.

► *ANSWER*

TWO ACCOUNT SYSTEM

Vehicle running expenses					
Date	Particulars	Rs.	Date	Particulars	Rs.
May 1	Prepaid insurance	2,900	May 1	Expenses payable	16,780
Jun 30	Bank	6,980			
Sep 1	Bank	34,800	Apr 30	**Expense in PL**	166,110
Dec 1	Bank	39,000			
Apr 30	Bank	130,000			
Apr 30	Expenses payable	3,560	Apr 30	Prepaid insurance **W1**	34,350
		217,240			217,240

Expenses payable					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
May 1	Vehicle running expenses	16,780	May 1	Balance b/d 4,780 + 12,000	16,780
Apr 30	Balance c/d	3,560	Apr 30	Vehicle running expenses	3,560
		20,340			20,340

Prepaid insurance					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
May 1	Balance b/d	2,900	May 1	Vehicle running expenses	2,900
Apr 30	Vehicle running expenses	34,350	Apr 30		34,350
		37,250			37,250

SINGLE ACCOUNT SYSTEM

Vehicle running expenses (Memorandum account)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
May 1	Bal b/d (Prepaid insurance)	2,900	May 1	Bal b/d (Expenses payable)	16,780
Jun 30	Bank	6,980			
Sep 1	Bank	34,800	Apr 30	**Expense in PL**	166,110
Dec 1	Bank	39,000			
Apr 30	Bank	130,000			
Apr 30	Balance c/d (Expenses payable)	3,560	Apr 30	Bal c/d (Prepaid insurance)	34,350
		217,240			217,240

W1 Calculation of closing prepaid insurance		Rs.
01.09.03	Prepaid insurance of one of the motor vehicles (34,800/12x4)	11,600
01.12.03	Prepaid insurance for other motor vehicle (39,000/12x7)	22,750
		34,350

2. ACCRUED AND UNEARNED INCOME

ACCRUED INCOME

These is income earned but not received by the end of an accounting period. The income must be recorded, even if it has not been received yet, as it relates to the period in which it was earned and the amount to be received should be recorded as an asset (Income Receivable).

The related journal entries (two account system) are as follows:

On receipt of income during accounting period

Debit Cash / Bank

Credit Income account

Period end adjustment for income not yet received

Debit Accrued income (an asset)

Credit Income account

At start of next accounting period, reversal of period end adjustment is needed

Debit Income account

Credit Accrued income

Under single account system, a memorandum T account represents income and asset both.

INCOME					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Bal. b/d (opening receivable)	**XX**			
	Income (balancing figure)	**XX**		Cash received	**XX**
				Bal. c/d (closing receivable)	**XX**
		XX			**XX**

► *Example 04:*

Maria sub-lets part of her factory building to a tenant at monthly rent of Rs. 10,000 on 1 Feb 2020. It was agreed that rent would be increased annually by 10%. Her business has a 31 December year end.

During the year ended 31 December 2020, she received rent of Rs. 100,000 (i.e. rent for the month of December 2020 was not received yet).

During the year ended 31 December 2021, she received rent of Rs. 130,000 (i.e. rent for the month of December 2021 was not received yet).

Required:

Prepare relevant ledger accounts for the year ended 31 December 2020 and 2021 under two account system and single account system.

► *ANSWER*

TWO ACCOUNT SYSTEM

Rent income					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020	**Income PL (10,000 x 11 months)**	**110,000**		Cash	100,000
				Accrued income	10,000
		110,000			110,000
2021	Accrued income	10,000		Cash	130,000
	Income PL (10,000 + 11,000 x11)	**131,000**		Accrued income	11,000
		141,000			141,000

Accrued income (Rent receivable)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020	Rent income	10,000			
				Balance c/d	10,000
		10,000			10,000
2021	Balance b/d	10,000		Rent income	10,000
	Rent income	11,000		Balance c/d	11,000
		21,000			21,000

SINGLE ACCOUNT SYSTEM

Rent income (Memorandum account)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020	**Income PL (10,000 x 11 months)**	**110,000**		Cash	100,000
				Balance c/d (receivable)	10,000
		110,000			110,000
2021	Balance b/d (receivable)	10,000		Cash	130,000
	Income PL (10,000 + 11,000 x11)	**131,000**		Balance c/d (receivable)	11,000
		141,000			141,000

UNEARNED INCOME

This is cash received in advance for income yet to be earned at the end of an accounting period. The amount that relates to next accounting period is not an income for this period and must be presented as a liability (unearned income / advance).

The related journal entries (two account system) are as follows:

On receipt of income during accounting period

Debit	Cash / Bank	
Credit		Income account

Period end adjustment for income not yet earned and received in advance

Debit	Income account	
Credit		Unearned income (a liability)

At start of next accounting period, reversal of period end adjustment is needed

Debit	Unearned income	
Credit		Income account

Under single account system, memorandum T account is prepared to represent income and liability both.

INCOME					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
				Bal. b/d (opening advance)	**XX**
	Income (balancing figure)	**XX**		Cash received	**XX**
	Bal. c/d (closing advance)	**XX**			
		XX			**XX**

► *Example 05:*

Zahra sub-lets part of her factory building to a tenant at monthly rent of Rs. 10,000 on 1 Feb 2020. It was agreed that rent would be increased annually by 10%. Her business has a 31 December year end.

During the year ended 31 December 2020, she received rent of Rs. 142,000 (i.e. rent of January to March 2021 was received in advance).

During the year ended 31 December 2021, she received rent of Rs. 110,000 (i.e. rent of January 2022 was received in advance).

Required:

Prepare relevant ledger accounts for the year ended 31 December 2020 and 2021 under two account system and single account system.

▶ *ANSWER*

TWO ACCOUNT SYSTEM

Rent income					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020	**Income PL (10,000 x 11 months)**	**110,000**		Cash	142,000
	Unearned rent	32,000			
		142,000			142,000
2021	**Income PL (10,000 + 11,000 x11)**	**131,000**		Unearned rent	32,000
	Unearned rent	**11,000**		Cash	110,000
		142,000			142,000

Unearned Rent					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020				Rent income	32,000
	Balance c/d	32,000			
		32,000			32,000
2021	Rent income	32,000		Balance b/d	32,000
	Balance c/d	11,000		Rent income	11,000
		43,000			43,000

SINGLE ACCOUNT SYSTEM

Rent income (Memorandum account)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2020	**Income PL (10,000 x 11 months)**	**110,000**		Cash	142,000
	Balance c/d (Unearned rent)	32,000			
		142,000			142,000
2021	**Income PL (10,000 + 11,000 x11)**	**131,000**		Balance b/d (Unearned rent)	32,000
	Balance c/d (Unearned rent)	**11,000**		Cash	110,000
		142,000			142,000

ACCRUED AND UNEARNED INCOME COMBINED

It is possible that some of the bills are due while some are received in advance at the end of an accounting period. The accounting treatment is not any different.

Under the two account system journal entries are passed as mentioned above.

Under the single account system, one memorandum T account is prepared to represent income, liability and asset.

INCOME					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Bal. b/d (opening receivable)	**XX**		Bal. b/d (opening advance)	**XX**
	Income (balancing figure)	**XX**		Cash received	**XX**
	Bal. c/d (closing advance)	**XX**		Bal. c/d (closing receivable)	**XX**
		XX			**XX**

- *Example 06:*

Bones owns various properties which he rents; some tenants pay in advance, some in arrears.

During 2013 rent collected was Rs. 229,500.

Rents receivable and paid in advance at the statement of financial position dates were as follows.

	31 December	
	2012	***2013***
	Rs.	***Rs.***
Rents owed by tenants	34,200	40,500
Rents prepaid by tenants	20,700	15,300

Required:

Write up ledger accounts under two account system and single account system for the year ended December 31, 2013.

- *ANSWER*

TWO ACCOUNT SYSTEM

Rent Income					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Jan	Rent receivable	34,200	1 Jan	Unearned rent	20,700
31 Dec	Profit or loss	241,200		Cash	229,500
31 Dec	Unearned rent	15,300	31 Dec	Rent receivable	40,500
		290,700			290,700

Rent receivable					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Jan	Balance b/d	34,200	1 Jan	Rent income	34,200
31 Dec	Rent income	40,500	31 Dec	Balance c/d	40,500
		74,700			74,700

Unearned rent					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Jan	Rent income	20,700	1 Jan	Balance b/d	20,700
31 Dec	Balance c/d	15,300	31 Dec	Rent income	15,300
		36,000			36,000

SINGLE ACCOUNT SYSTEM

Rent Income					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Jan	Bal b/d (Rent receivable)	34,200	1 Jan	Bal b/d (Unearned rent)	20,700
31 Dec	Profit or loss	241,200		Cash	229,500
31 Dec	Balance c/d (Unearned rent)	15,300	31 Dec	Bal c/d (Rent receivable)	40,500
		290,700			290,700

AT A GLANCE

SPOTLIGHT

STICKY NOTES

3. COMPREHENSIVE EXAMPLES

- *Example 07:*

Kirk started a business on 1 January 2012.

Accounting year ended 31 December 2012:

A new warehouse was acquired on 31 March 2012. On 21 April 2012, Kirk received a water bill demand for Rs. 1,000,000 for the 12 months to 31 March 2013. Payment was made, in full, on 30 April 2012.

Accounting year ended 31 December 2013:

An office extension was built. The water bill demand for the 12 months to 31 March 2014 was Rs. 1,600,000. Kirk paid the full amount on 1 June 2013.

Required:

a) Write up the water expense ledger account for 2012 and for 2013.

b) Assuming now that payments were made annually in arrears (i.e. Rs. 1,000,000 on 31 March 2013 and Rs. 1,600,000 on 31 March 2014), write up the water expense ledger account for each of the two accounting years.

- *ANSWER*

Part (a)

Water Expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
30.04.12	Bank	1,000,000	31.12.12	**Profit or loss**	**750,000**
			31.12.12	Balance c/d **N1**	250,000
		1,000,000			1,000,000
1.01.13	Balance b/d	250,000	31.12.13	**Profit or loss**	**1,450,000**
01.06.13	Bank	1,600,000	31.12.13	Balance c/d **N1**	400,000
		1,850,000			1,850,000

Note 1: Prepaid amount

Year 2012 Rs. 1,000,000 x 3/12 months = Rs. 250,000

Year 2013 Rs. 1,600,000 x 3/12 months = Rs. 400,000

Part (b)

Water Expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31.12.12	Balance c/d **N1**	750,000	31.12.12	**Profit or loss**	**750,000**
		750,000			750,000
31.03.13	Bank	1,000,000	01.01.13	Balance b/d	750,000
31.12.13	Balance c/d **N1**	1,200,000	31.12.13	**Profit or loss**	**1,450,000**
		2,200,000			2,200,000

Note 1: Accrued amount

Year 2012 Rs. 1,000,000 x 9/12 months = Rs. 750,000

Year 2013 Rs. 1,600,000 x 9/12 months = Rs. 1,200,000

▶ *Example 08:*

Spock owns a removal business and runs a small fleet of vans. He prepares his accounts to 31 December each year.

The following transactions occur in relation to insurance for the year 2013.

1 January	The amount prepaid for insurance was Rs.1,140,000.
1 April	He paid Rs.840,000 insurance for the year ended 31 March 2014 on six of the vans
1 May	He paid Rs.3,540,000 insurance for twenty vans for the year ended 30 April 2014
1 July	He paid Rs.560,000 insurance for the remaining vans for the year ended 30 June 2014

Required:

Write up the insurance account for the year ended 31 December 2013

▶ *ANSWER*

Insurance expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
01.01.13	Balance b/d	1,140,000			
01.04.13	Bank	840,000			
01.05.13	Bank	3,540,000	31.12.13	**Profit or loss**	**4,410,000**
01.07.13	Bank	560,000	31.12.13	Balance c/d **N1**	1,670,000
		6,080,000			6,080,000

Note 1: Prepaid amount

Paid on 1 April	Rs. 840,000 x 3/12 =	210,000
Paid on 1 May	Rs. 3,540,000 x 4/12 =	1,180,000
Paid on 1 July	Rs. 560,000 x 6/12 =	280,000
		1,670,000

▶ *Example 09:*

The details of two office buildings acquired on rent by Ninja Enterprises (NE) are as follows:

(i) On 1 April 2016, Building I was acquired on annual rent of Rs. 2,400,000. Effective from 1 October 2017 the rent was increased by 20%. NE pays rent on half yearly basis in advance.

(ii) On 1 September 2016, Building II was acquired on annual rent of Rs. 900,000. Payments were made on quarterly basis in advance. However, the quarterly payment due on 1 December 2017 was made on 15 January 2018.

NE's financial year ends on 31 December each year.

Required:

Prepare rent expense account for the year ended 31 December 2016 and 2017.

▶ *ANSWER*

Rent expense					
2016		**Rs. 000**			**Rs. 000**
1 Apr	Cash B1	1,200	31 Dec	PL B1	1,800
1 Sep	Cash B2	225	31 Dec	PL B2	300
1 Oct	Cash B1	1,200	31 Dec	c/d B1 [1,200 x 3/6]	600
1 Dec	Cash B2	225	31 Dec	c/d B2 [1,200 x 2/3]	150
		2,850			**2,850**
2017					
1 Jan	b/d	600	31 Dec	PL B1	2,520
1 Jan	b/d	150	31 Dec	PL B2	900
1 Mar	Cash B2	225	31 Dec	c/d B1 [1,440 x 3/6]	720
1 Apr	Cash B1	1,200			
1 Jun	Cash B2	225			
1 Sep	Cash B2	225			
1 Oct	Cash B1 [1,200 x 120%]	1,440			
31 Dec	c/d B2 [225 x 1/3]	75			
		4,140			**4,140**

▶ *Example 10:*

Amir sets up a business on 1 January 2016. The business has a 31 December year end.

The business was being conducted in a plaza purchased especially for conduct of business. However, ten shops on ground floor were spare to be given on rent from 01 January 2016. The rent of each shop had been agreed at Rs. 5,000 per annum with all the tenants.

On 31 December 2016, the rent collection report showed:

		Rs.
7 tenants paid rent for the year 2016	7 x 5,000 =	35,000
2 of above tenants paid advance rent for year 2017	2 x 5,000 =	10,000
		45,000
3 tenants have not paid rent of year 2016 yet	3 x 5,000 =	15,000

On 31 December 2017, the rent collection report showed:

		Rs.
3 outstanding rent were received for year 2016	3 x 5,000 =	15,000
6 tenants paid rent for the year 2017	6 x 5,000 =	30,000
3 of tenants paid advance rent for year 2018	3 x 5,000 =	15,000
		60,000
2 tenants have not paid rent of year 2017 yet	2 x 5,000 =	10,000

Required:

Prepare relevant ledger accounts to calculate Rent income and related asset and liability under two account system and single account system.

▶ *ANSWER*

TWO ACCOUNT SYSTEM

Rent Income					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	**Income PL**	**50,000**		Cash	45,000
	Unearned rent	10,000		Rent receivable	15,000
		60,000			60,000
2017	Rent receivable	15,000		Unearned rent	10,000
	Income PL	**50,000**		Cash	60,000
	Unearned rent	15,000		Rent receivable	10,000
		80,000			80,000

Rent receivable (asset)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	Rent income	15,000			
				Balance c/d	15,000
		15,000			15,000
2017	Balance b/d	15,000		Rent income	15,000
	Rent income	10,000		Balance c/d	10,000
		25,000			25,000

Unearned rent (liability)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016				Rent income	10,000
	Balance c/d	10,000			
		10,000			10,000
2017	Rent income	10,000		Balance b/d	10,000
	Balance c/d	15,000		Rent income	15,000
		25,000			25,000

SINGLE ACCOUNT SYSTEM

Rent					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2016	**Income PL**	**50,000**		Cash	45,000
	Balance c/d (unearned)	10,000		Balance c/d (receivable)	15,000
		60,000			60,000
2017	Balance b/d	15,000		Balance b/d	10,000
	Income PL	**50,000**		Cash	60,000
	Balance c/d (unearned)	15,000		Balance c/d (receivable)	10,000
		80,000			80,000

- *Example 11:*

Zamil Traders (ZT) commenced business on 1 January 2016 and is maintaining its accounting records under 'cash basis'. The following transactions are appearing in its records:

Transaction date	Description
8-Jan-2016	One year's office rent was paid in advance, amounting to Rs. 1.2 million.
15-Jan-2016	Advance payment of Rs. 20 million was made against a purchase order. 60% of the ordered goods were received in January 2016.
21-Jan-2016	Rs. 5 million were received against supply of goods in January 2016. Goods amounting to Rs. 3 million could not be delivered in time because of a transport strike.
31-Jan-2016	Sale was booked on receipt of a cheque amounting to Rs. 0.9 million which represents the price of goods supplied net of 10% cash discount.
1-Feb-2016	Payment of salaries and wages for the month of January 2016 amounted to Rs. 0.5 million. This amount includes Rs 0.02 million paid to an employee as advance salary for the month of February 2016.
15-Feb-2016	Payment of utility bills for the month of January 2016 amounted to Rs. 0.3 million.

Required:

Prepare adjusting entries to enable ZT to finalise its monthly financial statements for the month of January 2016 under accrual basis of accounting.

- *ANSWER*

Zamil Traders

Accounting entries for the month of January 2016

Date	Description	Debit	Credit
2016		**Rs. in millions**	
31-Jan	Prepaid rent	1.1	
	Rent expense		1.1
	(Rent for the period Feb – Dec 2016 debited to prepayment account		
31-Jan	Advance to suppliers/ Goods in transit	8.00	
	Purchases		8.00
	Purchases adjusted for the goods not yet received		
31-Jan	Sales	3.00	
	Advances from customers		3.00
	Sales adjusted for the goods not yet delivered		
31-Jan	Salaries and wages expense	0.48	
	Salaries and wages payable		0.48
	Salaries and wages for the month of January 2016 paid in February 2016		
31-Jan	Utility expenses	0.30	
	Utility bills payable		0.30
	Utility bills for the month of January 2016 received and paid in February 2016		

Revenue is reported net of discount in financial statements. No adjustment is required for sales booked net of 10% cash discount.

4. OBJECTIVE BASED Q&A

01. In the year to 31 December 2018, Saira received Rs. 50,800 rental income. The amounts of rent received in advance and due in arrears were as follows:

	31 Dec 2018	31 Dec 2017
	Rs.	**Rs.**
Rent received in advance	4,000	3,000
Rent due in arrears (accrued)	2,500	1,700

What figure for rental income should be recorded in the statement of profit or loss for the year ended 31 December 2018?

(a) Rs. 50,800

(b) Rs. 50,600

(c) Rs. 54,500

(d) Rs. 56,000

02. On 1 March 2017, Zahra pays an insurance premium of Rs. 2,400 for the period to 28 February 2018.

What is the charge to the statement of profit or loss for the year ended 31 October 2017 and prepayment in the Statement of Financial Position as at that date?

(a) Charge for SPL Rs. 800 and Prepayment Rs. Rs. 1,600

(b) Charge for SPL Rs. 1,600 and Prepayment Rs. 800

(c) Charge for SPL Rs. 2,400 and Prepayment 0

(d) Charge for SPL 0 and Prepayment Rs. 2,400

03. Zahra determines at year end that Salaries paid during the year include Rs. 10,000 in advance.

What is the correct year end adjustment for advance salary to be made?

(a) Dr Salaries Rs. 10,000 Cr Advance salaries Rs. 10,000

(b) Dr Salaries Rs. 10,000 Cr Accrued salaries Rs. 10,000

(c) Dr Advance salaries Rs. 10,000 Cr Salaries expense Rs. 10,000

(d) No entry required

04. On year end a business has outstanding electricity bills of Rs. 15,000. During the year electricity bills paid are Rs. 190,000.

What adjustment will be required to utilities expense account regarding the outstanding bills?

(a) Cr Rs. 15,000

(b) Dr Rs. 15,000

(c) No impact

(d) Dr Rs. 190,000

AT A GLANCE SPOTLIGHT STICKY NOTES

05. Atif finalized his draft accounts and ignored a prepayment for Rs. 100 and accrued expense Rs. 300. What will be the impact on profit for the year?

- **(a)** Understated by Rs. 100
- **(b)** Overstated by Rs. 100
- **(c)** Overstated by Rs. 200
- **(d)** Understated by Rs. 200

06. On finalizing the draft accounts Minhas identified that he has Rs. 1,000 rental income receivable. Rental income received and recorded during the year is Rs. 11,000.

What is the correct entry to record the accrued income?

- **(a)** Dr Rental income Rs. 1,000 Cr Accrued income Rs. 1,000
- **(b)** Dr Cash Rs. 12,000 Cr Rental income Rs. 12,000
- **(c)** Dr Cash Rs. 11,000 Cr Rental income Rs. 11,000
- **(d)** Dr Accrued income Rs. 1,000 Cr Rental income Rs. 1,000

07. Which of the following is asset account?

- **(a)** Prepaid expense
- **(b)** Accrued expense
- **(c)** Unearned income
- **(d)** Rent payable

08. After finalizing the draft accounts of a business it was identified that salary expense payable for Rs. 9,000 has been ignored. Salary expense paid during the year was Rs. 110,000.

What will be the impact of recording the salaries payable?

- **(a)** Profit will be reduced by Rs. 9,000
- **(b)** Profit will be increased by Rs. 9,000
- **(c)** Profit will be reduced by Rs. 110,000
- **(d)** Profit will be increased by Rs. 110,000

09. Jasia has taken a loan of Rs. 250,000 from HBL as on 1st March 2018 for the construction of her office building. The construction is completed as on June 30, 2018. She rented a portion of her office for Rs. 4,500 per month on July 1. Interest is accrued and paid annually @ 15% per annum on December each year.

What amount of interest expenses and rent income should be shown in the statement of Profit or Loss of Jasia's business prepared on December 31, 2018?

- **(a)** Interest expense Rs. 54,000, Rental income Rs. 37,500
- **(b)** Interest expenses. 37,500, Rental income Rs. 54,000
- **(c)** Interest expense Rs. 31,250, Rental income Rs. 27,000
- **(d)** Interest expenses. 37,500, Rental income Rs. 4,500

10. What is the treatment of Pre - received income in the Statement of Financial Position of the business?

- **(a)** Treated as a non – current asset
- **(b)** Treated as a current asset
- **(c)** Treated as a non – current liability
- **(d)** Treated as a current liability

11. The annual rent expense for TTT for the period 1 July 2018 to 30 June 2019 is Rs. 35,000, which is 25% more than the previous year. Rent expense is paid on 1 July.

What is the charge of rent expense in the statement of profit or loss for the year ended 31 December 2018?

- **(a)** Rs. 28,000
- **(b)** Rs. 31,500
- **(c)** Rs. 35,000
- **(d)** Rs. 7,000

12. Which of the following statements is incorrect?

- **(a)** Income received in advance is a current liability
- **(b)** Accrued income is a current asset
- **(c)** Prepaid insurance is a current liability
- **(d)** Salaries payable is a current liability

13. After finalizing the draft accounts Arsalan identified that he has treated prepaid insurance of Rs. 1,000 as accrued expense.

What will be the impact of correction?

- **(a)** Profit will be increased by Rs. 2,000
- **(b)** Profit will be increased by Rs. 1,000
- **(c)** Profit will be reduced by Rs. 1,000
- **(d)** Profit will be reduced by Rs. 2,000

14. A business pays rent quarterly in arrears on 1 January, 1 April, 1 July and 1 October each year. The rent was increased from Rs. 150,000 per year to Rs. 180,000 per year as from 1 October 2007.

What rent expense and accrual should be included in the company's financial statements for the year ended 31 January 2008?

	Rent expense Rs.	**Accruals Rs.**
(a)	110,000	10,000
(b)	80,000	15,000
(c)	160,000	15,000
(d)	100,000	10,000

AT A GLANCE
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15. Helix Corporation has sublet part of its office and in the year ended 30 November 2008 the rent receivable was:

Until 30 June 2008	Rs. 9,000 per year
From 1 July 2008	Rs. 12,000 per year

Rent was received quarterly in advance on 1 January, April, July, and October each year.

What amounts should appear in the company's financial statements for the year ended 30 November 2008?

	Rental income	**Statement of Financial Position**
(a)	Rs. 10,800	Rs. 1,000 in sundry payables
(b)	Rs. 10,900	Rs. 1,000 in sundry payables
(c)	Rs. 10,250	Rs. 1,000 in sundry receivables
(d)	Rs. 9,900	Rs. 2,000 in sundry receivables

16. Sitara Industries has taken a loan from Crescent Bank. Interest on the loan is payable every quarter i.e. on March 31, June 30, September 30 and December 31. Face amount of the loan is 500,000 and the rate of interest is 10% per annum. Due to financial problems, two instalments were not paid on September 30 and December 31.

What is the amount of the interest liability to be shown in the Statement of Financial Position prepared as on December 31?

Rs. _________

17. Rent paid on 1 September 2017 for the year to 31 August 2018 was Rs. 15,000, and rent paid on 1 September 2018 for the year to 31 August 2019 was Rs. 18,000.

What figure for rent expense should be shown in the statement of profit or loss for the year ended 31 December 2018?

Rs. _________

18. A business had deposited Rs. 500,000 into an annual fixed deposit on May 1, 2018. Interest is accrued quarterly on March 31, June 30, September 30 and December 31 each year. Interest will be paid only on maturity. Monthly interest amount is Rs. 3,000.

What amount of interest receivable should be shown in the Statement of Financial Position prepared as on December 31, 2018?

Rs. _________

19. A business has paid an annual salary of Rs. 36,000 in advance to one of its employees on 31 August 2017.

What is the amount of prepaid salaries at the end of the year on 31 December 2017?

Rs. _________

20. A business was started on January 1, 2008 in a building which is on a 25 year lease. The rent of the building is payable quarterly in advance. Payments of rent was made during the year as follows:

January 1, 2008	Rs. 7,500
March 29, 2008	Rs. 7,500
June 28, 2008	Rs. 7,500
September 30, 2008	Rs. 7,500
December 30, 2008	Rs. 7,500

What will be the rent expense charged to statement of profit or loss for the year ended December 31, 2008?

Rs. __________

21. An accrual is:

(a) An expense relating to next year but not paid in current year

(b) An expense relating to the current year and paid within current year

(c) An expense relating to the current year but not paid in current year

(d) An expense relating to next year and already paid in current year

22. Earned but not yet received income is treated as

(a) Asset

(b) Liability

(c) Capital

(d) Loss

23. Unearned income is classified as

(a) Assets

(b) Liability

(c) Equity

(d) Loss

24. A prepayment can be defined as:

(a) Payments for expenses for that are not yet incurred and classified as non-current asset

(b) Expenses incurred but not yet paid and classified as current asset

(c) Payments for expenses for that are not yet incurred and classified as current asset

(d) None

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25. Expenses relevant to the accounting period which remain unpaid by period end should be:

(a) Included with expenses paid and shown as an asset at the period end

(b) Ignored until they are paid for in the next period

(c) Deducted from amount already paid and shown as a liability at the period end

(d) Include in with the expenses and shown as a liability at the period end

26. Which of the following is not true?

(a) An accrual is an amount owing at the end of a period; a prepayment is an amount paid in advance

(b) An accrual is a liability; a prepayment is an asset

(c) An accrual is a liability; a prepayment is always a non-current asset

(d) An accrual is a current liability; a prepayment is a current asset

27. Staff salary remaining unpaid as at the year-end should be accounted for as:

(a) Prepaid salary (debit) and Staff salary expense (credit)

(b) Staff salary expense (debit) and Cash (credit)

(c) Accrued Salary (debit) and Staff salary expense (credit)

(d) Staff salary expense (debit) and accrued salary (credit)

28. A business has a year ended 30 September and receives an invoice for rent of Rs. 600,000 for the six months to 31 December. What accrual or prepayment is required for the invoice in the year end accounts?

(a) Prepaid rent = Rs.300,000

(b) Accrued rent = Rs.300,000

(c) Prepaid rent = Rs.600,000

(d) Accrued rent = Rs.600,000

29. During the year, a business paid an electricity bill for Rs. 900,000 for the 3 months to November. The year end of the business is 30 September, what accrual or prepayment is needed at the year end?

(a) Prepaid electricity = Rs. 600,000

(b) Accrued electricity = Rs. 600,000

(c) Prepaid electricity = Rs. 300,000

(d) Accrued electricity = Rs. 300,000

30. A business has a beginning utilities accrual of Rs. 50,000, an ending accrual of Rs. 60,000, and during the year, it pays for utilities of Rs. 80,000. What is the amount of utilities expense?

(a) Rs. 70,000

(b) Rs. 80,000

(c) Rs. 90,000

(d) Rs. 140,000

31. On 31 October 2019, a business pays annual insurance premium of Rs. 600,000. What is the prepayment at the end of the year (31 December 2019)?

(a) Nil

(b) Rs. 100,000

(c) Rs. 300,000

(d) Rs. 500,000

32. XYZ Ltd. receives interest of Rs. 100,000 on bank deposit for the month of December 2011 on 3rd January 2011. XYZ Ltd has an accounting year end of 31st December.

What would be the accounting entry for such transaction?

(a) Prepaid interest (debit) = Rs.100,000 and Interest income (credit) = Rs.100,000

(b) Cash (debit) = Rs.100,000 and Interest income (credit) = Rs.100,000

(c) Cash (debit) = Rs.100,000 and Prepaid interest (credit) = Rs.100,000

(d) Interest receivable (debit) = Rs.100,000) and interest income (credit) = Rs.100,000

33. XYZ Ltd. receives interest of Rs. 100,000 on bank deposit for the month of December 2011 on 3rd January 2011. XYZ Ltd has an accounting year end of 31st December.

What would be the accounting entry when subsequently on 3rd January, payment for interest is received?

(a) Prepaid interest (debit) = Rs.100,000 and Interest income (credit) = Rs.100,000

(b) Cash (debit) = Rs.100,000 and Interest receivable (credit) = Rs.100,000

(c) Cash (debit) = Rs.100,000 and Prepaid interest (credit) = Rs.100,000

(d) Interest receivable (debit) = Rs.100,000) and interest income (credit) = Rs.100,000

34. ABC Limited receives advance rent from its tenant of Rs.1 million on 31st December in respect of office rent for the following year.

ABC Ltd. has an accounting year end of 31st December. What accounting entry is to be passed in this year?

(a) Cash (debit) = Rs.1 million and Advance rent – liability (credit) = Rs.1 million

(b) Cash (debit) = Rs.1 million and Accrued rent (credit) = Rs.1 million

(c) Cash (debit) = Rs.1 million and Rent income (credit) = Rs.1 million

(d) None

35. ABC Limited receives advance rent from its tenant of Rs.1 million on 31st December in respect of office rent for the following year.

What would be the accounting entry in the following year?

(a) Accrued rent (debit) = Rs.1 million and rental income (credit) = Rs.1 million

(b) Advanced rent (debit) = Rs.1 million and rental income (credit) = Rs.1 million

(c) Accrued rent (debit) = Rs.1 million and prepaid rent (credit) = Rs.1 million

(d) None

36. F Limited year-end is 30 September. On 1 January 2016 the organization took out a loan of Rs. 100,000 with annual interest of 12%. The interest is payable in equal instalments on the first day of April, July, October and January in arrears.

How much should be charged to P&L for the year ended 30 September 2016, and how much should be accrued on the statement of financial position?

	Profit or loss	Statement of financial position
(a)	Rs. 12,000	Rs. 3,000 accrual
(b)	Rs. 9,000	Rs. 3,000 accrual
(c)	Rs. 9,000	Nil
(d)	Rs. 6,000	Rs. 3,000 prepayment

37. On the first day of Month 1, a business had prepaid insurance of Rs. 10,000. On the first day of Month 8, it paid, in full, the annual insurance invoice of Rs. 36,000, to cover the following year.

The amount charged in P&L and the amount shown in the statement of financial position at the year-end is:

	Profit or loss	SFP (Prepayment)
(a)	Rs. 5,000	Rs. 24,000
(b)	Rs. 22,000	Rs. 23,000
(c)	Rs. 25,000	Rs. 21,000
(d)	Rs. 36,000	Rs. 15,000

38. An entity's draft accounts for the year to 31st October 2015 report a loss of Rs. 1,486. When the assistant accountant prepared the accounts, she did not include an accrual of Rs. 1,625 and a prepayment of Rs. 834.

What is profit or loss for the year to 31st October 2015 following the inclusion of the accrual and prepayment?

- **(a)** A loss of Rs. 695
- **(b)** A loss of Rs. 2,277
- **(c)** A loss of Rs. 3,945
- **(d)** A profit of Rs. 1,807

39. The draft year end accounts were prepared without adjusting prepayment for rent of Rs. 970.

When the adjustment is made, which of the following would be effect thereof?

- **(a)** Profit increased by Rs. 970 and Liability increased by Rs. 970
- **(b)** Profit decreased by Rs. 970 and Liability increased by Rs. 970
- **(c)** Profit increased by Rs. 970 and assets increased by Rs. 970
- **(d)** Profit increased by Rs. 970 and assets decreased by Rs. 970

40. An entity prepared the draft end year accounts, but did not adjust these for a prepayment of Rs. 1,500 and an accrual of Rs. 400.

How will profit and net assets be affected by including the prepayment and accrual?

	NET PROFIT WILL	NET ASSETS WILL
(a)	Increase by Rs. 1,100	Reduce by Rs. 1,100
(b)	Reduce by Rs. 1,900	Increase by Rs. 1,900
(c)	Increase by Rs. 1,100	Increase by Rs. 1,100
(d)	Reduce by Rs. 1,900	Reduce by Rs. 1,900

41. A company pays rent quarterly in arrears on 1 January, 1 April, 1 July and 1 October each year. The rent was increased from Rs. 90,000 per year to Rs. 120,000 per year as from 1 October 2012.

What rent expense and accrual should be included in the company's financial statements for the year ended 31 January 2013?

	Rent Expense (Rs.)	Accrual (Rs.)
(a)	100,000	20,000
(b)	100,000	10,000
(c)	97,500	10,000
(d)	97,500	20,000

42. At 31 March 2012 a company had oil in hand to be used for heating costing Rs. 8,200 and an unpaid heating oil bill for Rs. 3,600. At 31 March 2013 the heating oil in hand was Rs. 9,300 and there was an outstanding heating oil bill of Rs. 3,200. Payments made for heating oil during the year ended 31 March 2013 totalled Rs. 34,600.

Based on these figures, what amount should appear in the company's Statement of Profit or Loss for heating oil for the year?

(a) Rs. 23,900

(b) Rs. 36,100

(c) Rs. 45,300

(d) Rs. 33,100

43. A company has sublet part of its offices and in the year ended 30 November 2013 the rent receivable was:

Until 30 June 2013	Rs. 8,400 per year
From 1 July 2013	Rs. 12,000 per year

Rent was paid quarterly in advance on 1 January, April, July and October each year.

What amounts should appear in the company's financial statements for the year ended 30 November 2013?

	Rent Receivable (Rs.)	SOFP (Rs.)
(a)	9,900	2,000 in sundry payables
(b)	9,900	1,000 in sundry payables
(c)	10,200	1,000 in sundry payables
(d)	9,900	2,000 in sundry receivables

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44. Which of the following statements is not true?

(a) Accruals decrease profit

(b) Accrued income decreases profit

(c) A prepayment is an asset

(d) All of the above statements are true

45. A business owns two properties which it rents to tenants. In the year ended 31 December 2016, it received Rs. 278,000 in respect of property 1 and Rs. 160,000 in respect of property 2. Balance on the rental accounts were as follows:

	31 December 2016	**31 December 2015**
Property 1	13,400 Dr	12,300 Cr
Property 2	6,700 Cr	5,400 Dr

What amount should be credited to the Statement of P&L and OCI for the year ended 31 December 2016 in respect of rental income?

(a) Rs. 451,600

(b) Rs. 738,000

(c) Rs. 939,200

(d) Rs. 858,600

46. Zameen, a property company, received cash totalling Rs. 838,600 from tenants during the year ended 31 December 2016. Figures for rent in advance and in arrears at the beginning and at the end of year were:

	31 December 2015	**31 December 2016**
	Rs.	**Rs.**
Rent receive in advance	102,600	88,700
Rent in Arrears (all subsequently received)	42,300	48,400

What amount should appear in company's Statement of P&L for the year ended 31 December 2016 for rental income?

(a) Rs. 818,600

(b) Rs. 738,000

(c) Rs. 939,200

(d) Rs. 858,600

47. Details of a company's insurance policy are shown below:

Premium for year ended 31 March 2016 paid April 2015	Rs. 10,800
Premium for year ended 31 March 2017 paid April 2016	Rs. 12,000

What figure should be included in the company's financial statements for the year ended 30 June 2016?

	Statement of P&L (Rs.)	**Statement of financial position (Rs.)**
(a)	11,100	9,000 prepayment
(b)	11,700	9,000 prepayment
(c)	11,100	9,000 accrual
(d)	11,700	9,000 accrual

48. A tenant pays annual rent of Rs. 6,000. Payment is made quarterly in advance on 1 January, 1 April, 1 July and 1 October. Which of the following should be included in his accounts for the year ended 31 October 2001?

(a) Rs. 500 Accrual

(b) Rs. 500 Prepayment

(c) Rs. 1,000 Accrual

(d) Rs. 1,000 Prepayment

49. A company's accounting year-end is 31st December. It always pays its insurance premiums annually in advance, on the due date 1 September each year. During the last few years the following premiums have been paid:

Year -1	Rs. 2,400
Year -2	Rs. 2,760
Year -3	Rs. 3,840

What will be charged for insurance in the company's Statement of Profit or Loss account for year 3?

Rs. ________________

50. X Ltd rents its building to Y Ltd. At 31st December 2018, Y Ltd owed Rs. 4,500 for rent, but at 31st December 2019, had paid Rs. 3,200 in advance. During the year X Ltd had received Rs. 17,100 in rental from Y Ltd.

What is the rental income to be shown in the Statement of Profit or Loss of X Ltd for the year ended 31st December 2019?

Rs. ____________________

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ANSWER

<table>
<tr><td>01.</td><td>(b)</td><td>
Rent
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>Bal. b/d (accrued)</td><td>1,700</td><td>Bal. b/d (Advance)</td><td>3,000</td></tr>
<tr><td>Profit or loss</td><td>50,600</td><td>Cash received</td><td>50,800</td></tr>
<tr><td>Bal. c/d (Advance)</td><td>4,000</td><td>Bal. c/d (Accrued)</td><td>2,500</td></tr>
<tr><td></td><td>56,300</td><td></td><td>56,300</td></tr>
</table>
</td></tr>
<tr><td>02.</td><td>(b)</td><td>Charge for SPL = Rs. 2,400/12x8 = Rs. 1,600
Prepayment = Rs. 24,00 - Rs. 1,600= Rs. 800</td></tr>
<tr><td>03.</td><td>(c)</td><td>Advance salaries are prepayment and an asset, so must be debited. This reduces the current year expense, which shall be credited.</td></tr>
<tr><td>04.</td><td>(b)</td><td>The expense must be recorded (debited) under matching concept in the year it has been incurred, even if the bill is outstanding.</td></tr>
<tr><td>05.</td><td>(c)</td><td>Prepayments are deducted from expenses and profit is increased and accruals are added to the expenses and profit is reduced as a result. Therefore, the profit has been overstated due to omissions.</td></tr>
<tr><td>06.</td><td>(d)</td><td>Accrued income is income receivable and must be recorded as an asset and corresponding increase in income (credited).</td></tr>
<tr><td>07.</td><td>(a)</td><td>Prepaid expense is an asset account. All other are liability account.</td></tr>
<tr><td>08.</td><td>(a)</td><td>Rs. 110,000 is already recorded only further Rs. 9,000 is to be recorded as expense on accrual basis, reducing the profit by Rs. 9,000.</td></tr>
<tr><td>09.</td><td>(c)</td><td>Interest expense = (Rs. 250,000x15%) x10/12=Rs. 31,250
Rental income = Rs. 4,500 x 6 = Rs. 27,000</td></tr>
<tr><td>10.</td><td>(d)</td><td>Income received in advance is an obligation to deliver goods or services in future and therefore a liability. As such advances are not for long term, it is treated as current liability.</td></tr>
<tr><td>11.</td><td>(b)</td><td>
<table>
<tr><th>Rent</th><th>Rs.</th><th>Rs.</th></tr>
<tr><td>1 Jan 18 – 30 June 18</td><td>(35,000/100 x 125)/12 x 6</td><td>14,000</td></tr>
<tr><td>1 July 18 – 31 Dec 18</td><td>35,000/12x6</td><td>17,500</td></tr>
<tr><td></td><td></td><td>31,500</td></tr>
</table>
</td></tr>
<tr><td>12.</td><td>(c)</td><td>Prepaid insurance is an asset as it is right to receive benefit from insurance services in the future.</td></tr>
<tr><td>13.</td><td>(a)</td><td>Rs. 1,000 accruals will be reversed (reduction in expense and increase in profit) & Rs. 1,000 prepayment will be recorded (reduction in expense and increase in profit)</td></tr>
<tr><td>14.</td><td>(c)</td><td>
<table>
<tr><th>Rent expense</th><th>Rs.</th><th>Rs.</th></tr>
<tr><td>1st Feb 2007 – 30 Sep 2007</td><td>150,000/12 x 8</td><td>100,000</td></tr>
<tr><td>1st Oct2007 – 31 Jan 2008</td><td>180,000/12 x 4</td><td>60,000</td></tr>
<tr><td></td><td></td><td>160,000</td></tr>
</table>
Accrued rent = 180,000/12 = Rs. 15,000
</td></tr>
</table>

<table>
<tr><td>15.</td><td>(c)</td><td>
<table>
<tr><th>Rental income</th><th>Rs.</th><th>Rs.</th></tr>
<tr><td>1st Dec 2007 – 30 June 2008</td><td>9,000/12 x 7</td><td>5,250</td></tr>
<tr><td>1st July 2008 – 30 Nov 2008</td><td>12,000 12 x 5</td><td>5,000</td></tr>
<tr><td></td><td></td><td>10,250</td></tr>
</table>
One month rent is receivable; Rs 12,000/12 = Rs. 1,000</td></tr>
<tr><td>16.</td><td>Rs. 25,000</td><td>Interest per quarter = Rs. 500,000x10%=Rs. 50,000/4 Quarters
= Rs. 12,500x2 quarters =Rs. 25,000</td></tr>
<tr><td>17.</td><td>Rs. 16,000</td><td>Rent for Jan to Aug 2018 = (Rs. 15,000/12x8) = Rs. 10,000
Rent for Sep to Dec 2018= (Rs. 18,000/12x4) =Rs. 6,000
Total = Rs. 16,000</td></tr>
<tr><td>18.</td><td>Rs. 24,000</td><td>= Rs. 3,000x8 months = Rs. 24,000
All interest will be received on maturity, therefore, all is accrued.</td></tr>
<tr><td>19.</td><td>Rs. 24,000</td><td>Advance salary = Rs. 36,000 x 8 /12 = 24,000
Four month salary is no more prepaid (services have been received against that).</td></tr>
<tr><td>20.</td><td>Rs. 30,000</td><td>
Rent
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td></td><td>SPL</td><td>30,000</td></tr>
<tr><td>Cash 7,500 x 5</td><td>37,500</td><td>c/d - advance</td><td>7,500</td></tr>
<tr><td></td><td>37,500</td><td></td><td>37,500</td></tr>
</table>
</td></tr>
<tr><td>21.</td><td>(c)</td><td>An expense relating to the current year but not paid in current year</td></tr>
<tr><td>22.</td><td>(a)</td><td>Liability</td></tr>
<tr><td>23.</td><td>(b)</td><td>Liability</td></tr>
<tr><td>24.</td><td>(c)</td><td>Payments for expenses for that are not yet incurred and classified as current asset.</td></tr>
<tr><td>25.</td><td>(d)</td><td>Include in with the expenses and shown as a liability at the period end</td></tr>
<tr><td>26.</td><td>(c)</td><td>An accrual is a liability; a prepayment is always a non-current asset</td></tr>
<tr><td>27.</td><td>(d)</td><td>Staff salary expense (debit) and accrued salary (credit)</td></tr>
<tr><td>28.</td><td>(b)</td><td>Rs. 600,000 x 3/6 months = Rs. 300,000</td></tr>
<tr><td>29.</td><td>(a)</td><td>Prepayment (as paid in advance)
Rs. 900,000 x 2/3 months = Rs. 600,000</td></tr>
<tr><td>30.</td><td>(c)</td><td>
Utilities
<table>
<tr><th>Particulars</th><th>Rs.</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td>Cash</td><td>80,000</td><td>b/d</td><td>50,000</td></tr>
<tr><td>c/d</td><td>60,000</td><td>PL</td><td>90,000</td></tr>
<tr><td></td><td>140,000</td><td></td><td>140,000</td></tr>
</table>
</td></tr>
<tr><td>31.</td><td>(d)</td><td>Rs. 600,000 x 10/12 months = Rs. 500,000</td></tr>
</table>

<table>
<tr><td>32.</td><td>(d)</td><td>Interest receivable Debit
Interest income Credit</td></tr>
<tr><td>33.</td><td>(b)</td><td>Cash (debit) = Rs.100,000 and Interest receivable (credit) = Rs.100,000</td></tr>
<tr><td>34.</td><td>(a)</td><td>Cash (debit) = Rs.1 million
Advance rent – liability (credit) = Rs.1 million</td></tr>
<tr><td>35.</td><td>(b)</td><td>Advanced rent (debit) = Rs.1 million
Rental income (credit) = Rs.1 million</td></tr>
<tr><td>36.</td><td>(b)</td><td><table>
<tr><td></td><td></td><td>Rs.</td></tr>
<tr><td>Interest expense for the year</td><td>100,000 x 12% x 9/12</td><td>9,000</td></tr>
<tr><td>Payable Quarter ending 30 Sep 2016</td><td>12,000 / 4</td><td>3,000</td></tr>
</table></td></tr>
<tr><td>37.</td><td>(c)</td><td>Insurance expense a/c<table>
<tr><th>Date</th><th>Particulars</th><th>Rs.</th><th>Date</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td>b/d</td><td>10,000</td><td></td><td>SPL</td><td>25,000</td></tr>
<tr><td></td><td>Cash</td><td>36,000</td><td></td><td>c/d 36,000 / 12 x 7</td><td>21,000</td></tr>
<tr><td></td><td></td><td>46,000</td><td></td><td></td><td>46,000</td></tr>
</table></td></tr>
<tr><td>38.</td><td>(b)</td><td>= 1,486+1,625-834= 2,277</td></tr>
<tr><td>39.</td><td>(c)</td><td>Profit increased by Rs. 970 and assets increased by Rs. 970</td></tr>
<tr><td>40.</td><td>(c)</td><td>Net profit and net assets to increase by Rs. 1,100 i.e. 1,500 – 400</td></tr>
<tr><td>41.</td><td>(b)</td><td><table>
<tr><td>Rent expense</td><td></td><td>Rs.</td></tr>
<tr><td>Rent for 01 Feb 2012 to 30 Sep 2012</td><td>Rs 90,000/12x8</td><td>60,000</td></tr>
<tr><td>Rent for 01 Oct 2012 to 31 Jan 2013</td><td>Rs. 120,000/12x4</td><td>40,000</td></tr>
<tr><td></td><td></td><td>100,000</td></tr>
</table>Accrued rent is for January 2013= Rs. 10,000</td></tr>
<tr><td>42.</td><td>(d)</td><td>Heating oil a/c<table>
<tr><th>Date</th><th>Particulars</th><th>Rs.</th><th>Date</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td>b/d oil in hand</td><td>8,200</td><td></td><td>b/d heating oil bill</td><td>3,600</td></tr>
<tr><td></td><td>Cash</td><td>34,600</td><td></td><td>SPL</td><td>33,100</td></tr>
<tr><td></td><td>c/d heating oil bill</td><td>3,200</td><td></td><td>c/d oil in hand</td><td>9,300</td></tr>
<tr><td></td><td></td><td>46,000</td><td></td><td></td><td>46,000</td></tr>
</table></td></tr>
<tr><td>43.</td><td>(b)</td><td><table>
<tr><td>Rent income</td><td></td><td>Rs.</td></tr>
<tr><td>Rent for 01 Dec 2012 to 30 Jun 2013</td><td>Rs 8,400/12x7</td><td>4,900</td></tr>
<tr><td>Rent for 01 Jul 2013 to 30 Nov 2013</td><td>Rs. 12,000/12x5</td><td>5,000</td></tr>
<tr><td></td><td></td><td>9,900</td></tr>
</table>Rent is for one month i.e. Dec 2013=12,000/12 = Rs. 1,000 (payables)</td></tr>
</table>

<table>
<tr><td>44.</td><td>(b)</td><td>Accrued income increases profit</td></tr>
<tr><td>45.</td><td>(a)</td><td>
Rent income a/c
<table>
<tr><th>Date</th><th>Particulars</th><th>Rs.</th><th>Date</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td>b/d P2</td><td>5,400</td><td></td><td>b/d P1</td><td>12,300</td></tr>
<tr><td></td><td>SPL</td><td>451,600</td><td></td><td>Cash
278,000+160,000</td><td>438,000</td></tr>
<tr><td></td><td>c/d P2</td><td>6,700</td><td></td><td>c/d P1</td><td>13,400</td></tr>
<tr><td></td><td></td><td>463,700</td><td></td><td></td><td>463,700</td></tr>
</table>
</td></tr>
<tr><td>46.</td><td>(d)</td><td>
Rent income a/c
<table>
<tr><th>Date</th><th>Particulars</th><th>Rs.</th><th>Date</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td>b/d</td><td>42,300</td><td></td><td>b/d</td><td>102,600</td></tr>
<tr><td></td><td>SPL</td><td>858,600</td><td></td><td>Cash</td><td>838,600</td></tr>
<tr><td></td><td>c/d</td><td>88,700</td><td></td><td>c/d</td><td>48,400</td></tr>
<tr><td></td><td></td><td>989,600</td><td></td><td></td><td>989,600</td></tr>
</table>
</td></tr>
<tr><td>47.</td><td>(a)</td><td>
<table>
<tr><td>Insurance expense</td><td></td><td>Rs.</td></tr>
<tr><td>1 July 2015 to 31 Mar 2016</td><td>10,800/12 x 9</td><td>8,100</td></tr>
<tr><td>01 April 2016 to 30 June 2016</td><td>12,000/12x3</td><td>3,000</td></tr>
<tr><td></td><td></td><td>11,100</td></tr>
</table>
Prepayment = 12,000/12 x 9 = 9,000
</td></tr>
<tr><td>48.</td><td>(d)</td><td>Prepayment = 6000/4 = 1,500/3 x 2 months = Rs. 1,000</td></tr>
<tr><td>49.</td><td>Rs. 3,120</td><td>
<table>
<tr><td></td><td>Rs.</td></tr>
<tr><td>Insurance premium 01 Jan to 31 Aug year 3 → 2,760/12x8</td><td>1,840</td></tr>
<tr><td>Insurance premium 01 Sep to 31 Dec year3 → 3,840/12x4</td><td>1,280</td></tr>
<tr><td></td><td>3,120</td></tr>
</table>
</td></tr>
<tr><td>50.</td><td>Rs. 9,400</td><td>
Rent income a/c
<table>
<tr><th>Date</th><th>Particulars</th><th>Rs.</th><th>Date</th><th>Particulars</th><th>Rs.</th></tr>
<tr><td></td><td>b/d</td><td>4,500</td><td></td><td>cash</td><td>17,100</td></tr>
<tr><td></td><td>SPL</td><td>9,400</td><td></td><td></td><td></td></tr>
<tr><td></td><td>c/d</td><td>3,200</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td>17,100</td><td></td><td></td><td>17,100</td></tr>
</table>
</td></tr>
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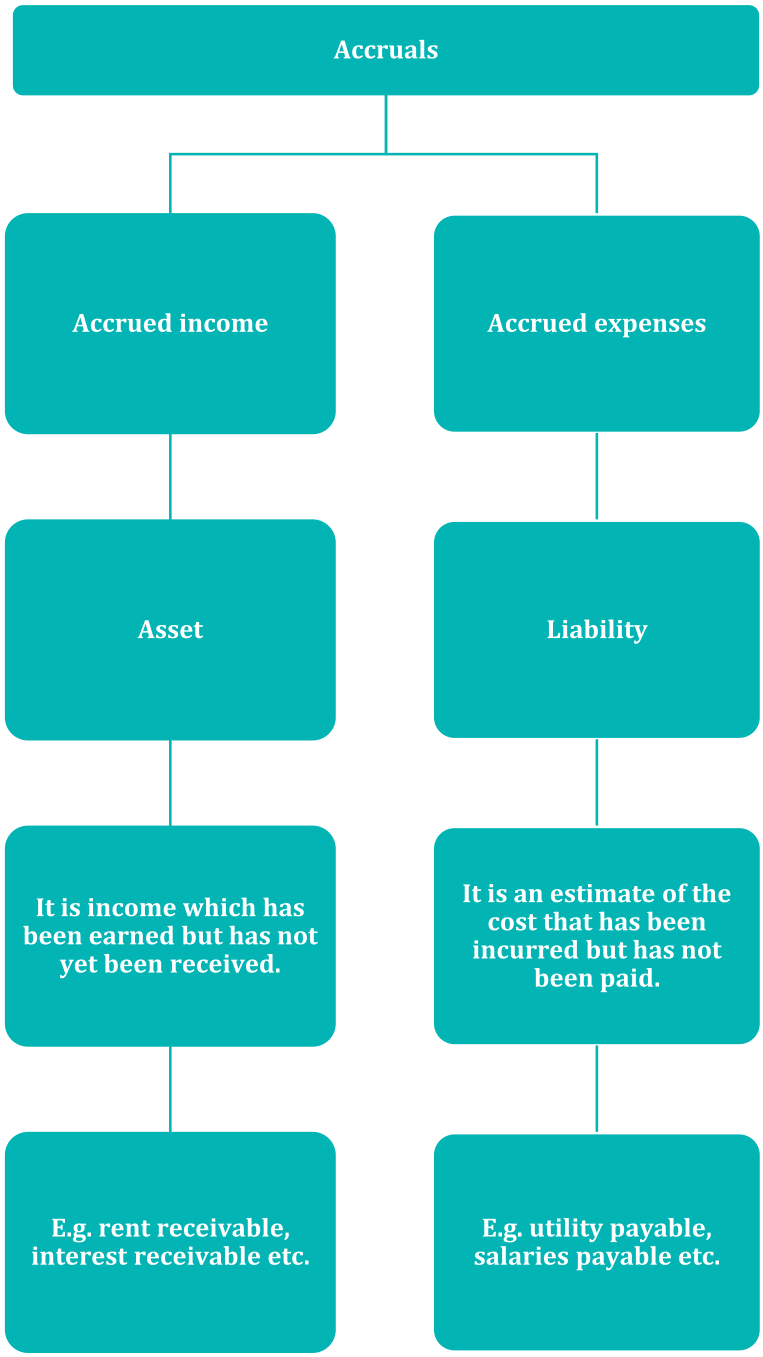
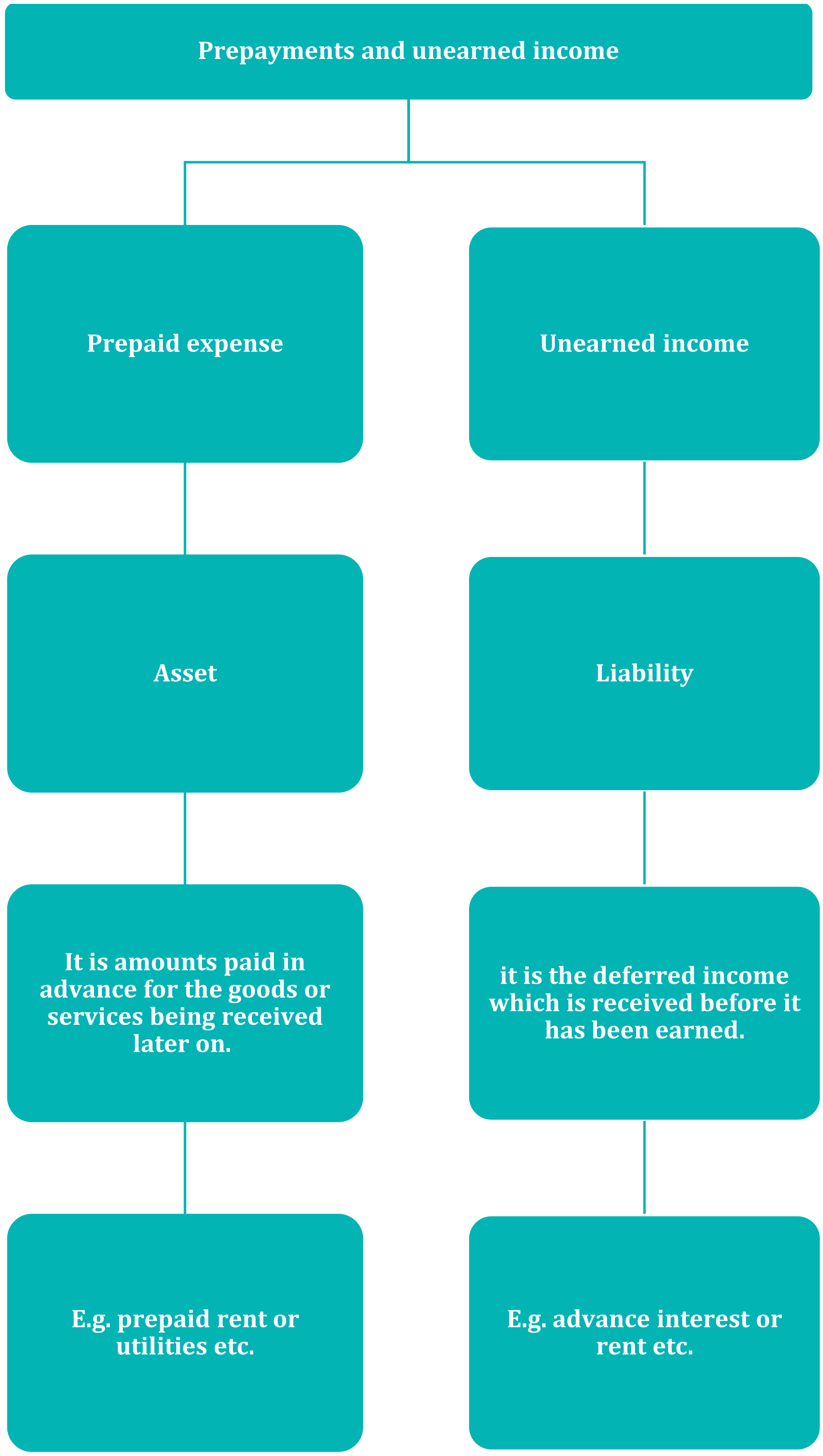
STICKY NOTES




Prepayments and unearned income
Prepaid expense
Unearned income
Asset
Liability
It is amounts paid in advance for the goods or services being received later on.
it is the deferred income which is received before it has been earned.
E.g. prepaid rent or utilities etc.
E.g. advance interest or rent etc.

AT A GLANCE

SPOTLIGHT

STICKY NOTES

CHAPTER 5

BAD AND DOUBTFUL DEBTS

IN THIS CHAPTER:

AT A GLANCE

A good debt is an account receivable that is clearly identified as collectible with certainty. No accounting treatment is required for a good debt.

A bad debt is an account receivable that has been clearly identified as not being collectible. This implies that a specific receivable needs to be removed from the accounts receivable account. So, bad debt expense is a sunk cost of doing business with customers on credit, as there is always a default risk inherent to extending credit.

Although rarely but a customer whose debt has been written off may pay later, and that is recorded as reduction in bad debts expense.

A doubtful debt is an account receivable that might become a bad debt at some point in the future. An expense is recognised at this point, but, the entity may or may not be able to specifically identify which customer might be so classified. So, the entity creates a reserve (allowance) account i.e. a contra asset account to be deducted from accounts receivable. This allowance is estimated periodically and the change is recorded as an expense or reduction in expense.

1. GOOD DEBTS AND BAD DEBTS

The transactions with credit customers are usually in following sequence:

Customer ➔ Credit Sales ➔ Receivable (trade debts) ➔ Collection of debts

However, some of the debts might never be collected or may prove difficult to be collected.

GOOD DEBTS

It is an amount owed by a customer (receivable) that the business believes it will have no difficulty in collecting from the customer. For example:

- secured receivables,
- remaining balance of receivable for which specific allowance has been made, and
- contra receivable & payable (we also owe to customer for goods or services procured).

Accounting treatment

The good debts do not require any special accounting treatment unlike bad and doubtful debts.

BAD DEBTS

It is the part of receivable that the business believes it will never be able to collect. This may arise due to bankruptcy, death or dishonesty of a customer.

Accounting treatment

This is a loss to business and, therefore, shall be written off as an ***expense***. The receivable is also removed from the accounting records.

The related journal entry is as follows:

Writing off a debt

Debit	Bad & doubtful debts expense	
Credit		Receivables

RECOVERY OF BAD DEBTS

A bad debt written off may be recovered subsequently. For example, a customer pays when his financial conditions are improved.

Accounting treatment

This may be recorded in either of the following two ways:

Reduction in bad debts expense

Debit	Bank / Cash	
Credit		Bad & doubtful debts expense

As income (bad debts recovered)

Debit	Bank / Cash	
Credit		Bad debts recovered

▶ *Example 01:*

On 1st January 2020, an entity had receivable balances of Rs. 1,750,000. During the year ended 31 December 2020, following details relate to customers.

- Cash sales of Rs. 8,000,000.
- Credit sales of Rs. 9,500,000
- A customer was declared insolvent who owed Rs. 350,000 and none of this amount is expected to be recovered.
- Total cash received from credit customers Rs. 9,200,000 (including Rs. 400,000 for a debt which was written off in 2018.
- Another customer has filed for bankruptcy who owed Rs. 500,000. Half of the amount is expected to be recovered from insolvency practitioner.

Required:

Journal entries of all the above transactions and ledger accounts of "Receivables" and "Bad & doubtful debts expense" for the year ended 31 December 2020.

▶ *ANSWER*

GENERAL JOURNAL				
Date	**Particulars**	**LF**	**Debit Rs.**	**Credit Rs.**
	Bank / Cash		8,000,000	
	Sales			8,000,000
	Receivables		9,500,000	
	Sales			9,500,000
	Bad & doubtful debts expense		350,000	
	Receivables			350,000
	Bank / Cash		9,200,000	
	Receivables			8,800,000
	Bad & doubtful debts expense			400,000
	Bad & doubtful debts expense		250,000	
	Receivables			250,000

Receivables					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Balance b/d	1,750,000		B&DD expense	350,000
	Sales	9,500,000		Bank / Cash	8,800,000
				B&DD expense	250,000
				Balance c/d	1,850,000
		11,250,000			11,250,000

Bad & doubtful debts expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	Receivables	350,000		Bank / Cash	400,000
	Receivables	250,000		**Profit or loss**	**200,000**
		600,000			600,000

AT A GLANCE
SPOTLIGHT
STICKY NOTES

2. DOUBTFUL DEBTS

It is an amount owed by a customer (receivable) that the business believes might prove difficult to collect but still hopes to collect it. For example, a disputed invoice with the customer or past experience that some customers might not pay.

Accounting treatment

Applying the prudence concept i.e. assets must not be overstated, these are also charged as an **expense**. However, instead of writing off the debt (which would remove it from the records) a business sets up an allowance account. The receivable must stay in the accounting records so that the business continues to chase payment.

The allowance account (a contra asset account) is a credit balance which is then set against the carrying amount of the receivables in the statement of financial position. The allowance account might also be called *provision for doubtful debts*.

Allowance may be:

- specific (for specific disputed/difficult debt); and/or
- general (for receivables excluding bad debts, good debts and specifically provided for).

The allowance account is estimated periodically and any adjustment is recognised either as an expense (in case of increase) or as reduction in an expense (in case of decrease).

One of the following two journal entries is recorded at year end:

Creating or increasing the allowance

Debit	Bad & doubtful debts expense	
Credit		Allowance for doubtful debts

Decreasing the allowance

Debit	Allowance for doubtful debts	
Credit		Bad & doubtful debts expense

Note that no additional accounting entry is required when any doubtful debt is recovered as receivable has not been written off in this case.

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	Rs.
Specific allowance	XX
General allowance (receivables excluding bad, good and specific x %)	XX
Total allowance required at period end	XX
Less: Opening balance of the allowance account	(XX)
Increase (Decrease) in the allowance account	XX

AGING ANALYSIS

Preparing an aged receivables analysis is a method of attempting to assess the likelihood of bad debts or to make an assessment of doubtful receivables. This may be an analysis for each individual credit customer for specific allowance calculation or it may be an analysis of total receivables for general allowance calculations. Two typical formats for an aged receivables analysis is given below:

- *Illustration: Aged debtors (receivables) analysis*

Customer	Credit limit	Total owed	< 30 days	30 – 60 days	60 – 90 days	Over 90 days
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
X	20,000	5,500	3,000	–	2,500	–
Y	15,000	2,700	–	1,000	1,000	700

- *Illustration: Aged debtors (receivables) analysis*

Debts outstanding	Amount	Allowance for doubtful debts	
	Rs.000	%	Rs.000
Up to 30 days	24,000	1	240
30 to 60 days	10,000	2	200
60 to 90 days	8,000	4	320
More than 90 days	3,000	5	150
Total	45,000		910

If a customer has old amounts outstanding, these should be investigated and an attempt should be made to collect payment. However, the investigation may indicate that the amount should either be written off as a bad debt, or that an allowance should be made for doubtful debts.

The **older the age** of debt, the **more uncertainty** in collection arises. Often created by accounting software, **aging schedules** can be produced for both accounts payable and accounts receivable to help an entity see whether it is making timely payments to others and whether its customers are paying it on time.

- *Example 02:*

Nelson makes allowance for doubtful debts at varying percentages based on statistical analysis and the level of outstanding trade receivables. The result of this policy for the last three years is as follows.

Year to December	2010	2011	2012
	Rs.	Rs.	Rs.
Trade receivables at the year end (before adjusting for any bad debts)	196,860	151,020	216,020
Estimated bad debts (accounts in liquidation)	1,860	1,020	6,020
Doubtful debts allowance (%)	5%	6%	7.5%

The doubtful debts allowance at 1 January 2010 was Rs. 10,000.

Required:

Write up the bad debts expense account and doubtful debts allowance account for each of the three years. Show the relevant calculations.

► *ANSWER*

Bad and doubtful debts expense					
2010					
Receivables	1,860			Profit or loss	1,610
				Allowance for doubtful debts	250
	1,860				1,860
2011					
Receivables	1,020			Profit or loss	270
				Allowance for doubtful debts	750
	1,020				1,020
2012					
Receivables	6,020				
Allowance for doubtful debts	6,750			Profit or loss	12,770
	12,770				12,770

Allowance for doubtful debts					
2010					
Bad and doubtful debts expense	250			Balance b/d	10,000
Balance c/d	9,750				
	10,000				10,000
2011					
Bad and doubtful debts expense	750			Balance b/d	9,750
Balance c/d	9,000				
	9,750				9,750
2012					
				Balance b/d	9,000
Balance c/d	15,750			Bad and doubtful debts exp.	6,750
	15,750				15,750

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	2010	2011	2012
	Rs.	Rs.	Rs.
Specific allowance	0	0	0
General allowance (receivables excluding bad, good and specific x %)			
2010: (196,860 – 1,860) x 5%	9,750		
2011: (151,020 – 1,020) x 6%		9,000	
2012: (216,020 – 6,020) x 7.5%			15,750
Total allowance required at period end	9,750	9,000	15,750
Less: Opening balance of the allowance account	(10,000)	(9,750)	(9,000)
Increase (Decrease) in the allowance account	(250)	(750)	6,750

▶ *Example 03:*

Homer commenced trading on 1 April 2010. He extracted the following list of balances from his sales ledger as at **31 March 2011**:

	Rs.
Bart	200,000
Lisa	400,000
Others	6,300,000
	6,900,000

In the year to 31 March 2011:

1. Bart emigrated leaving numerous debts.
2. Lisa is disputing certain invoices, amounting to Rs. 100,000, which have been outstanding for more than six months. Homer estimates that Lisa will eventually pay half the disputed amount.

In the year to 31 March 2012:

The sales ledger listing as at 31 March 2012 is as follows:	Rs.
Maggie	240,000
Marge	400,000
Lisa	60,000
Others	6,600,000
	7,300,000

1. Maggie has been declared bankrupt and her debt is to be written off.
2. Marge is experiencing cash flow difficulties. Homer considers a 50% allowance to be appropriate.
3. Homer is no longer supplying goods to Lisa. The balance, which is in respect of last year's disputed invoices, is to be written off.

In the year to 31 March 2013:

1. Total receivables per the sales ledger listing are Rs. 7,500,000 as at 31 March 2013.
2. There are no debts requiring specific allowance.
3. Rs. 50,000 has been received from Maggie.

Required:

Assuming that Homer requires a general allowance for doubtful debts of 5%, write up the bad and doubtful debt expense and allowance accounts for the three years to 31 March 2013.

▶ *ANSWER*

Bad and doubtful debts expense					
2011	**Rs.000**			**2011**	**Rs.000**
Bad debts (Bart)	200			Profit or loss	565
Allowance for doubtful debts	365				
	565				565

Bad and doubtful debts expense					
2012				**2012**	
Receivables	300			Profit or loss	465
Allowance for doubtful debts	165				
	455				465
2013				**2013**	
				Cash (Bad debts recovered)	50
Profit or loss	205			Allowance for doubtful debts	155
	205				205

Provision (Allowance) for doubtful debts					
2011	**Rs.000**			**2011**	**Rs.000**
Balance c/d	365			Bad & doubtful debts exp.	365
	365				365
2012				**2012**	
				Balance b/d	365
Balance c/d	530			Bad & doubtful debts exp.	165
	530				530
2013				**2013**	
Bad & doubtful exp.	155			Balance b/d	530
Balance c/d	375				
	530				530

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	2011	2012	2013
	Rs.000	**Rs.000**	**Rs.000**
Specific allowance	50	200	0
General allowance (receivables excluding bad, good and specific x %)			
2011: (6900 – 200 – 350 – 50) x 5%	315		
2012: (7,300 – 300* – 200 – 200) x 5%		330	
2013: (7,500 – 0 – 0 – 0) x 5%			375
Total allowance required at period end	365	530	375
Less: Opening balance of the allowance account	0	(365)	(530)
Increase (Decrease) in the allowance account	365	165	(155)

*Maggie Rs. 240,000 + Lisa Rs. 60,000 = Rs. 300,000 Bad debts

► *Example 04:*

Abdullah has provided you with following information regarding his receivables as at end of YR06:

Category	Age	Receivable Rs.	% of general allowance	
A	More than 180 days	15,000	8%	***Note 1***
B	90 to 180 days	20,000	6%	***Note 2***
C	30 to 90 days	25,000	5%	***Note 3***
D	Less than 30 days	60,000	2%	***Note 4***
Total		120,000		

Note 1: This includes Rs. 2,000 disputed amount owed by Ali

Note 2: This includes Rs. 1,000 owed from Beenish who has gone bankrupt. Abdullah decides to write this off.

Note 3: This includes Rs. 5,000 owed from Usuf which are secured against property title documents.

Note 4: This includes Rs. 1,000 owed from Aman, Aman is disputing an invoice of Rs.200 but otherwise is a good customer and pays on time.

The balance on allowance for doubtful debts account at start of year YR06 has been Rs. 4,000.

Required:

Calculate the amount by which allowance using the above aging analysis.

AT A GLANCE SPOTLIGHT STICKY NOTES

- *ANSWER*

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	YR06
	Rs.
Specific allowance (A 2,000 + D 200)	2,200
General allowance (receivables excluding bad, good and specific x %)	
A: (15,000 – 0 – 0 – 2,000) x 8%	1,040
B: (20,000 – 1,000 – 0 – 0) x 6%	1,140
C: (25,000 – 0 – 5,000 – 0) x 5%	1,000
D: (60,000 – 0 – 800 – 200) x 2%	1,180
Total allowance required at period end	6,560
Less: Opening balance of the allowance account	(4,000)
Increase (Decrease) in the allowance account	2,560

3. PRESENTATION IN FINANCIAL STATEMENTS

The relevant extracts of financial statements are as follows:

Statement of profit or loss (extracts)		Rs.
Bad & doubtful debts expense	(Note 1)	XX

Statement of financial position (extracts)		Rs.
Trade receivables	(Note 2)	XX
Less: Allowance for doubtful debts	(Note 3)	(X)
Net amount		XX

Note 1: This amount is taken from "Bad & doubtful debts expense" ledger. Alternatively, it may be calculated as follows:

= Bad debts written off + Increase (Decrease) in allowance – Bad debts recovered

Note 2: This amount is closing balance of "Receivables" ledger i.e. after deducting bad debts written off.

Note 3: This amount is closing balance of "Allowance for doubtful debts" i.e. total allowance (specific + general) required at period end.

▶ *Example 05:*

Shazim started a business of trading in law text books, on 1 January YR01.

On 31 December YR01:

- Shazim had receivables of Rs. 20,000 before writing off bad debts of Rs.500 which was owed from Amy.
- The receivables include Rs. 1,000 owed from Bernie and are secured against bank guarantee.
- The receivables include Rs.200 owed from Carl who is disputing an invoice of Rs.50 on account of incorrect specifications.
- He decides to make an allowance for doubtful debts at 5% for all other receivables.

On 31 December YR02:

- Shazim had receivables of Rs. 25,000 after writing off bad debts of Rs. 700.Unexpectedly, Amy paid Rs.200 to Shazim during the year.
- The receivables include Rs.300 from Dave for goods sold, Shazim also owes Dave Rs.700 for services rendered by Dave.
- He decided to make an allowance for doubtful debts at 6% for all other receivables.

Required:

Prepare relevant ledger accounts and relevant financial statements extracts of Shazim's business for above two years. Show necessary calculations.

▶ *ANSWER*

Bad and doubtful debts expense			
YR01			
Receivable	500	Profit or loss	1,465
Allowance for doubtful debts	965		
	1,465		1,465

Bad and doubtful debts expense				
YR02				
Receivable	700		Cash (bad debts recovered)	200
Allowance for doubtful debts	517		Profit or loss	1,017
	1,217			1,217

Provision (Allowance) for doubtful debts				
YR01				
			Balance b/d	0
Balance c/d	965		Bad & doubtful debts exp.	965
	965			965
YR02				
			Balance b/d	965
Balance c/d	1,482		Bad & doubtful debts exp.	517
	1,482			1,482

Financial Statement Extracts

Statement of Comprehensive Income (extracts)	YR01	YR02
For the year ended 31st December	**Rs.**	**Rs.**
Operating expenses		
Bad & doubtful debts (YR01: 500 + 965) (YR02: 700 + 517 – 200)	1,465	1,017

Statement of Financial Position (extracts)	YR01	YR02
As at 31st December	**Rs.**	**Rs.**
Current assets		
Receivables (YR01: 20,000 – 500) (YR02: 25,000 i.e. already after bad debts)	19,500	25,000
Less: Allowance for doubtful debts	965	1,482
	18,535	23,518

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	YR01	YR02
	Rs.	**Rs.**
Specific allowance	50	0
General allowance (receivables excluding bad, good and specific x %)		
YR01: (20,000 – 500 – 1,150* – 50) x 5%	915	
YR02: (25,000 – 300 good debts) x 6%		1,482
Total allowance required at period end	965	1,482
Less: Opening balance of the allowance account	0	(965)
Increase (Decrease) in the allowance account	965	517

*Good debts 1,000 Bernie + 150 Carl = Rs. 1,150

- *Example 06:*

In his first year of trading to 31 December 2011 Lopez made credit sales of Rs. 200,000 and received Rs. 150,000 from his credit customers.

At the end of the year he decided to write off Ludmila's debt of Rs. 8,000, make a specific allowance for Jozef's debt totalling Rs. 3,500 and create a general allowance of 5% of remaining trade receivables.

During his second year of trading he made sales on credit of Rs. 300,000 and received cash of Rs. 280,000 including Rs. 4,000 from Ludmila. At 31 December 2012, he decided to write off Jozef's debt, and create a specific allowance against 50% of Chokin's total debt of Rs. 6,000. He decided that his general allowance should now be 8% of remaining accounts receivable.

In the year to 31 December 2013 Lopez made credit sales of Rs. 500,000 and received cash of Rs. 400,000. Separate from this he also received a cheque from Chokin for Rs. 6,000.

At the year - end he decided to create a specific allowance against Paulo's debt of Rs. 50,000 and maintain his general allowance at 8%.

Required:

For each of the above years show the trade receivables account, bad debt expense account and allowance for doubtful debts account, and the statement of financial position extract as at each year end.

- *ANSWER*

Receivables Account				
2011	**Rs.**			**Rs.**
Sales	200,000		Collection from receivables	150,000
			Bad debts	8,000
			Balance c/d	42,000
	200,000			200,000
2012				
Balance b/d	42,000		Cash received from customers	276,000
Sales	300,000		Bad debts written off	3,500
			Balance c/d	62,500
	342,000			342,000
2013				
Balance b/d	62,500		Cash (400,000 + 6,000)	406,000
Sales	500,000		Balance c/d	156,500
	562,500			562,500

Bad and doubtful debts expense				
2011	**Rs.**		**2011**	**Rs.**
Receivables	8,000		Profit or loss	13,425
Allowance for doubtful debts	5,425			
	13,425			13,425

Bad and doubtful debts expense			
2012		**2012**	
Receivables	3,500	Cash (Bad debts recovered)	4,000
Allowance for doubtful debts	2,095	Profit or loss	1,595
	5,595		5,595
2013		**2013**	
Allowance for doubtful debts	51,000		
		Profit or loss	51,000
	51,000		51,000

Provision (Allowance) for doubtful debts			
2011	**Rs.**	**2011**	**Rs.**
Balance c/d	5,425	Bad and doubtful debts exp.	5,425
	5,425		5,425
2012		**2012**	
		Balance b/d	5,425
Balance c/d	7,520	Bad and doubtful debts exp.	2,095
	7,520		7,520
2013		**2013**	
		Balance b/d	7,520
Balance c/d	58,520	Bad and doubtful debts exp.	51,000
	58,520		58,520

Lopez – Statement of Financial Position (extracts)	2011	2012	2013
As at 31st December	**Rs.**	**Rs.**	**Rs.**
Current assets			
Receivables	42,000	62,500	156,500
Less: Allowance for doubtful debts	(5,425)	(7,520)	(58,520)
	36,575	54,980	97,980

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	2011	2012	2013
	Rs.	**Rs.**	**Rs.**
Specific allowance	3,500	3,000	50,000
General allowance (receivables excluding bad, good and specific x %)			
2011: (42,000* – 0 – 3,500) x 5%	1,925		
2012: (62,500* – 3,000 – 3,000) x 8%		4,520	
2013: (156,500* – 0 – 50,000) x 8%			8,520
Total allowance required at period end	5,425	7,520	58,520
Less: Opening balance of the allowance account	0	(5,425)	(7,520)
Increase (Decrease) in the allowance account	5,425	2,095	51,000

*receivables after deducting bad debts

4. COMPREHENSIVE EXAMPLES

- *Example 07:*

You have been provided following information relating to the business of Ghazi Traders (GT) for the year ended 30 June 2015.

	Rupees
Sales	12,000,000
Sales return	700,000
Discount allowed (recorded in separate ledger account upon collection)	500,000
Collection from customers	8,540,000

i. Credit sales were 80% of the total sales.

ii. As at 1 July 2014, debtors account and provision for doubtful debts account had a balance of Rs. 5,630,000 and 690,000 (comprising of specific provision of Rs. 430,000) respectively.

iii. Details of specific provision on 30 June 2014 and recoveries there against during the year ended 30 June 2015 are as follows:

	Amount due and provided	Recoveries
	--------- Rupees ---------	
Sabir Enterprises	100,000	50,000
Babur Traders	150,000	75,000
Zubair Associates	180,000	30,000
	430,000	155,000

Remaining debt from Zubair Associates needs to be written off.

iv. Specific provision is also required to be made against the entire balances of the following debtors:

	Rupees
Rahil Stores	50,000
Adam Enterprises	75,000
Shahid Traders	25,000
	150,000

v. A customer Nadir who had a debit balance of Rs. 280,000 had also supplied goods to GT worth Rs. 250,000. The two balances were adjusted with mutual consent.

vi. Sales return and discount allowed pertain to credit sales only.

vii. GT follows a policy of making a general provision of 5% against debtors.

viii. Collection from customers includes recovery against debts written off during the year ended 30 June 2014 amounted to Rs. 199,000.

Required:
Prepare debtors account and provision for doubtful debts.

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► *ANSWER*

Receivables				
Balance b/d	5,630,000		Sales return	700,000
Sales (80% of Rs. 12m)	9,600,000		Discount allowed	500,000
			Bank 8,540,000 – 199,000	8,341,000
			Bad debts	150,000
			Contra	250,000
			c/d	5,289,000
	15,230,000			15,230,000

Provision (Allowance) for doubtful debts				
Bad debts expense	164,300		b/d	690,000
c/d	525,700			
	690,000			690,000

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	2015
	Rs.
Specific allowance [Sabir 50,000 + Babur 75,000 + New 150,000]	275,000
General allowance (receivables excluding bad, good and specific x %)	
(5,289,000* – 275,000 specific) x 5%	250,700
Total allowance required at period end	525,700
Less: Opening balance of the allowance account	690,000
Increase (Decrease) in the allowance account	(164,300)

* receivables after deducting bad debts and contra settlement.

► *Example 08:*

Ravi Enterprises (RE) maintains specific provision for doubtful debts on the basis of individual assessment of its major customers. A general provision is also made at 5% of the remaining month-end balances. Following information pertains to trade debtors and provision for doubtful debts for the month of August 2016:

i. Opening balance:

		Rs. in million
Trade debtors		200.00
Provision for doubtful debts:		
– Specific	BEE Traders, 100% of the balance	(8.00)
	RAY Brothers, 60% of the balance	(6.00)
– General	5% of the remaining balance	(9.10)
		176.90

ii. Credit sales for the month amounted to Rs. 900 million.

iii. Collections from customers were Rs. 850 million, which included:

- a recovery of Rs. 4.5 million against trade debts written-off in previous years; and
- an amount of Rs. 7.2 million received net of 10% discount in full and final settlement of invoices. Discount allowed is recorded in separate ledger account.

iv. RAY Brothers were declared bankrupt and their debt has to be written-off.

v. A customer, TAJ & Co. has disputed certain sales invoices aggregating Rs. 2.8 million which have been outstanding for more than one year. RE estimates that the customer will eventually pay half of the disputed amount.

vi. Amounts aggregating Rs. 1.5 million due from general customers are not recoverable and have to be written-off.

Required:

Prepare relevant ledger accounts for the month of August 2016.

▶ *ANSWER*

Ravi Enterprises (Rs. In million)

Bad debts expense				
RA (Ray brothers)	10		Cash (Bad debts recovered)	4.5
RA (other)	1.5		Allowance for doubtful debts	2.13
			PL	**4.87**
	11.5			11.5

Provision (Allowance) for doubtful debts				
Bad debts expense	2.13		b/d [8 + 6 + 9.10]	23.1
c/d	20.97			
	23.1			23.1

Receivables				
Balance b/d	200		Discount 7.2 x 10/90	0.80
Sales	900		Bank 850 – 4.5	845.5
			Bad debts (Ray) 6 x 100/60	10
			Bad debts (other)	1.5
			c/d	242.2
	1,100			1,100

CALCULATION OF INCREASE OR DECREASE IN ALLOWANCE

	Aug 2016
	Rs. Million
Specific allowance [Taj 50% x 2.8 + BEE Traders 8]	9.4
General allowance (receivables excluding bad, good and specific x %)	
(242.2* – 1.4 – 9.4) x 5%	11.57
Total allowance required at period end	20.97
Less: Opening balance of the allowance account (8 + 6 + 9.1)	(23.1)
Increase (Decrease) in the allowance account	(2.13)

* receivables after deducting bad debts.

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- *Example 09:*

Following information pertains to Global Network Supplies (GNS) for the year ended 30 June 2017:

	Rs. in '000
Trade debtors – as at 1 July 2016	55,975
Transactions for the year ended 30 June 2017:	
– Sales (including cash sales which is 20% of credit sales)	540,000
– Sales returns pertaining to credit sales	6,300
– Collection from credit customers (including Rs. 8.1 million from customers who availed 10% discount)	438,000

GNS maintains specific provision for doubtful debts on the basis of assessment of its debtors. In addition, a general provision is maintained at 4% of the remaining customers' balances.

The status of debtors being considered for the purpose of specific provision is as under:

Customer's name	Balances as on		Specific provision as at 1 July 2016	Adjustments required as at 30 June 2017
	1 July 2016	30 June 2017*		
	------ Rs. In 000 ------			
Mehran Link	400	320	65	Mehran Link is facing severe cash flow difficulties; therefore, a provision at 30% of the outstanding balance is required.
Bolan Dialling	480	480	240	The entire amount needs to be written-off as Bolan Dialling has been declared bankrupt.
Khyber Cables	135	90	95	The balance is in respect of old disputed invoices and needs to be written-off.
Ravi Rays	460	460	-	Ravi Rays has stopped buying from GNS. It has been decided to set-off Rs. 120,000 payable by GNS to Ravi Rays and make provision at 25% of the remaining balance.
	1,475	**1,350**	**400**	

*before adjustment

Required:

Prepare following ledger accounts for the year ended 30 June 2017:

a) Trade debtors

b) Provision for doubtful debts

c) Bad debt expense

▶ *ANSWER*

(Rs. 000)

Trade debtors				
Balance b/d	55,975		Sales return	6,300
Credit Sales			Bank	438,000
(540,000 x 100/ 120)	450,000		Discount allowed	
			(8,100 x 10 / 90)	900
			Trade payables (Contra)	120
			Bad debts – Bolan Dialling	480
			Bad debts – Khyber Cables	90
			Balance c/d	60,085
	505,975			505,975

Provision (allowance) for doubtful debts				
Bad debts	40		b/d **W1**	2,598
c/d **W1**	2,558			
	2,598			2,598

Bad debts				
Receivables – Bolan Dialling	480		Provision for doubtful debts	40
Receivables – Kyber Cables	90		Profit or loss	530
	570			570

	2016	2017
	Rs.	**Rs.**
Specific allowance	400	181
General allowance (receivables excluding bad, good and specific x %)		
2016: (55,975* – 615 – 400) x 4%	2,198	
2017: (60,085* – 479 – 181) x 4%		2,377
Total allowance required at period end	2,598	2,558
Less: Opening balance of the allowance account		(2,598)
Increase (Decrease) in the allowance account		(40)

* receivables after deducting bad debts and contra settlement.

Specific doubtful debts	2016	2017
Mehran Link 320 x 30%	(65)	(96)
Bolan Dialling	(240)	-
Khyber Cables	(95)	-
Ravi Rays 460 – 120 = 340 x 25%	-	(85)
	(400)	(181)

Specific doubtful debts	2016	2017
Good debts		
Mehran Link 320 x 70% ; 400 – 65	(335)	(224)
Bolan Dialling 480 – 240	(240)	-
Khyber Cables 135 - 95	(40)	-
Ravi Rays 460 – 120 = 340 x 75%	-	(255)
	(615)	(479)

- *Example 10:*

Following balances were extracted from the records of Automan Enterprises:

	31 Dec 2017	31 Dec 2016
Trade receivables	Rs. 618,500*	Rs. 558,800

*after writing off receivables of Rs. 32,000 during 2017

The following adjustments need to be made at 31 December 2017:

i. Cash of Rs. 17,850 was received from MJM Traders whose balance had been written off in 2016. The amount received was credited to suspense account.

ii. Receivable from Noor Merchant of Rs. 31,800 which had been specifically provided for in full in 2016 is to be written off.

iii. A specific provision at 75% is to be made against balance of QT Bakers amounting to Rs. 24,200.

iv. A general provision is always maintained at 4% of the remaining receivables.

Required:

Prepare following ledger accounts for the year ended 31 December 2017:

- Provision for doubtful receivables
- Bad debt expense

- *ANSWER*

Provision (Allowance) for doubtful debts					
Bad debts expense	12,230			Balance b/d	52,880
Balance c/d	40,650				
	52,880				52,880

Bad debts expense					
Receivable (Already)	32,000			Suspense (recovered)	17,850
Receivable (Noor garments)	31,800			Allowance for doubtful debts	12,230
				Profit or loss	***33,720***
	63,800				63,800

	2016	2017
	Rs.	**Rs.**
Specific allowance [2016: Noor Merchant 31,800] & [2017: QT 24,200 x 75%]	31,800	18,150
General allowance (receivables excluding bad, good and specific x %)		
2016: (558,800 – 31,800 Noor Merchant Specific) x 4%	21,080	
2017: (586,700* – Quality Traders 24,200 good and specific) x 4%		22,500
Total allowance required at period end	52,880	40,650
Less: Opening balance of the allowance account		(52,880)
Increase (Decrease) in the allowance account		(12,230)

* receivables after deducting bad debts 31,800 Noor Merchant (bad debts of Rs. 32,000 had already been accounted for).

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5. OBJECTIVE BASED Q&A

01. The opening balance of "allowance for doubtful debts account" is Rs. 1,000 whereas the closing balance of Receivables account is Rs. 100,000.

What amount of allowance for doubtful debts should be charged to statement of comprehensive income using a 5% allowance for doubtful debts for the current accounting period?

- **(a)** Rs. 4,000
- **(b)** Rs. 5,000
- **(c)** Rs. 2,000
- **(d)** Rs. 1,000

02. At December 31, 2018 an entity's receivable totalled Rs. 600,000 and an allowance for bad and doubtful debts of Rs. 60,000 had been brought down from last year.

It was decided to write off the debts totalling Rs. 25,000 and to adjust allowance for receivable @ 10% of the receivable.

At what amount receivables are to be shown in statement of financial position as at 31 December 2018?

- **(a)** Rs. 572,500
- **(b)** Rs. 517,500
- **(c)** Rs. 540,000
- **(d)** Rs. 575,000

03. A business has closing receivables balance is Rs. 75,000. It includes one of the accounts receivable named Ali, who is going through financial crisis. It is expected that he can pay 75% of his total debt of Rs. 5,000. Business has decided to calculate an allowance for doubtful debt at 5%.

What is the amount of allowance to be deducted from receivable in statement of financial position?

- **(a)** Rs. 3,500
- **(b)** Rs. 3,750
- **(c)** Rs. 7,250
- **(d)** Rs. 4,750

04. The nature of "Allowance for doubtful debt" account is:

- **(a)** Contra asset account
- **(b)** Asset account
- **(c)** Expense
- **(d)** Liability account

05. At the end of accounting period, KLM Company finds out that its total Receivables are Rs. 10,000. On scrutiny of accounts, it turned out that a bad debt amounting to Rs. 1,000 was not recorded in the books of accounts. Furthermore, having considered the current economic situation, management of the company decided to increase the allowance for doubtful debts by Rs. 500.

Find out what net amount to be expensed out in the statement of comprehensive income?

(a) Rs. 10,000

(b) Rs. 1000

(c) Rs. 11,000

(d) Rs. 1500

06. At January 1, 2017 the allowances for receivable of Sidra was Rs. 35,000. During the year ended 31 December 2017 debts totalling Rs. 15,000 were written off. It was decided that the allowance for doubtful debts should be Rs. 30,000 as at December 31, 2017.

What amount should be charged to statement of comprehensive income of Sidra for bad and doubtful debts expense?

(a) Rs. 30,000

(b) Rs. 45,000

(c) Rs. 15,000

(d) Rs. 10,000

07. Which of the following can be most relevant to calculation of allowance for doubtful debts?

(a) Total credit sales

(b) Total credit purchases

(c) Total current assets

(d) Total current liabilities

08. At January 1, 2017 the balance in allowance for receivable showed Rs. 16,000. At the end of the year it is decided to write off Rs. 9,000 and adjust allowance for receivable to Rs. 18,000.

What will be the effect of this decision on profit for the year?

(a) Decrease by Rs. 27,000

(b) Increase by Rs. 18,000

(c) Decrease by Rs. 11,000

(d) Decrease by Rs. 9,000

09. Sania creates allowance for doubtful debts after considering the length of time the debt remains outstanding.

She has provided following data as at 31st March 2018

Debt amount Rs.	Days outstanding	Allowance required
130,000	30 days	Nil
75,000	31-60	2%
50,000	Over 60 days	5%

Opening balance of allowance for doubtful debts was Rs. 3,500.

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What is the amount to be charged to statement of comprehensive income for the year?

(a) Rs. 4,000

(b) Rs. 3,500

(c) Rs. 500

(d) Rs. 7,500

10. Which of the following Receivables have highest probability to default on trade debts?

(a) Current month Receivables

(b) Over 90 days old Receivables

(c) 60 to 90 days old Receivables

(d) 30 to 60 days old Receivables

11. A business has received an amount of Rs. 1,000 from a receivable that had been previously written off as irrecoverable.

What is the correct accounting entry to record the transaction?

(a) Dr Cash 1,000 Cr Bad and doubtful debts expense a/c Rs. 1,000

(b) Dr Cash 1,000 Cr Receivables Rs. 1,000

(c) Dr Statement of comprehensive income Rs. 1,000 Cr Receivables Rs. 1,000

(d) Dr Statement of comprehensive income Cr Cash Rs. 1,000

12. ss has provided following information;

	Rs.
Opening receivables	45,000
Credit sales	55,000
Cash sales	10,000
Cash received from customers	35,000
Bad debts written off	2,000
Discount received (separate ledger)	3,000

The business maintains allowance at 2% of receivables each year.

What accounting entry is to be passed to record the increase/ decrease of allowance to the statement of comprehensive income?

(a) Dr Bad and doubtful debts expense Rs. 360 Cr Allowance for doubtful debts Rs. 360

(b) Dr Allowance for doubtful debts Rs. 360 Cr Bad and doubtful debts expense Rs. 360

(c) Dr Bad and doubtful debts expense Rs. 360 Cr Receivables. 360

(d) Dr Receivables Rs. 360 Cr Bad and doubtful debts expense Rs. 360

13. At year end, the receivable balance on 31 March 2019 is Rs. 93,000. This includes a debt of Rs. 1,800 which needs to be written off.

The business maintains allowance for doubtful debts at 5% of Receivable balance. And this year allowance has increased by 20% as compared to last year.

What was the balance of Allowance for doubtful debts at 1 April 2018?

(a) Rs. 3,875

(b) Rs. 5,472

(c) Rs. 3,800

(d) Rs. 4,560

14. At 30 September 2012 an entity's allowance for receivables amounted to Rs. 38,000, which was five per cent of the receivables at that date.

At 30 September 2013 receivables totalled Rs. 868,500. It was decided to write off Rs. 28,500 of debts as irrecoverable and, based on past experience, to keep the allowance for receivables at 5% of receivables.

What should be the charge in the statement of comprehensive income for the year ended 30 September 2013 for the total of bad debts and the allowance for receivables?

(a) Rs. 42,000

(b) Rs. 33,925

(c) Rs. 70,500

(d) Rs. 32,500

15. The allowance for receivables in the accounts at 31 October 2011 was Rs. 9,000. During the year ended 31 October 2012, bad debts of Rs. 5,000 were written off.

The receivables balance at 31 October 2012 was Rs. 120,000 and, based on past experience, the entity wishes to set the allowance at 5% of receivables.

What is the total charge for bad debts and the allowance for receivables in the statement of comprehensive income for the year ended 31 October 2011?

(a) Rs. 2,000

(b) Rs. 3,000

(c) Rs. 5,000

(d) Rs. 8,000

16. Hamza has following information available for his business for the year ended 31st December 2017:

Opening allowance for doubtful debts	Rs. 5,000
Bad debts written off during the year	Rs. 3,000
Bad debts recovered	Rs. 1,500
Closing receivables	Rs. 90,000
Closing allowance for doubtful debts	5%.

What is the net charge for bad and doubtful debts for statement of comprehensive income?

Rs. __________

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17. At June 30, 2016 an entity's allowance for receivable amounted to Rs. 25,000 which was 2% of the trade receivables at that date.

At June 30, 2017 trade receivable amounted to Rs. 310,000. It was decided to write off Rs. 30,000 of debts as irrecoverable and to keep the allowance for receivable at 2% of trade receivable.

At what amount receivables would be shown in statement of financial position at 30 June 2017?

Rs. _________

18. At July 1, 2017Mira's allowance for receivable was Rs. 65,000.

At June 30, 2018 trade receivable amounted to Rs. 650,000. It was decided to write off Rs. 95,000 of these debts and adjust the allowance for receivable to Rs. 75,000.

At what amount receivables (net) to be appear in statement of financial position?

Rs. _________

19. At January 1, 2018 the balance in allowance for receivable showed Rs. 38,000. At the end of the year it is decided to write off Rs. 16,000 and adjust allowance for receivable to Rs. 35,000.

What will be the charge for bad and doubtful debts for the year?

Rs. _________

20. After writing off bad debts, Rashid has outstanding receivables of Rs. 238,750. He identifies two specific amounts for which he wishes to make full allowance:

- Rs. 450 owing by Syed
- Rs. 1,200 owing by Raja

Rashid also wishes to maintain a general allowance of 5% of outstanding receivables.

What amount is shown on Rashid's statement of financial position in respect of receivables?

Rs. _________

21. Which of the following is the effect on net profit if a business decreases provision for doubtful debts?

(a) It will increase net profit

(b) It will decrease net profit

(c) It will increase gross and net profit

(d) No effect

22. What is the nature of allowance for doubtful debt account?

(a) An asset

(b) A liability

(c) An equity

(d) Contra asset account

23. Is there a difference in bad and double debts?

- **(a)** No, they are inter-changeable
- **(b)** Yes, bad debt refers to an account receivable that has been clearly identified as not being collectible. Whereas a doubtful debt is an account receivable that might become a bad debt at some point in the future
- **(c)** Yes, doubtful debt refers to an account receivable that has been clearly identified as not being collectible. Whereas a bad debt is an account receivable that might become a bad debt at some point in the future
- **(d)** They are synonymous

24. What is the double entry for recording write-off of any of debts?

- **(a)** Bad debt expense (debit) and allowance for doubtful debts (credit)
- **(b)** Bad debt expense (debit) and accounts receivable (credit)
- **(c)** Allowance for doubtful debts (debit) and accounts receivable (credit)
- **(d)** None of the above

25. On June 1, Rs. 800,000 of goods are sold with credit terms of 1/10, n/30. How much should the seller expect to receive if the buyer pays on June 8?

- **(a)** 720,000
- **(b)** 768,000
- **(c)** 792,000
- **(d)** No change

26. On June 1, Rs. 800,000 of goods are sold with credit terms of 1/10, n/30. On June 3, the customer returned Rs. 100,000 of the goods.

How much should the seller expect to receive if the buyer pays on June 8?

- **(a)** 692,000
- **(b)** 693,000
- **(c)** 694,000
- **(d)** 700,000

27. Which account should be credited for Rs180,000 when writing off the account?

- **(a)** Accounts receivable
- **(b)** Allowance for doubtful debts
- **(c)** Bad debts expense
- **(d)** None of the above

28. Sorting an entity's accounts receivable into classifications such as current, 1-30 days past due, and 31-60 days past due etc. is known as the?

- **(a)** Ratio analysis
- **(b)** Trend analysis
- **(c)** Debtor's analysis
- **(d)** Aging analysis

29. The opening balance of "allowance for doubtful debts account" is Rs. 1,000 whereas the closing balance of Receivables account is Rs. 100,000.

What amount of allowance for doubtful debts should be charged to statement of profit or loss using a 5% allowance for doubtful debts for the current accounting period?

- **(a)** Rs.3,000
- **(b)** Rs.4,000
- **(c)** Rs.5,000
- **(d)** Rs.6,000

30. The Allowance for doubtful debts account has a year-end credit balance, prior to adjustment of Rs.500. The bad debts are estimated at 7% of Rs. 60,000 of outstanding accounts receivable.

After the appropriate adjusting entry to recognize the bad debt expense, the Allowance for Doubtful Accounts should have a __________ credit balance.

- **(a)** Rs.4,200
- **(b)** Rs.3,700
- **(c)** Rs.3,200
- **(d)** Rs.4,500

31. Good Traders (GT) accounts receivable totalled Rs. 80,000 at the year end. These include Rs. 900 of long overdue debts that might still be recoverable, but for which GT has created an allowance for doubtful debts. GT has also provided an allowance of Rs. 1,582, which is 2% of the other accounts receivable balances. What best describes GT's doubtful debt allowance as at its year end?

- **(a)** A specific allowance of Rs. 900 and a general allowance of Rs. 1,582
- **(b)** A specific allowance of Rs. 1,582 and a general allowance of Rs. 900
- **(c)** A specific allowance of Rs. 2,482
- **(d)** A general allowance of Rs. 2,482

32. The opening balance on Jamal Enterprises' receivables expense allowance was Rs. 1,000. Jamal wrote off Rs. 4,000 of bad debts during the year. The closing balance on the doubtful debts allowance was Rs. 1,200.

What is the total charge to Jamal Enterprises' Statement of Profit or Loss in respect of receivables expense for the year?

- **(a)** Rs. 200
- **(b)** Rs. 3,800
- **(c)** Rs. 4,000
- **(d)** Rs. 4,200

33. The turnover in an entity was Rs. 2 million and its accounts receivable were 5% of turnover. The entity wishes to have an allowance for doubtful debts of 4% of receivables, which would make the allowance one-third higher than the current allowance. How will the profit for the period affected by the change in allowance?

- **(a)** Profit will be reduced by Rs. 1,000
- **(b)** Profit will be increased by Rs. 1,000
- **(c)** Profit will be reduced by Rs. 1,333
- **(d)** Profit will be increased by Rs. 1,333

34. The allowance for doubtful debts in the ledger of Boom Boom Traders (BBT) at 31 October 2021 was Rs. 9,000. During the year ended 31 October 2022, irrecoverable debts of Rs. 5,000 were written off. Accounts receivable balances at 31 October 2022 were Rs. 120,000 and BBT policy is to have a general allowance of 5%. What is the charge for bad & doubtful debts expense in the Statement of Profit or Loss for the year ended 31 October 2022?

- **(a)** Rs. 2,000
- **(b)** Rs. 3,000
- **(c)** Rs. 5,000
- **(d)** Rs. 8,000

35. During the year ended 31 December 2019 Faisal Traders (FT) turnover totalled Rs. 3,000,000, its accounts receivable amounting to 4% of turnover for the year. FT wishes to maintain its doubtful debt allowance at 3% of accounts receivable, and discovers that the allowance, as a result is 25% higher than it was a year before. During the year specific irrecoverable debts of Rs. 3,200 were written off and irrecoverable debts (written off three years previously) of Rs. 150 were recovered.

What is the net charge for bad and doubtful debts for the year ended 31 December 2019?

- **(a)** Rs. 720
- **(b)** Rs. 900
- **(c)** Rs. 3,770
- **(d)** Rs. 3,950

36. Which of the following statements concerning an allowance for receivables is INCORRECT?

- **(a)** All businesses may create an allowance for doubtful debts in case credit sale customers do not pay their debts
- **(b)** The receivables account balance is written off when a specific allowance for doubtful debts for that customer is created
- **(c)** Setting up an allowance for doubtful debts account ensures that receivables are not overstated
- **(d)** The allowance is usually expected to increase as the value of sales revenue recognized increases as a firm expands

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37. An irrecoverable debt written off two years ago is unexpectedly recovered and entered in the cash book. What adjustment, if any, will be necessary?

(a) Credit Receivables

(b) Credit Bad debts expense

(c) Credit Suspense account

(d) No adjustment will be necessary

38. An increase in the allowance for doubtful debts results in:

(a) A decrease in current liabilities

(b) An increase in net profit

(c) An increase in current assets

(d) A decrease in current assets

39. At 30 September 2014, PSL Traders had an allowance for doubtful debts of Rs. 37,000. During the year ended 30 September 2015 the PSL Traders wrote off debts totalling Rs. 18,000 and at the end of the year it is decided that the allowance for doubtful debts should be Rs. 20,000.

What should be included in the Statement of Profit or Loss for bad and doubtful debts?

(a) Rs. 35,000 debit

(b) Rs. 1,000 debit

(c) Rs. 38,000 debit

(d) Rs. 1,000 credit

40. At 31 March Salma was owed Rs. 47,744 by her customers. At the same date her doubtful debts allowance was Rs. 3,500. How should these balances be reported on Salma's statement of financial position at 31 March?

(a) Rs. 44,244 as a current asset

(b) Rs. 3,500 as a current asset and Rs. 47,744 as a current liability

(c) Rs. 47,744 as a current asset and Rs. 3,500 as a current liability

(d) Rs. 51,244 as a current asset

41. What is the purpose of maintaining an allowance for doubtful debts?

(a) An estimate of future irrecoverable debts

(b) Records the expense of irrecoverable debts

(c) Matches the estimated cost of future irrecoverable debts against the revenue earned in giving rise to the potential irrecoverable debts

(d) Records irrecoverable debts without taking them out of the books of an entity, thus showing the gross and expected amount owned by trade receivables as a current asset

42. The existence of an allowance for bad or doubtful debts

(a) Increases the total of current liabilities

(b) Reduces the cost of sales

(c) Reduces the total of current assets

(d) None of above

43. A transfer to close the bad and doubtful debts account is to:

(a) The statement of financial position

(b) The Statement of Profit or Loss

(c) The trading account

(d) The allowance for doubtful debts account

44. At 31 December 2022 an entity's receivables totalled Rs. 400,000 and an allowance for receivables of Rs. 50,000 had been brought forward from the year ended 31 December 2021. It was decided to write off debts totalling Rs. 38,000 and to adjust the allowance for receivables to 10% of the receivables. What charge for bad and doubtful debts should appear in the entity's Statement of Profit or Loss for the year ended 31 December 2022?

(a) Rs. 74,200

(b) Rs. 51,800

(c) Rs. 28,000

(d) Rs. 24,200

45. At 30 September 2022 an entity's allowance for receivables amounted to Rs. 38,000, which was 5% of the receivables at that date. At 30 September 2023 receivables totalled Rs. 868,500. It was decided to write off Rs. 28,500 of debts as irrecoverable and to keep the allowance for receivables at 5% of receivables. What should be the charge in the Statement of Profit or Loss for the year ended 30 September 2023?

(a) Rs. 42,000

(b) Rs. 33,925

(c) Rs. 70,500

(d) Rs. 32,500

46. Saima creates allowance for doubtful debts according to the length of time the debt has been outstanding. At 31 May 2021 the analysis of accounts receivable balances and the associated allowance was:

Time debt has been outstanding	Allowance required	Balance at 31 May 2021
Less than 31 days	Nil	32,700
31 – 60 days	4% of balances	16,900
Over 60 days	50% of balances	8,750

If the balance at 1st June 2020 was Rs. 5,600, what adjustment should be made to the doubtful debts allowance?

(a) An increase of Rs. 5,051

(b) A decrease of Rs. 5,051

(c) An increase of Rs. 549

(d) A decrease of Rs. 549

47. Multan Sultans' (MS) receivables ledger account shows a balance at the end of the year of Rs. 58,200 before making the following adjustments:

(i) MS wishes to write off debts amounting to Rs. 8,900 as he believes they are irrecoverable.

(ii) MS also wishes to make specific allowance for Lahore Qalandars' debt of Rs. 1,350 and Islamabad United's debt of Rs. 750.

(iii) MS wishes to maintain a general allowance of 3% of the year and receivables balance.

MS's allowance for receivables at the last year end was Rs. 5,650. What is the charge to the Statement of Profit or Loss in respect of the above?

(a) Rs. 6,766

(b) Rs. 11,034

(c) Rs. 6,829

(d) Rs. 10,971

48. In the statement of financial position at 31 December 2015, Karachi Kings (KK) reported net receivables of Rs. 12,000. During 2016 KK made sales on credit of Rs. 125,000 and received cash from credit customers amounting to Rs. 115,500. At 31 December 2016, KK wished to write off debts of Rs. 7,100 and increase the allowance for receivable by Rs. 950 to Rs. 2,100. What is the net receivables figure at 31 December 2016?

(a) Rs. 12,300

(b) Rs. 13,450

(c) Rs. 14,400

(d) Rs. 15,550

49. In the year ended 30 September 2018. Quetta Gladiators (QG) had sales of Rs. 7,000,000. Year-end receivables amounted to 5% of annual sales. QG wishes to maintain the allowance for receivables at 4% receivables and as a result discovers that the allowance is 20% higher than at the previous year end. During the year irrecoverable debts amounting to Rs. 3,200 were written off and debts amounting to Rs. 450 and previously written off were recovered.

What are the bad and doubtful debt expenses for the year?

(a) Rs. 5,083

(b) Rs. 5,550

(c) Rs. 5,583

(d) Rs. 16,750

50. Peshawar Zalmi (PZ) started the year with total receivables of Rs. 87,000 and an allowance for receivables of Rs. 2,500. During the year, two specific debts were written off, one for Rs. 800 and the other for Rs. 550. A debt of Rs. 350 that had been written off as irrecoverable in the previous year was paid during the year. At the year end, total receivables were Rs. 90,000 and the allowance for receivables was Rs. 2,300.

What is the charge to the Statement of Profit or Loss for the year in respect of bad and doubtful debts?

(a) Rs. 800

(b) Rs. 1,00

(c) Rs. 1,150

(d) Rs. 1,550

ANSWERS

01.	**(a)**	Closing allowance = Rs. 100,000x5% = Rs. 5,000 Charge to statement of profit or loss = 5,000 - 1,000= Rs. 4,000
02.	**(b)**	Rs. Closing receivables — 600,000 - 25,000 — 575,000 Closing allowance — 575,000x10% — 57,500 Carrying amount of receivables — 575,000 - 57,500 — 517,500
03.	**(d)**	Closing allowance = (Rs. 75,000 - 5000) x5% = Rs. 3,500 + (Rs. 5,000 x 25%) = Rs. 4,750
04.	**(a)**	The allowance account is not liability (i.e. it is not present obligation for outflow of economic benefits). The allowance account is not an asset account, it is deducted from asset and therefore it is “Contra Asset” Account. The allowance account itself is not an expense, only changes in its balance are recognised in profit or loss.
05.	**(d)**	Expense = Bad debts + increase in allowance = Rs. 1,000+500= Rs. 1,500
06.	**(d)**	Charge = Closing Allowance-Opening allowance + debts written off = Rs. 30,000 - Rs. 35,000 + Rs. 15,000 = Rs. 10,000
07.	**(a)**	Allowance for doubtful debts are calculated usually on the basis of receivables. However, second most reliable amount is of credit sales as debt arises because of credit sales and then the chance of recoverability is calculated.
08.	**(c)**	Expense = Rs. 9,000+ (Rs. 18,000-16,000) = Rs. 11,000 therefore, decrease the profit by Rs. 11,000
09.	**(c)**	Closing allowance = (Rs. 75,000 x 2%) + (Rs. 50,000 x 5%) = Rs. 4,000 Charge to statement of profit or loss = Rs. 500
10.	**(b)**	The older the debt, the higher the chances of default.
11.	**(a)**	The correct treatment is to reduce the expense previously recognised.
12.	**(a)**	Increase in allowance = Closing allowance – opening allowance = (Rs. 63,000x2%) - (45,000x2%) = Rs. 360 Closing receivables = 45,000 + 55,000 - 35,000 - 2,000 = Rs. 63,000
13.	**(c)**	Closing balance of allowance Rs. 93,000 – 1,800 bad debts = Rs. 91,200 x 5% = Rs. 4,560 Opening balance of allowance Rs. 4,560 x 100/120 = Rs. 3,800
14.	**(d)**	**Rs.** Irrecoverable debts — 28,500 Allowance c/f (5% × (Rs. 868,500 – Rs. 28,500)) — 42,000 Allowance b/f — (38,000) 4,000 Increase in allowance — 32,500

15.	**(a)**		**Rs.**	
		Allowance at end of year (5% of Rs. 120,000)	6,000	
		Allowance at start of year	9,000	
		Decrease in allowance	(3,000)	
		Irrecoverable debts written off	5,000	
		Charge to SPL	2,000	
16.	**Rs. 1,000**	Closing allowance = Rs. 90,000x5% = Rs. 4,500 Bad debts are not to be deducted because already written off.		
		Charge for Statement of profit or loss	**Rs.**	
		Decrease in allowance	(Rs. 500)	
		Irrecoverable debts	3,000	
		Bad debts recovered	(1,500)	
		Profit or loss	1,000	
17.	**Rs. 274,400**	Receivables = (Rs. 310,000-Rs. 30,000) = Rs. 280,000 Carrying amount = Rs. 280,000 – (Rs. 280,000x2%) = Rs. 274,400		
18.	**Rs. 480,000**		**Rs.**	
		Receivables Rs. 650,000 – 95,000 =	555,000	
		Less: Allowance	(75,000)	
			480,000	
19.	**Rs. 13,000**	= Rs. 16,000 irrecoverable -Rs. 3,000 decrease in allowance =Rs. 13,000		
20.	**Rs. 225,245**	**Allowance**	**Rs.**	**Rs.**
		Receivables	238,750	
		Specific allowance		
		Syed	(450)	450
		Raja	(1,200)	1,200
		General allowance @5%	237,100	11,855
		Total allowance		13,505
		Receivables (Statement of Financial Position) Rs. 238,750 – Rs. 13,505 = Rs. 225,245		
21.	**(a)**	It will increase net profit		
22.	**(d)**	Contra asset account (it is deducted from asset)		
23.	**(b)**	Yes, bad debt refers to an account receivable that has been clearly identified as not being collectible. Whereas a doubtful debt is an account receivable that might become a bad debt at some point in the future		
24.	**(b)**	Bad debt expense (debit) and accounts receivable (credit)		

25.	**(c)**	Rs. 800,000 – 1% discount as payment made within 10 days = Rs. 792,000
26.	**(b)**	Rs. 800,000 – 100,000 = Rs. 700,000 – 1% discount as payment made within 10 days = Rs. 693,000
27.	**(a)**	Accounts receivables
28.	**(d)**	Aging analysis
29.	**(b)**	Rs. 100,000 x 5% = Rs. 5,000 – Rs. 1,000 opening = Rs. 4,000
30.	**(a)**	Rs. 60,000 x 7% = Rs. 4,200 (credit) closing balance.
31.	**(a)**	A specific allowance of Rs. 900 and a general allowance of Rs. 1,582
32.	**(d)**	Rs. 4,000 bad debts + [1,200 – 1,000 doubtful debts] = Rs. 4,200
33.	**(a)**	Rs. 2,000,000 x 5% x 4% = Rs. 4,000 x 33.33/133.33 = Rs. 1,000 Increase in allowance would increase expense, resulting in reduction in profit.
34.	**(a)**	Rs. 5,000 bad debts + [(120,000 x 5%) – 9,000 doubtful debts] = Rs. 2,000
35.	**(c)**	Rs. 3,200 bad debts + [3,000,000 x 4% x 3% x 25/125 doubtful debts] – 150 recovered = Rs. 3,770
36.	**(b)**	The receivables account balance is NOT written off when a specific allowance for doubtful debts for that customer is created.
37.	**(b)**	Debit Cash and Credit Bad debts expense
38.	**(d)**	An increase in allowance would decrease the net receivables presented under current assets in the statement of financial position.
39.	**(b)**	Rs. 18,000 bad debts + [20,000 – 37,000 reduction in doubtful debts] = Rs. 1,000 debit (expense)
40.	**(a)**	Rs. 44,244 as a current asset
41.	**(d)**	Records irrecoverable debts without taking them out of the books of an entity, thus showing the gross and expected amount owned by trade receivables as a current asset.
42.	**(c)**	An increase in allowance would decrease the net receivables presented under current assets in the statement of financial position.
43.	**(b)**	All expenses are closed to profit or loss account.
44.	**(c)**	Rs. 38,000 bad debts + [(400,000 x 10%) – 50,000 doubtful debts] = Rs. 28,000
45.	**(b)**	Rs. 28,500 bad debts + [(868,500 x 5%) – 38,000 doubtful debts] = Rs. 33,925
46.	**(d)**	Allowance = (32,700 x 0%) + (16,900 x 4%) + (8,750 x 50%) = Rs. 5,051 Decrease in allowance = Rs. 5,051 – 5,600 opening = Rs. (549)
47.	**(c)**	Bad debts Rs. 8,900 – reduction in allowance Rs. 2,071 = Rs. 6,829 expense Specific allowance Rs. 1,350 +750 = Rs. 2,100 General allowance Rs. 58,200 – 8,900 = Rs. 49,300 x 3% = Rs. 1,479 Reduction in allowance = (2,100 + 1,479) – 5,650 opening = Rs. 2,071
48.	**(a)**	b/d 12,000 + sales 125,000 – cash 115,500 – bad debts 7,100 = Rs. 14,400 Rs. 14,400 – allowance 2,100 = Rs. 12,300 net

49.	**(a)**	Rs. 3,200 bad debts + [7,000,000 x 5% x 4% x 20/120 doubtful debts] – 450 recovered = Rs. 5,083
50.	**(a)**	Bad debts Rs. 800 + 550 = Rs. 1,350 Reduction in allowance = Rs. 2,300 – 2,500 = Rs. (200) Bad debts recovered = Rs. (350) Charge as expense = Rs. 1,350 – 200 – 350 = Rs. 800

AT A GLANCE

SPOTLIGHT

STICKY NOTES

STICKY NOTES

Good debts

An accounts receivable that seems collectible without any difficulty.
No specific accounting treatment needed.

Bad debts

An accounts receivable that is not collectible, the receivable is written off (directly deducted from receivables).

When a debt is written off:

Bad debt expense	Debit	
Accounts receivable		Credit

When bad debts is recovered:

Bank	Debit	
Bad debt expense (or Recovered)		Credit

Doubtful debts

An accounts receivable that might not be collecible, recorded as an expense by creating allowance account (indirectly deducted from receivables).

Specific allowance on specific invoices or debts

General allowance on receivables excluding bad, good and specific doubtful.

When allowance is increased / Created

Doubtful debt expense	Debit	
Provision for doubtful debt		Credit

When allowance is decreased

Provision for doubtful debt	Debit	
Doubtful debt expense		Credit

Expense (charge) in profit or loss

Bad debts expense + Increase (decrease) in allowance – bad debts recovered

CHAPTER 6

DEPRECIATION

IN THIS CHAPTER:

AT A GLANCE

Non-current assets are used in business for more than one accounting period. Acquisition and improvement costs are capitalised and other costs are charged as an expense.

Depreciation is an accounting method of allocating the cost of a tangible non-current asset over its useful life. Depreciation represents how much of an asset's value has been used up. Depreciating assets helps entities measure financial performance by comparing revenue earned by utilising an asset and expensing a portion of asset's cost each year.

There are mainly four types of depreciation methods that may be used;

- Straight line method (recognising depreciation evenly throughout useful life)
- Reducing balance method (amount of depreciation reduces as the life of the asset progresses)
- Units of production method (usage basis)
- Sum of the digit method (amount of depreciation, calculated as a fraction of remaining years and sum of years' digits, reduces as the life of the asset progresses)

Non-current assets are presented in statement of financial position at cost less accumulated depreciation. The accumulated depreciation is cumulative depreciation charged to date.

1. NON CURRENT ASSETS

Assets that have a long useful life and are expected to provide future economic benefits for the entity over a period of several years. Non-current assets may be intangible or tangible.

Intangible non-current assets do not have a physical existence such as patent rights, licensing, software etc.

Tangible non-current assets are assets having physical existence, such as land and buildings, plant and equipment, office equipment, furniture and fixture and motor vehicles. These are often referred to as 'property, plant and equipment'.

Property, plant and equipment are tangible items that are expected to be used during more than one accounting period and are held:

- for use in the production or supply of goods or services,
- for rental to others, or
- for administrative purposes

Distinguish non-current assets and Inventory

If an entity's main business is selling machines, then that machine does not classify as non-current asset rather the machinery used to produce the machines for sales is non-current asset. The machines manufactured for sale are classified as inventory. The same goes for real estate businesses. Their offices are non-current assets but the houses they sell are inventory.

As a practical expedient, immaterial items are not recognised as non-current assets even if they meet the definition criteria, for example, staplers and calculators etc.

► *Example 01:*

Complete the following table by stating whether the items listed below can be recognised as property, plant and equipment and reason if they cannot be so recognised:

Items	ANSWER
Small tools and spare parts	No. These are immaterial items
Standby generator expected to be used for 7 years	Yes.
An office building.	Yes.
A trademark	No. This is intangible non-current asset.
An office printer.	Yes, unless immaterial.
A plot of land held for resale	No. This is inventory.
A factory including building and machinery.	Yes.
A bus for pick-and-drop of staff members.	Yes.
A generator given to another entity on rent	Yes.

MEASUREMENT AT COST

The concept of distinguishing capital expenditure from revenue expenditures is important here. ***Capital expenditure*** is expenditure made to acquire or improve long term **assets** that are used by the business. ***Revenue expenditure*** is expenditure on day-to-day operating expenses, for example, repair and maintenance expenses or salaries.

A non-current asset is initially measured at its cost which comprises:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Examples of directly attributable costs are:

- wages for the construction or acquisition;
- costs of site preparation including material and labour costs;
- initial delivery and handling costs (i.e. loading, unloading, carriage, freight);
- installation and assembly costs;
- costs of testing whether the asset is functioning properly; and
- professional fees such as architect and surveyor fee.

▶ *Example 02:*

An entity purchased some heavy machinery. The invoice for the machinery showed the following items:

	Rs.000
Cost of machinery	46,000
Cost of delivery	900
Cost of 12-month warranty on the machinery	1,600
Total amount payable	48,500

In addition, the entity incurred Rs.3.4 million in making modifications to its factory so that the heavy machinery could be installed. What should be the cost of the machinery in the entity's machinery account?

▶ *ANSWER*

Cost of machinery:	**Rs. 000**
Cost	46,000
Cost of delivery	900
Modification cost	3,400
Total	**50,300**

SUBSEQUENT EXPENDITURE

Subsequent expenditure relating to non-current assets, after their initial acquisition, should be capitalised (i.e. added to cost of the asset) if it meets the criteria for recognising an asset.

Improvements are capitalised

Expenditure on a non-current asset after acquisition is treated as capital expenditure when it represents an improvement. This is added to the cost of the original asset.

In practice, this means that expenditure is capitalised if it improves the asset (for example, by enhancing its performance or extending its useful life).

Repairs are expensed

Expenditure on a non-current asset after acquisition is treated as revenue expenditure when it is incurred to make a repair. This is recognised as an expense in the statement of comprehensive income.

Size of expenditure

A capital expenditure tends to involve larger monetary amounts than revenue expenditures. However, certain quite large expenditures can still be classified as revenue expenditures, as long they are directly associated with sales transactions or are period costs.

Consumption of economic benefits

A capital expenditure is assumed to be consumed over the useful life of the related non-current asset. A revenue expenditure is assumed to be consumed within a very short period of time. Therefore, capital expenditures are charged to expense gradually via depreciation or amortisation and over a long period of time. Revenue expenditures are charged to expense in the current period.

▶ *Example 03:*

A business acquired new premises at a cost of Rs. 400 million on 1 January 2015. In the period to the year end of 31 March 2015 the following further costs were incurred.

	Rs.000
Costs of initial adaptation of the building	12,000
Legal costs relating to the purchase	2,500
Monthly cleaning contract	3,400
Cost of air conditioning unit necessary for machinery to be used	2,800
Cost of machinery	12,300

What amount should appear as the cost of premises in the entity's statement of financial position as on 31 March 2015?

▶ *ANSWER*

Cost of premises:	Rs. 000
Cost	400,000
Adaptation	12,000
Legal fees	2,500
Total	**414,500**

The related journal entries are as follows:

When payment is made in cash

Debit Non-current assets

Credit Cash / Bank

When payment is made in arrears

Debit Non-current assets

Credit Payable to Vendors

When payment is made in advance (at the date of payment)

Debit Advance to Vendor (Receivable)

Credit Cash / Bank

When payment is made in advance (at the date asset is recognised)

Debit Non-current assets

Credit Advance to Vendor (Receivable)

Note: the advance is an asset too but it is not depreciated.

2. DEPRECIATION: CONCEPT AND COMPUTATION

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

In simple words, depreciation is an expense that matches the cost of a non-current asset to the benefit earned from its ownership. It is calculated so that a business recognises the full cost associated with a non-current asset over the entire period that the asset is used. In effect, the cost of the asset is transferred to the statement of comprehensive income over the life of the asset. This may be several years.

RELEVANT TERMINNOLOGY

Depreciable amount = Cost – residual value

The ***residual value*** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

a) the period over which an asset is expected to be available for use by an entity; or

b) the number of production or similar units expected to be obtained from the asset by an entity.

Accumulated Depreciation is the depreciation charged to date (cumulative) on a non-current asset. This is contra asset account.

Carrying amount (also called net book value or written down value) is the amount at which an asset is presented in statement of financial position.

Carrying amount = *Cost – accumulated depreciation*

► *Example 04:*

An asset costs Rs. 100,000 and can be easily used for ten years. The management of the business entity intends to use the asset for six years at which point expected residual value will be Rs. 40,000 (at current prices).

Required:

What is depreciable amount and useful life of above asset?

► *ANSWER*

Depreciable amount = Rs. 100,000 – 40,000 = Rs. 60,000

Useful life is six years as intended by the management of the entity.

METHODS OF CALCULATING DEPRECIATION

The depreciation method used should reflect as fairly as possible the pattern in which the asset's economic benefits are consumed by the entity.

Straight line depreciation

In this method, the depreciable amount is charged in equal amounts to each reporting period over the expected useful life of the asset.

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

$$Alternatively, depreciation = Cost\ \times Rate$$

$$Rate = \frac{Depreciable\ amount}{Cost\ \times Useful\ life}$$

AT A GLANCE

SPOTLIGHT

STICKY NOTES

- *Example 05:*

Plant bought on 1 January 2021 for Rs. 100,000 with expected useful life of 5 years and residual value of Rs. 10,000. The entity year ends on 31 December.

Required:

Using straight line method, calculate the amount of annual depreciation and carrying amount along with accumulated depreciation for the year 2021 to 2025.

- *ANSWER*

$$Rate = \frac{100{,}000 - 10{,}000}{100{,}000 \times 5years} = 18\%$$

	2021	2022	2023	2024	2025
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Annual depreciation Rs. 100,000 x 18%	18,000	18,000	18,000	18,000	18,000
Cost	100,000	100,000	100,000	100,000	100,000
Accumulated depreciation	(18,000)	(36,000)	(54,000)	(72,000)	(90,000)
	82,000	64,000	46,000	28,000	10,000

- *Example 06:*

An item of equipment costs Rs. 1,260,000. It has an expected useful life of six years and an expected residual value of Rs. 240,000. Using the straight-line method of depreciation, what is the annual depreciation charge and what will be the carrying amount of the asset after four years?

- *ANSWER*

Annual depreciation charge = Rs. (1,260,000 – 240,000) / 6 years = Rs. 170,000

	Rs.
Asset at cost	1,260,000
Less: Accumulated depreciation Rs. 170,000 x 4 years	(680,000)
	580,000

- *Example 07:*

The financial year of an entity is 1st January to 31st December. A non-current asset was purchased on 1st May for Rs. 60,000. Its expected useful life is five years and its expected residual value is zero. It is depreciated by the straight-line method.

Required:

What will be the charge for depreciation in the year of acquisition if a proportion of a full year's depreciation is charged, according to the period for which the asset has been held?

- *ANSWER*

Depreciation in year 1 = Rs. (60,000 – 0) / 5 years' x 8/12 = Rs. 8,000

Reducing balance method:

In this method, the annual depreciation charge is a fixed percentage of the carrying amount of the asset at the start of the period which results in gradually lower depreciation charge as asset's efficiency is reduced over its useful life.

$$Rate = 1 - \sqrt[number\ of\ years]{\frac{Residual\ value}{Cost}}$$

$$Depreciation = Net\ book\ value\ \times Rate$$

- *Example 08:*

Plant bought on 1 January 2021 for Rs. 100,000 with expected useful life of 5 years and residual value of Rs. 10,000. The entity year ends on 31 December.

Required:

Using reducing balance method, calculate the amount of annual depreciation and carrying amount along with accumulated depreciation for the year 2021 to 2025.

- *ANSWER*

$$Rate = 1 - \sqrt[5]{\frac{10,000}{100,000}} = 36.9\%$$

	2021	2022	2023	2024	2025
	Rs.	Rs.	Rs.	Rs.	Rs.
Annual depreciation Carrying amount x 36.9%	36,900	23,284	14,692	9,271	5,853
Cost	100,000	100,000	100,000	100,000	100,000
Accumulated depreciation	(36,900)	(60,184)	(74,876)	(84,147)	(90,000)
	63,100	39,816	25,124	15,853	10,000

- *Example 09:*

A non-current asset cost Rs. 64,000. It is depreciated by the reducing balance method, at the rate of 25% each year. What is the annual depreciation charge in Year 1, Year 2 and Year 3?

- *ANSWER*

	Rs.
Cost of asset	64,000
Year 1 Depreciation (25%)	(16,000)
Carrying amount at the end of year 1	48,000
Year 2 Depreciation (25%)	(12,000)
Carrying amount at the end of year 2	36,000
Year 3 Depreciation (25%)	(9,000)
Carrying amount at the end of year 3	27,000

Units of production method

In this method, depreciation is calculated by expressing the useful life of an asset in terms of its expected total output and allocating the annual charge to depreciation based on actual output. The higher the usage, the higher the depreciation charge and vice versa.

$$Rate = \frac{Cost - Residual\ value}{Useful\ life\ in\ units}$$

$$Depreciation = Units\ used\ or\ produced\ \times Rate$$

▶ *Example 10:*

Plant bought on 1 January 2021 for Rs. 100,000 with expected useful life of 5 years and residual value of Rs. 10,000 and the plant can be used to produce 7500 units over its life. The entity year ends on 31 December.

Actual production of units has been 1500 units, 1800 units, 1200 units, 2000 units and 1000 units from year 2021 to 2025 respectively.

Required:

Using units of production method, calculate the amount of annual depreciation and carrying amount along with accumulated depreciation for the year 2021 to 2025.

▶ *ANSWER*

$$Rate = \frac{100{,}000 - 10{,}000}{7500\ units} = Rs.\ 12\ per\ unit$$

	2021	2022	2023	2024	2025
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Annual depreciation Units produced x Rs. 12	18,000	21,600	14,400	24,000	12,000
Cost	100,000	100,000	100,000	100,000	100,000
Accumulated depreciation	(18,000)	(39,600)	(54,000)	(78,000)	(90,000)
	82,000	60,400	46,000	22,000	10,000

Sum of digits method

In this method, depreciation is calculated by multiplying the depreciable amount by a fraction where numerator is the remaining life of the asset at the start of the period and the denominator is the sum of all the years' useful life at the start of ownership. This method results in step-wise lower depreciation in later years of useful life.

$$Depreciation = Depreciable\ amount\ \times \frac{Remaining\ years}{Sum\ of\ years'digits}$$

Sum of years' digits may also be calculated using the following formula:

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

▶ *Example 11:*

Plant bought on 1 January 2021 for Rs. 100,000 with expected useful life of 5 years and residual value of Rs. 10,000. The entity year ends on 31 December.

Required:

Using sum of digits method, calculate the amount of annual depreciation and carrying amount along with accumulated depreciation for the year 2021 to 2025.

▶ *ANSWER*

$$Sum\ of\ digits = \frac{n(n+1)}{2} = \frac{5(5+1)}{2} = 15$$

	2021	2022	2023	2024	2025
	Rs.	Rs.	Rs.	Rs.	Rs.
Annual depreciation Rs. 90,000 x remaining years / 15	30,000	24,000	18,000	12,000	6,000
Cost	100,000	100,000	100,000	100,000	100,000
Accumulated depreciation	(30,000)	(54,000)	(72,000)	(84,000)	(90,000)
	70,000	46,000	28,000	16,000	10,000

▶ *Example 12:*

A motor vehicle cost Rs.400,000. It has an expected residual value after 5 years of Rs.40,000. If the sum of the digits method of depreciation is used, what will be the carrying amount of the asset at the end of Year 2?

▶ *ANSWER*

Sum of digits = 5 + 4 + 3 + 2 + 1 = 15

	Rs.
Cost of asset	400,000
Year 1 Depreciation (400,000 – 40,000) x 5/15	(120,000)
Carrying amount at the end of year 1	280,000
Year 2 Depreciation (400,000 – 40,000) x 4/15	(96,000)
Carrying amount at the end of year 2	184,000

DEPRECIATION CHARGE AND PERIOD

Depreciation should be charged as an **expense** in the statement of comprehensive income each year over the life of the asset even if the asset is idle and not being used. However, under usage methods of depreciation (sum of units' method), the depreciation charge can be zero while there is no production.

Land is not depreciated because it has indefinite useful life.

Commencement of depreciation

Depreciation must be charged from the date the asset is available for use. This may be earlier than the date it is actually brought into use.

End of depreciation

The depreciation is no more charged when the asset is derecognized or disposed of.

- *Example 13:*

An office property cost Rs. 5 million, of which the land value is Rs. 2 million and the cost of the building is Rs. 3 million. The building has an estimated life of 50 years. What is the annual depreciation charge on the property, using the straight-line method?

- *ANSWER*

Rs. 3,000,000 / 50 years = Rs. 60,000

Land is not depreciated.

- *Example 14:*

An entity constructed a building for its own use. The building was completed on 1 July 2008 and occupied on 1 September 2008. The entity used the building for a long time but then due to expansion in its business it decided on 1 July 2015 to shift to new rented premises. The entity shifted to new premises on 1 August 2015 and disposed of the old building on 31 December 2015.

Required:

Identify the date from which depreciation should be commenced and date when depreciation charge should cease.

- *ANSWER*

Commencement of depreciation: 1 July 2008 (when asset became available for use)

Cessation of depreciation: 31 December 2015 (when asset is disposed of)

CHANGE IN DEPRECIATION METHOD

A change from one method of providing depreciation to another method is permissible only on the grounds that the new method will give a fairer presentation of the results and of the financial position.

The carrying amount should be written off over the remaining useful life, commencing with the period in which the change is made.

- *Example 15:*

On 1 January 2001, Air Limited purchased an asset for Rs. 10,000 with nil residual value and is intended to be used for 10 years. The entity uses straight line method.

On 1 January 2003, Air Limited reconsidered the use of its depreciation methods and concluded that the straight-line method is not appropriate for this type of asset instead 25% depreciation on reducing balance method is appropriate.

Required:

Calculate depreciation expense from year 2001 to year 2004.

- *ANSWER*

Year	Calculation	Rs.
2001	Rs. 10,000 / 10 years	1,000
2002	Rs. 9,000 / 9 years	1,000
2003	Rs. 10,000 – 1,000 – 1,000 = Rs. 8,000 x 25%	2,000
2004	Rs. 8,000 – 2,000 = Rs. 6,000 x 25%	1,500

AT A GLANCE
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REVIEW OF USEFUL LIFE AND RESIDUAL VALUES

Useful life and residual value of tangible non-current assets should be reviewed at end of each reporting period and revised if expectations are significantly different from previous estimates.

The carrying amount of the asset at the date of revision less any residual value should be depreciated over the revised remaining useful life.

- *Example 16:*

On 1 January 2001, Water Limited purchased an asset for Rs. 12,000 with estimated residual value of Rs. 2,000 and is intended to be used for 10 years. The entity uses straight line method.

In 2003, Water Limited reviewed the useful life and residual value of the asset. It was estimated that the asset's remaining useful life is now only 5 years, however, the estimate of residual value has been increased to Rs. 3,000.

Required:

Calculate depreciation expense from year 2001 to year 2004.

- *ANSWER*

Year	Calculation	Rs.
2001	Rs. 12,000 – 2,000 = Rs. 10,000 / 10 years	1,000
2002	Same as above	1,000
2003	Rs. 12,000 – 1,000 – 1,000 = Rs. 10,000 – Rs. 3,000 = Rs. 7,000 / 5 years	1,400
2004	Same as above	1,400

3. ACCOUNTING FOR DEPRECIATION

The accounting entry for recognising the depreciation is as follows:

Debit **Depreciation expense** *[Profit or loss]*

Credit **Accumulated depreciation** *[deducted from asset]*

RELEVANT LEDGER ACCOUNTS:

Non-current asset					
	Balance b/d	XXX			
	Bank (new additions)	XXX		**Balance c/d (SFP)**	**XXX**
		XXX			XXX
	Balance b/d	XXX			

Accumulated depreciation					
				Balance b/d	XX
	Balance c/d (SFP)	**XX**		Depreciation expense	XX
		XX			XX
				Balance b/d	XX

Depreciation expense					
	Accumulated dep.	XX		**Profit or loss**	**XX**
		XX			XX

PRESENTATION IN FINANCIAL STATEMENTS

STATEMENT OF PROFIT OR LOSS *(extracts)*	Rs.
Depreciation	XX

STATEMENT OF FINANCIAL POSITION *(extracts)*		Rs.
Non-current asset		XXX
Less: Accumulated depreciation		(XX)
Carrying amount (net book value)		XXX

- *Example 17:*

An item of equipment cost Rs. 40,000 at the beginning of Year 1. It has an expected life of 5 years. The annual depreciation charge is Rs. 8,000. Prepare relevant ledger accounts for Years 1 and 2 and extracts of financial statement for each period.

- *ANSWER*

Equipment					
Y 01	Bank (new additions)	40,000			
				Balance c/d	40,000
		40,000			**40,000**
Y 02	Balance b/d	40,000			
				Balance c/d	40,000
		40,000			**40,000**

Accumulated depreciation					
Y 01				Depreciation expense	8,000
	Balance c/d	8,000			
		8,000			**8,000**
Y 02				Balance b/d	8,000
	Balance c/d	16,000		Depreciation expense	8,000
		16,000			16,000

Depreciation Expense					
Y 01	Depreciation expense	8,000			
				Profit or loss	8,000
		8,000			**8,000**
Y 02	Depreciation expense	8,000			
				Profit or loss	8,000
		8,000			8,000

Statement of profit or loss (extracts)	**Y 01**	**Y02**
	Rs.	**Rs.**
Depreciation expense	8,000	8,000

Statement of financial position (extracts)	**Y 01**	**Y02**
	Rs.	**Rs.**
Non-current asset	40,000	40,000
Less: Accumulated depreciation	(8,000)	(16,000)
Carrying amount (net book value)	32,000	24,000

AT A GLANCE
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- *Example 18:*

Maturin bought a machine for Rs. 10,000 on 1 January 2012. He estimates a useful life of 8 years and a residual value of Rs.800. Depreciation is to be calculated on a straight-line basis.

Required:

a) Write up for 2012 and 2013 the

- Machinery account
- Accumulated depreciation account
- Depreciation expense account.

b) Show how the machine would be presented in the statement of financial positions as at 31 December 2012 and 31 December 2013.

- *ANSWER*

Part a

Machinery					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2012			2012		
1 Jan	Bank	10,000	31 Dec	Balance c/d	10,000
		10,000			10,000
2013			2013		
1 Jan	Balance b/d	10,000	31 Dec	Balance c/d	
		10,000			10,000

Accumulated Depreciation					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2012			2012		
31 Dec	Balance c/d	1,150	31 Dec	Depreciation	1,150
		1,150			1,150
2013			2013		
			1 Jan	Balance b/d	1,150
31 Dec	Balance c/d	2,300	31 Dec	Depreciation	1,150
		2,300			2,300

Depreciation expense					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2012			2012		
31 Dec	Acc. Dep	1,150	31 Dec	P & L	1,150
		1,150			1,150
2013			2013		
31 Dec	Acc. Dep	1,150	31 Dec	P & L	1,150
		1,150			1,150

Depreciation = [10,000 – 800] /8 years= Rs. 1,150

Part (b)

	2013	2012
Non-current assets	**Rs.**	**Rs.**
Machinery at cost	10,000	10,000
Acc. Depreciation	(2,300)	(1,150)
	7,700	8,850

AT A GLANCE SPOTLIGHT STICKY NOTES

4. COMPREHENSIVE EXAMPLES

- *Example 19:*

Since he commenced business on 1 January 2010 Sophie has purchased for cash the following three machines:

	Year of purchase	Cost Rs.	Rate of depreciation
Machine 1	2010	4,200	25%
Machine 2	2011	5,000	30%
Machine 3	2012	3,500	35%

Sophie's policy is to charge a full year's depreciation in the year of purchase irrespective of the date of purchase. The reducing balance method is used to calculate depreciation.

Accounts are prepared to 31 December each year.

Required:

a) Prepare the machinery account and accumulated depreciation account showing the charge to the depreciation account for each year.

b) Show the relevant statement of financial position extracts for each year.

- *ANSWER*

Part (a):

Machinery					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2010			2010		
20 Jan	Bank	4,200	31 Dec	Balance c/d	4,200
		4,200			4,200
2011			2011		
1 Jan	Balance b/d	4,200			
17 Apr	Bank	5,000	31 Dec	Balance c/d	9,200
		9,200			9,200
2012			2012		
1 Jan	Balance b/d	9,200			
11 July	Bank	3,500	31 Dec	Balance c/d	12,700
		12,700			12,700

Accumulated Depreciation					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2010			2010		
31 Dec	Balance c/d	1,050	31 Dec	Depreciation- (W1)	1,050
		1,050			1,050
2011			2011		
			1 Jan	Balance b/d	1,050
31 Dec	Balance c/d	3,337	31 Dec	Depreciation- (W1)	2,287
		3,337			3,337
2012			2012		
			1 Jan	Balance b/d	3,337
31 Dec	Balance c/d	6,203	31 Dec	Depreciation- (W1)	2,866
		6,203			6,203

Part (b)

Statement of financial position (extract)	2012	2011	2010
Non-current assets	**Rs.**	**Rs.**	**Rs.**
Machinery at cost	12,700	9,200	4,200
Acc. Depreciation	(6,203)	(3,337)	(1,050)
	6,497	5,863	3,150

W1 – Depreciation			Rs.
Year 2010			
Machine 1		Rs.4, 200 x 25% =	1,050
			1,050
Year 2011			
Machine 1	Rs.4,200 – 1,050 =	Rs.3,150 x 25% =	787
Machine 2		Rs.5,000 x 30% =	1,500
			2,287
Year 2012			
Machine 1	Rs. 3,150 – 787 =	Rs.2,363 x 25% =	591
Machine 2	Rs.5000 – 1,500 =	Rs.3,500 x 30% =	1,050
Machine 3		Rs.3,500 x 35% =	1,225
			2,866

- *Example 20:*

Diana leases out German sports cars. She started business on 1 January 2010 and has decided to depreciate the cars on a straight line basis at 25% per annum on cost at the year-end. During the years 2010 to 2013 the following purchases took place.

2010	Acquired 20 Porsche 924 Turbos at a cost of Rs.18,600,000 each
2011	Purchased 6 Porsches for a total cost of Rs.108,600,000.
2012	Purchased a further two cars costing Rs.19,800,000 each.
2013	Purchased 15 cars for Rs.21,000,000 each.

Required:

Prepare a vehicle account, an accumulated depreciation account and a depreciation account for the years 2010 to 2013. Diana prepares accounts to 31 December each year.

- *ANSWER*

Vehicle					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
2010			2010		
	Bank	372,000	31 Dec	Balance c/d	372,000
		372,000			372,000
2011			2011		
1 Jan	Balance b/d	372,000			
	Bank	108,600	31 Dec	Balance c/d	480,600
		480,600			480,600

Vehicle					
2012			2012		
1 Jan	Balance b/d	480,600			
	Bank	39,600	31 Dec	Balance c/d	520,200
		520,200			520,200
2013			2013		
1 Jan	Balance b/d	520,200			
	Bank	315,000	31 Dec	Balance c/d	835, 200
		835,200			835,200

Accumulated Depreciation					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
2010			2010		
31 Dec	Balance c/d	93,000	31 Dec	Depreciation- (W)	93,000
		93,000			93,000
2011			2011		
			1 Jan	Balance b/d	93,000
31 Dec	Balance c/d	213,150	31 Dec	Depreciation- (W)	120,150
		213,150			213,150
2012			2012		
			1 Jan	Balance b/d	213,150
31 Dec	Balance c/d	343,200	31 Dec	Depreciation- (W)	130,050
		343,200			343,200
2013			2013		
			1 Jan	Balance b/d	343,200
31 Dec	Balance c/d	552,000	31 Dec	Depreciation- (W)	208,800
		552,000			552,000

Depreciation expense					
Date	**Particulars**	**Rs.000**	**Date**	**Particulars**	**Rs.000**
2010			2012		
31 Dec	Acc. Dep	93,000	31 Dec	P & L	93,000
		93,000			93,000
2011			2013		
31 Dec	Acc. Dep	120,150	31 Dec	P & L	120,150
		120,150			120,150
2012			2013		
31 Dec	Acc. Dep	130,050	31 Dec	P & L	130,050
		130,050			130,050
2013			2013		
31 Dec	Acc. Dep	208,800	31 Dec	P & L	208,800
		208,800			208,800

Working (W)

Year	Calculation	Depreciation
2010	372,000 x 25%	93,000
2011	480,600 x 25%	120,150
2012	520,200 x 25%	130,050
2013	835,200 x 25%	208,800

► *Example 21:*

An entity started business on 1 January 2023, the financial year end being 31 December.

The machinery bought was:

2023	1 January	1 machine costing Rs. 1,400
2024	1 July	2 machines costing Rs. 600 each
	1 October	1 machine costing Rs. 1,000
2026	1 April	1 machine costing Rs. 400

Depreciation is over ten years, using the straight line method, machines being depreciated for the proportion of the year that they are owned.

Required:

i. The machinery account.

ii. The provision for depreciation account.

iii. The statement of financial position extracts

for each of the years 2023, 2024, 2025, 2026.

► *ANSWER*

Machinery Account (i)						
Date	**Particulars**	**Rs.**		**Date**	**Particulars**	**Rs.**
01.01.23	Bank	1,400		31.12.23	Balance c/d	1,400
		1,400				1,400
01.01.24	Balance b/d	1,400				
01.07.24	Bank	1,200				
01.10.24	Bank	1,000		31.12.24	Balance c/d	3,600
		3,600				3,600
01.01.25	Balance b/d	3,600				
				31.12.25	Balance c/d	3,600
		3,600				3,600
01.01.26	Balance b/d	3,600				
01.04.26	Bank	400		31.12.26	Balance c/d	4,000
		4,000				4,000

Accumulated depreciation (ii)						
Date	**Particulars**	**Rs.**		**Date**	**Particulars**	**Rs.**
31.12.23	Balance c/d	140		31.12.23	Depreciation (W)	140
		140				140
				01.01.24	Balance b/d	140
31.12.24	Balance c/d	365		31.12.24	Depreciation (W)	225
		365				365
				01.01.25	Balance b/d	365
31.12.25	Balance c/d	725		31.12.25	Depreciation (W)	360
		725				725
				01.01.26	Balance b/d	725
31.12.26	Balance c/d	1,115		31.12.26	Depreciation (W)	390
		1,115				1,115

Depreciation (workings)		
2023	Rs. 1,400 x 10% x 12/12	Rs. 140
2024	Rs. 1,400 x 10% x 12/12 + Rs. 12,00 x 10% x 6/12 + Rs. 1,000 x 10% x 3/12	Rs. 225
2025	Rs. 3,600 x 10% x 12/12	Rs. 360
2026	Rs. 3,600 x 10% x 12/12 + Rs. 400 x 10% x 9/12	Rs. 390

Statement of financial position (extracts) (iii)				
	2023	**2024**	**2025**	**2026**
Machinery	1,400	3,600	3,600	4,000
Less: Accumulated depreciation	(140)	(365)	(725)	(1,115)
	1,260	3,235	2,875	2,885

- *Example 22:*

Sajid Limited (SL) purchased a plant on 1 January 2011 for Rs. 34,000 with expected life of 5 years and residual value of Rs. 4,000 at the end of its useful life. The entity uses reducing balance method for depreciation of plant.

SL purchased another plant on 1 Apr 2012 for Rs. 51,000 with expected life of 5 years and residual value of Rs. 6,000 at the end of its useful life.

SL purchased its third plant on 1 July 2013 for Rs. 68,000 with expected useful life of 5 years and residual value of Rs. 8,000 at the end of its useful life.

Required:

Prepare "Plant Account" and "Accumulated depreciation Account" for the year 2011 to 2013.

- *ANSWER*

Plant account					
Date	**Particulars**	**Rs**	**Date**	**Particulars**	**Rs**
01.01.11	Cash	34,000			
			31.12.11	Balance c/d	34,000
		34,000			34,000
01.01.12	Balance b/d	34,000			
01.01.12	Cash	51,000	31.12.12	Balance c/d	85,000
		85,000			85,000
01.01.13	Balance b/d	85,000			
01.07.13	Cash	68,000	31.12.12	Balance c/d	153,000
		153,000			153,000

Accumulated depreciation account					
Date	Particulars	Rs	Date	Particulars	Rs
			01.01.11	Balance b/d	0
31.12.11	Balance c/d	11,832	31.12.11	Depreciation (w-1)	11,832
		11,832			11,832
			01.01.12	Balance b/d	11,832
31.12.12	Balance c/d	32,857	31.12.12	Depreciation (w-2)	21,025
		32,857			32,857
			01.01.13	Balance b/d	32,857
31.12.13	Balance c/d	62,834	31.12.13	Depreciation (w-3)	29,977
		62,834			62,834

Depreciation Calculation	Cost	2011	NBV	2012	NBV	Dep
Asset 1 [12, 12, 12 months]	34,000	(11,832)	22,168	(7,714)	14,454	(5,030)
Asset 2 [0, 9, 12 months]			51,000	(13,311)	37,689	(13,115)
Asset 3 [0, 0, 6 months]					68,000	(11,832)
Total		(11,832)		(21,025)		(29,977)

Depreciation Rates calculation

Asset 1: 1 – 5√ (4000/34000) = 34.8%;

Asset 2: 1 – 5√ (6000/51000) = 34.8%;

Asset 3: 1 – 5√ (8000/68000) = 34.8%

- *Example 23:*

On 1 January 2013 Delta acquired a specialized machine for its production department. The available information is as follows:

	Rupees
List price of machine	9,200,000
Freight charges	263,000
Electrical installation cost	245,000
Staff training for use of machine	351,000
Pre-production testing	193,000
Purchase of a three-year maintenance contract	528,000
Estimated residual value	175,000
Discount (trade & settlement) on list price	5%
Estimated life (in machine hours)	12,000

Machine hours used during the years ended 31 December 2013, 2014 and 2015 were 2000, 3200 and 1400 respectively.

On 1 January 2015 Delta decided to upgrade the machine by adding new components at a cost of Rs. 1,753,000. This upgrade led to a reduction in the production time per unit of goods being manufactured by the machine. The upgrade also increased the estimated remaining life of the machine at 1 January 2015 to 8,000 machine hours and its estimated residual value to Rs. 350,000.

Required:

For the years ended 31 December 2013, 2014 and 2015, compute the relevant amounts to be included (under each head) in the statement of profit or loss and statement of financial position. Notes to the financial statements are not required.

▶ *ANSWER*

Year ended	31-Dec-13	31-Dec-14	31-Dec-15
Statement of profit or loss	-------------- **Amount in Rs.**	-------------	
Depreciation			
[9,441,000(W-1)-175,000]×2,000/12,000	1,544,333		
[9,441,000(W-1)-175,000]×3,200/12,000		2,470,934	
[7,178,733(W-2)-350,000]×1,400/8,000			1,195,028
Maintenance cost (528,000/3)	176,000	176,000	176,000
Administration expenses (Staff training)	351,000	-	-
As at	**31-Dec-13**	**31-Dec-14**	**31-Dec-15**
Statement of financial position:	-------------- **Amount in Rs.**	-------------	
Property, plant and equipment			
Cost (W-1)	9,441,000	9,441,000	*11,194,000
Accumulated depreciation	(1,544,333)	(4,015,267)	(5,210,295)
	7,896,667	5,425,733	5,983,705
Long term prepayment	176,000	-	-
Short term Prepayment	176,000	176,000	-

* [9,441,000+1,753,000]

W1: Cost price of machine	Rupees
List price	9,200,000
Less: Discount (9,200,000×5%)	(460,000)
Add: Freight charges	263,000
Electrical installation cost	245,000
Pre-production testing	193,000
	9,441,000

W2 – Valuation after upgrade	Rupees
Original cost **W1**	9,441,000
Depreciation up to 31-12-14 (1,544,333 + 2,470,934**)**	(4,015,267)
Carrying amount on 1-Jan-15	5,425,733
Capitalisation of upgrade	1,753,000
Valuation after capitalisation	7,178,733

5. OBJECTIVE BASED Q&A

01. Which of the following cannot be classified as tangible non-current asset:

(a) A commercial generator held for use in factory in case of electricity shortage

(b) A commercial generator held for earning by renting to customers

(c) A commercial generator held for use in office in case of electricity shortage

(d) A commercial generator held for resale to customers

02. Which of the following are items of property, plant and equipment?

(i) Standby generator expected to be used for seven years
(ii) A plot of land held for resale
(iii) A bus for pick-and-drop of staff members
(iv) A generator for rental to others

(a) (i) to (iv) all

(b) (i), (ii) and (iii) only

(c) (i), (iii) and (iv) only

(d) (ii), (iii) and (iv) only

03. Which of the following is not a property, plant and equipment?

(a) Tangible assets

(b) Assets held for the production or supply of goods or services

(c) Assets held for sale in the normal course of business

(d) Assets expected to be used for more than one period

04. A building contractor decides to construct an office building to be occupied by his own staff.

Which TWO of the following costs incurred by the building contractor cannot be included as a part of the cost of the office building?

(a) Cement, iron, sand and crushed stone bought for construction

(b) A proportion of the contractor's general administration costs

(c) Hire of plant and machinery for use on the office building site

(d) Additional design work caused by initial design errors

05. Alpha Trading Limited (ATL) used its own staff, assisted by contractors when required, to construct a new warehouse for its own use.

Identify the costs listed below that cannot be capitalized.

(a) Clearance of the site prior to commencement of construction

(b) Professional surveyor fees for managing the construction work

(c) ATL's own staff wages for time spent working on construction

(d) A proportion of ATL's administration costs, based on staff time spent

06. Which TWO of the following items should be capitalised within the initial carrying amount of an item of plant?

(a) Cost of transporting the plant to the factory

(b) Cost of installing a new power supply required to operate the plant

(c) A deduction to reflect the estimated residual value

(d) Cost of a three-year maintenance agreement

07. An entity purchased some heavy machinery. The invoice for the machinery showed the following items:

	Rs.000
Cost of machinery	46,000
Cost of delivery	900
Cost of 12-month warranty on the machinery	1,600
Total amount payable	48,500

In addition, the entity incurred Rs.3.4 million in making modifications to its factory so that the heavy machinery could be installed.

What should be the cost of the machinery in the entity's machinery account in the ledger?

(a) Rs. 48,500,000

(b) Rs. 46,900,000

(c) Rs. 46,000,000

(d) Rs. 50,300,000

08. A business acquired new premises at a cost of Rs.400 million on 1 January 2015. In the period to the year end of 31 March 2015 the following further costs were incurred.

	Rs.000
Costs of initial adaptation of the building	12,000
Legal costs relating to the purchase	2,500
Monthly cleaning contract	3,400
Air conditioning unit necessary for machinery to be used	2,800
Cost of machinery	12,300

What amount should appear as the cost of premises in the entity's statement of financial position at 31 March 2015?

(a) Rs. 414,500,000

(b) Rs. 412,000,000

(c) Rs. 425,800,000

(d) Rs. 417,800,000

09. An entity has built a new factory incurring the following costs:

	Rs. '000
Land	1,200
Materials	2,400
Labour	3,000
Architect's fees	25
Surveyor's fees	15
Site overheads	300
Apportioned administrative overheads	150
Testing of fire alarms	10
Business rates for first year	12
	7,112

What will be the total amount capitalised in respect of the factory?

(a) Rs. 6,112,000

(b) Rs. 6,950,000

(c) Rs. 7,112,000

(d) Rs. 7,100,000

10. On 1 March 2018 Mercury Limited (ML) acquired a machine from Plant under the following terms:

	Rs. 000
List price of machine	82,000
Import duty	1,500
Delivery fees	2,050
Electrical installation costs	9,500
Pre-production testing	4,900
Purchase of a five-year maintenance contract with Plant	7,000

In addition to the above information ML was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5% on remaining amount if payment for the machine was received within one month of purchase. ML expected and paid for the plant on 25 March 2018.

On what amount, the plant should be initially measured on acquisition?

(a) Rs. 98,750,000

(b) Rs. 95,060,000

(c) Rs. 91,750,000

(d) Rs. 88,060,000

11. Construction of Venice Limited's new store began on 1 April 2019. The following costs were incurred on the construction:

	Rs. 000
Freehold land	4,500
Architect fees	620
Site preparation	1,650
Materials	7,800
Direct labour costs	11,200
Legal fees	2,400
General overheads	940

The store was completed on 1 January 2020.

Calculate the amount to be included as property, plant and equipment in respect of the new store

(a) Rs. 28,170,000

(b) Rs. 29,110,000

(c) Rs. 25,770,000

(d) Rs. 23,670,000

12. On 1 March 2010 Earth Limited (EL) purchased an upgrade package from Sun Limited at a cost of Rs. 18 million for the machine it originally purchased in 2008. The upgrade took a total of two days where new components were added to the machine. EL agreed to purchase the package as the new components would lead to a reduction in production time per unit of 15%. This will enable EL to increase production without the need to purchase a new machine.

What is appropriate accounting treatment?

(a) EL should expense this additional expenditure

(b) EL should capitalise this additional expenditure in the cost of existing plant

(c) EL should capitalise the 15% of Rs. 18 million in the cost of existing plant

(d) None of the above is appropriate treatment

13. A machine price was Rs.1, 000,000 and was carried through a truck. The truck's fares were Rs. 20,000. The engineers charged Rs. 45,000 for the installation.

The cost of the machine is?

(a) Rs.1,000,000

(b) Rs.1,020,000

(c) Rs.1,045,000

(d) Rs.1,065,000

14. Which of the following is not a component of cost of an asset?

(a) Purchase price

(b) Import duties

(c) Refundable sales tax

(d) Installation and assembly costs

15. Which of these cost is capitalised as cost of an asset?

(a) Professional fees

(b) General overheads

(c) Initial operating losses

(d) Administration expenses

16. Which of the following is not capitalised as a directly attributable cost of a machine?

(a) Site preparation

(b) Initial testing cost

(c) Carriage inwards for fuel for the machinery

(d) Installation and assembly costs

17. An entity just received civil work bill from their contractor of Rs. 580,000 for construction of a new guard room and repair of sewerage system. It is estimated that 15% of total bill relates to repair work. What amount should be capitalised and/or charged as an expense?

(a) Capitalise Rs. 580,000

(b) Expense Rs. 580,000

(c) Capitalise Rs. 493,000 and Expense Rs. 87,000

(d) Expense Rs. 493,000 and Capitalise Rs. 87,000

18. On 22nd February an equipment was purchased for Rs. 800,000. It was delivered immediately. The entity paid Rs. 500,000 immediately and remaining are to be paid on 4th March.

What journal entry should be recorded on 22nd February?

(a) Debit Equipment Rs. 800,000; Credit Bank Rs. 500,000; Credit Advance Rs. 300,000

(b) Debit Equipment Rs. 800,000; Credit Payables Rs. 500,000; Credit Bank Rs. 300,000

(c) Debit Equipment Rs. 800,000; Credit Bank Rs. 500,000; Credit Payables Rs. 300,000

(d) Debit Equipment Rs. 800,000; Credit Advance Rs. 500,000; Credit Payables Rs. 300,000

19. On 22nd February an equipment was ordered for Rs. 800,000 by paying 20% advance. It was delivered on 4th March when the entity paid 50% of amount due and promised remaining to be paid on 25th April.

What journal entry should be recorded on 4th March?

(a) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 400,000 & Payables Rs. 240,000

(b) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 740,000

(c) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 320,000 & Payables Rs. 320,000

(d) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Payables Rs. 640,000

20. On 22nd February an equipment was ordered for Rs. 800,000 by paying 20% advance. It was delivered on 4th March when the entity paid 50% of total bill and promised remaining to be paid on 25th April.

What journal entry should be recorded on 4th March?

(a) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 400,000 & Payables Rs. 240,000

(b) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 740,000

(c) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 320,000 & Payables Rs. 320,000

(d) Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Payables Rs. 640,000

21. The purpose of depreciation is to:

(a) Allocate the cost less residual value on a systematic basis over the asset's useful life

(b) Write the asset down to its realisable value each period

(c) Accumulate a fund for asset replacement

(d) Recognise that assets lose value over time

22. Depreciable amount means;

(a) Cost of an asset + Residual value

(b) Cost of an asset – Residual value

(c) Cost of an asset – Residual value / useful life

(d) Residual value – Cost of an asset

23. What is the net amount an entity expects to obtain for an asset at the end of its useful life?

(a) Residual value

(b) Depreciated value

(c) Present value

(d) Fair value

24. Huge Ltd. purchases the machine for Rs.6 million. It has an estimated salvage value of Rs.1 million and a useful life of five years.

What is the depreciation charged for the year under the straight line method?

(a) Rs.1,200,000

(b) Rs.1,000,000

(c) Rs.800,000

(d) None of the above

25. Small Limited purchased a machine for Rs. 8 million. It has an estimated residual value of Rs. 1.5 million and useful life of seven years. Calculate depreciation percentage (to be applied to cost) under straight line method.

(a) 7%

(b) 12.7%

(c) 11.6%

(d) 7.11%

26. An item of plant was purchased on 1 April 2008 for Rs. 2,000,000 and is being depreciated at 25% on a reducing balance basis. What would be its residual value after its useful life of 5 years?

(a) Rs. 632,809

(b) Rs. NIL

(c) Rs. 474,609

(d) Rs. 400,000

27. Small Ltd. purchases the equipment for Rs. 600,000. It has an estimated salvage value of Rs. 100,000 and a useful life of five years.

What is the book value of equipment under the reducing balance method at the end of its useful life?

(a) Rs.163,840

(b) Rs.165,000

(c) Rs.120,000

(d) Rs.100,000

28. Small Limited purchased a machine for Rs. 8 million. It has an estimated residual value of Rs. 1.5 million and useful life of seven years. Calculate depreciation percentage (to be applied to cost) under reducing balance method.

(a) 21.27%

(b) 22.63%

(c) 23.45%

(d) 24.55%

29. Under which of the following methods of depreciation the expense may be zero in the period in which asset is not used at all?

(a) Straight line method

(b) Reducing balance method

(c) Units of production method

(d) Sum of digits' method

30. An aeroplane engine was acquired for Rs. 75 million and has life of 48000 flying hours. The plane was flown 1800 hours during the year. What amount of depreciation should be charged in profit or loss?

(a) Rs. 2,812.5

(b) Rs. 2,500,000

(c) Rs. 2,500

(d) Rs. 2,812,500

31. A motor vehicle cost Rs. 400,000. It has an expected residual value after 5 years of Rs. 40,000.

If the sum of the digits method of depreciation is used, what will be the carrying amount of the asset at the end of Year 2?

(a) Rs. 96,000

(b) Rs. 120,000

(c) Rs. 280,000

(d) Rs. 184,000

32. Medium Ltd. purchases the car for Rs. 2,200,000. It has an estimated salvage value of Rs. 200,000 and a useful life of five years.

What is the depreciation charge for the first year under the sum-of-the-year digit method?

(a) Rs. 400,000

(b) Rs. 555,555

(c) Rs. 666,667

(d) None of the above

33. Normal Limited purchased premises for Rs. 16 million with no salvage value and useful life of 45 years.

What is the depreciation charge for the fourth year under the sum-of-the-year digit method?

(a) Rs. 4,692,754

(b) Rs. 6,492,754

(c) Rs. 7,544,926

(d) Rs. 5,744,926

34. Hunza Limited acquired a new office building on 1 October 2014. Its initial carrying amount consisted of:

	Rs. 000
Land	2,000
Building structure	10,000
Air conditioning system	4,000
	16,000

The estimated lives of the building structure and air conditioning system are 25 years and 10 years respectively.

When the air conditioning system is due for replacement, it is estimated that the old system will be dismantled and sold for Rs. 500,000.

Depreciation is time-apportioned where appropriate.

At what amount will the non-current assets be shown in Hunza Limited's statement of financial position as at 31 March 2015?

(a) Rs. 15,625,000

(b) Rs. 15,250,000

(c) Rs. 15,585,000

(d) Rs. 15,600,000

35. An entity purchases land with an office building. The building has a useful life of 20 years. How should the land be depreciated?

(a) Depreciate over 20 years

(b) Depreciate over useful life of the land

(c) Do not depreciate the land

(d) None of these

36. If an asset is idle then?

(a) Depreciation is paused

(b) Depreciation for the entire period

(c) Depreciation is ignored

(d) Depreciation continues

37. Tom Limited runs a sports equipment manufacturing business with a year end of 31 December 2019. On 1 April 2019, Tom Limited acquired a delivery truck at a cost of Rs. 4,800,000. The expected life of the truck is 8 years and residual value is expected to be nil. What is depreciation charge for 2019 on straight line basis?

(a) Rs. 600,000

(b) Rs. 800,000

(c) Rs. 450,000

(d) Rs. 500,000

38. An entity which makes up its accounts annually to 31 December provides for depreciation of its machinery at the rate of 10% per annum using the straight line method.

On 31 December 2016, the machinery consisted of three items purchased as under:

On 1 January 2014	Machine A	Cost Rs. 3,000,000
On 1 April 2015	Machine B	Cost Rs. 2,000,000
On 1 July 2016	Machine C	Cost Rs. 4,000,000

AT A GLANCE SPOTLIGHT STICKY NOTES

What would be depreciation charge for the year 2016?

(a) Rs. 600,000

(b) Rs. 628,000

(c) Rs. 700,000

(d) Rs. 900,000

39. An entity which makes up its accounts annually to 31 December provides for depreciation of its machinery at the rate of 10% per annum using the reducing balance method.

On 31 December 2016, the machinery consisted of three items purchased as under:

On 1 January 2014	Machine A	Cost Rs. 3,000,000
On 1 April 2015	Machine B	Cost Rs. 2,000,000
On 1 July 2016	Machine C	Cost Rs. 4,000,000

What would be depreciation charge for the year 2016?

(a) Rs. 600,000

(b) Rs. 628,000

(c) Rs. 700,000

(d) Rs. 900,000

40. An entity which makes up its accounts annually to 31 December provided for depreciation of its equipment at the rate of 10% per annum using the reducing balance method since it was bought on 1 January 2018 for Rs. 4,000,000.

On 1 January 2021, the entity concluded that straight line method would be more appropriate for this equipment and estimated remaining useful life of 5 years with residual value of Rs. 500,000 at the end of useful life.

What is depreciation expense for the year ended 31 December 2021?

(a) Rs. 816,097

(b) Rs. 460,000

(c) Rs. 700,000

(d) Rs. 483,200

41. An entity which makes up its accounts annually to 31 December provided for depreciation of its equipment at the rate of 10% per annum using straight line method since it was bought on 1 January 2018 for Rs. 4,000,000.

On 1 January 2021, the entity concluded that reducing balance method would be more appropriate for this equipment and estimated remaining useful life of 5 years with residual value of Rs. 500,000 at the end of useful life.

What is depreciation expense for the year ended 31 December 2021?

(a) Rs. 816,097

(b) Rs. 460,000

(c) Rs. 700,000

(d) Rs. 483,200

42. How often should the residual value of an asset be reviewed?

(a) Every six months

(b) As and when the market value will significantly change

(c) At the end of each reporting period

(d) Never

43. How often should the useful life of an asset be reviewed?

(a) Every six months

(b) As and when the market value will significantly change

(c) At the end of each reporting period

(d) Never

44. At financial year end of 31 December 2020, an entity reported the following in its statement of financial position:

		Rs. in million
Property, plant and equipment	– Cost	860
	– Accumulated depreciation	(260)
		600

On 31 August 2021, the entity purchased another item of equipment for Rs. 100 million. Depreciation is charged at 20% per annum on pro rata basis using straight line method.

What is the depreciation charge for the year ended 31 December 2021?

(a) Rs. 192 million

(b) Rs. 178.67 million

(c) Rs. 140 million

(d) Rs. 126.67 million

45. At financial year end of 31 December 2020, an entity reported the following in its statement of financial position:

		Rs. in million
Property, plant and equipment	– Cost	860
	– Accumulated depreciation	(260)
		600

On 31 August 2021, the entity purchased another item of equipment for Rs. 100 million. Depreciation is charged at 20% per annum on pro rata basis using reducing balance method.

What is the depreciation charge for the year ended 31 December 2021?

(a) Rs. 192 million

(b) Rs. 178.67 million

(c) Rs. 140 million

(d) Rs. 126.67 million

46. At financial year end of 31 December 2020, an entity reported the following in its statement of financial position:

		Rs. in million
Property, plant and equipment	– Cost	860
	– Accumulated depreciation	(260)
		600

The cost amount of Rs. 860 million includes Rs. 150 million relating to freehold land. On 31 August 2021, the entity purchased another item of equipment for Rs. 100 million. Depreciation is charged at 20% per annum on pro rata basis using reducing balance method.

What is the depreciation charge for the year ended 31 December 2021?

(a) Rs. 96.67 million

(b) Rs. 106.67 million

(c) Rs. 116.67 million

(d) Rs. 126.67 million

47. A non-current asset was bought for Rs. 1,400,000 on 1 January 2019. It has estimated useful life of 3 years and residual value of Rs. 200,000. The entity uses reducing balance method of depreciation. What would be carrying amount of this asset on 31 December 2021?

(a) Rs. 100,000

(b) Rs. 200,000

(c) Rs. 300,000

(d) Rs. 400,000

48. A non-current asset was bought for Rs. 1,400,000 on 1 January 2019. It has estimated useful life of 3 years and residual value of Rs. 200,000. The entity uses reducing balance method of depreciation. Calculate the total depreciation to be charged throughout the useful life of the asset?

(a) Rs. 1,000,000

(b) Rs. 1,100,000

(c) Rs. 1,200,000

(d) Rs. 1,300,000

49. The following are details for two entities as at 30 June 2021:

	Entity A	Entity B
Property, plant and equipment	**Rs.**	**Rs.**
Cost	100,000,000	25,000,000
Less: Accumulated depreciation	(80,000,000)	(5,000,000)
	20,000,000	20,000,000

Which TWO of the following statements are correct?

(a) The details above do not provide any comparable information.

(b) Entity A has initially invested more in non-current assets as compared to Entity B

(c) Entity A has older assets as compared to Entity B

(d) Entity A profitability must be higher than Entity B

50. Jupiter Limited (JL) purchased a machine on 1 July 2017 for Rs. 500,000. It is being depreciated on a straight line basis over its expected life of ten years. Residual value is estimated at Rs. 20,000. On 1 January 2018, following a change in legislation, JL fitted a safety guard to the machine. The safety guard cost Rs. 25,000 and has a useful life of five years with no residual value.

What amount will be charged to profit or loss for the year ended 31 March 2018 in respect of depreciation on this machine?

Rs. __________

ANSWERS

01.	**(d)**	Items held for resale are inventories and not property, plant and equipment.	
02.	**(c)**	Plot of land held for resale is inventory and not property, plant and equipment.	
03.	**(c)**	Assets held for sale in the normal course of business are inventories.	
04.	**(b) & (d)**	Direct costs relating to the acquisition of the asset can be included such as materials and labour costs, the administration cost is not a direct cost. Also costs relating to errors or wastage cannot be capitalised.	
05.	**(d)**	Administration costs or share thereof cannot be capitalised.	
06.	**(a) & (b)**	The maintenance costs should be expensed as incurred over three years. The residual value should be taken into account for the purposes of calculating depreciation, but not for the amount to be capitalised.	
07.	**(d)**	***Cost of machinery:***	**Rs. 000**
		Cost	46,000
		Cost of delivery	900
		Modification cost	3,400
		Total	**50,300**
08.	**(a)**	***Cost of premises:***	**Rs. 000**
		Cost	400,000
		Adaptation	12,000
		Legal fees	2,500
		Total	**414,500**
09.	**(b)**		**Rs. 000**
		Land	1,200
		Materials	2,400
		Labour	3,000
		Architects fees	25
		Surveyors fees	15
		Site overheads	300
		Testing fire alarms	10
			6,950
10.	**(d)**		**Rs. 000**
		List price of machine	82,000
		Less: trade discount 10%	(8,200)
			73,800
		Less: cash discount 5%	(3,690)
		Import duty	1,500
		Delivery fees	2,050
		Electrical installation costs	9,500
		Pre-production testing	4,900
			88,060

11.	**(a)**	**Rs. 000** Freehold land 4,500 Architect fees 620 Site preparation 1,650 Materials 7,800 Direct labour costs 11,200 Legal fees 2,400 28,170
12.	**(b)**	The additional amount should be capitalised as it is probable that economic benefits would increase.
13.	**(d)**	Rs. 1,000,000 + 20,000 + 45,000 = Rs. 1,065,000
14.	**(c)**	Refundable sales tax is not a cost as it would be received back.
15.	**(a)**	Professional fees are directly attributable expenditure. Other items are not.
16.	**(c)**	Carriage inwards for fuel for the machinery are revenue expenditure.
17.	**(c)**	New room is improvement and the repair work is revenue expenditure.
18.	**(c)**	Debit Equipment Rs. 800,000; Credit Bank Rs. 500,000; Credit Payables Rs. 300,000
19.	**(c)**	Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 320,000 & Payables Rs. 320,000
20.	**(a)**	Debit Equipment Rs. 800,000; Credit Advance Rs. 160,000 & Bank Rs. 400,000 & Payables Rs. 240,000
21.	**(a)**	The depreciation is systematic allocation of depreciable amount of an asset over its useful life.
22.	**(b)**	Depreciable amount = Cost less residual value
23.	**(a)**	Residual value is amount expected at the end of useful life.
24.	**(b)**	(Rs. 6m – 1m) / 5 years = Rs. 1 million
25.	**(c)**	= 6.5m / (8m x 7 years) = 11.6%
26.	**(c)**	Rs. 2,000,000 x $(0.75)^5$ = 474,609
27.	**(d)**	The carrying amount of an asset is equal to its residual value at the end of useful life, under any depreciation method.
28.	**(a)**	= 1 – $(1.5/8)^{(1/7)}$ = 21.27%
29.	**(c)**	Units of production method
30.	**(d)**	Rs. 75,000,000 / 48,000 x 1,800 = Rs. 2,812,500
31.	**(d)**	***Sum of digits = 5 + 4 + 3 + 2 + 1 = 15*** **Rs.** Cost of asset 400,000 Year 1 Depreciation (400,000 – 40,000) x 5/15 (120,000) Carrying amount at the end of year 1 280,000 Year 2 Depreciation (400,000 – 40,000) x 4/15 (96,000) Carrying amount at the end of year 2 184,000
32.	**(c)**	(Rs. 2,200,000 – 200,000) x 5/15 = Rs. 666,667

33.	**(b)**	Sum of digits = [45 (45+1)] /2 = 1035 Depreciation 4th year = Rs. 160m x 42/1035 = Rs. 6,492,754
34.	**(a)**	Six months' depreciation is required on the building structure and air conditioning system. **Rs. 000** Land (not depreciated) 2,000 Building structure (10,000 – (10,000/25 × 6/12)) 9,800 Air conditioning system (4,000 – (3,500/10 × 6/12)) 3,825 15,625
35.	**(c)**	Land is not depreciated because it has indefinite life.
36.	**(d)**	Depreciation continues even if the asset is not in use.
37.	**(c)**	Rs. 4,800,000/8 years = Rs. 600,000 x 9/12 = Rs. 450,000
38.	**(c)**	Rs. 3,000,000 x 10% x 12/12 = Rs. 300,000 Rs. 2,000,000 x 10% x 12/12 = Rs. 200,000 Rs. 4,000,000 x 10% x 6/12 = Rs. 200,000 Total Rs. 700,000
39.	**(b)**	(Rs. 3,000,000 – 300,000 – 270,000) x 10% x 12/12 = Rs. 243,000 (Rs. 2,000,000 – 150,000) x 10% x 12/12 = Rs. 185,000 Rs. 4,000,000 x 10% x 6/12 = Rs. 200,000 Total Rs. 628,000
40.	**(d)**	Carrying amount on 1 Jan 2021 = Rs. 4,000,000 x $(0.90)^3$=Rs. 2,916,000 Depreciation 2021 = Rs. (2,916,000 – 500,000) / 5 years = Rs. 483,200
41.	**(a)**	Carrying amount on 1 Jan 2021 = Rs. 4,000,000 - (400,000 x 3) = Rs. 2,800,000 Depreciation rate = 1 – $(500{,}000/2{,}800{,}000)^{(1/5)}$ = 29.15% Depreciation 2021 = Rs. 2,800,000 x 29.15% = Rs. 816,097
42.	**(c)**	Residual value is reviewed annually at the end of each reporting period
43.	**(c)**	Useful life is reviewed annually at the end of each reporting period
44.	**(b)**	Rs. 860 m x 20% x 12/12 = Rs. 172 million Rs. 100 m x 20% x 4/12 = Rs. 6.67 million Total Rs. 178.67 million
45.	**(d)**	Rs. 600 m x 20% x 12/12 = Rs. 120 million Rs. 100 m x 20% x 4/12 = Rs. 6.67 million Total Rs. 126.67 million
46.	**(a)**	Rs. (600 m – 150m) x 20% x 12/12 = Rs. 90 million Rs. 100 m x 20% x 4/12 = Rs. 6.67 million Total Rs. 96.67 million

47.	**(b)**	At the end of useful life, the carrying amount of asset becomes equal to its residual value.
48.	**(c)**	The total depreciation throughout useful life is equal to depreciable amount. = Rs. 1,400,000 – 200,000 = Rs. 1,200,000
49.	**(b) & (c)**	Entity A has initially invested more in non-current assets as compared to Entity B. Entity A has older assets as compared to Entity B.
50.	**Rs. 37,250**	<table><tr><td></td><td>Rs. '000</td></tr><tr><td>Machine ((500,000 – 20,000) / 10 × 9/12)</td><td>36,000</td></tr><tr><td>Safety guard ((25,000/5) × 3/12)</td><td>1,250</td></tr><tr><td></td><td>37,250</td></tr></table>

STICKY NOTES

Methods of depreciation

- **Straight line method**
  - depreciates the asset evenly throughout its useful life
- **Reducing balance method**
  - is calculated by applying a fixed percentage on the book value of the asset each year.
- **Sum-of-the-year-digit method**
  - it will result in greater depreciation in the earlier years of an asset's useful life and less in the later years.
- **Units of production method**
  - is based on the units produced during the year. The estimated total production of the asset is the criteria for providing depreciation.

Formula of methods of Depreciation

Formula: Straight-line method

$$\text{Depreciation charge} = \frac{\text{Cost of asset less expected residual value}}{\text{Expected useful life (years)}}$$

Formula: Reducing balance method

$$\text{Depreciation charge} = \text{Carrying amount at the start of the year} \times \text{Fixed }\%$$

Formula: Sum of the years digits method

$$\text{Sum of digits} = \frac{n(n+1)}{2}$$

Where:

n = the useful life at the start of ownership

Formula: Units of production method

$$\text{Depreciation charge} = \frac{\text{Cost of asset less expected residual value}}{\text{Expected total output of asset over its life}} \times \text{Output this year}$$

AT A GLANCE

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CHAPTER 7

IAS 2: INVENTORIES

IN THIS CHAPTER:

AT A GLANCE

Inventory represents unsold stock lying with the entity. It is the most important tangible current asset on an entity's statement of financial position. When an inventory item is sold, its carrying cost is transferred to the cost of goods sold and profit is recognised on such sale.

Inventories are measured at lower of cost and net realisable value (NRV). Cost comprises cost of purchases, conversion costs and other costs incurred in bringing the inventories to their present location and condition. NRV is net amount expected to be realised by selling inventories.

It must be noted that materials prices affect the value of entity's inventory, it is important to understand how an entity accounts for its inventory. Most common methods of inventory valuation are First-In, First Out (FIFO) method and Weighted average method.

There are two inventory recording systems. One is Periodic inventory system in which inventory is recorded periodically by passing an adjustment entry. Other method is perpetual inventory system, in which inventory account is updated with every transaction which increases or decreases the value of inventory, thus resulting in better control over inventory.

There are generally three reasons entities maintain inventories:

i. Meeting variation in production demand;

ii. Economies of scale in procurement;

iii. Guarding against price increases and stock outs.

AT A GLANCE
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1. MEASUREMENT: LOWER OF COST AND NRV

INTRODUCTION

IAS 2 Inventories deals with accounting for inventories.

Inventories are assets:

a) held for sale in the ordinary course of business (finished goods);

b) in the process of production for such sale (work in process); or

c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials and other supplies).

Goods in transit

Goods in transit are also categorised as inventory of buyer entity, where control (risk and rewards) is transferred to the buyer.

The basic requirement for counting an item in inventory is economic control rather than physical possession (substance over form). Therefore, when an entity purchases inventory, the item is included in the inventory even if the purchaser does not have physical possession of those items.

Measurement

Inventories are measured at ***lower*** of cost and net realisable value (NRV).

COSTS OF INVENTORIES

The costs of inventories shall comprise:

a) all costs of purchase,

b) costs of conversion,

c) other costs incurred in bringing the inventories into their present location and condition e.g. it may be appropriate to include non- production overheads or the costs of designing products for specific customers.

Costs of Purchase

The following table summarises the measurement of costs of purchase.

Include	Exclude
Purchase price	
Non-refundable import duties	Refundable sales tax
Non-adjustable taxes	Adjustable income tax
Transport and handling costs	Costs not directly attributable to acquisition
Other costs directly attributable to acquisition	Discounts and rebates

- *Example 01:*

Sajid Ltd imported raw material for use in production of goods with following details:

	Rs (000)
Invoice value (List price Rs. 1,050,000; trade discount Rs. 50,000)	1,000
Custom duty	150
Federal excise duty	50
Non adjusting income tax	225
Refundable sales tax	180
Carriage	40
Commission paid to agent for clearance of raw materials	100

Required: Calculate the cost of purchase on inventories.

- *ANSWER*

Cost of purchase	Rs (000)
Invoice value (net of discount)	1,000
Customs duty	150
Federal excise duty	50
Non-adjustable income tax	225
Carriage	40
Commission to agent	100
	1,565

Costs of Conversion

These include:

a) costs directly related to the units of production, such as direct labour

b) a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

Fixed production overheads

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.

Variable production overheads

Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Costs to be excluded

Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

a. abnormal losses and wastages;

b. storage costs, unless necessary for the production process;

c. administrative overheads; and

d. selling costs.

Storage costs of raw materials requiring further processing may be included in the cost of inventory. However, storage cost of finished goods is not included in the cost of inventory as it does not contribute to bringing the inventory to its present location and condition.

Level of Production

The conversion costs are included in inventory on the basis of following levels of production:

Cost	Level of activity
Direct labour and other direct costs	Actual level of production
Variable production overheads	Actual level of production
Fixed production overhead	Normal production capacity (actual production is used, if it exceeds normal capacity).

Normal capacity

Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.

► *Example 02:*

Khewra Manufacturing was formed on 1 January 2015. The entity manufactures and sells a single product and values it on a first-in, first-out basis. One ton of raw material is processed into one ton of finished goods.

The following details relate to 2015.

Purchases of raw materials	
Purchases:	1,000 tons of raw materials per week
Price:	Rs. 100,000 per ton on 1 January, increasing to Rs.150,000 per ton on 1 July
Import duties:	Rs.10,000 per ton
Transport from docks to factory:	Rs.20,000 per ton
Production costs	
Production capacity:	1,000 tons per week
Variable costs:	Rs.25,000 per ton
Fixed costs:	Rs.30,000,000 per week
Inventories at 31 December 2015	
Raw materials:	2,000 tons
Finished goods:	2,000 tons

Required:

Calculate the cost of inventories at 31 December 2015 in accordance with IAS 2.

▶ *ANSWER*

	Rs.
Raw materials (2,000 tons x 180,000 **W1**)	360,000,000
Finished goods (2,000 tons x 235,000 **W1**)	470,000,000
	830,000,000

Working 1 – Cost per ton	**Rs.**
Raw material	150,000
Import duties	10,000
Transport cost	20,000
Raw material cost	180,000
Variable cost	25,000
Fixed cost (30,000,000 / 1,000 normal level of capacity)	30,000
Finished goods costs	235,000

▶ *Example 03:*

NKL Enterprises produces a single product. On July 31, 2015, the finished goods inventory consisted of 4,000 units valued at Rs. 220 per unit and the inventory of raw materials was worth Rs. 540,000. For the month of August 2015, the books of account show the following:

	Rupees
Raw material purchases	845,000
Direct labour	735,000
Selling costs	248,000
Depreciation on plant and machinery	80,000
Distribution costs	89,560
Factory manager's salary	47,600
Indirect labour	148,000
Indirect material consumed	45,000
Other production overheads	84,000
Other accounting costs	60,540
Other administration overheads	188,600

Other information:

i. 8,000 units of finished goods were produced during August 2015.

ii. The value of raw materials on August 31, 2015 amounted to Rs. 600,000.

iii. There was no work-in-progress at the start of the month. However, on August 31, the value of work-in-progress is approximately Rs. 250,000.

iv. 5,000 units of finished goods were available in inventory as on August 31, 2015.

Required:

Compute the value of closing inventory of finished goods as on August 31, 2015 based on weighted average cost method.

▶ *ANSWER*

Cost of closing inventory 5,000 units x 212.88 **W1** = **Rs. 1,064,400**

W1 - Finished goods	Units	Amount
Opening inventory	4,000	880,000
Production **W2**	8,000	1,674,600
Total	**12,000**	**2,554,600**

Per unit cost of closing inventory = 2,554,600/12,000 = **Rs. 212.88**

W2 - Cost of production	Rupees
Raw material: Opening inventory	540,000
Purchases	845,000
Closing inventory	(600,000)
Raw material consumed	785,000
Direct labour	735,000
Depreciation cost	80,000
Factory manager's salary	47,000
Indirect labour	148,000
Indirect material consumed	45,000
Other production overheads	84,000
	1,924,600
Less: work-in-progress (closing)	250,000
Cost of 8,000 units of finished goods produced	**1,674,600**

NET REALISABLE VALUE (NRV)

NRV is the estimated selling price in the ordinary course of business

less the estimated costs of completion **and**

less the estimated costs necessary to make the sale.

The estimated selling price may or may not be equal to fair value depending upon how entity sells in the ordinary course of business.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Write down

The following points should be noted:

- Inventories are originally recorded at cost
- Inventories are to be measured at lower of cost and NRV

The above has following implication:

- If cost is lower, no adjustment is needed
- If NRV is lower, the carrying amount of inventories is reduced (written down) to its NRV and the difference is recorded (in periodic system, automatically) as an expense (loss).

The practice of writing inventories down below cost to NRV is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

Reasons for write down

The cost of inventories may not be recoverable if:

- those inventories are damaged;
- wholly or partially obsolete;
- their selling prices have declined;
- the estimated costs of completion have increased; or
- the estimated costs to be incurred to make the sale have increased.

Item by Item

Inventories are usually written down to NRV item by item. In some circumstances, however, it may be appropriate to group similar or related items. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.

NRV of raw material

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

▶ *Example 04:*

Goods purchased to be resold, cost of Rs. 10,000 have been damaged. At the year-end their replacement buying price is Rs. 9,000. They can be sold in the normal course of business for Rs.14000, provided Rs. 4,500 is spent on rectifying the damage.

Required:

At what amount should the stock be valued?

▶ *ANSWER*

	Rs.
Cost	10,000
NRV (Rs. 14,000 – 4,500)	9,500
Value to be reported in financial statements (lower)	9,500
Write down to NRV (loss) Rs. 10,000 – 9,500	500

▶ *Example 05:*

Chintu Co. deals in two products namely product A and Product B, the details related to each product is as follows:

Product A

At 31 December 2001, Chintu Co. had 100,000 units of Product A with a carrying amount Rs. 400,000. Of this, 20,000 units had been set-aside for XYZ Limited in terms of a firm sales commitment at Rs. 6 per unit. The current selling price per unit is Rs. 4. Selling costs for the 20,000 unit is only Rs. 1,000 whereas the normal estimated selling costs are Re. 1 per unit.

Product B

Product B has been placed in a warehouse with little infra structure, the factory manager informed the management on 15 January 2002 that the entire warehouse and all the inventory contained therein, with a carrying amount of Rs. 900,000 – had been destroyed in a series of storms. The first storm hit the warehouse on 29 December 2001 destroying 70% of the inventory.

AT A GLANCE

SPOTLIGHT

STICKY NOTES

He explained that the remaining inventory was quickly moved to higher ground but flood waters from a second storm on 5 January 2002 destroyed this too. He estimates that the entire inventory will be saleable as scrap for Rs. 100,000.

Costs to sell the entire inventory as scrap is estimated at Rs. 1,000. The normal sales value for the entire inventory would have been Rs. 1,500,000 and the selling costs would have been 10% thereof.

Required

Calculate net realisable value as at 31st December 2001.

- *ANSWER*

Product A

		Rs.
Estimated selling price	(20,000 x Rs. 6) + (80,000 x Rs. 4)	440,000
Less: Selling costs	(Rs. 1,000) + (80,000 x Re. 1)	(81,000)
		359,000

Product B

Estimated selling price	(Rs. 100,000 x 70%) + (Rs.1,500,000 x 30%)	520,000
Less: Selling costs	(Rs. 1,000 x 70%) + (Rs. 1,500,000 x 30% x 10%)	(45,700)
		474,300
Total Value		***833,300***

- *Example 06:*

HM has following products in hand as at 31st December 2001, the relevant information is as follows:

Product	Cost	Estimated selling price (ESP)	Estimated Selling Cost (ESC)	Estimated cost to complete sales (ECCS)	Ratio of credit sales based on past experience	Recovery cost	Bad debt expense
A	100,000	20% mark up	5% of ESP	15% of cost	60%	1% of cost	5%
B	270,000	15% margin	3% of ESP	7% of cost	40%	1% of cost	3%
C	830,000	25% mark up	6% of ESP	20% of cost	20%	1% of cost	2%
D	690,000	30% mark up	8% of ESP	22% of cost	0%	0%	0%
E	500,000	50% margin	10% of ESP	2% of cost	100%	2% of cost	10%

Based on above information, calculate the value of inventories to be shown in financial statements and NRV loss to be booked if any.

▶ *ANSWER*

Product	Cost	ESP	ESC	ECCS	NRV	Lower	(Loss)
	Rs.						
A	100,000	120,000	6,000	15,000	99,000	99,000	(1,000)
B	270,000	317,647	9,529	18,900	289,218	270,000	-
C	830,000	1,037,500	62,250	166,000	809,250	809,250	(20,750)
D	690,000	897,000	71,760	151,800	673,440	673,440	(16,560)
E	500,000	1,000,000	100,000	10,000	890,000	500,000	-
Total						2,351,690	(38,310)

▶ *Example 07:*

Marfani & Co. has purchased goods costing Rs. 100,000 at the start of 2001, however the goods remain unsold for 5 years and the estimated selling prices (ESP) and estimated cost of realisation (ECR) were as follows as at each year end:

	Estimated Selling price (ESP)	Estimated Cost of Realisation (ECR)
	Rupees	
01-Jan-01	220,000	20,000
31-Dec-01	135,000	15,000
31-Dec-02	100,000	10,000
31-Dec-03	90,000	15,000
31-Dec-04	110,000	15,000
31-Dec-05	120,000	10,000

Required:

As at each year end, calculate the value at which inventory should be reported in the financial statements of Marfani & Co. and NRV loss/reversal of any write down for each accounting year assuming year end is 31st December.

▶ *ANSWER*

Date	Cost	ESP	ECR	NRV	Lower	(Loss) / Reversal
	Rs.					
01.01.01	100,000	220,000	20,000	200,000	100,000	-
31.12.01	100,000	135,000	15,000	120,000	100,000	-
31.12.02	100,000	100,000	10,000	90,000	90,000	(10,000)
31.12.03	100,000	90,000	15,000	75,000	75,000	(15,000)
31.12.04	100,000	110,000	15,000	95,000	95,000	20,000
31.12.05	100,000	120,000	10,000	110,000	100,000	5,000

- *Example 08:*

M/S Lasani Associates have provided you with the following working papers regarding inventory on hand at 31 December 2002. The entity is a manufacturer of two product lines:

	Cost Rs.	NRV Rs.	Write Down Rs.
Raw Materials	200,000	150,000	50,000
-Air cooler parts	80,000	50,000	-
-Fans parts	120,000	100,000	-
Work In progress	160,000	170,000	-
-Air cooler	60,000	50,000	-
-Fans	100,000	120,000	-
Finished goods	320,000	330,000	-
-Air cooler	160,000	110,000	-
-Fans	160,000	220,000	-
	680,000	650,000	50,000

Due to the strengthening of the local currency, the parts used in the manufacture of both the air coolers and fans became cheaper. As a direct result thereof, the net realisable value of both the finished air coolers and fans also dropped.

Required:

Critically analyse, whether the write down has been calculated correctly.

- *ANSWER*

The calculation of possible write-downs of inventory must not be done based on the classifications (raw materials, work-in-progress and finished goods) but should be assessed on an item-by-item basis.

Although both items of raw materials have net realisable values that are lower than cost, raw materials should not be written-down unless the reason for the drop in the NRV of the raw materials has also resulted in the NRV of the related finished product also dropping.

Since the NRV of the finished air coolers has dropped below cost, air coolers (raw materials) should be written-down to their net realisable value (the NRV in this case is usually the net replacement cost).

Despite the NRV of the finished fans having dropped, the NRV of the fan parts has not dropped below cost. The fan parts (raw materials) should therefore not be written-down.

Calculation of write down	Cost Rs.	NRV Rs.	NRV Loss Rs.
Air coolers			
Raw Materials	80,000	50,000	30,000
WIP	60,000	50,000	10,000
Finished goods	160,000	110,000	50,000
Fans			
Raw Materials	120,000	100,000	-
WIP	100,000	120,000	-
Finished goods	160,000	220,000	-
			90,000

▶ *Example 09:*

Cheesecake Limited produces cheese cakes for the local market. At its financial year ended 30 September 2005, it had raw materials of Rs. 320,000 on hand (market value has declined to Rs. 300,000 only). It is expected that the cost to convert the raw materials into finished cheese cakes is Rs. 80,000.

Required

Calculate the net realisable value of the raw materials and amount of the write-down, if any, assuming that, once converted into the finished cheese cakes, the total inventory of cheese cakes would have a:

i. sales value of Rs. 480,000, where related selling costs would be Rs. 40,000.

ii. sales value of Rs. 400,000, where related selling costs would be Rs. 40,000.

▶ *ANSWER*

(i)	Cost	NRV	Value
		Rs.	
Raw material	320,000	300,000	320,000
Finished goods (320,000+80,000) & (480,000-40,000)	400,000	440,000	400,000
			720,000

Note: Materials are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

(ii)	Cost	NRV	Value	NRV Loss
			Rs.	
Raw material	320,000	300,000	300,000	20,000
Finished goods (320,000+80,000)	400,000	360,000*	360,000	40,000
	720,000		660,000	60,000

*Rs. 400,000 – 40,000 = Rs. 360,000

2. COST FORMULAS: FIFO AND WEIGHTED AVERAGE

COST FORMULAS

Specific identification of costs is necessary for:

- NOT ordinarily interchangeable goods.
- Goods produced and segregated for specific projects

However, an efficient way is to use any of the following cost formula for ordinarily interchangeable goods:

- First In First Out (FIFO): The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.
- Weighted Average: Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Consistency

An entity shall use the same cost formula for all inventories having a similar nature and use to the entity.

For inventories with a different nature or use, different cost formulas may be justified. Difference in geographical location is not sufficient to justify using a different cost formula.

Impact on profit

Inventory valuation has a direct effect on profit measurement. In periods of inflation, FIFO method measures inventory (and thus, profit) at higher value as compared to weighted average method.

COST MEASUREMENT TECHNIQUES

Standard cost method

This method takes into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and if necessary, revised in the light of current conditions.

Retail method

It is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin.

► *Example 10:*

The following information is available from records of K Limited, in respect of Chemical X, for the year ended December 31, 2007.

	Quantity (litres)	Rate per unit	Total value
Opening Inventory			
As at January 01, 2007	20,000	11	220,000
Purchases			
15 Jan	11,000	12	132,000
21 Apr	8,000	13	104,000
07 July	7,000	14	98,000
08 Nov	14,000	15	210,000
TOTAL	**40,000**		**544,000**

	Quantity (litres)	Rate per unit	Total value
Sold			
11 Jan	9,000	15	135,000
22 Apr	18,000	15	270,000
11 May	9,000	16	144,000
20 Dec	12,000	16	192,000
TOTAL	**48,000**		**741,000**

Required

Calculate closing inventory as at 31 December 2007 and prepare profit statement under perpetual and periodic method of FIFO and weighted average.

▶ *ANSWER*

FIFO - Perpetual									
Date	Received			Issued / Sold			Balance		
	Qty.	@	Rs.	Qty.	@	Rs.	Qty.	@	Rs.
01.01.07							20,000	11	220,000
11.01.07				9,000	11	99,000	11,000	11	121,000
15.01.07	11,000	12	132,000				11,000 11,000	11 12	121,000 132,000
21.04.07	8,000	13	104,000				11,000 11,000 8,000	11 12 13	121,000 132,000 104,000
22.04.07				11,000 7,000	11 12	121,000 84,000	4,000 8,000	12 13	48,000 104,000
11.05.07				4,000 5,000	12 13	48,000 65,000	3,000	13	39,000
07.07.07	7,000	14	98,000				3,000 7,000	13 14	39,000 98,000
08.11.07	14,000	15	210,000				3,000 7,000 14,000	13 14 15	39,000 98,000 210,000
20.12.07				3,000 7,000 2,000	13 14 15	39,000 98,000 30,000	***12,000***	***15***	***180,000***
	Purchases Rs. 544,000			***COS Rs. 584,000***			***Closing inventory ↑***		

FIFO – Periodic	
	Units
Opening inventory	20,000
Add: Purchases	40,000
Less: Sold	48,000
Closing inventory	12,000

Value of closing inventory	
Last 12,000 units were purchased at Rs. 15 per unit	***Rs. 180,000***

Weighted Average - Perpetual									
Date	Received			Issued / Sold			Balance		
	Qty.	@	Rs.	Qty.	@	Rs.	Qty.	@	Rs.
01.01.07							20,000	11	220,000
11.01.07				9,000	11	99,000	11,000	11	121,000
15.01.07	11,000	12	132,000				22,000	11.5	253,000
21.04.07	8,000	13	104,000				30,000	11.9	357,000
22.04.07				18,000	11.9	214,200	12,000	11.9	142,800
11.05.07				9,000	11.9	107,100	3,000	11.9	35,700
07.07.07	7,000	14	98,000				10,000	13.37	133,700
08.11.07	14,000	15	210,000				24,000	14.32	343,700
20.12.07				12,000	14.32	171,850	***12,000***	***14.32***	***171,850***
	Purchases Rs. 544,000			***COS Rs. 592,150***			***Closing inventory ↑***		

Weighted average – Periodic		
	Units	**Cost Rs.**
Opening inventory	20,000	220,000
Purchases during the period	40,000	544,000
	60,000	764,000
Weighted average rate for the period Rs. 764,000 / 60,000	**12.73**	

	Units
Opening inventory	20,000
Add: Purchases	40,000
Less: Sold	48,000
Closing inventory	12,000

Value of closing inventory	
12,000 units at Rs. 12.73 per unit	***Rs. 152,800***

Profit statement/ Trading account	First in First out		Weighted average	
	Perpetual	Periodic	Perpetual	Periodic
	Rs.			
Sales	741,000	741,000	741,000	741,000
Cost of sales				
Opening inventory	220,000	220,000	220,000	220,000
Purchases	544,000	544,000	544,000	544,000
	764,000	764,000	764,000	764,000
Closing inventory	***(180,000)***	***(180,000)***	***(171,850)***	***(152,800)***
	(584,000)	(584,000)	(592,150)	(611,200)
Gross profit	***157,000***	***157,000***	***148,850***	***129,800***

▶ *Example 11:*

Quality Products (QP) deals in various goods. Following information pertains to one of its product for the month of January 2016:

Date	Description	Units	Purchase / sale price per unit (Rs.)
6-Jan-2016	Purchase	15,000	150
10-Jan-2016	Sale	(18,000)	210
16-Jan-2016	Purchase	13,000	160
18-Jan-2016	Purchase return	(1,000)	150
25-Jan-2016	Sale	(12,000)	215
28-Jan-2016	Drawing	(2,000)	-
29-Jan-2016	Purchase	10,000	140
31-Jan-2016	Shortage	(800)	-

Opening inventory consisted of 10,000 units costing Rs. 1,480,000. Closing inventory includes 1,200 units found damaged during stock taking. Net realisable values (NRVs) of the damaged and the good units are Rs. 120 and Rs. 200 per unit respectively. QP uses perpetual inventory method to record the inventory.

Required:

Compute the value of closing inventory using Weighted average cost and FIFO.

▶ *ANSWER*

Weighted average cost

Date Jan 2016	Transactions	Balance		
		Quantity	Rate	Rs.
1	Balance	10,000	148.00	1,480,000
6	Purchases 15,000 @150 = Rs. 2,250,000	25,000	149.20	3,730,000
10	Sales 18,000 @149.20 = Rs. 2,685,600	7,000	149.20	1,044,400
16	Purchases 13,000 @160 = Rs. 2,080,000	20,000	156.22	3,124,400
18	Purchase returns 1,000 @150 = Rs. 150,000	19,000	156.55	2,974,400
25	Sales 12,000 @156.55 = Rs. 1,878,600	7,000	156.54	1,095,800
28	Drawings 2,000 @156.54 = Rs. 313,080)	5,000	156.54	782,720
29	Purchases 10,000 @140 = Rs. 1,400,000	15,000	145.51	2,182,720
31	Shortages 800@145.51@116,408	14,200	145.51	2,066,312

	Qty.	Cost per unit	NRV per unit	Closing inventory at lower Rs.
Good units (14,200 – 1,200)	13,000	145.51	200	1,891,630
Damaged units	1,200	145.51	120	144,000
	14,200			2,035,630

Closing inventory at lower of cost or NRV – using FIFO

	Qty.	Cost per unit	NRV per unit	Closing inventory at lower Rs.
Good units	10,000	140	200	1,400,000
Good units	3,000	160	200	480,000
Damaged units	1,200	160	120	144,000
	14,200			2,024,000

- *Example 12:*

The following information has been extracted from the books of Zamil Traders (ZT):

PRODUCT: VITA-PLUS			
Date	**Description**	**No. of units**	**Purchase/sales price per unit (Rs.)**
1-Feb-2017	Opening balance	4,500	120
3-Feb-2017	Purchases	2,700	125
8-Feb-2017	Sales	(2,800)	150
15-Feb-2017	Purchase return	(255)	120
18-Feb-2017	Purchases	2,650	130
20-Feb-2017	Drawings	(180)	125
23-Feb-2017	Sales return	300	150
25-Feb-2017	Sales	(3,200)	160
	Closing balance	**3,715**	

As per physical inventory carried out at month end, 315 units were found short and 400 units were found damaged. Out of damaged units, 300 units can be sold for Rs. 140 per unit after being repaired at a cost of Rs. 20 per unit. Remaining damaged units have no sales value.

ZT uses periodic inventory method and the inventory is valued at lower of cost determined on weighted average basis and net realisable value.

Required:

Compute value of closing inventory as would appear in ZT's financial statements for the month ended 28 February 2017.

- *ANSWER*

Weighted average cost per unit – periodic inventory

Particulars	Units	Rate	Rs.
Opening balance	4,500	120	540,000
Purchases	2,700	125	337,500
Purchases	2,650	130	344,500
Purchase return	(255)	120	(30,600)
Drawings	(180)	125	(22,500)
	9,415	***124.15***	**1,168,900**

	Good units	Shortage	Damaged - Saleable	Damaged - unsaleable	Total
Units	3,000	315	300	100	3,715
Cost (Rs.)	124.15	124.15	124.15	124.15	
NRV (Rs.)	160 last sales	0	120 (140- 20)	0	
Lower (Rs.)	**160**	**0**	**120**	**0**	
Value (Rs.)	372,450	0	36,000	0	***408,450***

► *Example 13:*

Following information relates to M/S Mola Bakhsh

Product A		Units		Rate
01-Jan-16	Opening stock	40	@	400
02-Jan-16	Purchases	100	@	500
03-Jan-16	Sales	50	@	1,000
04-Jan-16	Sales	10	@	1,500
05-Jan-16	Purchases	200	@	300
06-Jan-16	Purchases	300	@	700
07-Jan-16	Sales	200	@	500
08-Jan-16	Sales return	100	@	500
09-Jan-16	Purchases	200	@	400
10-Jan-16	Purchase return were 100 units of purchases on 9 Jan 2016			
11-Jan-16	Shortage	10 units		
12-Jan-16	Drawings	5 units		

At the end of the month the estimated Selling price of the product A was Rs.300 and the cost of realisation was Rs.150

Required

Calculate the value of closing stock and cost of sales under perpetual system using FIFO and weighted average.

► *ANSWER*

Perpetual System (FIFO)

	Purchases/Inflows			Cost of Sales/Outflows			Stock balance		
	Unit	**Rate**	**Amount**	**Unit**	**Rate**	**Amount**	**Unit**	**Rate**	**Amount**
01-Jan-16							40	400	16,000
02-Jan-16	100	500	50,000				40 100	400 500	16,000 50,000
03-Jan-16				40 10	400 500	16,000 5,000	90	500	45,000
04-Jan-16				10	500	5,000	80	500	40,000
05-Jan-16	200	300	60,000				80 200	500 300	40,000 60,000
06-Jan-16	300	700	210,000				80 200 300	500 300 700	40,000 60,000 210,000
07-Jan-16				80 120	500 300	40,000 36,000	80 300	300 700	24,000 210,000
08-Jan-16				(80) (20)	500 300	(40,000) (6,000)	80 20+80 300	500 300 700	40,000 30,000 210,000

	Purchases/Inflows			Cost of Sales/Outflows			Stock balance		
09-Jan-16	200	400	80,000				80 100 300 200	500 300 700 400	40,000 30,000 210,000 80,000
10-Jan-16	(100)	400	(40,000)				80 100 300 100	500 300 700 400	40,000 30,000 210,000 40,000
11-Jan-16				10	500	5,000	70 100 300 100	500 300 700 400	35,000 30,000 210,000 40,000
12-Jan-16				5	500	2,500	65 100 300 100	500 300 700 400	32,500 30,000 210,000 40,000
	700		***360,000***	***175***		***63,500***	***565***		***312,500***

Valuation of stock	Rs.	
Cost	312,500	
NRV	84,750	*(300-150) x 565*
Value	84,750	
NRV loss	227,750	

Perpetual System (Weighted Average)

	Purchases / Inflows			Cost of Sales / Outflows			Stock balance		
Date	**Unit**	**Rate**	**Amount**	**Unit**	**Rate**	**Amount**	**Unit**	**Rate**	**Amount**
01-Jan-16							40	400	16,000
02-Jan-16	100	500	50,000				140	471	66,000
03-Jan-16				50	471	23,550	90	471	42,390
04-Jan-16				10	471	4,710	80	471	37,680
05-Jan-16	200	300	60,000				280	349	97,720
06-Jan-16	300	700	210,000				580	531	307,980
07-Jan-16				200	531	106,200	380	531	201,780
08-Jan-16				(100)	531	(53,100)	480	531	254,880
09-Jan-16	200	400	80,000				680	492	334,560
10-Jan-16	(100)	400	(40,000)				580	508	294,640
11-Jan-16				10	508	5,080	570	508	289,560
12-Jan-16				5	508	2,540	**565**	508	***287,020***
	700		***360,000***	***175***		***88,980***			

Valuation of stock	Rs.	
Cost	287,020	
NRV	84,750	*(300-150) x 565*
Value (lower)	84,750	
NRV loss	202,270	

3. RECOGNITION AND DISCLOSURE

RECOGNITION AS AN EXPENSE

When Inventories are sold

The carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised i.e. cost of sales in statement of comprehensive income.

Write down and losses

Recognised as an expense in the period the write-down or loss occurs.

Reversal of write down

Recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

ALLOCATION TO OTHER ASSETS

Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

DISCLOSURE REQUIREMENTS OF IAS 2

The disclosure requirements of IAS 2 include:

- the accounting policies adopted in measuring inventories, including the cost formula used
- the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity
- the amount of inventories recognised as an expense during the period
- the amount of any write-down of inventories recognised as an expense in the period

▶ *ILLUSTRATIVE DISCLOSURE*

Notes to the Financial Statements

Significant Accounting Policies

Inventories are measured at lower of cost and net realisable value. Cost is measured by using weighted average formula.

Inventories	Rs.
Raw Material	5,000
Work in process	6,000
Finished goods	7,000
Total	18,000

Inventories sold and recognised as an expense	288,000
Amount of write down to NRV recognised as an expense	400

▶ *Example 14:*

A company deals in Solar Panels which are imported from China. The company follows a perpetual inventory system and values its inventory on weighted average basis. Details of sales and purchases during the year ended 30 June 2015 are as follows:

i. Opening inventory on 1 July 2014 amounted to Rs. 49,000,000 and consisted of 2,450 solar panels.

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ii. Purchases during the year were as follows:

Date	Quantity (units)	Price Rs. in '000'
30-Sep-2014	4,200	78,120
31-Mar-2015	4,350	87,000

Costs related to imports were 29% of purchase cost, of which 17% is refundable.

iii. Sales during the year were as follows:

Date	Quantity (units)	Price Rs. in '000'
31-Jul-2014	2,100	52,500
31-Oct-2014	2,050	48,750
28-Feb-2015	2,300	55,200
15-May-2015	2,260	53,110

iv. Sale on 31 October 2014 includes 100 solar panels which were damaged during the year and sold at Rs. 12,000 per unit.

v. On 31 May 2015, 50 solar panels were totally damaged and were written off.

vi. On 30 June 2015 there was a significant decline in the prices of solar panels as a new type of solar panel was introduced in the market. Selling prices are now Rs. 18,500 per unit. However, the company has made some modification in its product which will enable it to sell it at Rs. 22,000 per unit. Cost of modification is Rs. 2,500 per unit.

Required:

Prepare disclosure of inventories in the financial position as at 30 June 2015 in accordance with the requirements of IAS-2 'Inventories'.

▶ *ANSWER*

		2015
		Rs. in '000'
20	**Closing inventory**	
	Finished goods **(W-1)**	43,680

20.1 Closing inventory includes items costing Rs. 50,015,000 valued at net realisable value of Rs. 43,680,000.

20.2 The inventory expenses (cost of sales) for the year is Rs. 190,254,000 **(W-4)**

20.3 Damaged inventory of Rs. 1,116,000 **(W-1)** has been written off.

W - 1: Determination of value of closing inventory under perpetual inventory system

Date	Description	QTY	Price/unit (Rs.)		Value (Rs. in '000')
01-Jul-14	Opening	2,450	20,000		49,000
31-Jul-14	Issue	2,100	20,000		42,000
	Balance	350	20,000		7,000
30-sep-14	Purchase	4,200	20,832	**W-2**	87,494
	Balance	4,550	20,768		94,494

Date	Description	QTY	Price/unit (Rs.)		Value (Rs. in '000')
31-Oct-14	Issue	2,050	20,768		42,574
28-Feb-15	Issue	2,300	20,768		47,766
	Balance	200	20,768		4,154
31-Mar-15	Purchase	4350	22,400	**W-2**	97,440
	Balance	4550	22,328		101,594
15-May-15	Issue	2,260	22,328		50,462
	Balance	2,290	22,328		51,132
30-Jun-15	Units w/off	50	22,328		1,116
		2,240	22,328		50,015
30-Jun-15	NRV adjustment **(W-3)**	-	-		6,335
30-Jun-15		2,240	19,500		43,680

W – 2

Purchase cost per unit	September	March
	Rs.	**Rs.**
Purchase price / unit	18,600	20,000
Non-refundable import costs12% (29% - 17%)	2,232	2,400
	20,832	22,400

W – 3

NRV of Solar Panel	Rs.
Cost	22,328
Selling price	22,000
Less: Cost of modification	(2,500)
NRV per unit	19,500
Decline in value(22,328-19,500)	2,828
Expense (2,240 × Rs. 2,828)	6,335,000

W – 4

Cost of sales	Rs. in'000'
Opening stock	49,000
Purchases	184,934
	233,934
Less: Closing stock	(43,680)
	190,254

4. RECORDING INVENTORIES: PERIODIC VS PERPETUAL

The two main methods of recording inventory to calculate cost of sales are:

- Periodic inventory system (period end system)
- Perpetual inventory system

Each method uses a ledger account for inventory, but these have different roles. It is possible that an entity will use the periodic system in its general ledger and use a different computer system outside of its general ledger to track the flow of goods in and out of inventory.

Periodic Inventory System	Perpetual Inventory System
Inventory and cost of goods sold are not updated continuously. Instead purchases are recorded in ***Purchases account*** and each sale transaction is recorded via a single journal entry. Thus, cost of goods sold account does not exist during the accounting period. It is determined at the end of accounting period via a closing entry.	***Inventory*** and ***cost of goods sold*** are updated continuously on each sale and purchase transaction. Some other transactions may also require an update to inventory account for example, sale / purchase return. Purchases are directly debited to inventory account whereas for each sale two journal entries are made: one to record sale value of inventory and other to record cost of goods sold. Purchases account is not used in perpetual inventory system.
Purchases and purchase return accounts are maintained.	These accounts are not required.
Any loss of inventory is automatically dealt with and does not require a special accounting treatment. However, in this way losses may go un-noticed as well.	Any loss detected by comparing physical inventory-count and perpetual records is to be recorded in inventory account. Most losses are identified in this way (see below).
This system is suitable to large size items or low value inventory.	This system is suitable to high value inventories or where inventory movements are frequent.

POSSIBLE CAUSES OF DIFFERENCE

Possible causes of difference between the balance on the inventory account and the physical inventory counted include the following.

- Theft of inventory.
- Incorrect posting of inventory receipts or issues (to different item category).
- Damage to inventory with failure to record that damage.
- Failure to record a receipt.
- Failure to record an issue.

JOURNAL ENTRIES	
Periodic Inventory System	***Perpetual Inventory System***
Opening inventory	
Dr. Cost of Sales Cr. Inventory	b/d balance of inventory account
Purchases	
Dr. Purchases Cr. Payables / Cash	Dr. Inventory Cr. Payables / Cash
Freight or carriage or other direct costs	
Dr. Carriage in / production costs Cr. Payables / Cash	Dr. Inventory Cr. Payables / Cash

JOURNAL ENTRIES	
Settlement discount on purchases	
Dr. Payables Cr. Purchases / Discount received	Dr. Payables Cr. Inventory
Returns to suppliers	
Dr. Payables / Cash Cr. Purchases returns	Dr. Payables / Cash Cr. Inventory
Sales	
Dr. Receivables / Cash Cr. Sales	Dr. Receivables / Cash Cr. Sales
	Dr. Cost of Sales Cr. Inventory
Returns from customers	
Dr. Sales returns Cr. Receivables / Cash	Dr. Sales returns Cr. Receivables / Cash
	Dr. Inventory Cr. Cost of sales
Abnormal loss	
Dr. Abnormal loss Cr. Purchases	Dr. Abnormal loss Cr. Inventory
Drawings	
Dr. Drawings Cr. Purchases	Dr. Drawings Cr. Inventory
Free samples / Charity	
Dr. Marketing expense / Charity expense Cr. Purchases	Dr. Marketing expense / Charity expense Cr. Inventory
Inventory used to construct non-current assets	
Dr. Non-current assets Cr. Purchases	Dr. Non-current assets Cr. Inventory
Normal loss	
No entry required	Dr. Cost of Sales Cr. Inventory
Write down to NRV – identified BEFORE final adjustment of closing inventory	
No entry required	Dr. Cost of Sales Cr. Inventory
Closing inventory (year-end adjustment)	
Dr. Inventory Cr. Cost of Sales	The closing balance of inventory account.
Write down to NRV – identified AFTER final adjustment of closing inventory	
Dr. Cost of Sales Cr. Inventory	Dr. Cost of Sales Cr. Inventory
All entries are recorded at cost except entry of write down to NRV and entries to sales and sales returns account which are based on selling price.	

▶ *Example 15:*

Medium Savings sells goods at cost plus 30% and uses periodic inventory method to record the inventory. The following transactions pertain to August 2017:

04-Aug	Purchased goods on cash for Rs. 568,000.
07-Aug	Sold goods on credit for Rs. 2,418,000.
10-Aug	Returned goods to a supplier costing Rs. 87,000.
13-Aug	Purchased goods on credit for Rs. 2,360,000.
13-Aug	Paid carriage inward of Rs. 48,000.
20-Aug	A customer returned goods which had been invoiced at Rs. 58,500.
24-Aug	Cash sales of Rs. 120,000 net of a special discount of Rs. 10,000.
31-Aug	Physical inventory count revealed that goods having list price of Rs. 26,000 have expired and had to be scrapped. This has been considered abnormal loss.

Required:

Prepare journal entries to record the above transactions.

▶ *ANSWER*

Journal entries

Date	Particulars	Dr. Rs.	Cr. Rs.
04 Aug 17	Purchases	568,000	
	Cash		568,000
	(To record cash purchases)		
07 Aug 17	Receivables	2,418,000	
	Sales		2,418,000
	(To record credit sales)		
10 Aug 17	Payables	87,000	
	Purchases return		87,000
	(To record goods returned to suppliers)		
13 Aug 17	Purchases	2,360,000	
	Payables		2,360,000
	(To record purchase of inventory on credit)		
13 Aug 17	Carriage inwards (Purchase expenses)	48,000	
	Cash / Bank		48,000
	(To record carriage inwards)		
20 Aug 17	Sales return	58,500	
	Receivable		58,500
	(To record sales returns)		
24 Aug 17	Cash	120,000	
	Sales		120,000
	(To record sales)		
31 Aug 17	Abnormal loss (26,000 x 100 /130)	20,000	
	Purchases		20,000
	(To record inventory losses)		

- *Example 16:*

Max Savings sells goods at cost plus 30% and uses perpetual inventory method to record the inventory. The following transactions pertain to August 2017:

04-Aug	Purchased goods on cash for Rs. 568,000.
07-Aug	Sold goods on credit for Rs. 2,418,000.
10-Aug	Returned goods to a supplier costing Rs. 87,000.
13-Aug	Purchased goods on credit for Rs. 2,360,000.
13-Aug	Paid carriage inward of Rs. 48,000.
20-Aug	A customer returned goods which had been invoiced at Rs. 58,500.
24-Aug	Cash sales of Rs. 120,000 net of a special discount of Rs. 10,000.
31-Aug	Physical inventory count revealed that goods having list price of Rs. 26,000 have expired and had to be scrapped. This has been considered abnormal loss.

Required:

Prepare journal entries to record the above transactions.

- *ANSWER*

Journal entries

Date	Particulars	Dr. Rs.	Cr. Rs.
04 Aug 17	Inventory	568,000	
	Cash		568,000
	(To record cash purchases)		
07 Aug 17	Receivables	2,418,000	
	Sales		2,418,000
	Cost of sales (2,418,000 x 100 / 130)	1,860,000	
	Inventory		1,860,000
	(To record sales and cost of sales)		
10 Aug 17	Payables	87,000	
	Inventory		87,000
	(To record goods returned to suppliers)		
13 Aug 17	Inventory	2,360,000	
	Payables		2,360,000
	(To record purchase of inventory on credit)		
13 Aug 17	Inventory	48,000	
	Cash / Bank		48,000
	(To record carriage inwards)		
20 Aug 17	Sales return	58,500	
	Receivable		58,500
	Inventory (58,500 x 100 /130)	45,000	
	Cost of Sales		45,000
	(To record sales returns)		
24 Aug 17	Cash	120,000	
	Sales		120,000
	Cost of sales (120,000+10,000= 130,000 x 100 / 130)	100,000	
	Inventory		100,000
	(To record sales and cost of sales)		
31 Aug 17	Abnormal loss (26,000 x 100 /130)	20,000	
	Inventory		20,000
	(To record inventory losses)		

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- *Example 17:*

The following transaction relate to Multan Trading Company (MTC) for the year ended 31 December 2017:

- They had opening inventory of Rs. 10,000
- Purchases during the year amounted to Rs. 150,000
- Freight on the purchases amounted to Rs. 8,000
- The goods costing Rs. 22,000 were returned to Vendors during the year.
- The sales amounted to Rs. 170,000 (these goods had cost MTC Rs. 145,000).
- The customers returned goods worth Rs. 25,000 (the cost of these goods was Rs. 20,000).
- During December, loss was caused by flood which amounted to Rs. 7,000
- MTC estimates that 1% of stock purchased is usually lost in handling every time.
- Physical stock-take was carried on December 31, 2017 and stock was valued at Rs. 12,500

Required:

Prepare relevant ledgers and trading account under periodic inventory system and perpetual inventory system.

- *ANSWER*

PERIODIC INVENTORY SYSTEM

Inventory					
1 Jan	b/d	10,000		Transfer to PL	10,000
31 Dec	Cost of sales (closing)	12,500		c/d	12,500
		22,500			22,500
1.01.18	b/d	12,500			

Purchases					
	Payables	150,000		Loss by flood	7,000
			31 Dec	Transfer to PL	143,000
		150,000			150,000

Purchases return					
31 Dec	Transfer to PL	22,000		Payables (returns)	22,000
		22,000			22,000

Freight					
	Cash	8,000	31 Dec	Transfer to PL	8,000
		8,000			8,000

Trading Account	**Rs.**
Sales (Rs. 170,000 – 25,000)	145,000
<u>*Cost of sales*</u>	
Opening inventory	10,000
Purchases	143,000
Add: Freight in	8,000
Less: Purchase return	(22,000)
	139,000
Closing inventory	(12,500)
	(126,500)
Gross profit	***18,500***

PERPETUAL INVENTORY SYSTEM

Inventory Account					
01 Jan	b/d	10,000		Payables (P. Returns)	22,000
	Payables (purchases)	150,000		COS (Sales)	145,000
	Cash (Freight)	8,000		Loss by Flood	7,000
	COS (S. Return)	20,000		COS (normal loss)	1,500
			31 Dec	c/d	12,500
		188,000			188,000
1.01.18	b/d	12,500			

Cost of sales					
	Inventory (sales)	145,000		Inventory (S Return)	20,000
	Inventory (normal loss)	1,500			
			31 Dec	***Transfer to PL***	***126,500***
		146,500			146,500

Trading Account	**Rs.**
Sales (Rs. 170,000 – 25,000)	145,000
Cost of sales	(126,500)
Gross profit	***18,500***

5. COMPREHENSIVE EXAMPLES

▶ *Example 18:*

Kidz Party & Co. (KPC) manufactures and sells toys. Following information is available regarding four of its inventory items as on 31 December 2017:

Items	Units	Cost per unit (Rs.)	Normal selling price per unit (Rs.)
Toy cars	10,000	1,250	1,200
Doll houses	5,000	1,800	2,700
Stuffed toys	1,850	1,200	1,900
Minion costumes	870	1,500	2,500

Following information is also available:

i. A sales order for 3,000 toy cars @ Rs. 1,100 per unit is in hand. The remaining units can be sold at normal selling price after incurring selling cost of Rs. 150 per unit.

ii. Doll houses include 1,000 defective units with no scrap value. 20% of the remaining doll houses are damaged and can be sold at 50% of cost.

iii. Stuffed toys costing Rs. 420,000 were accidentally damaged and are beyond repair. KPC plans to sell these toys as scrap. Proceeds from such sale are estimated at Rs. 175,000 and the sale would require transportation cost of Rs. 6,300.

iv. All minion costumes have manufacturing faults and can be sold in present condition at Rs. 1,350 per unit. However, 60% of the units can be rectified at a cost of Rs. 200 per unit after which they can be sold at Rs. 1,600 per unit.

Required:

Calculate the amount at which above inventory items should be carried as on 31 December 2017 in accordance with IAS 2 ‘Inventories’.

▶ *ANSWER*

Inventory valuation as on 31 December 2017

	Units	Cost per unit	Normal selling price per unit	Cost to sell per unit	NRV per unit	Inventory valuation at lower of cost and NRV	
	1	**2**	**3**	**4**	**5=(3-4)**	**6**	
	--------------------------------------- **Rupees** ---------------------------------------						
Toy cars	7,000	1,250	1,200	150	1,050	NRV	7,350,000
	3,000	1,250	1,100	-	1,100	NRV	3,300,000
	10,000						**10,650,000**
Doll houses	1,000	1,800	-		-	NRV	-
	800 **W1**	1,800	900 **W2**	-	900	NRV	720,000
	3,200	1,800	2,700	-	2,700	Cost	5,760,000
	5,000						**6,480,000**
Stuffed toys	350 **W3**	1,200	500 **W4**	18 **W5**	482	NRV	168,700
	1,500	1,200	1,900	-	1,900	Cost	1,800,000
	1,850						**1,968,700**
Minion costumes	522 **W6**	1,500	1,600	200	1,400	NRV	730,800
	348	1,500	1,350	-	1,350	NRV	469,800
	870						**1,200,600**
							20,299,300

W1 ➔ [5,000-1,000]) × 20% = 800

W2 ➔ 1800 x 50% = 900

W3 ➔ (420,000 / 1,200) = 350

W4 ➔ (175,000 / 350) = Rs. 500

W5 ➔ (6,300 / 350) = 18

W6 ➔ (870×60%) = 522

- *Example 19:*

AK Limited follows a perpetual inventory system. Following information is available from the accounting records for the month of January 2016:

	Quantity	Amount (Rs.)
Inventory as at 31 December 2015	3,500	35,000
Purchase on 7 January 2016	3,700	44,400
Purchase on 13 January 2016	4,200	58,800
Purchase on 31 January 2016	2,000	26,000
Sale on 12 January 2016	3,000	60,000
Sale on 25 January 2016	5,500	115,500

Additional information:

i. 100 units out of 4,200 units purchased on 13 January 2016 were found defective and returned to supplier on 28 January 2016.

ii. Inventory count conducted on 31 January 2016 revealed that 4,820 units were physically available.

Required:

a) Prepare inventory cards for the month of January 2016 under the perpetual system showing quantity, unit cost and value under FIFO and weighted average methods of inventory valuation.

b) Record journal entries for additional information provided above.

- *ANSWER*

Part (a)

FIFO Method

Date	Description	Transaction			Balance		
		Quantity	Unit cost	Rs.	Quantity	Unit cost	Rs.
1/01/15	Opening Inventory	--	--	--	3,500	10	35,000
7/01/15	Purchase	3,700	12	44,400	3,500 3,700	10 12	35,000 44,400
12/01/15	Sale	(3,000)	10	30,000	500 3,700	10 12	5,000 44,400
13/01/15	Purchase	4,200	14	58,800	500 3,700 4,200	10 12 14	5,000 44,400 58,800
25/01/15	Sale	(500) (3,700) (1,300)	10 12 14	5,000 44,400 18,200	2,900	14	40,600
28/01/15	Purchase return	(100)	14	1,400	2,800	14	39,200
31/01/15	Purchase	2,000	13	26,000	2,800 2,000	14 13	39,200 26,000
31/01/15	Surplus inventory	20	14	280	2,820 2,000	14 13	39,480 26,000

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Weighted average method

Date	Description	Transaction			Balance		
		Qty.	Unit cost	Rs.	Qty.	Unit cost	Rs.
1/01/15	Opening Inventory				3,500	10.00	35,000
7/01/15	Purchase	3,700	12.00	44,400	7,200	11.03	79,400
12/01/15	Sale	(3,000)	11.03	(33,083)	4,200	11.03	46,317
13/01/15	Purchase	4,200	14.00	58,800	8,400	12.51	105,117
25/01/15	Sale	(5,500)	12.51	(68,826)	2,900	12.51	36,291
28/01/15	Purchase return	(100)	14.00	(1400)	2,800	12.46	34,891
31/01/15	Purchase	2,000	13.00	26,000	4,800	12.69	60,891
31/01/15	Surplus inventory	20	12.69	254	4,820	12.69	61,145

Part (b) Journal Entries

Date	Description	Debit	Credit
		----------Rupees--------	
28/01/2015	Payables(58,800/4,200×100)	1,400	
	Inventory (returns)		1,400
31/01/2015	Inventory(4,820-4,800)×12.96	254	
	Miscellaneous income		254

▶ *Example 20:*

Multan Traders (MT) held 200 units of product A valued at Rs. 175 each on 1 December 2018. Following transactions related to product A have occurred during December 2018:

Date	Description
07	Purchased 400 units from Alpha on credit for Rs. 80,700. Alpha gave further 50 units at no cost under a promotion scheme.
13	Sold 360 units on cash for Rs. 72,000.
16	Purchased 500 units from Bravo on credit for Rs. 89,000. MT also incurred transportation cost of Rs. 1,580.
21	Sold 440 units for Rs. 92,400 on credit to Charlie. To avail the 5% discount on early payment, Charlie paid the amount on 24 December 2018.
25	Purchased 350 units from Delta on credit. Delta offered discount of 8% on list price of Rs. 200 per unit if at least 250 units were purchased. Delta also offered further 2% discount if payment was made within 10 days. MT expects to pay in 30 days.
27	30 units were found in unsaleable condition and were removed from the inventory.
28	Sold 300 units on cash for Rs. 61,000. MT incurred cost of Rs. 1,600 for delivery.

MT follows weighted average method for valuation of its inventory.

Required:

a) Prepare inventory ledger card for product A for the month of December 2018 under perpetual inventory system.

b) Compute gross profit on sale of product A for December 2018.

▶ *ANSWER*

Part (a)

Multan Traders – Inventory Ledger Card (Weighted Average) – December 2018

Date	Received			Issued			Balance		
	Q	R	V	Q	R	V	Q	R	V
01							200	175	35,000
07	450	179.33	80,700				650	178	115,700
13				360	178	64,080	290	178	51,620
16	500	181.16	90,580				790	180	142,200
21				440	180	79,200	350	180	63,000
25	350	184	64,400				700	182	127,400
27				30*	182	5,460	670	182	121,940
28				300	182	54,600	***370***	***182***	***67,340***
	Purchases Rs. 235,680			***COS Rs. 203,340***			***Closing inventory ↑***		

***Unsaleable**

Part (b)

Multan Traders – Gross Profit Computation (Product A) – December 2018

	Rs.
Sales [72,000 + 92,400 x 95% + 61,000]	220,780
Cost of sales [part (a)]	(203,340)
Gross profit	17,440

▶ *Example 21:*

Omikron Traders (OT) deals in one product. Following information for the month of June 2019 has been collected for preparation of trading account:

Description	Units	Rupees	Remarks
Opening inventory	4,000	745,000	At cost
Purchases	11,000	2,340,000	Inclusive of sales tax
Sales	12,000	4,800,000	Exclusive of sales tax

Additional information:

i. Sales tax @ 17% on purchases is adjustable against sales tax payable by OT.

ii. Handling and transportation costs to OT's premises are Rs. 20 per unit.

iii. Units purchased are polished at a cost of Rs. 10 per unit prior to transferring to the warehouse.

iv. Units are stored in a warehouse which is acquired at a monthly rent of Rs. 380,000.

v. 350 units were withdrawn for personal use during the month.

vi. During the month-end physical inventory verification, it was observed that:

- 20 units were found short.
- 150 units were damaged during handling and are saleable at 40% of its selling price after incurring an additional cost of Rs. 15 per unit.
- Shortages/damages up to 200 units in a month are treated as normal loss.

vii. OT uses periodic inventory method and cost is determined using weighted average cost method.

Required:

Prepare 'Trading account' for the month of June 2019.

► *ANSWER*

Omikron Traders

Trading account for the month of June 2019

	Units		Rupees
Sales	12,000	@400 per unit	4,800,000
Cost of sales:			
Opening stock	4,000		745,000
Purchases	11,000	2,340 x 117 / 100	2,000,000
Handling and transportation		11,000 × 20	220,000
Cost of polishing		11,000 × 10	110,000
			3,075,000
Goods withdrawn	(350)	205 **W2**	(71,750)
Closing stock (balancing units)	**(2,650)**	**W1**	(530,150)
	12,000		(2,473,100)
Gross profit			2,326,900

W1 Closing stock	Units	Cost	NRV	Rs.
Inventory shortage	20	205	0	-
Damaged units at NRV	150	205	400 x 40% – 15 = Rs 145	21,750
Good units at cost (remaining)	2,480	205	400	508,400
	2,650			530,150

W2 Cost per unit	Rs.
Cost of (opening stock + purchases)	3,075,000
Units of (opening stock + purchases)	15,000
Weighted average cost per unit (3,075,000 / 15,000)	***205***

6. OBJECTIVE BASED Q&A

01. Which of the following is included in the cost of purchases?

(a) Administrative Salaries

(b) Abnormal loss

(c) Freight in

(d) Rent of store

02. Which of the following costs are included in conversion costs?

(a) Commission of selling staff

(b) Carriage in

(c) Carriage outwards

(d) Factory supervisor's wages

03. After preparing draft accounts, Saima reviews her closing inventory. She discovers that some items included at cost of Rs. 2,600 can be sold for Rs. 2,550 after incurring selling costs of Rs. 65.

What effect will any required adjustment have on Saima's profits?

(a) Profit decreases by Rs. 65

(b) Profit decreases by Rs. 115

(c) No change to profit

(d) Profit decreases by Rs. 50

04. Tasweeb Corporation sells three products – Alpha, Beta and Gamma. The following information was available at the yearend:

	Alpha	Beta	Gamma
	Rs. per unit	**Rs. per unit**	**Rs. per unit**
Original cost	10	13	15
Estimated selling price	15	14	14
Selling and distribution costs	3	5	2
	Units	**Units**	**Units**
Inventory: units held	300	380	240

The value of inventory at the end of year should be?

(a) Rs. 8,300

(b) Rs. 5,700

(c) Rs. 9,300

(d) Rs. 6,150

AT A GLANCE
SPOTLIGHT
STICKY NOTES

05. The following information is related to a mobile dealer about his inventory at year end.

Mobile Set	Cost value (Rs.)	Net realisable value (Rs.)
A	5,000	3,300
B	13,000	13,500
C	14,200	13,900
D	14,900	15,000

What value of inventory should be shown in his Statement of Financial Position prepared at the year end?

(a) Rs. 39,800

(b) Rs. 45,900

(c) Rs. 40,000

(d) Rs. 45,100

06. The closing stock of Daniel amounts to Rs. 130,200. But later on it was discovered that some damaged items were included having cost of Rs. 25,000. Total repair cost is expected to be Rs. 3,500. After repair these could be sold for Rs. 18,000.

What is the correct value of Daniel inventory?

Rs. _______________

07. Following is the detail of inventory of Hamid at December 31, 2018:

Product	Cost value (Rs.)	Net realisable value (Rs.)
A	15,000	17,000
B	12,000	10,000
C	13,500	11,000
D	12,600	14,000
TOTAL	**53,100**	**52,000**

What value of inventory should be shown by the corporation in its Statement of Financial Position at year end?

Rs._______________

08. Which of the following is not permitted as a cost of inventory?

(a) Non-recoverable taxes

(b) Storage costs

(c) Shipping

(d) Fixed manufacturing overheads

09. An entity sold goods of worth Rs.1 million, the manufacturing cost of the goods were Rs. 600,000. The carriage outwards are Rs. 50,000 and commission paid to agent were also Rs. 50,000. What is the gross and net profit?

- **(a)** Gross profit = 600,000 and net profit = 250,000
- **(b)** Gross profit = 300,000 and net profit = 200,000
- **(c)** Gross profit = 400,000 and net profit = 300,000
- **(d)** Gross profit = 350,000 and net profit = 300,000

10. Bazuka Limited (BL) manufacturers and sells office equipment for workplaces. The stock of equipment was included in the closing inventory as of 31 December 2019 at a cost of Rs. 50,000 per equipment.

During the final audit, the auditors noted that the subsequent selling price for the inventory at 15th January 2020 was Rs. 40,000 per item. Furthermore, inquiry reveals that during the physical stock take, a water leakage has damaged the equipment. Accordingly, in the following week, BL spent a total of Rs. 15,000 per equipment for repairing the equipment.

The net realizable value and inventory write-down (loss) amount to?

- **(a)** Rs. 40,000 and Rs.10,000 respectively
- **(b)** Rs. 25,000 and Rs. 25,000 respectively
- **(c)** Rs. 35,000and Rs. 25,000 respectively
- **(d)** Rs. 30,000 and Rs.15,000 respectively

11. Which of the following is allowed as a cost of inventory?

- **(a)** Abnormal waste
- **(b)** Storage costs
- **(c)** Selling costs
- **(d)** Variable manufacturing overheads

12. Spice Limited, imported raw materials from China worth Rs.10 million. They paid Rs. 800,000 as import duties and Rs. 200,000 as import taxes (the import taxes were subsequently refunded by the government). They paid Rs. 150,000 for transportation of the materials from China and another Rs. 200,000 as port handling charges for loading the materials at China. Marketing expenses were Rs. 100,000 and the general administrative overheads amounted to Rs. 200,000.

What will be the value of inventories?

- **(a)** Rs.11,600,000
- **(b)** Rs.11,400,000
- **(c)** Rs.11,150,000
- **(d)** Rs.10,950,000

AT A GLANCE
SPOTLIGHT
STICKY NOTES

13. Any amount of write-down of inventories to net realisable value should?

(a) Treated as a deferred expense and written off based on the average inventory holding period

(b) Recognised as an expense in the period in which the write-down occurs

(c) Recognised as an expense in the subsequent period in which such write-down is warranted

(d) Recognized as a current liability in the statement of financial position

14. The estimated selling price in the ordinary course of business less estimated cost of completion and estimated cost of sale is called

(a) Market value

(b) Fair value

(c) Net realisable value

(d) Current value

15. Which of the following costs must be expensed?

(a) Costs of purchase that are paid to the suppliers of raw materials

(b) Import duties on raw materials that are paid to the authorities

(c) Variable production overheads that are allocated to each unit based on actual usage

(d) Distribution cost

16. Kamran is an antiques dealer. His inventory includes a clock which cost Rs. 158,000. Kamran expects to spend Rs. 7,000 on repairing the clock which will mean that he will be able to sell it for Rs. 260,000. To replace the same item of inventory would cost Rs. 255,000. At what value should the clock be included in Kieron's inventory?

(a) Rs. 151,000

(b) Rs. 158,000

(c) Rs. 253,000

(d) Rs. 260,000

17. What is the unit cost of the following item?

Raw Materials	Rs. 500
Labour	Rs. 300
Manufacturing overheads	Rs. 100
Variable administrative overheads	Rs. 250

(a) Rs. 500

(b) Rs. 800

(c) Rs. 900

(d) Rs. 1,150

18. Jazib Associates has 40 units of inventory, out of which 10 units are damaged. The cost per unit is Rs. 2,554 and normal selling price is Rs. 2,900. The damaged units are expected to be sold at 60% of normal selling price. The selling cost of Rs. 150 are incurred on each unit sold, whether normal or damaged. What is the amount of write down of inventory, if any?

(a) Rs. 964

(b) Rs. 9,640

(c) Rs. 92,520

(d) Rs. Nil

19. Ghalib Associates has 20 units of Product C4 at cost of Rs. 3,660 each. The product has been sold at Rs. 4,000 per unit and Rs. 150 commission is paid on each unit sold.

A new product has been introduced by a competitor. It is similar to product C4 and is being marketed at Rs. 3,200 per unit. Ghalib is of the opinion that in future, it will also have to reduce the price to Rs. 3,500 per unit. Calculate NRV per unit of Product C4.

(a) Rs. 3,510

(b) Rs. 3,850

(c) Rs. 3,050

(d) Rs. 3,350

20. Arma Associates has 40 units of inventory, out of which 10 units are damaged. The cost per unit is Rs. 2,000 and normal selling price is Rs. 3,000. The damaged units are expected to be sold at 80% of normal selling price. The selling cost of Rs. 100 are incurred on each unit sold, whether normal or damaged. What is the amount of write down of inventory, if any?

(a) Rs. 600

(b) Rs. 6,000

(c) Rs. 80,000

(d) Rs. Nil

21. In preparing its financial statements for the current year, an entity's closing inventory was understated by Rs. 200,000.

What will be the effect of this error if it remains uncorrected?

(a) The current year's profit will be overstated and next year's profit will be understated

(b) The current year's profit will be understated and next year's profit will be overstated

(c) The current year's profit will be understated but there will be no effect on next year's profit

(d) The current year's profit will be overstated but there will be no effect on next year's profit

22. Maria had opening inventory of 900 units at Rs. 5 units at 01 January 2019. During the month she made following purchases and sales transactions:

January 05	Purchased 1,000 units at Rs. 6 per unit
January 09	Sold 1,250 units
January 15	Purchased 600 units at Rs. 7 per unit
January 28	Sold 550 units

Maria uses periodic weighted average cost method for inventory valuation. What is value of closing inventory at 31 January 2019?

(a) Rs. 4,800

(b) Rs. 4,116

(c) Rs. 6,468

(d) None of the above

23. What is impact on closing inventory if an item having cost of Rs. 2,500 and a net realizable value of Rs. 3,000 has been omitted from year - end inventory count?

(a) Understated by Rs. 2,500

(b) Understated by Rs. 3,000

(c) Overstated by Rs. 2,500

(d) Understated by Rs. 500

24. If closing inventory is accounted for as Rs.240,000 instead of Rs.180,000 then;

(a) Gross profit as well as net profit will be exaggerated

(b) Gross profit and net profit would both be understated

(c) Gross profit will be exaggerated, and net profit understated

(d) Gross profit will be exaggerated but net profit correctly reported

25. An organization had opening inventory of 35,000 units @Rs. 3.5 per unit. During the month it made purchases of 40,000 units @Rs. 5 per unit. Sales were 50,000 units.

What is value of cost of goods sold during the month if the entity uses continuous weighted average method for inventory valuation?

(a) Rs. 107,500

(b) Rs. 215,000

(c) Rs. 197,500

(d) Rs. 75,000

26. On 1st July 2018, Imad had opening inventory of 50 units at a cost of Rs. 60 per unit. During July 2018 he has made following purchases and sales:

July 09	120 units purchased at a cost of Rs. 65 per unit
July 16	65 units sold
July 24	45 units purchased at a cost of Rs. 67 per unit
July 30	100 units sold

What is the value of inventory at 31 March using the FIFO method?

Rs.________________

27. Which of the following cost models is not permitted under IAS 2?

(a) First in, First out ('FIFO')

(b) Last in, First out ('LIFO')

(c) Weighted Average

(d) Actual cost

28. Phill Morris Limited (PML) is in the business of procuring a specific type of machine and sells them to international markets. During the year, PML bought four machines costing Rs.12million, Rs.14 million, Rs.13 million and Rs.10 million respectively. During the year it sold only one machine for Rs.14 million and follows the FIFO method of valuation.

Which of the following statements is TRUE?

(a) The cost of Inventory is Rs.37 million and the cost of sales is Rs.10 million

(b) The cost of Inventory is Rs.39 million and the cost of sales is Rs.14 million

(c) The cost of Inventory is Rs.37million and the cost of sales is Rs.12 million

(d) The cost of Inventory is Rs.37 million and the cost of sales is Rs.13 million

29. The following information relates to Shazim Enterprise (SE) for the month of March 2020:

1 March	Opening inventory of 400 units @ Rs. 100 each = Rs. 40,000
8 March	Purchased 100 units @ Rs. 150 each = Rs. 15,000
24 March	Purchased 300 units @ Rs. 200 each = Rs. 60,000

No units were sold during March 2020. What would be cost of closing inventory per unit of SE as at 31 March 2020 valued on weighted average (perpetual)?

(a) Rs. 110 per unit

(b) Rs. 143.75 per unit

(c) Rs. 150 per unit

(d) Rs. 187.5 per unit

30. The following information relates to Shazil Enterprise (SE) for the month of March 2020:

1 March	Opening inventory of 400 units @ Rs. 100 each = Rs. 40,000
8 March	Purchased 100 units @ Rs. 150 each = Rs. 15,000
24 March	Purchased 300 units @ Rs. 200 each = Rs. 60,000

No units were sold during March 2020. What would be cost of closing inventory per unit of SE as at 31 March 2020 valued on weighted average (periodic)?

(a) Rs. 110 per unit

(b) Rs. 143.75 per unit

(c) Rs. 150 per unit

(d) Rs. 187.5 per unit

31. Which of the following items should be disclosed as per the requirements of IAS 2?

(a) Average holding period of inventories of the entity as at the end of the reporting period

(b) List of major customers to whom the inventories were sold during the reporting period

(c) Amount of expense recognised due to write down of inventories

(d) Average lead time of procurement for major classes of inventories

32. **Which of the following is NOT a disclosure requirement of IAS 2?**

(a) The accounting policies adopted in measuring inventories

(b) The cost formula used

(c) The amount of any write-down of inventories recognised as an expense in the period

(d) Location of each place where entity keeps its inventory

33. Super electronics bought 10 air conditioners for Rs. 50,000 each. Two of these were installed in office, three have been sold to customers at a profit margin and remaining are held in stock for resale. Which of the following represents correct accounting treatment?

(a) Cost of sales Rs. 100,000; Inventory Rs. 400,000

(b) Cost of sales Rs. 500,000; Inventory Rs. 400,000

(c) Cost of sales Rs. 150,000; Inventory Rs. 350,000

(d) Cost of sales Rs. 150,000; Inventory Rs. 250,000

34. Hulk Building Materials used 500 cement bags from inventory for constructing parking area of their office building. How these 500 cement bags should be accounted for?

(a) It should remain included in inventory at cost

(b) It should remain included in inventory at lower of cost and NRV

(c) It should be charged as an expense when used

(d) It should be allocated to building asset in which it has been used

35. Which TWO of the following are recognised as expense under IAS 2?

(a) Inventory sold during the period

(b) Inventory remained unsold at the end of period

(c) Inventory pledged with the bank as security for the loan financing

(d) Amount of writ down to NRV

36. At 01 December 2018 Nida had opening inventory of Rs. 20,000 and at 31 December 2018 Nida had closing inventory of Rs. 35,000.

Which of the following entries are required to account for opening and closing inventory when preparing financial statements of the business?

(a) Dr Cost of sales Rs. 20,000 Cr Inventory Rs. 20,000 and Dr Inventory Rs. 35,000 Cr Cost of sales Rs. 35,000

(b) Dr Cost of sales Rs. 35,000 Cr Inventory Rs. 35,000 and Dr Inventory Rs. 20,000 Cr Cost of sales Rs. 20,000

(c) Dr Cost of sales Rs. 20,000 Dr Inventory Rs. 20,000 and Dr Inventory Rs. 35,000 Dr Cost of sales Rs. 35,000

(d) Cr Cost of sales Rs. 35,000 Cr Inventory Rs. 35,000 and Cr Inventory Rs. 20,000 Cr Cost of sales Rs. 20,000

37. Ali had opening inventory of Rs. 1,500,000. Purchases made during the period were Rs. 2,550,000. Sales during the period were Rs. 4,500,000 and he had closing inventory of Rs. 1,000,000.

Gross profit for the period was?

(a) Rs. 1,950,000 Profit

(b) Rs. 450,000 Profit

(c) Rs. 1,450,000 Profit

(d) Rs. 550,000 Loss

38. What is correct entry for goods taken by owner for personal use?

(a) Cr Purchases account and Dr Drawings account with the cost price of the goods.

(b) Cr Opening Inventory account and Dr Drawings account with cost price of the goods.

(c) Cr Trading account and Dr Drawings account with the selling price of the goods.

(d) Cr Sales account and Dr Drawings account with the sale price of the goods.

39. Bulk Building Materials used 500 cement bags from inventory for constructing parking area of their office building. How these 500 cement bags should be accounted for under periodic inventory recording system?

(a) Debit Inventory & Credit Purchases

(b) Debit Non-Current assets & Credit Inventory

(c) Debit Non-Current assets & Credit Purchases

(d) Debit Inventory & Credit Non-current assets

AT A GLANCE
SPOTLIGHT
STICKY NOTES

40. If trial balance includes "purchase" and "purchase return" account, it is an indication of:

- **(a)** Weighted average method
- **(b)** FIFO method
- **(c)** Perpetual inventory recording system
- **(d)** Periodic inventory recording system

41. In which TWO of the following circumstances, a periodic inventory system might be more suitable?

- **(a)** Large size items
- **(b)** High value items
- **(c)** Low value items
- **(d)** Where inventory movements are frequent

42. In which TWO of the following circumstances, a perpetual inventory system might be more suitable?

- **(a)** Large size items
- **(b)** High value items
- **(c)** Low value items
- **(d)** Where inventory movements are frequent

43. An entity uses periodic inventory system, which of the following TWO are correct for recoding a credit sales transaction?

- **(a)** Debit Receivables & Credit Sales
- **(b)** Debit Cost of sales & Credit Purchases
- **(c)** Debit Cost of sales & Credit Inventory
- **(d)** No other entry is required

44. An entity uses perpetual inventory system, which of the following is required to incorporate closing year inventory at the time of preparing financial statements?

- **(a)** Debit Inventory & Credit Cost of sales
- **(b)** Debit Cost of sales & Credit Inventory
- **(c)** Debit Cost of sales & Credit purchases
- **(d)** No adjustment is required

45. An entity uses periodic inventory system, which of the following is required to incorporate normal loss of inventory?

- **(a)** Debit Loss & Credit Inventory
- **(b)** Debit Loss & Credit Purchases
- **(c)** Debit Loss & Credit Cost of sales
- **(d)** No journal entry is required

46. An entity uses periodic inventory system, which of the following TWO are correct for recoding a credit sales return transaction?

(a) Debit Sales Return & Credit Receivables

(b) Debit Inventory & Credit Cost of sales

(c) Debit Cost of sales & Credit Inventory

(d) No other entry is required

47. Kind General Mills gave 1000 bags of flour to flood affected community for free. What is correct journal entry to record this transaction under perpetual inventory method?

(a) No entry is required

(b) Debit Drawings & Credit Purchases

(c) Debit Expenses & Credit Inventory

(d) Debit Expenses & Credit Purchases

48. Jaffer Associates sold a generator to Sajid Enterprises for Rs. 1,440,000. This price is net of Rs. 60,000 special discount. Jaffer Associates normally sells items at 25% mark-up and uses perpetual inventory system to record its inventory. Which of the following entry is correct to update the inventory?

(a) Debit Cost of Sales Rs. 1,152,000 & Credit Inventory Rs. 1,152,000

(b) Debit Cost of Sales Rs. 1,200,000 & Credit Inventory Rs. 1,200,000

(c) Debit Cost of Sales Rs. 1,104,000 & Credit Inventory Rs. 1,104,000

(d) Debit Inventory Rs. 1,500,000 & Credit Cost of sales Rs. 1,500,000

49. An entity uses perpetual inventory system, which of the following TWO are correct for recoding a credit sales return transaction?

(a) Debit Sales Return & Credit Receivables

(b) Debit Inventory & Credit Cost of sales

(c) Debit Cost of sales & Credit Inventory

(d) No other entry is required

50. An entity uses perpetual inventory system, which of the following TWO are correct for recoding a credit sales transaction?

(a) Debit Receivables & Credit Sales

(b) Debit Cost of sales & Credit Purchases

(c) Debit Cost of sales & Credit Inventory

(d) No other entry is required

ANSWERS

<table>
<tr><td>01.</td><td>(c)</td><td>Freight in is necessary to bring the inventory in its present condition and location. All other costs are period costs.</td></tr>
<tr><td>02.</td><td>(d)</td><td>Conversion costs include direct labour and manufacturing overheads. Only supervisor’s wages are part of overheads.</td></tr>
<tr><td>03.</td><td>(b)</td><td>The cost is Rs. 2,600 and NRV is Rs. 2,485 (2,550 – 65)
As NRV is lower, inventory will be written down by Rs. 115 (2,600 – 2,485). This would reduce the profit by Rs. 115 as well.</td></tr>
<tr><td>04.</td><td>(c)</td><td>
<table>
<tr><th></th><th>Alpha</th><th>Beta</th><th>Gamma</th></tr>
<tr><th></th><th>Rs. per unit</th><th>Rs. per unit</th><th>Rs. per unit</th></tr>
<tr><td>Original cost</td><td>10</td><td>13</td><td>15</td></tr>
<tr><td>NRV</td><td>12</td><td>9</td><td>12</td></tr>
<tr><td>Inventory: units held</td><td>300</td><td>380</td><td>240</td></tr>
<tr><td>Valuation Rs.</td><td>3,000</td><td>3,420</td><td>2,880</td></tr>
</table>
Total valuation = 3,000 + 3,420 + 2,880 = Rs. 9,300</td></tr>
<tr><td>05.</td><td>(d)</td><td>Rs. 3,300 + 13,000 + 13,900 + 14,900 = Rs. 45,100</td></tr>
<tr><td>06.</td><td>Rs. 119,700</td><td>Balance given= Rs. 130,200
Less: cost of damaged item already included= Rs. 25,000
Add: NRV of damaged item Rs. 18,000-Rs. 3,500 = Rs. 14,500
Correct value of inventory Rs. 119,700</td></tr>
<tr><td>07.</td><td>Rs. 48,600</td><td>Product A Rs. 15,000+ Product B Rs. 10,000+Product C Rs. 11,000+Product D Rs. 12,600 = Rs. 48,600
Cost and NRV comparison are to be made on item by item basis and not on the basis of totals.</td></tr>
<tr><td>08.</td><td>(b)</td><td>Storage costs</td></tr>
<tr><td>09.</td><td>(c)</td><td>Gross profit = Rs. 1,000,000 – 600,000 = Rs. 400,000
Net profit = Rs. 400,000 – 50,000 – 50,000 = Rs. 300,000</td></tr>
<tr><td>10.</td><td>(b)</td><td>NRV = Rs. 40,000 estimated sale price – 15,000 cost of repairs = Rs. 25,000
Write down = Rs. 50,000 Cost – Rs. 25,000 NRV = Rs. 25,000</td></tr>
<tr><td>11.</td><td>(d)</td><td>Variable manufacturing overheads</td></tr>
<tr><td>12.</td><td>(c)</td><td>Rs. 10,000,000 + 800,000 + 150,000 + 200,000 = Rs. 11,150,000</td></tr>
<tr><td>13.</td><td>(b)</td><td>Recognised as an expense in the period in which the write-down occurs</td></tr>
<tr><td>14.</td><td>(c)</td><td>Net realisable value</td></tr>
<tr><td>15.</td><td>(d)</td><td>Distribution cost</td></tr>
<tr><td>16.</td><td>(b)</td><td>Cost Rs. 158,000 is lower
NRV Rs. 253,000 (i.e. Rs. 260,000 – 7,000) is higher
Replacement cost Rs. 255,000 is irrelevant</td></tr>
</table>

17.	**(c)**	Administration costs (whether variable or fixed) are not included in cost of inventory.
18.	**(b)**	No write down on normal units Cost Rs. 2,554 and NRV Rs. 2,750 On damaged units Cost Rs. 2,554 and NRV Rs. 1,590 (i.e. Rs. 2,900 x 60% - 150) = Rs. 964 per unit x 10 units = Rs. 9,640
19.	**(d)**	Rs. 3,500 – 150 = Rs. 3,350
20.	**(d)**	No write down on normal units Cost Rs. 2,000 and NRV Rs. 2,900 No write down on damaged units Cost Rs. 2,000 and NRV Rs. 2,300 (i.e. Rs. 3,000 x 80% - 100)
21.	**(b)**	Closing inventory is understated so current year's profit will be understated as well. However next year the effect will be opposite as it would become opening inventory.
22.	**(b)**	Closing inventory units = 900+1,000+600-1,250-550 = 700 Average cost per unit = ((900x5) +(1,000x6) +(600x7))/2,500 units = Rs. 5.88 Closing inventory = 700xRs. 5.88 = Rs. 4,116
23.	**(a)**	Inventory is valued at lower of cost and NRV which is Rs. 2,500 in this case. Omission would understate the inventory.
24.	**(a)**	Gross profit as well as net profit will be exaggerated
25.	**(b)**	Cost per unit = [(35,0000x3.5) +(40,000x5)]/ (35,000+40,000) =Rs. 4.3 Cost of goods sold = 50,000 x Rs. 4.3 = Rs. 215,000
26.	**Rs. 3,340**	The closing inventory units 50+120+45 – 65 – 100 = 50 units 45 units @ Rs. 67 per unit and 5 units @ Rs. 65 per unit = Rs. 3,340
27.	**(b)**	Last in, First out (LIFO)
28.	**(c)**	Cost of machine sold = Rs. 12 million Cost of machines not sold yet (inventories) = Rs. 14m + 13m + 10m = Rs. 37 million
29.	**(b)**	8 March (Rs. 40,000 + 15,000)/ (400+100 units) = Rs. 110 per unit 8 March (Rs. 55,000 + 60,000)/ (500+300 units) = Rs. 143.75 per unit
30.	**(b)**	Total value [Rs. 40,000 + (15,000 + 60,000)] = Rs. 115,000 Total Units [400 + (100 + 300)] = 800 Rate = Rs. 115,000 / 800 units = Rs. 143.75 per unit
31.	**(c)**	Amount of expense recognised due to write down of inventories
32.	**(d)**	Location of each place where entity keeps its inventory is not required disclosure under IAS 2
33.	**(d)**	Cost of sales Rs. 150,000; Inventory Rs. 250,000
34.	**(d)**	It should be allocated to building asset in which it has been used

35.	**(a) & (d)**	Inventory sold during the period Amount of write down to NRV
36.	**(a)**	Opening inventory is charged to cost of sales and closing inventory is credited in cost of sales.
37.	**(c)**	Sales – costs of sales = gross profit Rs. 4,500,000 – (Rs. 1,500,000+2,550,000-1,000,000) = Rs. 1,450,000
38.	**(a)**	The correct entry for drawings is Debit Drawings and Credit Purchases (or Cost of Sales). The cost price of goods is relevant, not selling price.
39.	**(c)**	Debit Non-Current assets & Credit Purchases
40.	**(d)**	Periodic inventory recording system
41.	**(a) & (c)**	Large size items Low value items
42.	**(b) & (d)**	High value items Where inventory movements are frequent
43.	**(a) & (d)**	Debit Receivables & Credit Sales No other entry is required
44.	**(d)**	No adjustment is required. Simply balance the inventory account.
45.	**(d)**	No journal entry is required
46.	**(a) & (d)**	Debit Sales Return & Credit Receivables No other entry is required
47.	**(c)**	Debit Expenses & Credit Inventory
48.	**(b)**	Debit Cost of Sales Rs. 1,200,000 & Credit Inventory Rs. 1,200,000 Rs. 1,440,000 + 60,000 = Rs. 1,550,000 x 100/125 = Rs. 1,200,000
49.	**(a) & (b)**	Debit Sales Return & Credit Receivables Debit Inventory & Credit Cost of sales
50.	**(a) & (c)**	Debit Receivables & Credit Sales Debit Cost of sales & Credit Inventory

STICKY NOTES

Inventories include raw material and supplies, work in process and finished goods held for resale.

Inventory is measured at lower of cost and NRV.

Cost = Cost of purchase + Conversion costs+ other direct costs
Cost of inventory does not include admin, selling and non-production overheads.

NRV is the expected revenue from the sale of inventory after deducting any further costs that are necessary in order to sell the inventory.

Cost of inventory may be determined by:

- **Actual cost (for non-interchangeable goods)**
- **First in First out formula**
- **Weighted average formula (perpetual & periodic)**

Valuation of inventories affects profit. The higher the value of closing inventory, the higher the amount of profit.

Recognition

- **Inventories sold are recognised as an expense.**
- **In addition, write off of inventory to NRV is also charged as an expense.**
- **Inventory used in construciton of non-current assets is allocated to those assets.**

Inventory Recording systems – Differences

PERIODIC	PERPETUAL
Adjustment entry for opening and closing balances	No adjustment required. Balance b/d and c/d of inventory account, only.
Purchase and purchase return accounts are maintained.	No need of these accounts, rather inventory is debited and credited.
No additional entry required in case of sales and sales return.	Additional entries are required to update the inventory with each transaction.
Purchases account is credited in case of abnormal loss, drawings, free sample etc.	Inventory account is credited in case of abnormal loss, drawings, free sample etc.
No entry is required in case of normal loss.	Debit Cost of sales Credit Inventory

CHAPTER 8

ACCOUNTING FOR MANUFACTURING

IN THIS CHAPTER:

AT A GLANCE

The operations of manufacturing businesses are usually more complex as compared to trading entities. A factory ledger is maintained to record these manufacturing related transactions and then are summarised periodically in the form of a manufacturing account.

Factory ledger is the group of accounts used to record factory-related transactions and to keep track of various manufacturing costs such as direct materials, direct labour and factory overhead costs. In integrated accounting system, the factory ledger is an integral part of general ledger.

Manufacturing account is one of the important components that is required for preparation of trading account. Accordingly, in order to calculate the gross profit, it is essential to determine the cost of goods manufactured or sold.

The main purpose of preparing manufacturing account is to ascertain the cost of goods manufactured or sold, which is transferred to the trading account. This account is debited with opening stock and all items of costs including purchase related to production and credited with closing balance of work-in-progress and cost of goods produced is transferred to trading account.

AT A GLANCE
SPOTLIGHT
STICKY NOTES

1. DIRECT AND INDIRECT COSTS

TYPES OF BUSINESSES BY ACTIVITY

Service Business

A service type of business provides intangible products (products with no physical form). Service type firms offer professional skills, expertise, advice, and other similar products. Examples of service businesses are salons, repair shops, schools, banks, accounting firms, and law firms.

Trading Business

This type of business buys products at wholesale price and sells the same at retail price. They make profit by selling the products at prices higher than their purchase costs. A trading business sells a product without changing its form. Examples are grocery stores, convenience stores, distributors, and other resellers.

Manufacturing Business

Unlike a trading business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased. A manufacturing business combines raw materials, labour, and overhead costs in its production process. The manufactured goods will then be sold to customers.

It is important to distinguish direct costs and indirect costs in a manufacturing business.

DIRECT COSTS (PRIME COST)

Costs that can be traced in full to a cost unit. A direct cost can be attributed in its entirety to the cost of an item that is being produced.

Direct material costs

Direct materials are all materials that become part of the cost unit. Direct materials are all materials that can be attributed directly in full to a cost unit. They are used directly in the manufacture of a product or in providing a service. For example, sugarcane used in producing sugar is a direct material cost.

Direct labour costs

Direct labour is labour time that can be attributed directly in full to a cost unit. For example, wages of labour working in assembly of automobile manufacturing are direct labour costs.

Direct expenses

Direct expenses are expenses that can be attributed directly in full to a cost unit. Direct expenses are expenses that have been incurred in full as a direct consequence of making a unit of product. For example, royalty paid to product-designer/patent-holder for each unit produced.

Prime Cost

The prime cost of a cost unit is the sum of all of the direct costs of making that unit.

Prime cost = direct material cost + direct labour cost + direct expenses

INDIRECT COSTS

An indirect cost (overhead cost) is any cost that is not a direct cost. Indirect costs (overheads) cannot be attributed directly and in full to a cost unit.

Indirect materials cost

Indirect materials are any materials that are used or consumed that cannot be attributed in full to the item being costed. Indirect materials in production include cleaning materials and any materials used by production departments or staff who are not engaged directly in making a product.

Indirect labour costs

Indirect labour costs consist mainly of the cost of indirect labour employees. Indirect labour employees are individuals who do not work directly on the items that are produced or the services that are provided.

Some factory workers do not work directly in the production of cost units but are necessary so that production takes place. In a manufacturing environment, indirect labour employees include staff in the stores and materials handling department (for example, fork lift truck drivers), supervisors, and repairs and maintenance engineers.

Indirect expense

Many costs incurred cannot be directly linked to cost units. For example, the rental costs for a factory and the costs of gas and electricity consumption for a factory cannot be attributed in full to any particular units of production. They are indirect production costs (production overheads).

FULL COST OF UNIT

The **full cost** of a unit of product (or the full cost of a unit of service) is a cost that includes both direct costs and overheads.

	Rs.
Direct materials cost	X
Direct labour cost	X
Direct expenses	X
Prime cost	X
Manufacturing (or production) overhead i.e. indirect production costs	X
Full production cost	X
Non-production costs	
Administration overhead	X
Selling and distribution overhead	X
Full cost of unit	**X**
Profit margin	X
Selling price	**X**

In cost accounting systems, it is common practice to include production overheads in unit costs and measure the full production cost per unit. However, administration and selling and distribution overhead costs are not usually included in the cost of each unit. Instead, they are treated in total as an expense for the period in profit or loss.

- *Example 01:*

Identify the following costs as either direct or indirect.

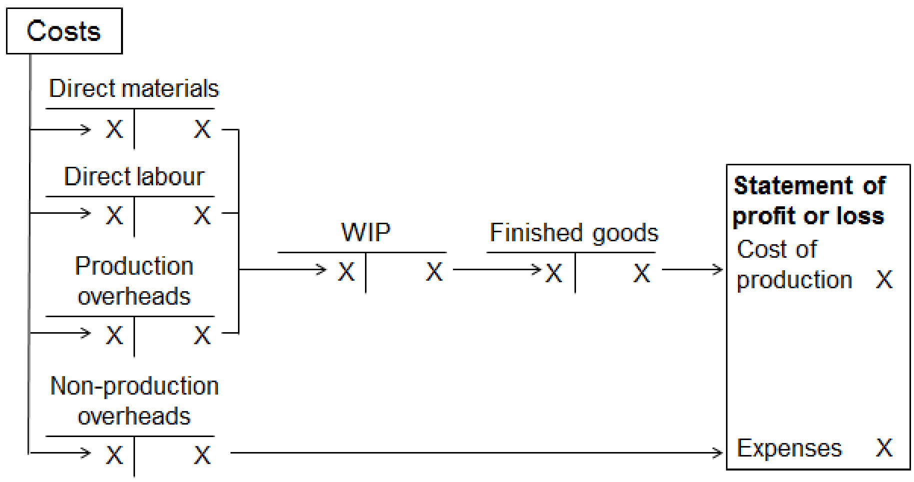
Industry	Cost unit	Details	Classification
Shoe factory	Pair of shoes	Leather, glue, nails, laces	**Direct material cost**
Furniture business	Office chair	Wheels, a stand, a seat (with seat cushion), back rest, arm rests and fabric	**Direct material cost**
Restaurant	Restaurant meal	Ingredients	**Direct material cost**
Car manufacturer	Car	Steel, aluminium, windows, lights, gear box, engine, wheels etc. etc.	**Direct material cost**
		Machinists working in the machining department	**Direct labour**
		Assembly workers in the assembly department	**Direct labour**
		Workers in the spray painting shop	**Direct labour**
Construction business	House	Bricks, wood, cement	**Direct material cost**
		Bricklayers (workers)	**Direct labour**
		Hire of equipment (for example a cement mixer)	**Direct expenses**
		Payment of fees to sub-contractors.	**Direct expenses**
Coal mine extraction	Tonne of coal	Miners	**Direct labour**
Service industry	Day of storage	Warehouse staff	**Direct labour**
	Audit (other consultancy)	Professional staff	**Direct labour**
	Teaching day	Teachers (tutorial staff at a college)	**Direct labour**
Road transport	Vehicle running costs	Fuel cost per km per vehicle	**Direct material cost**
Construction			**Indirect material cost**
Motorway Fuel station			**Direct material cost**

2. FACTORY LEDGER

A factory ledger is made for manufacturing entities and is not prepared for trading concerns. It can be defined as a set of accounts, containing the production costs of a business. Generally, the factory ledger is maintained for manufacturing operations especially when it is located in far-away area from the head office.

Why is factory ledger needed?

The accounting for inventory for an entity that buys and sells goods has been explained in previous chapter i.e. periodic inventory system and perpetual inventory system. This chapter explains how to account for goods that are manufactured instead of purchased. The cost of goods sold is simply the purchase price of the goods in a trading business. In contrast, for a manufacturing entity, the cost of goods sold is the total production cost including prime cost and production overheads. The accounting systems must identify these costs and then transfer them into finished goods (usually via work-in-progress) and thus into cost of sales.



COST ACCOUNTING SYSTEMS

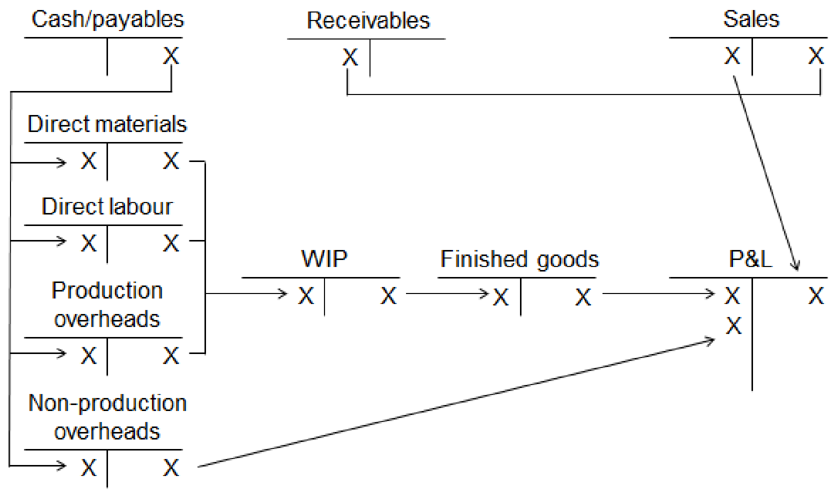
In practice, there is variation in cost accounting systems, for example, a complex production process might involve several different processes and this might be reflected in the transfer of costs along a chain of WIP accounts before a final transfer into finished goods. Similarly, in many industries certain processes are outsourced e.g. in textile companies, the process of spinning may be done in-house then the thread be given to an outsourced vendor for knitting and then the knitted cloth be brought back after paying manufacturing charges to the outsourced party to make finished products.

The two common accounting systems are:

- **Integrated accounts:** A single set of accounting records that provide financial and cost accounts using a common input of data. A system where all information (both financial and costing) is kept in a single set of books.
- **Interlocking accounts:** A system in which the books are divided into two ledgers. Cost accounts are maintained in a cost ledger (also known as the factory ledger) and the other accounts are maintained in the general ledger.

In practice most companies and ERP solutions available in the market use integrated accounting system. This chapter is focused on integrated accounts using perpetual inventory systems only.

Chart of accounting flow in an integrated accounts system



The direct materials account above might be named differently, for example, raw materials a/c, inventory (raw materials) a/c, stores etc. Similarly, the WIP account might be described as inventory (WIP) a/c and the finished goods account as inventory (finished goods) a/c.

The above diagram does not show it but there may well be a need for an entry to account for Over (under) absorption of fixed production overhead as explained later.

Profit or loss is calculated in the usual way as the balance on the P&L account.

ACCOUNTING ENTRIES IN INTEGRATED COST ACCOUNTING SYSTEM

The following suite of journals describes the typical accounting entries that might be posted within an integrated cost accounting system that uses perpetual inventory system.

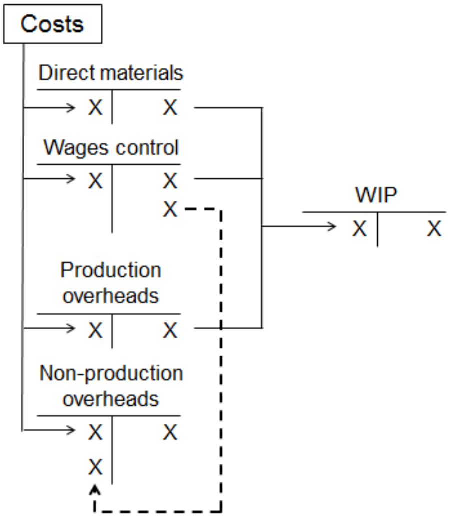
Journals to recognise expenses as incurred

	Debit	Credit
Purchase of raw materials		
Inventory (raw materials)	X	
Payables (or cash)		X
Payment of salaries and wages		
Payroll expense (direct labour)	X	
Cash/ payroll accrual		X
Recognition of production overhead		
Production overhead	X	
Cash		X
Record non-production overheads		
Operating expenses	X	
Payables (or cash)		X
Record production depreciation within overheads		
Production overhead (depreciation of assets used in production)	X	
Operating expenses (depreciation of other assets)		
Accumulated depreciation		X

Journals to reclassify expense into production overheads and non-production overheads

Some of the material and labour recognised earlier might relate to indirect material / indirect labour or non-production activities.

- Any amounts relating to indirect material / indirect labour must be transferred to a production overhead account.
- Any amounts relating to non-production labour (e.g. sales or administration) should be transferred into one or more non-production overhead accounts
- Then direct material and direct labour related to production is transferred to WIP



	Debit	Credit
Reclassification of labour costs		
Operating expenses (amount related to non-production)	X	
Production overhead (amount related to indirect labour)		
Payroll expense (direct labour)		X
Issue of indirect materials		
Production overhead	X	
Inventory (raw materials)		X

Journals to recognise use of resources in production

	Debit	Credit
Issue of direct materials to WIP		
Inventory (WIP)	X	
Inventory (raw materials)		X
Use of direct labour in production		
Inventory (WIP)	X	
Payroll expense		X
Absorption of overheads into production		
Inventory (WIP)	X	
Production overhead		X

Journal to recognise completion of production and sale of goods

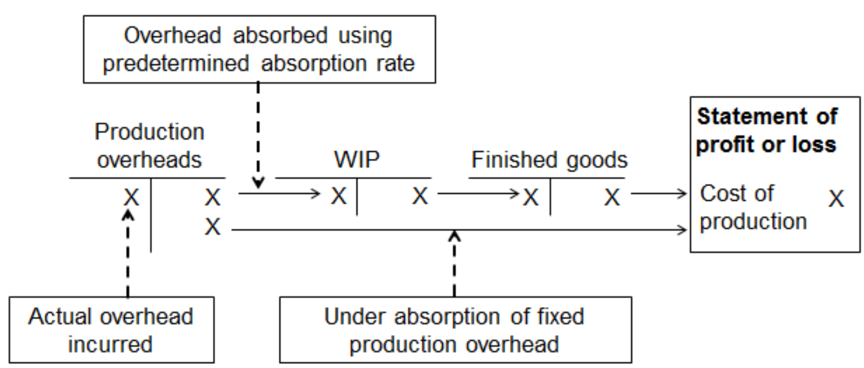
	Debit	Credit
Transfer of costs on completion of production		
Inventory (finished goods)	X	
Inventory (WIP)		X
Recognition of cost of sales in profit or loss		
Cost of sales (P&L)	X	
Inventory (finished goods)		X

Journal to recognise over (under) absorption of fixed production overhead

The fixed production overheads account is debited with the actual fixed production overhead incurred in the period. Fixed production overheads are transferred into WIP using a **pre-determined absorption rate.**

Pre-determined absorption rate	= Budgeted overheads / Normal production capacity
Budgeted overheads	estimated fixed production overheads for an accounting period.
Actual overheads	production overheads incurred during an accounting period.
Absorbed overheads	= Actual Production (units) x absorption rate
Over (under) absorbed overheads	= Absorbed overheads – Actual overheads

The difference between the absorbed overhead and the actual overhead is over (under) absorption. This must be adjusted in the statement of profit or loss.



	Debit	Credit
Recognition of under-absorption of fixed production overhead		
Cost of sales (P&L)	X	
Production overheads		X
Recognition of over-absorption of fixed production overhead		
Production overheads	X	
Cost of sales (P&L)		X

- *Example 02:*

An entity manufactures and sells a range of products in a single factory. Its budgeted production overheads for Year 6 were Rs. 150,000, and budgeted direct labour hours were 50,000 hours.

Actual results in Year 6 were as follows:

	Rs.	
Direct materials costs	130,000	
Direct labour costs	160,000	
Fixed production overhead	140,000	(40,000 hours)

There was no opening or closing inventory at the beginning or end of Year 6. The company uses an absorption costing system, and production overhead is absorbed using a direct labour hour rate.

Required:

Using the above information, prepare accounting entries for Year 6.

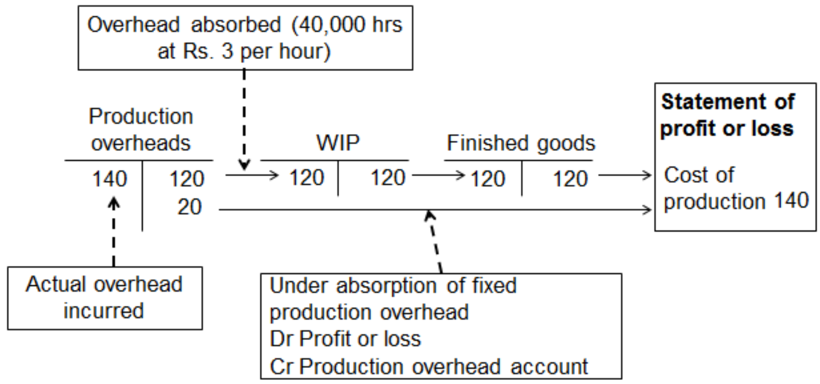
- *ANSWER*

JOURNAL ENTRIES

Date	Particulars	LF	Debit Rs.	Credit Rs.
	Direct materials		130,000	
	Direct labour		160,000	
	Fixed production overhead		140,000	
	Cash/payables			430,000
	(Recognition of costs)			
	WIP		130,000	
	Direct materials			130,000
	(Transfer of materials to WIP)			
	WIP		160,000	
	Direct labour			160,000
	(Transfer of labour cost to WIP)			
	WIP **Working 1**		120,000	
	Fixed production overhead			120,000
	(Absorbed overheads transferred to WIP)			
	Finished goods		410,000	
	WIP			410,000
	(Transfer from WIP into finished goods)			
	Cost of sales (P&L) **Working 1**		20,000	
	Fixed production overhead			20,000
	(under absorbed overheads)			

Working 1	Rs.
Pre-determined absorption rate = Rs. 150,000 / 50,000 hours = Rs. 3 per hour	
Overhead absorbed (40,000 hours @ Rs. 3 per hour)	120,000
Overhead incurred (actual cost)	(140,000)
Under absorption	(20,000)

This can be represented (in part) by the following diagram (figures in Rs. 000)



- *Example 03:*

The following balances and transactions relate to a manufacturing company.

Opening inventories	raw materials	10,000kg	Rs.25,000
	work in progress	nil	
	finished goods	1,000 units	Rs.100,000
Materials	purchases	28,000 kg	Rs.77,000
	issues to production	30,000kg	FIFO
Labour	paid	16,000 hours	Rs.96,000
	production	15,000 hours	
Production overhead			Rs.250,000
Standard overhead rate per hour			Rs.20
Completed production		4,000 units	
Closing inventories	raw materials	see above	
	work in progress	nil	
	finished goods	500 units	FIFO
Sales revenue		see above	Rs.540,000

Required:

Journal entries, ledgers and gross profit calculation for the above transactions and balances.

- *ANSWER*

	Debit	Credit	
Recognition of expenses as incurred			
Purchase of raw materials			
Inventory (raw materials)	77,000		
Payables		77,000	

AT A GLANCE
SPOTLIGHT
STICKY NOTES

	Debit	Credit	
Payment of wages			
Wages control / Payroll	96,000		
Cash		96,000	
Overhead incurred			
Production overheads	250,000		
Cash		250,000	
Reclassification of wages expense into overhead			
Production overhead	6,000		
Wages control / Payroll		6,000	
Working			
Number of hours: 16,000 – 15,000	1,000		
Hourly rate: Rs. 96,000/16,000 hours	Rs.6		
Transfer (Rs.)	6,000		
Transfer of expenses into WIP as production proceeds			
Raw materials used			
Inventory (WIP)	80,000		
Inventory (raw materials)		80,000	
Working: FIFO	Rs.		
First 10,000 Kgs (opening inventory)	25,000		
Next 20,000 Kgs (from purchases (20,000 Kgs/28,000 Kgs) × Rs.77,000	55,000		
Transfer (Rs.)	80,000		
Use of direct labour			
Inventory (WIP)	90,000		
Wages control / Payroll (96,000 – 6,000)		90,000	
Overhead absorbed			
Inventory (WIP)	300,000		
Production overhead		300,000	
Working			
15,000 hours @ Rs. 20 per hour (given)	Rs. 300,000		

	Debit	Credit
Transfer of costs from WIP into finished goods		
Inventory (finished goods)	470,000	
Inventory (WIP)		470,000
Working: Balance in WIP before transfer	Rs.	
Opening WIP	–	
Raw materials	80,000	
Direct labour	90,000	
Overhead absorbed	300,000	
	470,000	
Less: Closing WIP	–	
	470,000	
Cost per unit = Rs. 470,000 /4,000 units	Rs. 117.5	
Transfer of finished goods to cost of sales		
Cost of sales (P&L)	511,250	
Inventory (finished goods)		511,250
Working	**Units**	**Rs.**
Opening inventory of finished goods	1,000	100,000
Production	4,000	470,000
	5,000	570,000
Closing inventory of finished goods (@ Rs. 117.5)	(500)	(58,750)
	4,500	511,250
Over-absorption of overhead		
Production overheads	44,000	
Cost of sales (P&L)		44,000
Working:	Rs.	
Overhead incurred	250,000	
Transfer from wages control a/c	6,000	
	256,000	
Overhead absorbed	300,000	
Over absorption	44,000	
Recognition of sales		
Receivables	540,000	
Sales		540,000

The ledger T accounts after the double entries are as follows:

Raw materials				
	Rs. '000		Rs. '000	
b/d	25,000			
Payables (not shown)	77,000	To WIP	80,000	
		c/d	22,000	
	102,000		102,000	

Wages control (Payroll)				
	Rs. '000		Rs. '000	
Cash	96,000	Production Overhead(indirect)	6,000	
		WIP	90,000	
	96,000		96,000	

Production overheads				
	Rs. '000		Rs. '000	
Cash	250,000	WIP	300,000	
Wages control	6,000			
Cost of sales (over)	44,000			
	300,000		300,000	

Work in progress (WIP)				
	Rs. '000		Rs. '000	
Raw materials	80,000	Finished goods	470,000	
Wages control	90,000			
Production overheads	300,000			
	470,000		470,000	

Finished goods				
	Rs. '000		Rs. '000	
b/d	100,000	Cost of sales	511,250	
WIP	470,000	c/d	58,750	
	570,000	.	570,000	

Sales				
	Rs. '000		Rs. '000	
Profit or loss	540,000	Receivables	540,000	
	540,000		540,000	

Cost of sales				
	Rs. '000		Rs. '000	
Finished goods (sold)	511,250	Production OH (Over)	44,000	
		Profit or loss	467,250	
	511,250		511,250	

Calculation of gross profit	Rs.			
Sales	540,000			
Cost of sales	(467,250)			
Gross profit	72,750			

3. MANUFACTURING ACCOUNT

PURPOSE

The primary purpose of preparing manufacturing account is to ascertain the manufacturing costs of producing finished goods. Non-manufacturing entities are involved in the trading of goods at a profit. Therefore, manufacturing entities prepare a manufacturing account also in addition to trading account, profit and loss account and statement of financial position.

The manufacturing account helps to better understand the cost-effectiveness of manufacturing activities. After the ascertainment of the costs of finished goods, we need to transfer this cost to Trading Account.

SEPARATING PRODUCTION AND NON-PRODUCTION COSTS

Separating costs into the costs for each function can provide useful information for management. Functional costs show managers what they are expected to spend on each function (budgeted costs) and how much they are actually spending.

It is important to separate production costs from non-production costs in a manufacturing business for the purpose of valuing closing inventory which will consist of:

- finished goods that have been produced during the financial period but not yet sold (finished goods inventory); and
- partly finished production (work-in-progress or WIP).

The costs of finished goods and work-in-progress consist of their production costs.

Total production costs during a period must therefore be divided or shared between:

- goods produced and sold in the period;
- goods produced but not yet sold (finished goods);
- work-in-progress.

Non-production costs e.g. salaries of sales persons are never included in the cost of inventory.

REPORTING PROFIT AND MANUFACTURING ACCOUNT

Profit is the revenue for a financial period minus the costs for the period.

In trading businesses, the cost of sales figure is built from purchases as adjusted by inventory movement. However, in manufacturing businesses, it is comprised of the **cost of goods manufactured (instead of purchases)** as adjusted by finished goods inventory movement. The cost of goods made is a more complex figure than purchases. It comprises prime costs and production overheads adjusted by movement in work in progress in the year.

It is often constructed in a **manufacturing account**. The total from this account feeds into the statement of comprehensive income.

Format: Statement of Comprehensive Income

	Rs.	Rs.
Sales (net)		XXX
Less: Cost of goods sold		
Opening stock → Finished goods	*XX*	
+ Purchase of finished goods (if any)	*X*	
+ ***Cost of goods manufactured (as calculated below)***	XXX	
Cost of goods available for sale	XXX	
- Closing stock → Finished goods	(XX)	***(XXX)***

AT A GLANCE SPOTLIGHT STICKY NOTES

	Rs.	Rs.
Gross profit		***XX***
Less: Administration costs		(XX)
Less: Selling and distribution costs		(XX)
Net profit		**XX**

Points to remember

- In the absence of ledger balances like Inventories, quantity manufactured etc., we need to calculate the figures for Inventories, sales etc. from the available data.
- The Manufacturing Account format must show values and the quantities (if available in data).
- Units sold = Opening inventory + units manufactured- closing inventory
- In the absence of specific information, we always assume "first in-first out" basis, for closing inventory valuation.

▶ *Example 04:*

The following data has been extracted from the books of Beauty Bars Ltd at 31 December 2018:

	Rs.
Inventory at 1 Jan 2018	
Raw materials	15,000
Work in progress	10,000
Finished goods	25,000
Purchases of raw materials	50,000
Sales	500,000
Direct Labour	20,000
Rent	22,000
Electricity	18,000
Office Salaries	30,000
Depreciation for the year:	
Office	7,000
Factory	3,000
Advertisement	16,000
Inventory as on 31 Dec 2018	
Raw materials	11,000
Work in progress	6,000
Finished goods	10,000

Rent and electricity are to be apportioned: Factory 70%, Office 30%

Required:

Make a manufacturing account and statement of comprehensive income for Beauty Mar Ltd for the year ended December 31, 2018.

AT A GLANCE SPOTLIGHT STICKY NOTES

▶ *ANSWER*

Beauty Bars Limited

Manufacturing Account

For the year ended 31 December 2018

		Rs.	*Rs.*
Purchases of raw material (including carriage in) net of returns			50,000
+	Opening stock → raw material		15,000
Cost of materials available for consumption			65,000
-	Closing stock → raw material		(11,000)
Cost of materials consumed			54,000
+	Direct labour (wages)		20,000
+	Other direct expenses		0
Prime Cost (Total direct costs)			74,000
+	*<u>Factory(production or manufacturing) overheads (expenses)</u>*		
	Rent [22,000 x 70%]	15,400	
	Depreciation	3,000	
	Electricity [18,000 x 70%]	12,600	31,000
Factory (manufacturing or production) cost			105,000
+	Opening stock → work in process		10,000
+	Purchase of WIP		0
Cost of goods available for manufacturing			115,000
-	Closing stock → work in process		(6,000)
COST OF GOODS MANUFACTURED			**109,000**

Beauty Bars Limited

Statement of Comprehensive Income

For the year ended 31 December 2018

		Rs.	**Rs.**
Sales (net)			500,000
<u>Less: Cost of goods sold</u>			
Opening stock → Finished goods		*25,000*	
+ Purchase of finished goods (if any)		*0*	
+ ***Cost of goods manufactured (as calculated above)***		109,000	
Cost of goods available for sale		134,000	
-	Closing stock → Finished goods	(10,000)	***(124,000)***
Gross profit			***376,000***
Administration costs [(22,000 + 18,000) x 30% +7,000 + 30,000			(49,000)
Selling and distribution costs (Advertisement)			(16,000)
Net profit			**311,000**

► *Example 05:*

The following balances were extracted from HM's accounts as at 31 March 2007.

	Rs. in "000"
Sales	3,200
Purchase of raw material	450
Purchase returns	18
Carriage inward	10
Direct labour	400
Direct expenses	60
Rent	40
Electricity	30
Insurance	55
Factory supervision salaries	65
Office salaries	70
Indirect factory wages	13
Factory cleaning	50
Office cleaning	50
Stocks at 1 April 2006:	
- Raw material	110
- Work in progress	55
- Finished goods	80
Factory machinery cost	640
Provision for depreciation on factory machinery	280

Additional information at 31 March 2007:

	Rs. In "000"
Rent Prepaid	5
Electricity accrued	15
Insurance prepaid	10
Stocks:	
Raw material	140
Work in progress	75
Finished goods	170

- Depreciation on factory machinery is to be provided at 25% per annum reducing balance.
- Rent electricity and insurance are apportioned on the basis of 80% to factory and 20% to office.

Required

Prepare HM's manufacturing account for the year ended 31 March 2007

AT A GLANCE SPOTLIGHT STICKY NOTES

▶ *ANSWER*

M/s HM

Cost of Goods Manufactured for the period ended March 31, 2007

MANUFACTURING ACCOUNT		**Rs. 000**
Purchases of raw material 450-18		432
Transportation cost		10
+	Opening stock → raw material	110
Cost of materials available for consumption		552
-	Closing stock → raw material	140
Cost of materials consumed		412
+	Direct labour (wages)	400
+	Other direct expenses	60
Prime Cost (Total direct costs)		872
+	*Factory (production or manufacturing) overheads (expenses)*	
	Indirect wages	13
	Rent (40-5) x 80%	28
	Electricity (30+15) x80%	36
	Insurance (55-10) x80%	36
	Supervisory salaries	65
	Cleaning	50
	Provision for depreciation on machinery (640-280) x25%	90
Factory (manufacturing or production) cost		1,190
+	Opening stock → work in process	55
+	Purchase of WIP	-
Cost of goods available for manufacturing		1,245
-	Closing stock → work in process	75
COST OF GOODS MANUFACTURED		1,170

Following items were to be ignored (being non-production):

Sales

Office salaries

Office cleaning

▶ *Example 06:*

Soya Fry Limited manufactures Cooking Oil. Following information is available with respect to purchases and overheads for the year ended 31 December 2014.

Details of purchases:	**Rs. (000)**
Raw material purchased (including 17% sales tax which is refundable)	60,500
Packing material purchased (directly identified with product)	2,050
Transportation cost relating to raw material (70%) and packing material (30%)	300

Details of overheads	Rs. (000)
Rent	2,700
Salaries and wages	2,500
Other variable overheads	5,000
Other fixed overheads	1,500

Other information:

The break-up of rent is as follows:

	Rs. in (000)
Factory	2,000
Warehouse (50% for raw material, 10% for packing material and 40% for finished goods)	500
Shelf spacing in super markets	200

Break-up of salaries and wages, other variable and fixed overheads is as follows:

	Allocation between	
	Manufacturing	Administration
Salaries and wages	*60%	40%
Other variable overheads	80%	20%
Other fixed overheads	60%	40%
**Manufacturing salaries includes 70% direct wages to labourers working in factory which vary with the level of production.*		

Normal production level is 45,000 units per annum. Actual production during the year was 40,000 units.

Opening and closing inventories are as follows:

	1-Jan-2014	31-Dec-2014
	……Rs. in '000'……	
Packing material	700	285
Raw material	5,000	7,780
Finished goods	2,962	4,162
Work in process	1,950	3,000

Goods costing Rs. 200,000 (2013: Rs. 300,000) are considered as obsolete and should be fully provided. Further, closing stock of finished goods include goods costing Rs. 75,000 which were damaged due to flood and can only be sold at 60% of its cost.

Required:

Disclose the above information in the note on 'Cost of goods sold' as would appear in the profit and loss account for the year ended 31 December 2014.

▶ *ANSWER*

COST OF GOODS SOLD		Rs.
Cost of goods manufactured (as calculated below)		59,344
+	Opening stock → Finished goods 2,962 – 300 obsolete	2,662
+	Purchase of finished goods (if any)	-
Cost of goods available for sale		62,006
-	Closing stock → Finished goods 4,162 – 200 obsolete – 75 x 40% write down	(3,932)
COST OF GOODS SOLD		**58,074**

MANUFACTURING ACCOUNT		Rs.
Purchases of raw material 60,500 x 100 /117		51,709
Purchases of packing material		2,050
Transportation cost		300
+	Opening stock → raw material & packing 5,000 + 700	5,700
Cost of materials available for consumption		59,759
-	Closing stock → raw material & packing 285 + 7,780	(8,065)
Cost of materials consumed		51,694
+	Direct labour (wages) 2,500 x 60% x 70%	1,050
+	Other direct expenses	-
Prime Cost (Total direct costs)		52,744
+	*Factory(production or manufacturing) overheads (expenses)*	
	Indirect wages 2500 x 60% x 30%	450
	Rent factory	2,000
	Rent warehouse 500 x 60%	300
	Other variable overheads 5,000 x 80%	4,000
	Other fixed overheads 1,500 x 60%	900
Factory (manufacturing or production) cost		60,394
+	Opening stock → work in process	1,950
+	Purchase of WIP	-
Cost of goods available for manufacturing		62,344
-	Closing stock → work in process	(3,000)
COST OF GOODS MANUFACTURED		59,344

Following items were to be ignored (being not related to production):

Warehouse rent for finished goods

Rent for shelf spacing

4. COMPREHENSIVE EXAMPLES

► *Example 07:*

The following balances and transactions relate to month of March 2020 of Maria Enterprises (ME). ME manufacture and sells only one product which it had patented and branded last year.

Inventory on 1 March 2020		
Raw materials (direct materials only)	1,000 Kgs	Rs. 150,000
Work in progress	Nil	Nil
Finished goods	800 Units	Rs. 160,000

One kg of raw materials is used to manufacture one unit of finished goods. The budgeted production overheads are Rs. 100,000 and normal capacity per month is 5,000 units.

Transactions during March 2020		
Purchases of direct material	5,200 Kgs	Rs. 780,000
Indirect material purchased and used		Rs. 5,000
Issue of materials to production	4,800 Kgs	FIFO basis
Total payroll		Rs. 204,000
Payroll of production supervisors		Rs. 20,000
Payroll relating to selling and admin department		Rs. 40,000
Production expenses (other than depreciation)		Rs. 39,600
Selling and admin expenses (other than depreciation)		Rs. 35,400
Depreciation (80% relates to production)		Rs. 48,000
Sales	5,000 units	Rs. 1,250,000

There is no WIP inventory at the end of March 2020. The finished goods inventory is measured using periodic weighted average method using pre-determined absorption rate.

Required:

Prepare relevant ledger account, manufacturing account and statement of comprehensive income for the month of March 2020.

► *ANSWER*

Inventory (Materials)					
	Kgs	Rs.		Kgs	Rs.
b/d	1,000	150,000	Production OH (indirect)		5,000
Purchase	5,200	780,000	Inventory (WIP)	4,800	720,000
Purchase		5,000	c/d	1,400	210,000
	6,200	**935,000**		**6,200**	**935,000**

Issued to WIP using FIFO	Rs.
1,000 Kgs @ Rs. 150 each	150,000
3,800 Kgs @ Rs. 150 each (i.e. Rs. 780,000 / 5,200 Kgs)	570,000
	720,000
Raw material inventory 1,000 + 5,200 purchased – 4,800 issued	1,400 Kgs
Value 1,400 Kgs @ Rs. 150 each	Rs. 210,000

Payroll Account			
	Rs.		**Rs.**
Cash / Accrual	204,000	Production OH (indirect)	20,000
		Selling and admin	40,000
		Inventory (WIP)	144,000
	204,000		**204,000**

Production overheads			
	Rs.		Rs.
Cash / Accrual	39,600	Inventory (WIP)	96,000
Inventory (Materials)	5,000	Cost of sales (under absorbed)	7,000
Payroll Account	20,000		
Accumulated depreciation Rs. 48,000 x 80%	38,400		
	103,000		**103,000**

Pre-determined absorption rate Rs. 100,000 / 5,000 units	Rs. 20 per unit
Absorbed overhead to WIP Rs. 20 x 4,800 units	Rs. 96,000
Under absorbed = Rs. 103,000 – 96,000	Rs. 7,000

Selling and admin expenses			
	Rs.		Rs.
Cash / Accrual	35,400	Profit or loss	85,000
Payroll Account	40,000		
Accumulated depreciation Rs. 48,000 x 20%	9,600		
	85,000		**85,000**

Inventory (WIP)					
	Kgs	Rs.		Units	Rs.
b/d	0	0			
Inventory (Materials)	4,800	720,000	Finished goods	4,800	960,000
Payroll account		144,000			
Production overheads		96,000			
	4,800	**960,000**		**4,800**	**960,000**

Inventory (Finished goods)					
	Units	Rs.		Units	Rs.
b/d	800	160,000	Cost of sales	5,000	1,000,000
Inventory (WIP)	4,800	960,000	c/d	600	120,000

	5,600	1,120,000		5,600	1,120,000

Rs. 1,120,000 / 5,600 units = Rs. 200 per unit

Cost of Sales					
		Rs.			Rs.
Finished goods (sold)		1,000,000			
Production OH (under absorbed)		7,000	Profit or loss		1,007,000
		1,007,000			1,007,000

Sales					
		Rs.			Rs.
Profit or loss		1,250,000	Trade receivables/Cash		1,250,000
		1,250,000			1,250,000

MANUFACTURING ACCOUNT

		Kgs/Units	*Rs.*
Purchases of Raw Materials		5,200	780,000
+	Opening stock → raw material	1,000	150,000
Materials available for consumption		6,200	930,000
-	Closing stock → raw material	(1,400)	(210,000)
Materials consumed		4,800	720,000
+	Direct labour (wages)		144,000
+	Other direct expenses		0
Prime Cost (Total direct costs)			864,000
+	*Factory(production or manufacturing) overheads (expenses)*		
	Indirect materials		5,000
	Indirect wages		20,000
	Depreciation (on production related assets)		38,400
	Other factory or production expenses		39,600
			103,000
Factory (manufacturing or production) cost			967,000
+	Opening stock → work in process		0
+	Purchase of WIP		0
Cost of goods available for manufacturing			967,000
-	Closing stock → work in process		0
COST OF GOODS MANUFACTURED		4,800	967,000

Statement of Comprehensive Income

		Rs.	Rs.
Sales (net)			1,250,000
<u>Less: Cost of goods sold</u>			
Opening stock → Finished goods		*160,000*	
+ Purchase of finished goods (if any)		*0*	
+ ***Cost of goods manufactured (as calculated above)***		967,000	
Cost of goods available for sale		1,127,000	
-	Closing stock → Finished goods	(120,000)	
			(1,007,000)
Gross profit			***243,000***
Less: Selling and administration costs			(85,000)
Net profit			**158,000**

AT A GLANCE

SPOTLIGHT

STICKY NOTES

5. OBJECTIVE BASED Q&A

01. Prime cost means

- **(a)** Sum of direct material and factory overhead costs
- **(b)** Sum of direct material and selling costs
- **(c)** Sum of indirect material and direct labour costs
- **(d)** Sum of direct material and direct labour costs

02. Which of the following is correct for conversion cost?

- **(a)** Cost of direct material + cost of direct labour
- **(b)** Cost of direct material + cost of production
- **(c)** Prime cost + production cost
- **(d)** Cost of direct labour + production overhead

03. Direct costs are the costs that

- **(a)** Are under the control of directors of the company
- **(b)** Are directly charged to department
- **(c)** Are directly under the control of a manager
- **(d)** Can be directly identified with a product of service

04. A restaurant has the following costs in a period

1. wages of the kitchen staff
2. depreciation of kitchen equipment
3. costs of ingredients for meals
4. rent paid for the restaurant building

What are indirect costs for an individual meal?

- **(a)** 1, 2, 3 and 4
- **(b)** 1, 2 and 3 only
- **(c)** 1 and 2 only
- **(d)** 2 and 4 only

05. Which item is a direct cost?

- **(a)** Royalty paid on number of units of product SK produced
- **(b)** Cleaning materials for the factory
- **(c)** Factory rent
- **(d)** Wages of the factory manager

06. Which TWO of the following are direct costs for a bakery?

- **(a)** Chocolates chips purchased
- **(b)** Electricity bill of the bakery
- **(c)** Hours of cake decorator's time
- **(d)** Rent of bakery premises

07. Which TWO of the following are indirect costs for a business that produces tablecloths?

- **(a)** 300 meters of white cotton fabric purchased
- **(b)** 5 litres of lubricant for sewing machines purchased
- **(c)** Wages of two sewing machine operators working 40 hours each week
- **(d)** Electricity bill of production area

08. Which of the following would be classified as direct labour cost as opposed to indirect labour costs?

- **(a)** Wages of security guards for factory
- **(b)** Wages of operator in the cutting department
- **(c)** Wages of storekeepers in raw materials store
- **(d)** Wages of fork lift truck drivers who handle raw materials

09. Which of the following is most likely to be treated as an indirect cost by a house construction contractor?

- **(a)** Windows
- **(b)** Bricks
- **(c)** Electricity cables
- **(d)** Nails and screws

10. Which of the following costs would be classified as an indirect cost?

- **(a)** Flour for baking bread
- **(b)** Bill paid for icing a wedding cake
- **(c)** Wages cost of baker
- **(d)** Depreciation of ovens

11. Which one of the following would be classified as direct labour?

- **(a)** Human resource manager in a company servicing cars
- **(b)** Bricklayer in a construction company
- **(c)** General manager in a departmental store
- **(d)** Maintenance manager in a company producing cameras

12. Which one of the following would be classified as indirect labour?

(a) Stipend of audit trainee in an audit firm

(b) Wages of assembly worker in car manufacturing business

(c) Wages of store assistant in a factory store

(d) Wages of plasterer in a building construction firm

13. Which of the following account is most unlikely to be part of factory ledger?

(a) Inventory (Work in progress)

(b) Production overheads

(c) Plant and Machinery (installed in factory premises)

(d) Direct Labour (wages control)

14. A manufacturing business has purchased material costing Rs. 204,000 on credit during the month of March 2020. At the start of March, there were inventories of raw material of Rs. 26,000. During the month Rs. 176,000 of direct materials and Rs. 30,000 of indirect materials were issued for production.

What is correct accounting entry to record issue of direct materials?

(a) Dr. Inventory (Materials) Rs. 176,000 and Cr. Production Overheads Rs. 176,000

(b) Dr. Inventory (Materials) Rs. 176,000 and Cr. Inventory (WIP) Rs. 176,000

(c) Dr. Production Overheads Rs. 176,000 and Cr. Inventory (Materials) Rs. 176,000

(d) Dr. Inventory (WIP) Rs. 176,000 and Cr. Inventory (Materials) Rs. 176,000

15. A manufacturing business has purchased material costing Rs. 204,000 on credit during the month of March 2020. At the start of March, there were inventories of raw material of Rs. 26,000. During the month Rs. 176,000 of direct materials and Rs. 30,000 of indirect materials were issued for production.

What is correct accounting entry to record issue of indirect materials?

(a) Dr. Inventory (Materials) Rs. 30,000 and Cr. Production Overheads Rs. 30,000

(b) Dr. Inventory (Materials) Rs. 30,000 and Cr. Inventory (WIP) Rs. 30,000

(c) Dr. Production Overheads Rs. 30,000 and Cr. Inventory (Materials) Rs. 30,000

(d) Dr. Inventory (WIP) Rs. 30,000 and Cr. Inventory (Materials) Rs. 30,000

16. A manufacturing business started its operations on 1 September 2020 by acquiring a factory on the same date. The cost of factory is Rs. 82 million on this date, it has useful life of 20 years and residual value of Rs. 10 million. The two-third of the factory area is used for production and remaining is used for office and showroom.

What is correct accounting entry for the year ended 30 June 2021 in integrated accounting system?

(a) Dr. Work in progress Rs. 2.4 million
Dr. Operating expenses Rs. 1.2 million
Cr. Accumulated depreciation Rs. 3.6 million

(b) Dr. Production overheads Rs. 2.4 million
Dr. Operating expenses Rs. 1.2 million
Cr. Accumulated depreciation Rs. 3.6 million

(c) Dr. Work in progress Rs. 2 million
Dr. Operating expenses Rs. 1 million
Cr. Accumulated depreciation Rs. 3 million

(d) Dr. Production overheads Rs. 2 million
Dr. Operating expenses Rs. 1 million
Cr. Accumulated depreciation Rs. 3 million

17. During the month of April 2021, a manufacturing business issued Rs. 19.6 million of direct materials to the factory and Rs. 3.2 million of indirect materials. What is the double entry for these issues of materials?

(a) Dr. Materials Control Rs. 22.8m & Cr. WIP Rs. 19.6m & Cr. Production OH Rs. 3.2m

(b) Dr. WIP Rs. 19.6m & Dr. Production OH Rs. 3.2m & Cr. Materials Control Rs. 22.8m

(c) Dr. WIP Rs. 3.2m & Dr. Production OH Rs. 19.6m & Cr. Materials Control Rs. 22.8m

(d) Dr. Materials Control Rs. 22.8m & Cr. WIP Rs. 3.2m & Cr. Production OH Rs. 19.6m

18. In a month, the direct production workers worked for 740 hours including 110 hours of general overtime. The indirect workers worked for 200 hours, which included 40 hours of general overtime. The direct production workers have a basis rate of Rs. 840 per hour and the indirect have a basic rate of Rs. 600 per hour. All overtime is paid at time plus one-third.

What is the amount that will be debited to the production overhead account?

(a) Rs. 158,800

(b) Rs. 200,800

(c) Rs. 579,600

(d) Rs. 621,600

19. In a month, the direct production workers worked for 740 hours including 110 hours of general overtime. The indirect workers worked for 200 hours, which included 40 hours of general overtime. The direct production workers have a basis rate of Rs. 840 per hour and the indirect have a basic rate of Rs. 600 per hour. All overtime is paid at time plus one-third.

What is the amount that will be transferred to Work in Progress inventory from wages control account?

(a) Rs. 158,800

(b) Rs. 200,800

(c) Rs. 579,600

(d) Rs. 621,600

20. During the month of May 2021, a manufacturing business payroll totalled Rs. 23.7 million. Rs. 3.7 million of this amount was for indirect wages and the remainder was for direct worker wages.

What is the double entry for the above labour costs?

(a) Dr. Wages Control Rs. 23.7m & Cr. WIP Rs. 20m & Cr. Production OH Rs. 3.7m

(b) Dr. Wages Control Rs. 23.7m & Dr. WIP Rs. 3.7m & Cr. Production OH Rs. 20m

(c) Dr. WIP Rs. 20m & Dr. Production OH Rs. 3.7m & Cr. Wages Control Rs. 23.7m

(d) Dr. WIP Rs. 3.7m & Dr. Production OH Rs. 20m & Cr. Wages Control Rs. 23.7m

21. Factory overheads can be absorbed by which of the following methods?

1. Direct labour hours
2. Machine hours
3. As a percentage of prime cost
4. A fixed amount per unit of production

(a) All of above

(b) 1 and 2 only

(c) 1, 2 and 3 only

(d) 2, 3 and 4 only

22. What entry should be made in the cost accounting system on completion of production?

(a) Debit Finished goods & Credit Cost of sales (P&L)

(b) Debit Finished goods & Credit Inventory (WIP)

(c) Debit Inventory (WIP) & Credit Finished goods

(d) Debit Cost of sales (P&L) & Credit Finished goods

23. What entry should be made in the cost accounting system on sale of finished goods?

(a) Debit Finished goods & Credit Cost of sales (P&L)

(b) Debit Finished goods & Credit Inventory (WIP)

(c) Debit Inventory (WIP) & Credit Finished goods

(d) Debit Cost of sales (P&L) & Credit Finished goods

24. A business has an overhead absorption rate of Rs. 425 per machine hour, based on a budgeted activity level of 12,400 hours. In the period covered by the budget, actual machine hours worked were 2% more than the budgeted hours and actual overhead expenditure incurred was Rs. 5,638,900. What was the budgeted overheads for the period?

(a) Rs. 5,270,000

(b) Rs. 5,638,000

(c) Rs. 5,375,400

(d) Rs. 5,500,000

25. A business has an overhead absorption rate of Rs. 425 per machine hour, based on a budgeted activity level of 12,400 hours. In the period covered by the budget, actual machine hours worked were 2% more than the budgeted hours and actual overhead expenditure incurred was Rs. 5,638,900. What was the total absorbed overheads for the period?

(a) Rs. 5,270,000

(b) Rs. 5,638,000

(c) Rs. 5,375,400

(d) Rs. 5,500,000

26. A business has an overhead absorption rate of Rs. 425 per machine hour, based on a budgeted activity level of 12,400 hours. In the period covered by the budget, actual machine hours worked were 2% more than the budgeted hours and actual overhead expenditure incurred was Rs. 5,638,900. What was the total over or under absorption of overheads in the period?

(a) Rs. 105,400 over absorbed

(b) Rs. 263,500 under absorbed

(c) Rs. 368,900 over absorbed

(d) Rs. 368,900 under absorbed

27. Which of the following represents over-absorbed overheads?

(a) Actual overheads > Budgeted overheads

(b) Budgeted overheads > Actual overheads

(c) Actual overheads > Absorbed overheads

(d) Absorbed overheads > Actual overheads

28. Which of the following represents "Absorbed overheads"?

(a) Budgeted production x Pre-determined rate

(b) Budgeted production x Actual rate

(c) Actual production x Pre-determined rate

(d) Normal capacity x Actual rate

29. What entry should be recorded when actual overhead expenditure is incurred?

(a) Debit Production Overheads & Credit Cash / Accrual

(b) Debit Inventory (WIP) & Credit Production Overheads

(c) Debit Cost of sales (P&L) & Credit Production Overheads

(d) Debit Production Overheads & Credit Cost of sales (P&L)

30. What entry should be recorded when overheads are absorbed in production?

(a) Debit Production Overheads & Credit Cash / Accrual

(b) Debit Inventory (WIP) & Credit Production Overheads

(c) Debit Cost of sales (P&L) & Credit Production Overheads

(d) Debit Production Overheads & Credit Cost of sales (P&L)

31. What entry should be recorded for under absorbed overheads at the end of period?

(a) Debit Production Overheads & Credit Cash / Accrual

(b) Debit Inventory (WIP) & Credit Production Overheads

(c) Debit Cost of sales (P&L) & Credit Production Overheads

(d) Debit Production Overheads & Credit Cost of sales (P&L)

32. What entry should be recorded for over absorbed overheads at the end of period?

(a) Debit Production Overheads & Credit Cash / Accrual

(b) Debit Inventory (WIP) & Credit Production Overheads

(c) Debit Cost of sales (P&L) & Credit Production Overheads

(d) Debit Production Overheads & Credit Cost of sales (P&L)

33. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Inventory (Materials) 1 January 2020	75,000
Inventory (Material) 31 December 2020	105,000
Purchases of direct materials during the year	410,000
Return outwards during the year	20,000

Calculate the cost of materials available for consumption.

Rs. _______________

34. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Inventory (Materials) 1 January 2020	75,000
Inventory (Material) 31 December 2020	105,000
Purchases of direct materials during the year	410,000
Return outwards during the year	20,000

Calculate the cost of materials consumed during the year.

Rs. _______________

35. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Cost of direct material consumed	360,000
Direct labour wages	60,000
Indirect labour wages and indirect materials	12,500
Depreciation (80% relates to production)	24,000
Rent and utilities expenses of factory	19,800
Royalty paid on number of units of product produced	12,000

Calculate the Prime Cost.

Rs. _______________

36. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Cost of direct material consumed	360,000
Direct labour wages	60,000
Indirect labour wages and indirect materials	12,500
Depreciation (80% relates to production)	24,000
Rent and utilities expenses of factory	19,800
Royalty paid on number of units of product produced	12,000

Calculate the production overheads for the year.

Rs. _______________

37. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Cost of direct material consumed	360,000
Direct labour wages	60,000
Indirect labour wages and indirect materials	12,500
Depreciation (80% relates to production)	24,000
Rent and utilities expenses of factory	19,800
Royalty paid on number of units of product produced	12,000

Calculate the Total manufacturing cost for the year.

Rs. _______________

38. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Factory cost (Prime cost + production overheads)	483,500
Inventory (WIP) 1 January 2020	40,000
Inventory (WIP) 31 December 2020	35,000
Purchases of WIP inventory during the year to fulfil an urgent order	30,000

Calculate the Cost of goods available for manufacturing.

Rs. _______________

39. The following data relates to Sequence Limited who is in process of preparing manufacturing account for the year ended December 31, 2020.

	Rs.
Factory cost (Prime cost + production overheads)	483,500
Inventory (WIP) 1 January 2020	40,000
Inventory (WIP) 31 December 2020	35,000
Purchases of WIP inventory during the year to fulfil an urgent order	30,000

Calculate the Cost of goods manufactured/produced.

Rs. _______________

40. The following data relates to Sequence Limited who is in process of preparing annual accounts for the year ended December 31, 2020.

	Rs.
Cost of goods manufactured	518,500
Inventory (Finished goods) 1 January 2020	60,000
Inventory (Finished goods) 31 December 2020	70,000
Purchases of finished goods during the year to fulfil an urgent order	80,000

Calculate the Cost of goods available for sale.

Rs. _______________

41. The following data relates to Sequence Limited who is in process of preparing annual accounts for the year ended December 31, 2020.

	Rs.
Cost of goods manufactured	518,500
Inventory (Finished goods) 1 January 2020	60,000
Inventory (Finished goods) 31 December 2020	70,000
Purchases of finished goods during the year to fulfil an urgent order	80,000

Calculate the Cost of goods sold during the year.

Rs. _______________

AT A GLANCE
SPOTLIGHT
STICKY NOTES

42. The following data relates to ABC Enterprises who is in process of preparing annual accounts for the year ended December 31, 2020.

	Rs.
Prime Cost	500,000
Production overheads	200,000
Selling overheads	80,000
Administrative overheads	70,000
WIP inventory at start and end of the year	Nil

Calculate the Cost of goods manufactured during the year.

Rs. _______________

43. The following data relates to ABC Enterprises who is in process of preparing annual accounts for the year ended December 31, 2020.

	Rs.
Prime Cost	500,000
Production overheads	200,000
Selling overheads	80,000
Administrative overheads	70,000
WIP inventory at start and end of the year	30,000

Calculate the Cost of goods manufactured during the year.

Rs. _______________

44. The following data relates to XYZ who is in process of preparing annual accounts for the year ended December 31, 2020.

	Rs.
Cost of goods manufactured	518,500
Inventory (Finished goods) 1 January 2020	60,000
Inventory (Finished goods) 31 December 2020	70,000

Calculate the Cost of goods sold during the year.

Rs. _______________

45. Which of the following equation is correct for calculating cost of goods manufactured?

(a) = Prime Cost + Opening inventory (raw material) – Closing inventory (raw material)

(b) = Prime Cost + Opening inventory (WIP) – Closing inventory (WIP)

(c) = Factory Cost + Opening inventory (raw material) – Closing inventory (raw material)

(d) = Factory Cost + Opening inventory (WIP) – Closing inventory (WIP)

AT A GLANCE
SPOTLIGHT
STICKY NOTES

46. A manufacturing entity has policy of holding no inventory of any type whether raw materials, WIP or finished goods. During an accounting period it only produced goods from raw material purchased by it. Its cost of sales shall be equal to:

(a) Cost of direct materials consumed

(b) Prime Cost

(c) Direct labour + Production Overheads

(d) Prime Cost + Production Overheads

47. Faran Limited is manufacturer of hand bags. Following figures have been provided for the month of April 2019;

	April 1 Rs.	April 30 Rs.
Raw material inventory	39,000	66,000
Raw materials purchased		400,000
Direct labour cost		300,000

What is the amount of raw materials consumed for the month of April 2019?

Rs. _________

48. Faran Limited is manufacturer of hand bags. Following figures have been provided for the month of April 2019;

	Rs.
Raw materials consumed	373,000
Direct labour cost	300,000
Indirect labour	40,000

What is the figure for prime cost for the April 2019?

Rs. _________

49. Faran Limited is manufacturer of hand bags. Following figures have been provided for the month of April 2019:

	Rs.
Raw materials purchased	400,000
Direct labour cost	300,000
Advertising expense	150,000
Selling and administrative salaries	140,000
Rent for factory	120,000
Depreciation - Sales equipment	110,000
Depreciation - Factory equipment	70,000
Indirect labour cost	40,000
Factory utilities	20,000
Factory insurance	10,000

Only 60% of the utilities expenses and 70% of the insurance expense apply to factory operations, the remaining amount should be charged to selling and administrative expenses.

What is the amount of factory overheads for the month?

Rs. __________

50. Neelam & Co. has provided following data for the month of January 2019;

(i) Material purchased for Rs. 500,000.

(ii) Opening inventory of raw material is Rs. 80,000 and closing inventory is Rs. 120,000.

(iii) Gross payroll for the month was Rs. 2,000,000. The distribution of payroll was 50% direct labour, 20% indirect labour, 20% administrative staff salaries, and 10% sales staff salaries.

What is the amount of prime cost incurred for the month of January 2019?

Rs. __________

AT A GLANCE SPOTLIGHT STICKY NOTES

ANSWERS

01.	**(d)**	Sum of direct material and direct labour cost
02.	**(d)**	Cost of direct labour + production overhead
03.	**(d)**	Can be directly identified with a product of service
04.	**(d)**	depreciation of kitchen equipment rent paid for the restaurant building
05.	**(a)**	Royalty paid on number of units of product SK produced
06.	**(a) & (c)**	Chocolates chips purchased Hours of cake decorator's time
07.	**(b) & (d)**	5 litres of lubricant for sewing machines purchased Electricity bill of production area
08.	**(b)**	Wages of operator in the cutting department
09.	**(d)**	Nails and screws
10.	**(d)**	Depreciation of ovens
11.	**(b)**	Bricklayer in a construction company
12.	**(c)**	Wages of store assistant in a factory store
13.	**(c)**	Plant and Machinery (installed in factory premises)
14.	**(d)**	Dr. Inventory (WIP) Rs. 176,000 Cr. Inventory (Materials) Rs. 176,000
15.	**(c)**	Dr. Production Overheads Rs. 30,000 Cr. Inventory (Materials) Rs. 30,000
16.	**(d)**	Dr. Production overheads Rs. 2 million Dr. Operating expenses Rs. 1 million Cr. Accumulated depreciation Rs. 3 million Rs. (82m – 10m) = Rs. 72m / 20 years = Rs. 3.6m x 10/12 = Rs. 3 million
17.	**(b)**	Dr. WIP Rs. 19.6m Dr. Production OH Rs. 3.2m Cr. Materials Control Rs. 22.8m
18.	**(a)**	Indirect worker base rate = Rs. 600 x 200 hours = Rs. 120,000 Indirect worker overtime = Rs. 200 x 40 hours = Rs. 8,000 Direct worker overtime = Rs. 280 x 110 hours = Rs. 30,800 Rs. 158,800
19.	**(d)**	Rs. 621,600 (i.e. Rs. 840 x 740 hours) Direct workers' general overtime premium is charged to production overheads
20.	**(c)**	Dr. WIP Rs. 20m & Dr. Production OH Rs. 3.7m & Cr. Wages Control Rs. 23.7m
21.	**(a)**	All of the listed methods may be used for absorption.
22.	**(b)**	Debit Finished goods & Credit Inventory (WIP)

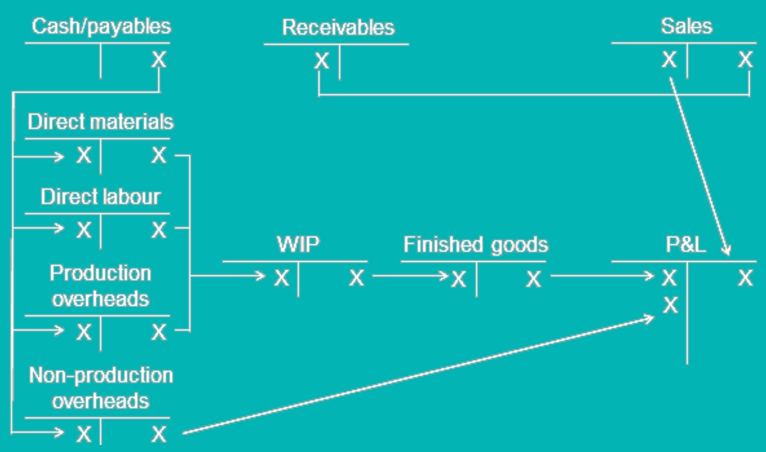
23.	**(d)**	Debit Cost of sales (P&L) & Credit Finished goods
24.	**(a)**	12,400 hours' x Rs. 425 per hour = Rs. 5,270,000
25.	**(c)**	Absorbed Overheads = Rs. 425 x (12400 x 102%) = Rs. 5,375,400
26.	**(b)**	Actual – Absorbed = Rs. 5,638,900 – 5,375,400 = Rs. 263,500 under
27.	**(d)**	Absorbed overheads > Actual overheads
28.	**(c)**	Actual production x Pre-determined rate
29.	**(a)**	Debit Production Overheads & Credit Cash / Accrual
30.	**(b)**	Debit Inventory (WIP) & Credit Production Overheads
31.	**(c)**	Debit Cost of sales (P&L) & Credit Production Overheads
32.	**(d)**	Debit Production Overheads & Credit Cost of sales (P&L)
33.	**Rs. 465,000**	Opening inventory + Purchases (net) Rs. 75,000 + (410,000 – 20,000) = Rs. 465,000
34.	**Rs. 360,000**	Opening inventory + Purchases (net) – Closing inventory Rs. 75,000 + (410,000 – 20,000) – 105,000= Rs. 360,000
35.	**Rs. 432,000**	Prime Cost = All direct costs Rs. 360,000 + 60,000 + 12,000 (royalty) = Rs. 432,000
36.	**Rs. 51,500**	Rs. 12,500 indirect + Rs. 24,000 x 80% Depreciation + Rs. 19,800 rent and utilities = Rs. 51,500
37.	**Rs. 483,500**	Prime Cost + Production overheads Rs. 432,000 + 51,500 = Rs. 483,500
38.	**Rs. 553,500**	Opening WIP + Purchases of WIP + Factory Cost Rs. 40,000 + 30,000 + 483,500 = Rs. 553,500
39.	**Rs. 518,500**	Opening WIP + Purchases of WIP + Factory Cost – Closing (WIP) Rs. 40,000 + 30,000 + 483,500 – 35,000 = Rs. 518,500
40.	**Rs. 658,500**	Opening FG + Purchases FG + CGM Rs. 60,000 + 80,000 + 518,500 = Rs. 658,500
41.	**Rs. 588,500**	Opening FG + Purchases FG + CGM – Closing FG Rs. 60,000 + 80,000 + 518,500 – 70,000 = Rs. 588,500
42.	**Rs. 700,000**	Rs. 500,000 + 200,000 = Rs. 700,000
43.	**Rs. 700,000**	Rs. 500,000 + 200,000 + 30,000 – 30,000 = Rs. 700,000
44.	**Rs. 508,500**	Opening FG + CGM – Closing FG Rs. 60,000 + 518,500 – 70,000 = Rs. 508,500
45.	**(d)**	= Factory Cost + Opening inventory (WIP) – Closing inventory (WIP)
46.	**(d)**	Prime Cost + Production Overheads

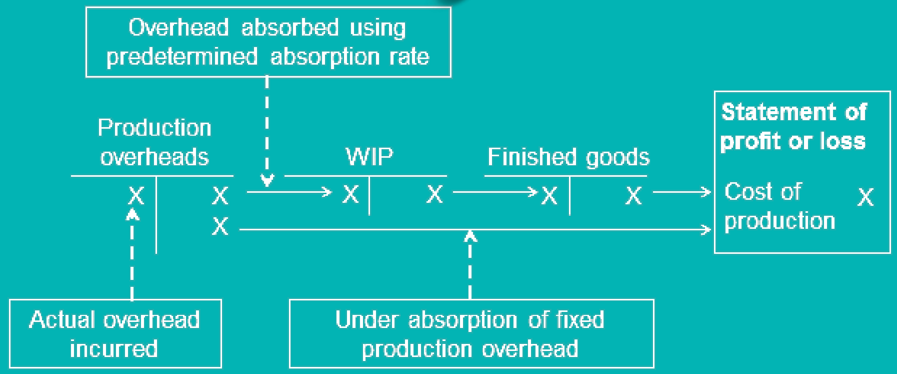
47.	**Rs. 373,000**		**Rs.**
		Raw materials - opening	39,000
		Raw material purchases	400,000
		Raw material available for consumption	439,000
		Raw materials - closing	(66,000)
		Raw material consumed	373,000
48.	**Rs. 673,000**		**Rs.**
		Raw materials consumed	373,000
		Direct labour	300,000
		Prime cost	673,000
49.	**Rs. 249,000**		**Rs.**
		Indirect labour cost	40,000
		Rent for factory	120,000
		Depreciation - Factory equipment	70,000
		Factory utilities - 60%	12,000
		Factory insurance – 70%	7,000
			249,000
50.	**Rs. 1,460,000**		**Rs.**
		Raw materials - opening	80,000
		Raw material purchases	500,000
		Raw material available for consumption	580,000
		Raw materials - closing	(120,000)
		Raw material consumed	460,000
		Direct labour – Rs. 2,000,000 x 50%	1,000,000
		Prime cost	1,460,000

STICKY NOTES

Direct Cost are cost that can be traced in full to a cost unit. An indirect cost (overhead cost) is any cost that is not a direct cost and these cannot be attributed directly and in full to a cost unit.

Factory ledger is kept for accounting for factory related transactions.





Format: Statement of Comprehensive Income

	Rs.	Rs.
Sales (net)		XXX
Less: Cost of goods sold		
Opening stock → Finished goods	*XX*	
+ Purchase of finished goods (if any)	*X*	
+ Cost of goods manufactured (as calculated below)	XXX	
Cost of goods available for sale	XXX	
- Closing stock → Finished goods	(XX)	*(XXX)*
Gross profit		*XX*
Less: Administration costs		(XX)
Less: Selling and distribution costs		(XX)
Net profit		XX

Format: MANUFACTURING ACCOUNT

	Units	Rs.
Purchases of raw material (including carriage in) net of returns	XX	XXX
+ Opening stock → raw material	XX	XX
Cost of materials available for consumption	XXX	XXX
- Closing stock → raw material	(XX)	(XX)
Cost of materials consumed	XXX	XXX
+ Direct labour (wages)		XX
+ Other direct expenses		XX
Prime Cost (Total direct costs)		XXX
+ *Factory(production or manufacturing) overheads (expenses)*		
Indirect wages		XX
Depreciation (on production related assets)		XX
Insurance (relating to inventories or production)		XX
Fuel and power (electricity)		XX
Other factory or production expenses		X
		XX
Factory (manufacturing or production) cost		XXX
+ Opening stock → work in process	XX	XX
+ Purchase of WIP	XX	XX
Cost of goods available for manufacturing	XX	XXX
- Closing stock → work in process	(XX)	(XX)
COST OF GOODS MANUFACTURED	XXX	XXX

CHAPTER 9

PREPARATION OF FINANCIAL STATEMENTS

IN THIS CHAPTER:

AT A GLANCE

The published financial statements are available for review of external stakeholders (e.g. owners, lenders, suppliers, customers etc.), who use it to evaluate the financial performance, financial position, liquidity and cash flows of an entity.

The preparation of financial statements involves the process of aggregating accounting information from the trial balance and year-end adjustments.

It is necessary to incorporate double entry effect of year-end adjustments as opposed to the balances in trial balance which are already the result of double entry bookkeeping process.

Statement of financial position is a snapshot of the entity's financial position at a point in time that enlists assets, liabilities and equity of an entity at a particular date.

Statement of comprehensive income is a combination of profit or loss and other comprehensive income. Profit or loss shows the financial results for a period by summarising income earned and expenses incurred during that particular period.

1. IAS 1 Presentation of Financial Statements

IAS 1 Presentation of Financial Statements prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

GENERAL REQUIREMENTS

True and fair view

Financial statements should present fairly the financial position, financial performance and cash flows of the entity.

Comparatives

Comparative information for the immediately preceding accounting period should be disclosed (you will not be asked to provide comparative information).

Identification

Each component of the financial statements must be properly identified with the following information displayed prominently:

- the name of the reporting entity
- the date of the end of the reporting period or the period covered by the statement, whichever is appropriate
- the currency in which the figures are reported
- the level of rounding used in the figures (for example, whether the figures thousands of rupees or millions of rupees).

Other titles

IAS 1 does not specify what the statements must be called and allows the use of other terminology. For example, a statement of financial position is often called a balance sheet and a statement of profit or loss is often called an income statement.

REQUIREMENTS AS TO STATEMENT OF FINANCIAL POSITION

Current and non-current assets

IAS 1 states that an asset should be classified as a current asset if it satisfies any of the following criteria:

- The entity expects to realise the asset, or sell or consume it, in its normal operating cycle.
- The asset is held for trading purposes.
- The entity expects to realise the asset within 12 months after the reporting period.
- It is cash or a cash equivalent unless the asset is restricted from being used for at least 12 months after the reporting date. (Note: An example of 'cash' is money in a current bank account. An example of a 'cash equivalent' is money held in a term deposit account with a bank.)

All other assets should be classified as non-current assets.

This definition allows inventory or trade receivables to qualify as current assets, even if they may not be realised into cash within 12 months, provided that they will be realised in the entity's normal operating cycle or trading cycle.

Current and non-current liabilities

IAS 1 also states that a liability should be classified as a current liability if it satisfies any of the following criteria:

- The entity expects to settle the liability in its normal operating cycle.
- The liability is held primarily for the purpose of trading. This means that all trade payables are current liabilities, even if settlement is not due for over 12 months after the end of the reporting period.
- It is due to be settled within 12 months after the end of the reporting period.
- The entity does not have the unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

All other liabilities should be classified as non-current liabilities.

▶ *Illustration:*

If a company obtains a five-year bank loan, where none of the loan principal is repayable until the end of the loan period, the loan will be a non-current liability for the first four years and will then become a current liability in fifth year when it is repayable within 12 months.

Accrued expenses (and deferred income) are current liabilities as these are monies due to a third party but not yet paid; for example, wages payable

Operating cycle

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. This is almost always the case.

Minimum face items

IAS 1 provides a list of items that, as a minimum, must be shown on the face of the statement of financial position as a 'line item' (in other words, on a separate line in the statement):

Assets

- Property, plant and equipment
- Investment property
- Intangible assets
- Long-term investments
- Investment in associate
- Biological assets
- Inventories
- Trade and other receivables
- Cash and cash equivalents.

Liabilities

- Trade and other payables
- Provisions
- Financial liabilities, loan etc.
- Current tax liabilities (but possibly assets)
- Deferred tax liabilities (but possibly assets). These are always non-current.

Equity

- Issued capital and reserves attributable to the owners of the entity. (The term 'owners', refers to the equity holders.)

Additional line items

Additional line items should be included in the statement of financial position when presenting them separately and is relevant to an understanding of the entity's financial position.

Face or Notes

Some of the line items in the statement of financial position should be sub-classified into different categories, giving details of how the total figure is made up. This sub-classification may be presented either:

- as additional lines on the face of the statement of financial position (adding up to the total amount for the item as a whole) or
- in notes to the financial statements.

▶ *For example:*

- Tangible non-current assets should be divided into sub-categories, as required by IAS 16
- Receivables should be sub-classified into trade receivables, receivables from related parties, prepayments and other amounts.
- Inventories are sub-classified in accordance with IAS 2 into categories of materials, work in progress and finished goods.

Statement of financial position

As at 31 December 202X

Assets	Rs. m
Non-current assets	
Property, plant and equipment (details are usually provided in notes)	100
Intangible assets	100
Investments	100
	300
Current assets	
Inventories (usually nil in service organization)	50
Trade and other receivables (details are usually provided in notes)	50
Other current assets (prepayments and accrued income)	50
Cash and cash equivalent	50
	200
	500
Equity and liabilities	
Equity	
Owners' Capital	200
Profit (loss) for the period	100
Less: Drawings	(50)
	250

	Rs. m
Non-current liabilities	
Long term borrowings	100
Deferred tax	50
	150
Current liabilities	
Trade payables	20
Other payables (unearned income and accrued expenses)	20
Short term borrowings / Bank overdraft	20
Current portion of long-term borrowing	20
Current tax payable	20
	100
	500

REQUIREMENTS AS TO STATEMENT OF COMPREHENSIVE INCOME

A single statement or two statements

This statement provides information about the performance of an entity in a period. It consists of two parts:

- a statement of profit or loss – a list that summarizes the revenues, costs and expenses incurred during a specified period which result in a profit or loss for the period; and
- a statement of other comprehensive income – a list of other gains and losses that have arisen in the period.

The statement of comprehensive income shows the performance of the business in terms of its main activities. It is a structured presentation of all revenue, other income earned in a period and the costs of earning those.

IAS 1 allows an entity to present the two sections in a single statement or in two separate statements. If two separate statements are used, they should include all the information that would otherwise be included in the single statement of comprehensive income.

Total comprehensive income

Total comprehensive income during a period is the sum of:

- the profit or loss for the period and
- other comprehensive income.

Minimum face items

As a minimum, IAS 1 requires that the statement of comprehensive income should include line items showing the following amounts for the financial period:

- revenue
- finance costs (for example, interest costs)
- tax expense
- profit or loss
- each component of 'other comprehensive income
- total comprehensive income.

AT A GLANCE
SPOTLIGHT
STICKY NOTES

Additional line items

Additional line items should be presented on the face of the statement of comprehensive income when it is relevant to an understanding of the entity's financial performance.

Face or Notes

The following information may be shown either on the face of the statement of comprehensive income or in a note to the financial statements:

- material items of income and expense
- an analysis of expenses, providing either:
  - expenses analysed by their nature, or
  - expenses analysed by the function that has incurred them.

Examples of material items

Material items that might be disclosed separately include:

- a write-down of inventories from cost to net realisable value, or a write-down of items of property, plant and equipment to recoverable amount
- the cost of a restructuring of activities
- disposals of items of property, plant and equipment
- discontinued operations
- litigation settlements
- a reversal of a provision

Analysis of expense by nature

When expenses are analysed according to their nature, the categories of expenses will vary according to the nature of the business.

In a manufacturing business, expenses would probably be classified as:

- raw materials and consumables used;
- staff costs ('employee benefits costs'); and
- depreciation.

Items of expense that are immaterial are presented as 'other expenses'.

There will also be an adjustment for the increase or decrease in inventories of finished goods and work-in-progress during the period.

Other entities (non-manufacturing entities) may present other expenses that are material to their business.

Statement of comprehensive income (ANALYSIS OF EXPENSE BY NATURE)

For the year ended 31 December 202X

		Rs. m
Revenue		1,250
Other income		100
		1,350

		Rs. m
Changes in inventories of WIP and finished goods		(600)
Raw material and consumables used		(200)
Staff costs		(200)
Depreciation		(150)
Other expenses		(50)
Finance cost		(50)
Profit before tax		**100**
Tax		-
Profit after tax		100
Other comprehensive income:		
Gain on revaluation		0
Other gain or losses		0
		0
Total comprehensive income		**100**

- *Example 01:*

The following is data relating to the accounts of Entity Red.

	Rs. 000
Increase in inventories of finished goods and work-in-progress	86
Revenue	14,823
Raw materials and consumables	5,565
Depreciation	1,533
Other income	22
Staff costs	4,926
Other operating expenses	2,118

The first part of Entity Red's statement of comprehensive income using the 'nature of expenditure' method, down to the operating profit level shall be as follows:

Entity Red: Statement of comprehensive income for the year ended 30 June 20X5		
	Rs. 000	**Rs. 000**
Revenue		14,823
Other income		22
		14,845
Changes in inventories of finished goods and work-in-progress (reduction = expense, increase = negative expense)	(86)	
Raw materials and consumables used	5,565	
Staff costs (employee benefits costs)	4,926	
Depreciation and amortisation expense	1,533	
Other operating expenses	2,118	
		14,056
Profit before tax		789

Analysis of expense by function

When expenses are analysed according to their function, the functions are commonly 'cost of sales', 'distribution costs', 'administrative expenses' and 'other expenses'. This method of analysis is also called the 'cost of sales method'. In practice, most entities use this method.

Statement of comprehensive income (ANALYSIS OF EXPENSE BY FUNCTION)

For the year ended 31 December 202X

	Rs. m
Revenue	1,250
Cost of sales (details are usually provided in notes)	(950)
Gross profit	300
Other income	100
Admin expenses (details are usually provided in notes)	(100)
Distribution expenses (details are usually provided in notes)	(100)
Other expenses (e.g. research and development expense)	(50)
Finance cost	(50)
Profit before tax	**100**
Tax	-
Profit after tax	100
Other comprehensive income:	
Gain on revaluation	0
Other gain or losses	0
	0
Total comprehensive income	**100**

- *Example 02:*

The following is an extract from the accounts of Entity Red for the year to 30 June 20X5, after the year-end adjustments had been made:

	Debit	Credit
	Rs. 000	Rs. 000
Cost of sales	6,214	
Distribution costs	3,693	
Revenue		14,823
Other expenses	248	
Administrative expenses	3,901	
Other income		22

The first part of Entity Red's statement of comprehensive income using the 'cost of sales' analysis method shall be as follows:

Entity Red: Statement of comprehensive income for the year ended 30 June 20X5	
	Rs. 000
Revenue	14,823
Cost of sales	6,214
Gross profit	8,609
Other income	22
Distribution costs	(3,693)
Administrative expenses	(3,901)
Other expenses	(248)
Profit before tax	789

FINANCIAL STATEMENTS OF A SERVICE ORGANISATIONS

Service organizations do not sell goods but provides services to its clients by using the innovative and technical skillset and expertise of its personnel. Examples include investment banking, consulting, audit, accounting and advisory firms.

Financial Statements of Merchandise/trading Company	Financial Statements of Service Company
A large percentage of the assets comprise inventory.	A large percentage of the assets comprise receivables.
They have less cash on hand than service businesses as their capital is tied up in relatively illiquid assets.	The funds of service companies are usually tied up towards accounts receivable.
Such companies' income statement shows calculation of costs of goods sold.	There is no line item for the cost of goods sold in the income statement of service companies.

▶ *Illustration: Statement of financial position of an advertising agency*

Statement of Financial Position at June 30, 2018	
	2018
	Rs. '000'
Current assets	
Cash and cash equivalents	120,000
Short term investments	50,000
Trade receivables	150,000
Other receivables	5,000
Total current assets	**325,000**
Non-current assets	
Property, plant and equipment	70,000
Other receivables	3,000
Website and domains	46,000
Other intangible assets	12,000
Deferred tax asset	25,000
Total non-current assets	**156,000**
Total assets	**481,000**

	2018
	Rs. '000'
Current liabilities	
Trade and other payables	45,000
Short term bank borrowings	50,000
Income tax payable	25,000
Total current liabilities	**120,000**
Non-current liabilities	
Long term bank borrowings	60,000
Other non-current liabilities	20,000
Total non-current liabilities	**80,000**
Total Liabilities	**200,000**
Equity	
Owner's equity	**281,000**
Total of equity and liabilities	**481,000**

- *Illustration: Statement of comprehensive income of an advertising agency*

Statement of comprehensive income for the year ended June 30, 2018	
	Rs. in '000'
Revenue	400,000
Cost of revenues	(250,000)
Gross profit	**150,000**
Research and development expenses	(30,000)
Selling and marketing expenses	(60,000)
General and administrative expenses	(40,000)
Operating profit	20,000
Finance expense	(2,000)
Profit for the year	**18,000**

2. PREPARING FINANCIAL STATEMENTS

The statement of financial position and the statement of comprehensive income can be prepared in any order but the statement of financial position can only be completed after the profit or loss for the period is known because this figure becomes part of the equity capital.

OPENING AND CLOSING INVENTORY AND THE COST OF SALES

The cost of sales in the statement of comprehensive income is not the cost of goods purchased or the cost of goods produced. It must be the cost of the goods sold. The accruals or matching concept must be applied.

When there are differences between the quantity of materials purchased or made, and the quantity of materials used or sold, there is an increase or decrease in inventory during the period.

To calculate the cost of sales for a statement of comprehensive income, it is necessary to make an adjustment for changes in the amount of inventory.

- *Illustration: Cost of sales*

	Rs.	
Opening inventory	5,000	
Purchases	45,000	
	50,000	This is the total amount of goods that were available to be sold.
Less: Closing inventory	(12,000)	This is the total amount of goods still held at the end of the period.
Cost of sales	38,000	Therefore, this is the total amount of goods that were sold.

YEAR-END ADJUSTMENTS

In order to prepare a statement of financial position and statement of comprehensive income from a trial balance you need to develop a good technique in order to execute such tasks in an effective way.

A typical question provides trial balance with few adjustments and requires preparing the financial statements. The rest of this chapter illustrates how such questions might be approached.

Step 1: Prepare formats of statement of financial position and statement of comprehensive income.

Step 2: Transfer amounts from trial balance to the formats. Ensure that no amount is omitted or duplicated.

Step 3: Incorporate the double entry effect of adjustments in the relevant figures in the format

Step 4: Perform sub-totals and grand totals in the format.

- *Example 03:*

ABC – Trial balance as at 31 December 2013		
	Rs.	**Rs.**
Sales		428,000
Purchases	304,400	
Wages and salaries	64,000	
Rent	14,000	
Heating and lighting	5,000	
Inventory as at 1 January 2013	15,000	

AT A GLANCE SPOTLIGHT STICKY NOTES

	Rs.	Rs.
Drawings	22,000	
Allowance for doubtful debts		4,000
Non-current assets	146,000	
Accumulated depreciation:		32,000
Trade receivables	51,000	
Trade payables		42,000
Cash	6,200	
Capital as at 1 January 2013		121,600
	627,600	627,600

Further information:.

a) Rs. 400 is owed for heating and lighting expenses.

b) Rs. 700 has been prepaid for rent.

c) It is decided that a bad debt of Rs. 1,200 should be written off, and that the allowance for doubtful debts should be increased to Rs. 4,500.

d) Depreciation is to be provided for the year at 10% on cost

e) Inventory at 31st December 2013 was valued at Rs. 16,500.

Required:

Prepare statement of comprehensive income for the year ended 31 December 2013 and statement of financial position as at that date.

► *ANSWER*

ABC – Statement of comprehensive income for the year ended 31 December 2013

	Rs. m	Rs. m
Revenue		428,000
Cost of sales*		
Opening inventory	15,000	
Purchases	304,400	
	319,400	
Closing inventory	(16,500)[e]	
		(302,900)
Gross profit		125,100
Expenses:		
Wages and salaries	64,000	
Depreciation **(Rs. 146,000 x 10%)**	14,600[d]	
Rent (14,000 – 700[b])	13,300	
Heating an lighting (5,000 + 400[a])	5,400	
Bad and doubtful debts (1,200[c] + 500[c])	1,700	
		(99,000)
		26,100

*Alternatively cost of sales may be presented in single line item supported by details given in notes.

ABC – Statement of financial position as at 31 December 2013		
Assets	**Rs. m**	**Rs. m**
Non-current assets		
Cost	146,000	
Accumulated depreciation (32,000 + 14,600[d])	(46,600)	
		99,400
Current assets		
Inventories	16,500[e]	
Trade receivables (51,000 – 1,200[c])	49,800	
Allowance for doubtful debts (4,000 + 500[c])	(4,500)	
	45,300	
Prepayments	700[b]	
Cash	6,200	
		68,700
Total assets		168,100
Equity and liabilities		
Capital		
At start of year	121,600	
Profit for the year	26,100	
Drawings	(22,000)	
		125,700
Current liabilities		
Trade payables	42,000	
Accruals (and prepaid income)	400[a]	
		42,400
Total equity and liabilities		168,100

Note that adjustments have two effects, while amounts from trial balance have been included only once.

- *Example 04:*

The following trial balance was extracted from the main ledger of Steven Chee, a sole trader, as at 31 May 2013 – the end of his financial year.

Steven Chee: Trial balance as at 31 May 2013			
	DR		**CR**
	Rs.(000)		**Rs.(000)**
Land and buildings at cost	120,000		
Equipment at cost	80,000		

	DR	CR
	Rs.(000)	Rs.(000)
Accumulated depreciation (as at 1 June 2012)		
On land and buildings		20,000
On equipment		38,000
Purchases	250,000	
Revenue		402,200
Inventory as at 1 June 2012	50,000	
Discounts allowed	18,000	
Discounts received		4,800
Returns outwards		15,000
Wages and salaries	61,800	
Bad debts	4,600	
Loan interest	2,100	
Other operating expenses	17,700	
Trade payables		36,000
Trade receivables	38,000	
Cash in hand	300	
Bank	1,300	
Drawings	24,000	
Allowance for doubtful debts		500
7% long-term loan		30,000
Capital as at 1 June 2012		121,300
	667,800	667,800

The following additional information is available:

a) Inventory as at 31 May 2013 has been valued at cost at Rs. 42,000,000.

b) There are accrued wages and salaries of Rs. 800,000.

c) Other operating expenses are prepaid by Rs. 300,000.

d) The allowance for doubtful debts is to be adjusted so that it is 2% of trade receivables.

e) Depreciation for the year ended 31 May 2013 should be provided for as follows:

- Land and buildings – 1.5% per annum on cost, using the straight-line method.
- Equipment – 25% per annum, using the reducing balance method.

Steven Chee's statement of comprehensive income for the year ended 31 May 2013 and his statement of financial position as at that date shall be prepared as follows:

Statement of comprehensive income for the year ended 31 May 2013	
	Rs.(000)
Revenue (W1)	384,200
Cost of sales (W2)	(238,200)
Gross profit	**146,000**
Operating expenses (W3)	(99,260)
Net profit	**46,740**

Statement of financial position as at 31 May 2013	
Non-current assets	**Rs.(000)**
Land and buildings (W5)	98,200
Equipment (W5)	31,500
	129,700
Current assets:	
Inventory	42,000
Trade receivables (W6)	37,240
Prepayment	300
Bank	1,300
Cash in hand	300
	81,140
Total assets	**210,840**
Owner's Equity (W7)	**144,040**
Non-current liabilities	
7% long-term loan	30,000
Current liabilities	
Trade payables	36,000
Accrued wages and salaries	800
	36,800
Total equity and liabilities	**210,840**

W1 – Sales / Revenue	**Rs.(000)**
Sales	402,200
Less: Discount	(18,000)
	384,200

W2 – Cost of sales	**Rs.(000)**
Opening inventory at 1 June 2012	50,000
Purchases less returns and discounts (250,000 – 15,000 – 4,800)	230,200
	280,200
Less: Closing inventory at 31 May 2013	(42,000)
Cost of sale	238,200

W3 – Operating expenses	Rs.(000)
Wages and salaries (61,800 + accrual 800)	62,600
Other operating expenses (17,700 – prepayment 300)	17,400
Depreciation, land and buildings: (1.5% x 120,000,000)	1,800
Depreciation, equipment: (25% x (80,000 – 38,000))	10,500
Loan interest	2,100
Bad debts	4,600
Increase in allowance for doubtful debts (W4)	260
	99,260

W4 – Increase in allowance	Rs. (000)
Allowance for doubtful debts at 31 May 2013: (2% x 38,000)	760
Allowance for doubtful debts at 1 June 2012	(500)
Increase in allowance	260

W5 – Property, plant and equipment			
	Cost	Accumulated depreciation	Carrying Amount
	---------------------- Rs.(000) ----------------------		
Land and buildings	120,000	21,800	98,200
Equipment	80,000	48,500	31,500
	200,000	70,300	129,700

W6 – Trade receivable	Rs.(000)
Trade receivables	38,000
Less allowance for doubtful debts **(W4)**	(760)
	37,240

W7 – Owners' Equity	Rs.(000)
At 1 June 2012	121,300
Net profit for the year	46,740
	168,040
Drawings	(24,000)
At 31 May 2013	144,040

3. COMPREHENSIVE EXAMPLES

- *Example 04:*

The following trial balance has been extracted from the ledger of Herbert, a sole trader, as at 31 May 2013, the end of his most recent financial year.

Herbert: Trial balance as at 31 May 2013		
	DR	**CR**
	Rs.(000)	**Rs.(000)**
Land and buildings at cost	90,000	
Equipment at cost	57,500	
Accumulated depreciation (as at 1 June 2012)		
On land and buildings		12,500
On equipment		32,500
Inventory as at 1 June 2012	27,400	
Revenue		405,000
Purchases	259,600	
Discounts allowed	3,370	
Discounts received		4,420
Wages and salaries	52,360	
Bad debts	1,720	
Loan interest	1,560	
Other operating expenses	38,800	
Trade receivables	46,200	
Trade payables		33,600
Allowance for doubtful debts		280
Cash in hand	151	
Bank overdraft		14,500
Carriage out	5,310	
Drawings	28,930	
10% loan		15,600
Capital as at 1 June 2012		94,501
	612,901	**612,901**

The following additional information as at 31 May 2013 is available:

a) Inventory as at 31 May 2013 was valued at Rs. 25,900,000.

b) Depreciation for the year ended 31 May 2013 has yet to be provided as follows:

- Property – 1% using the straight-line method;
- Equipment – 15% using the straight-line method.

c) There are accrued wages and salaries of Rs. 140,000.

d) Other operating expenses include some prepaid expenses of Rs. 500,000 and some accrued expenses of Rs. 200,000.

e) The allowance for doubtful debts should be adjusted to 5% of trade receivables as at 31 May 2013.

f) The amount for purchases includes goods valued at Rs. 1,040,000 which were withdrawn by Herbert for his own personal use.

Required

Prepare Herbert's statement of comprehensive income for the year ended 31 May 2013 and his statement of financial position as at that date.

▶ *ANSWER*

Statement of comprehensive income for the year ended 31 May 2013	
	Rs.(000)
Revenue (W1)	401,630
Cost of sales (W2)	(255,640)
Gross profit	**145,990**
Operating expenses (W4)	(111,145)
Net profit	**34,845**

Statement of financial position as at 31 May 2013	
	Rs.(000)
Non-current assets	
Land and buildings (W7)	76,600
Equipment (W7)	16,375
	92,975
Current assets	
Inventory	25,900
Trade receivables (46,200 – 2,310(W5))	43,890
Prepayments	500
Cash in hand	151
	70,441
Total assets	**163,416**
Owner's Equity (W8)	**99,376**
Non-current liabilities	
10% loan	15,600
Current liabilities	
Bank overdraft	14,500
Trade payables	33,600
Accruals (140 wages + 200 operating expenses)	340
	48,440
Total equity and liabilities	**163,416**

Workings

W1 – Sales / Revenue	Rs.(000)
Revenue	405,000
Less: Discount allowed to customers	(3,370)
	401,630

W2 – Cost of sales	Rs.(000)
Opening inventory at 1 June 2012	27,400
Purchases (W3)	254,140
	281,540
Less: Closing inventory at 31 May 2013	(25,900)
	255,640

W3 - Purchases	Rs.(000)
Purchases in the trial balance	259,600
Less: Discount received	(4,420)
Less: goods taken by the owner for his own use	(1,040)
	254,140

W4 – Operating expenses	Rs.(000)
Wages and salaries (52,360 + accrual 140)	52,500
Other operating expenses (W5)	38,500
Depreciation: land and buildings: (1% x Rs. 90,000)	900
Depreciation: equipment: (15% x Rs. 57,500)	8,625
Carriage out	5,310
Loan interest	1,560
Bad debts	1,720
Increase in allowance for doubtful debts (W6)	2,030
	111,145

W5 – Other operating expenses	Rs.(000)
Expenses in the trial balance	38,800
Add: accrual	200
Less: prepayment	(500)
Expenses in the statement of comprehensive income	38,500

W6 – Change in allowance for doubtful debts	Rs.(000)
Allowance for doubtful debts at 31 May 2013: (5% x 46,200)	2,310
Allowance for doubtful debts at 1 June 2012	(280)
Increase in allowance	2,030

W7 - Non-current assets			
	Cost	**Accumulated depreciation**	**Carrying amount**
	Rs.(000)		
Land and buildings	90,000	13,400	76,600
Equipment	57,500	41,125	16,375
	147,500	54,525	92,975

W8 - Owner's Equity	**Rs.(000)**
At 1 June 2012	94,501
Net profit for the year	34,845
	129,346
Drawings (28,930 + 1,040)	(29,970)
At 31 May 2013	99,376

▶ *Example 05:*

The following trial balance has been extracted from the ledger of Bradbury and Co, as at 31 December 2013, the end of its most recent financial year.

Bradbury and Co: Trial balance as at 31 December 2013		
	DR	**CR**
	Rs.	**Rs.**
Plant and machinery at cost	920,000	
Allowance for depreciation (as at 1 January 2013)		215,000
Inventory as at 1 January 2013	39,000	
Revenue		1,292,000
Purchases	550,000	
Capital		173,000
Distribution expenses	116,000	
Administrative expenses	241,000	
Bad debts	23,500	
Loan (charging interest at 6%)		400,000
Trade receivables	200,000	
Trade payables		73,500
Allowance for doubtful debts		6,000
Interest paid on loan	12,000	
Bank	58,000	
	2,159,500	2,159,500

The following additional information as at 31 December 2013 is available:

a) Inventory as at 31 December 2013 was valued at Rs. 35,000.

b) Depreciation on plant and machinery for the year ended 31 December 2013 is to be provided at the rate of 10% of cost.

c) There are accrued distribution expenses of Rs. 7,500 and prepaid administrative expenses of Rs. 4,000.

d) The allowance for doubtful debts should be adjusted to 2% of trade receivables as at 31 December 2013

e) Interest has not been accrued on the loan at year end.

AT A GLANCE SPOTLIGHT STICKY NOTES

Required

Prepare the statement of comprehensive income of Bradbury and Co for the year ended 31 December 2013 and its statement of financial position as at that date in a format suitable for publication.

▶ *ANSWER*

Bradbury: Statement of comprehensive income for the year ended 31 December 2013	
	Rs.
Revenue	1,292,000
Cost of sales (W1)	(554,000)
Gross profit	**738,000**
Operating expenses	(498,000)
Net Profit	**240,000**

Bradbury: Statement of financial position as at 31 December 2013	
Non-current assets	**Rs.**
Plant and machinery (W3)	613,000
Current assets	
Inventory	35,000
Receivables (200,000 – 4,000 allowance)	196,000
Prepayment	4,000
Bank	58,000
	293,000
Total assets	**906,000**
	Rs.
Owner's Equity (W4)	**413,000**
Non-current laibilities	
Loan	400,000
Current liabilities	
Payables	73,500
Accruals	19,500
Total equity and liabilities	**906,000**

Workings	
W1- Cost of sales	**Rs.**
Opening inventory at 1 January 2013	39,000
Purchases	550,000
	589,000
Less: Closing inventory at 31 December 2013	(35,000)
	554,000

W2 – Operating expenses	Rs.
Administrative expenses (241,000 – 4,000 prepayment)	237,000
Distribution expenses (116,000 + 7,500 accrual)	123,500
Depreciation, land and buildings: (10% x Rs.920,000)	92,000
Bad and doubtful debts (see W2A)	21,500
Bond interest (6% x Rs.400,000)	24,000
	498,000

W2A - Bad and doubtful debts	Rs.
Allowance for doubtful debts at 31 December 2013: (2% x Rs.200,000)	4,000
Allowance for doubtful debts at 1 January 2013	(6,000)
Reduction in allowance	(2,000)
	23,500
Bad and doubtful debts expense	21,500

W3 - Non-current assets	Rs.
Plant and machinery at cost	920,000
Accumulated depreciation (Rs.215,000 + Rs.92,000)	(307,000)
	613,000

W4 – Owner's equity	Rs.
Capital at 1 January 2013	173,000
Profit for the year	240,000
Capital at 31 December 2013	413,000

▶ *Example 06:*

The following information relates to the business of Maria for the year ended 31 December 2012.

	Rs.	Rs.
Capital account, 1 January 2012		13,640
Freehold properties at cost	7,500	
Furniture and fittings at cost	2,000	
Motor cars at cost	6,300	
Accumulated depreciation to 1 January		
Freehold properties		450
Furniture and fittings		800
Motor cars		2,370
Inventory 1 January	6,740	
Purchases	54,520	
Revenue		79,060
Salaries	8,760	

	Rs.	Rs.
Rates	1,170	
Office expenses	3,950	
Motor expenses	3,790	
Drawings	4,800	
Allowance for doubtful debts 1 January		600
Loan		4,000
Trade receivables	9,240	
Trade payables		10,040
Bank balance	2,190	
	110,960	110,960

You are also supplied with the following information.

1. Inventory at 31 December 2012 was Rs. 7,330.
2. Rates paid in advance at 31 December 2012 amounted to Rs.250.
3. Allowance for doubtful debts is to be made equal to 5% of accounts receivable at 31 December 2012.
4. Depreciation is to be provided for the year at the following annual rates calculated on cost at the year end
   - Freehold properties 1%
   - Furniture and fittings 10%
   - Motor cars 20%
5. Interest on the loan at 5% per annum is to be provided.

Required:

Prepare a statement of comprehensive income for the year ended 31 December 2012 and a statement of financial position at that date.

▶ *ANSWER*

MARIA

Statement of Comprehensive Income

For the year ended 31 December 2012

	Rs.
Sales	79,060
Cost of sales W1	(53,930)
Gross profit	25,130
Operating expenses W2	(18,817)
Finance costs 4,000 x 5%	(200)
Net profit	6,113

MARIA
Statement of Financial Position
As at 31 December 2012

Non-current assets	**Rs.**
Property, plant and equipment W3	10,645
Current assets	
Stock	7,330
Debtors W4	8,778
Prepaid rates	250
Cash at Bank	2,190
	18,548
	29,193
Owner's equity	**Rs.**
Capital	13,640
Add Net profit	6,113
Less Drawings	(4,800)
	14,953
Non-Current liabilities	
Long term loan	4,000
Current liabilities	
Creditors	10,040
Interest accrued	200
	10,240
	29,193

W1 Cost of goods sold	**Rs.**
Opening Stock	6,740
Purchases	54,520
Carriage inwards	-
	61,260
Less Closing Stock	(7,330)
	53,930

W2 Operating expenses	**Rs.**
Salaries	8,760
Rates (1,170 – 250 prepaid)	920
Office Expense	3,950
Motor Expense	3,790
Doubtful debts 462 (W4) - 600	(138)
Depreciation:	
Freehold property: 7,500 x 1%	75
Furniture & fittings: 2,000 x 10%	200
Motor cars: 6,300 x 20%	1,260
	18,817

W3 PPE	Rs.
Freehold property (7,500 – 450 – 75)	6,975
Furniture & fittings (2,000 – 800 – 200)	1,000
Motor vans (6,300 – 2,370 – 1,260)	2,670
	10,645

W4 Receivables	Rs.
Debtors	9,240
Less Allowance for doubtful debts Rs. 9,240 x 5%	(462)
	8,778

▶ *Example 07:*

Stewart is a sole trader, supplying building materials to local builders. He prepares his accounts to 30 June each year. At June 30, 2013, his trial balance was as follows:

	Dr	Cr
	Rs.	**Rs.**
Capital at 1 July 2012		55,550
Purchases and sales	324,500	625,000
Returns	2,300	1,700
Discounts	1,500	2,500
Building materials at 1 July 2012	98,200	
Packing materials purchased	12,900	
Distribution costs	17,000	
Rent, rates and insurance	5,100	
Telephone	3,200	
Car expenses	2,400	
Wages	71,700	
Allowance for doubtful debts at 1 July 2012		1,000
Heat and light	1,850	
Sundry expenses	6,700	
Delivery vehicles – cost	112,500	
Delivery vehicles – depreciation at 1 July 2012		35,000
Equipment – cost	15,000	
Equipment – depreciation at 1 July 2012		5,000
Trade receivables and payables	95,000	82,000
Loan		10,000
Loan repayments	6,400	
Bank deposit account	15,000	
Bank current account	26,500	
	817,750	**817,750**

The following additional information at 30 June 2013 is available:

a) Inventory of building materials Rs. 75,300 and Inventory of packing materials Rs.700. There was also an unpaid invoice of Rs.200 for packing materials received and consumed during the year.

b) Prepayments: rent, rates and insurance Rs.450

c) Accrued expenses: heat and light Rs.400 and telephone Rs.500

d) Wages include Rs. 23,800 cash withdrawn by Stewart.

e) Trade receivables have been analysed as follows:

	Rs.
Current month	60,000
30 to 60 days	20,000
60 to 90 days	12,000
over 90 days	3,000

Allowance is to be made for doubtful debts as follows:

30 to 60 days	1%
60 to 90 days	2.5%
over 90 days	5% (after writing off Rs. 600)

f) Sundry expenses includes Rs. 3,500 for Stewart's personal tax bill.

g) The loan was taken out some years ago, the final payment is due on 31 March 2014. The figure shown in the trial balance for "loan repayments" includes interest of Rs.800 for the year.

h) The bank deposit account was opened on 1 January 2013 as a short-term investment; interest is credited at 31 December annually; the average rate of interest since opening the account has been 6% per annum.

i) At 1 July 2012, Stewart decided to bring one of his family cars, valued at Rs. 8,000, into the business. No entries have been made in the business books for its introduction. Depreciation is to be provided as follows:

- 20% on cost for delivery vehicles
- 25% on the reducing balance for the car
- 25% on the reducing balance for the equipment

Required:

Prepare a statement of comprehensive income for the year ended 30 June 2013.

Prepare a statement of financial position at 30 June 2013.

▶ *ANSWER*

STEWART

Statement of Comprehensive Income

For the year ended 30 June 2013

	Rs.
Sales [625,000 – 2,300 return – 1,500 discount]	621,200
Cost of sales W1	(343,200)
Gross profit	278,000
Other income: Interest 15,000 x 6% x 6/12	450
	278,450
Operating expenses W2	(120,720)
Finance cost	(800)
Net profit	156,930

STEWART

Statement of Financial Position as at 30 June 2013

Non-current assets	**Rs.**
Property, plant and equipment W3	68,500
Current assets	
Inventory	75,300
Trade debts W4	93,780
Prepaid expenses	450
Packing material unused	700
Interest Receivable 15,000 x 6% x 6/12	450
Bank Deposit	15,000
Bank Current	26,500
	212,180
	280,680
Owner's equity	
Capital	55,550
Add Capital introduced (vehicle)	8,000
Add Net profit	156,930
Less Drawings (23,800 from wages + 3,500 personal tax bill)	(27,300)
	193,180

AT A GLANCE SPOTLIGHT STICKY NOTES

Current liabilities	**Rs.**
Creditors	82,000
Loan (10,000 – (6,400 – 800 interest)	4,400
Expenses accrued 200 packing + 400 heat and light + 500 telephone	1,100
	87,500
	280,680

W1 Cost of sales	**Rs.**
Opening Stock	98,200
Purchases (324,500– 1,700 returns – 2,500 discount)	320,300
	418,500
Less Closing Stock	(75,300)
	343,200

W2 Operating expenses	**Rs.**
Packing materials consumed (12,900 – 700 stock + 200 accrued)	12,400
Salaries and wages (71,700 – 23,800 drawings)	47,900
Rent, rates & insurances (5,100– 450 prepaid)	4,650
Heating & Lighting (1,850+400 accrued)	2,250
Car expenses	2,400
Postage, stationery and telephone (3,200+ 500 accrued)	3,700
Bad debts(600 bad debts – 380 W5)	220
Distribution costs	17,000
Sundry expenses (6,700 – 3,500 personal tax bill)	3,200
Depreciation:	
Delivery Vehicles: 112,500 x 20%	22,500
Cars: (8,000 – 0) x 25%	2,000
Equipment: (15,000 – 5,000) x 25%	2,500
	120,720

W3 Property, plant and equipment	**Rs.**
Delivery Vehicle (112,500 – (35,000 + 22,500))	55,000
Cars (8,000 – (0 + 2,000))	6,000
Equipment (15,000 – (5,000 + 2,500))	7,500
	68,500

W4 Trade debts	**Rs.**
Debtors (95,000 – 600 bad debts)	94,400
Less Allowance for doubtful debts W5	(620)
	93,780

AT A GLANCE
SPOTLIGHT
STICKY NOTES

W5 Allowance for doubtful debts	Rs.
20,000 x 1%	200
12,000 x 2.5%	300
3,000 – 600 = 2,400 x 5%	120
	620
Opening	(1,000)
Decrease	380

- *Example 08:*

Following is the trial balance of Sofia Trader (ST) for the year ended 30 June 2018:

	Debit	Credit
	---------- Rs.'000 ----------	
Equipment - cost	17,000	
Equipment - accumulated depreciation - 1 Jul 2017		4,800
Vehicles - cost	3,000	
Vehicles - accumulated depreciation - 1 Jul 2017		1,200
Inventory - 1 Jul 2017	5,500	
Trade receivables	5,350	
Provision for doubtful receivables		220
Prepaid insurance - 1 Jul 2017	140	
Advance	384	
Bank deposit (invested on 1 Feb 2017 at 7%)	1,400	
Cash and bank balances	620	
Capital		16,000
Drawings	352	
Trade payables		3,500
Accruals and other payables		1,520
Sales		32,350
Purchases	21,000	
Returns	950	750
Salaries and utilities	2,790	
Rent	1,000	
Discounts	270	220
Other expenses	480	
Insurance	300	
Bad debts	106	
Interest income on bank deposit		82
	60,642	**60,642**

Following further information is available:

i. Cost of closing physical inventory was Rs. 7,400,000. Inventory included goods costing Rs. 240,000 which were damaged in the warehouse. These goods can be sold for Rs. 250,000 after incurring a cost of Rs. 16,000.

ii. Rent includes payment of annual rent of Rs. 240,000 expiring on 30 November 2018 for owner's residence.

iii. Prepaid insurance represents premium which expired on 31 January 2018 while insurance represents annual premium which is expiring on 31 January 2019.

iv. On 29 June 2018, dishonoured cheque of Rs. 285,000 was returned by a bank. No entry has been made in the books for this return. This cheque was received from a customer net of 5% settlement discount.

v. ST maintains a 4% provision against trade receivables.

vi. Advance represents 40% payment made for purchase of vehicle. Remaining balance would be paid in September 2018. No entry was passed when the vehicle was delivered on 1 June 2018.

vii. ST depreciates equipment and vehicles at 15% and 25% respectively using reducing balance method.

Required:

Prepare statement of profit or loss for the year ended 30 June 2018

Prepare statement of financial position as at 30 June 2018.

▶ *ANSWER*

Sofia Traders

Statement of Comprehensive Income

For the year ended 30 June 2018

	Rs. 000
Sales [32,350 – 950 returns – (270 – 15*) discount]	31,145
Cost of sales W1	(18,136)
Gross profit	13,009
Other income W2	98
Operating expenses W3	(6,707)
Net profit	6,400

** discount reversed related to dishonoured cheque.*

Sofia Traders

Statement of Financial Position as at 30 June 2018

Non-current assets		**Rs. 000**
Property, plant and equipment W4		12,660
Current assets		
Stock W6	7,394	
Trade debtors W5	5,424	
Prepayments 300 x 7/12	175	
Interest receivable 1,400 deposit x 7% = 98 – 82 already recorded	16	
Bank deposit	1,400	
Cash and bank balance 620 – 285 dishonoured	335	
		14,744
		27,404

Owner's equity	
Capital	16,000
Add Net profit	6,400
Less Drawings 352+ 240 rent of owner's residence	(592)
	21,808
Current liabilities	
Trade payables	3,500
Accruals and other payables 1,520 + 576 for vehicle	2,096
	5,596
	27,404

W1 Cost of sales	**Rs. 000**
Opening Stock	5,500
Purchases [21,000 – 750 returns – 220 discount]	20,030
Less Closing Stock W6	(7,394)
	18,136

W2 Other income	**Rs. 000**
Interest on bank deposit 82 + 16 accrued	98

W3 Operating expenses	**Rs. 000**
Salaries and utilities	2,790
Rent 1,000 – 240 related to owner's residence	760
Other expenses	480
Insurance 300 + 140 last year prepaid – 175 this year prepaid	265
Bad debts 106 + (226 W5 - 220 opening)	112
Depreciation:	
Equipment (17,000 – 4,800) x 15%	1,830
Vehicle W7	470
	6,707

W4 Property, plant and equipment	Rs. 000
Equipment	17,000
Accumulated depreciation 4,800 + 1,830	(6,630)
	10,370
Vehicles 3,000 + 384 advance + 576 payable for vehicle	3,960
Accumulated depreciation 1,200 + 470	(1,670)
	2,290
	12,660

W5 Trade debts	Rs. 000
Trade debtors 5,350 + 300 (i.e. 285 x 100/95)	5,650
Less: Allowance 5,650 x 4%	(226)
	5,424

W6 Inventory	Rs. 000
Cost (as given)	7,400
Write down of damaged items cost 240 vs NRV 234 i.e. (250 – 16)	(6)
	7,394

W7 Depreciation on vehicle	Rs. 000
On opening assets Rs. 3,000 – 1,200 = 1,800 x 25%	450
On additions Rs. 960 x 25% x 1/12	20
	470

4. OBJECTIVE BASED Q&A

01. A complete set of financial statement does not include;

(a) a statement of financial position as at the end of the period

(b) a statement of comprehensive income for the period

(c) Aging analysis of receivables

(d) a statement of changes in equity for the period

02. Following is the trial balance of Salman for the year ended 30 June 2014

	Rs.
Insurance	2,000,000

Insurance is prepaid to the extent of Rs. 650,000.

What is the amount of insurance premium to be shown in the statement of comprehensive income and statement of financial position?

(a) Insurance expense Rs. 2,000,000; Prepaid insurance Rs. 650,000

(b) Insurance expense Rs. 2,650,000; Prepaid insurance Rs. 650,000

(c) Insurance expense Rs. 650,000; Prepaid insurance Rs. 2,000,000

(d) Insurance expense Rs. 1,350,000; Prepaid insurance Rs. 650,000

03. Salman has prepared his trial balance for the year ended 30 June 2014.

He has provided following information relating to stock: Closing stock as on 30 June 2014 amounted to Rs. 237,500 thousand.

What is the correct accounting entry to record the adjustment?

(a) Dr inventory Rs. 237,500,000 Cr Cost of sales Rs. 237,500,000

(b) Dr Cost of sales Rs. 237,500,000 Cr Inventory Rs. 237,500,000

(c) Dr inventory Rs. 237,500,000 Cr Purchases Rs. 237,500,000

(d) Dr Purchases Rs. 237,500,000 Cr Inventory Rs. 237,500,000

04. Salman has prepared his trial balance for the year ended 30 June 2014. He has provided following information relating to drawings:

	Debit Rs. 000
Drawings	30,500

Salman's son works as the head of administration and received a salary of Rs. 150 thousand per month, which has been included in drawings.

What is the amount of drawings to be shown in the statement of financial position?

(a) Rs. 30,500

(b) Rs. 30,350

(c) Rs. 32,300

(d) Rs. 28,700

05. Azam is in process of preparation of trial balance for the year ended 30 June 2015.

	Debit	Credit
	Rs. in '000'	
Purchases	105,950	

Azam withdrew goods costing Rs. 4,000 thousand for personal use during the year. However, no entry was made to record the withdrawal of goods.

What is the amount of purchases to be shown in statement of comprehensive income?

(a) Rs. 105,950,000

(b) Rs. 4,000,000

(c) Rs. 101,950,000

(d) Rs. 109,950,000

06. Following is the trial balance of Salman for the year ended 30 June 2014:

Rs. in '000

	Debit		Credit
Trade discount	2,432	Sales	353,300
Sales return	10,000		
Discount allowed	4,500		

Assistant account has informed that sales was recorded incorrectly on gross amount and trade discount was debited to correct it.

What is the amount of sales to be shown in statement of comprehensive income?

(a) Rs. 353,300

(b) Rs. 340,868

(c) Rs. 336,368

(d) Rs. 346,368

07. Following summarised trial balance as at 31 December 2015 pertains to Moon Trading (MT) who deals in office machines:

	Debit		Credit
	Rs. in million		
Bank loan			160
Interest on bank loan	8		

Additional information

The bank loan was acquired on 1 April 2015. The principal amount is repayable in five equal annual instalments on 31 March each year. Interest is payable at 10% per annum on six monthly basis and is recorded at the time of payment.

What adjusting entry is required to record interest payable as at 31 December 2015?

(a) Dr Interest expense Rs. 4 million Cr Interest payable Rs. 4 million

(b) Dr Interest expense Rs. 4 million Cr Bank loan Rs. 4 million

(c) Dr Interest expense Rs. 8 million Cr Interest payable Rs. 8 million

(d) Dr Interest expense Rs. 12 million Cr Interest payable Rs. 12 million

08. Following summarised trial balance as at 31 December 2015 pertains to Moon Trading (MT) who deals in office machines:

	Debit		Credit
	Rs. in million		
Other income			15

Additional information

Review of other income revealed the following information:

On 1 August 2015, MT received an amount of Rs. 1.8 million as 50% advance against a maintenance contract covering the period from 1 September 2015 to 31 May 2016 and was credited to other income. The balance amount would be paid on completion of the contract.

What is the amount of unearned income to be shown in statement of financial position?

(a) Rs. 1.8 million

(b) Rs. 3.6 million

(c) Rs. 0.2 million

(d) Rs. 1.6 million

09. Following summarised trial balance as at 31 December 2015 pertains to Moon Trading (MT) who deals in office machines:

	Debit		Credit
	Rs. in million		
Other income			15

Additional information

On 1 August 2015, MT received an amount of Rs. 1.8 million as 50% advance against a maintenance contract covering the period from 1 September 2015 to 31 May 2016 and was credited to other income. The balance amount would be paid on completion of the contract.

What is the amount of other income to be shown in statement of comprehensive income?

(a) Rs. 15 million

(b) Rs. 14.8 million

(c) Rs. 13.2

(d) Rs. 11.4

10. Which of the following is not a characteristic of service organization?

(a) A large percentage of assets comprise inventory

(b) A large percentage of assets comprise receivable

(c) The funds of service companies are usually tied up towards accounts receivable

(d) There is no line item for the cost of goods sold in the income statement of service companies.

11. A business has provided following extracts from trial balance as at 31 December 2018;

	Debit		Credit
	Rs. in million		
Receivables	100		
Provision for doubtful debts – 1.1.18			4
Bad debts	3		

Additional information

A customer included in receivables in trial balance above owing Rs. 1 million gone bankrupt and is unable to pay anything.

It has been decided to calculate a provision of 6% for the year.

What is the amount of closing balance of provision for doubtful debts account?

(a) Rs. 5.94 million

(b) Rs. 3 million

(c) Rs. 6 million

(d) Rs. 5.76 million

12. A business has provided following extracts from trial balance as at 31 December 2018;

	Debit		Credit
	Rs. in million		
Receivables	100		
Provision for doubtful debts – 1.1.18			4.5
Bad debts	3		

Additional information

A customer included in receivables in trial balance above owing Rs. 1 million gone bankrupt and is unable to pay anything.

It has been decided to calculate a provision of 6% for the year.

What is the amount of bad and doubtful debts expense in statement of comprehensive income?

(a) Rs. 4.44

(b) Rs. 5.44 million

(c) Rs. 1.44

(d) Rs. 5.94

13. A business has provided following extracts from trial balance as at 31 December 2018;

	Debit		Credit
	Rs. in million		
Receivables	100		
Provision for doubtful debts – 1.1.18			4
Bad debts	3		

Additional information

A customer included in receivables in trial balance above owing Rs. 1 million gone bankrupt and is unable to pay anything.

It has been decided to calculate a provision of 6% for the year.

What is the number of receivables to be shown in statement of financial position?

- **(a)** Rs. 92 million
- **(b)** Rs. 94.06
- **(c)** Rs. 91.06
- **(d)** Rs. 90.06

14. A business has provided following extracts from trial balance as at 31 December 2018;

	Debit		Credit
	Rs. in million		
Administration expenses	150		

Additional information

Electricity expense of Rs. 1.5 million is outstanding. No adjustment for bill payable has been recorded. Electricity expense paid during the year have already been included in administration expenses.

Included in the administration expenses in trial balance advance rent is Rs. 1.2 million.

What is the amount of administration expenses to be shown in statement of comprehensive income?

- **(a)** Rs. 150.3 million
- **(b)** Rs. 151.5
- **(c)** Rs. 152.7
- **(d)** Rs. 150

15. A business has provided following extracts from trial balance as at 31 December 2018:

	Debit		Credit
	Rs. in million		
Administration expenses	150		

Additional information

Electricity expense of Rs. 1.5 million is outstanding. No adjustment for bill payable has been recorded.

Electricity expense paid during the year have already been included in administration expenses.

Included in the administration expenses in trial balance advance rent is Rs. 1.2 million.

Which of the following is correct regarding administration expenses?

- **(a)** Accrued expense Rs. 1.2 million; Prepayment Rs. 1.5 million
- **(b)** Accrued expense Rs. 1.5 million; Prepayment Rs. 1.2 million
- **(c)** Accrued expenses Rs. 2.7 million
- **(d)** Prepayment Rs. 2.7 million

16. Following is the summarised trial balance of Fortune Traders (FT) for the year ended 30 June 2016;

	Debit		Credit
	Rs. 000		
Plant & machinery - cost	6,650		
Plant & mach. – Acc. Dep. as at 1 July 2015			2,414

Additional information:

(i) On 1 March 2016, FT paid an advance of Rs. 330,000 for purchase of a machine and debited it to plant and machinery. The machine was delivered on 1 September 2016.

(ii) FT depreciates its fixed assets from the month of addition. Depreciation is to be charged on written-down value (WDV) as follows:

Plant & machinery	10%

What is the amount of depreciation to be charged to statement of profit or loss?

Rs. __________

17. Following is the summarised trial balance of Fortune Traders (FT) for the year ended 30 June 2016;

	Debit		Credit
	Rs. 000		
Plant & machinery - cost	6,650		
Plant & mach. – Acc. Dep. as at 1 July 2015			2,414

Additional information:

(iii) On 1 March 2016, FT paid an advance of Rs. 330,000 for purchase of a machine and debited it to plant and machinery. The machine was delivered on 1 September 2016.

(iv) FT depreciates its fixed assets from the month of addition. Depreciation is to be charged on written-down value (WDV) as follows:

Plant & machinery	10%

What is the amount of Plant & machinery to be shown in statement of financial position?

Rs. __________

18. Azam owns a retail outlet with the name Azam Autoparts Store. The trial balance as at 30 June 2015 is as follows:

	Debit	Credit
	Rs. in '000'	
Bank loan		5,050
Interest expenses	600	
	167,436	167,436

Bank loan was received on 1 July 2014. Interest payable for the month of June 2015 has been credited to the loan account.

What is the amount of interest payable to be shown in statement of financial position?

Rs. ________

19. Rainbow Lights (RL) has prepared a trial for the year ended 31 December 2016:

	Debit	Credit
	Rs. in million	
Miscellaneous income		45

Additional information

Miscellaneous income includes Rs. 12 million received against an annual maintenance contract expiring on 30 April 2017.

What is the amount of Miscellaneous income to be shown in statement of comprehensive income?

Rs. ________

20. Rainbow Lights (RL) has prepared a trial for the year ended 31 December 2016:

	Debit	Credit
	Rs. in million	
Miscellaneous income		45

Additional information

Miscellaneous income includes Rs. 12 million received against an annual maintenance contract expiring on 30 April 2017.

What is the amount of Miscellaneous income to be shown in statement of financial position as unearned income?

Rs. ________

21. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Stock in trade 31-12-2017	3,900	
Cost of sales	23,580	

While carrying out the physical inventory count at year-end, following matters were identified:

- Goods costing Rs. 1,000 were slightly defective. These can be sold for Rs. 1,130 after incurring a cost of Rs. 200.

- Goods costing Rs. 670 purchased on credit were returned to a supplier on 28 December 2017 but the return was not recorded in the books.

Calculate the "Cost of Sales" amount that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. _______________

22. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Stock in trade 31-12-2017	3,900	
Cost of sales	23,580	

While carrying out the physical inventory count at year-end, following matters were identified:

- Goods costing Rs. 1,000 were slightly defective. These can be sold for Rs. 1,130 after incurring a cost of Rs. 200.
- Goods costing Rs. 670 purchased on credit were returned to a supplier on 28 December 2017 but the return was not recorded in the books.

Calculate the "Inventory" amount that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. _______________

23. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Advances	450	
Property, plant and equipment - Cost	12,500	
Accumulated depreciation		4,630

Additional information:

- A machine costing Rs. 450 was received on 1 October 2017 against 100% advance payment. The advance has not yet been adjusted due to non-receipt of the invoice.
- TE depreciates property, plant & equipment at 15% per annum on reducing balance method.

Calculate the "Depreciation expense" that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. _______________ (to nearest rupee)

24. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Advances	450	
Property, plant and equipment - Cost	12,500	
Accumulated depreciation		4,630

Additional information:

- A machine costing Rs. 450 was received on 1 October 2017 against 100% advance payment. The advance has not yet been adjusted due to non-receipt of the invoice.
- TE depreciates property, plant & equipment at 15% per annum on reducing balance method.

Calculate "property, plant and equipment" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. ______________ (to nearest rupee)

25. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Accrual and other payables		1,320
Miscellaneous income		940

Additional information:

- On 1 October 2017, 50% advance received for an annual maintenance contract of Rs. 480 was credited to miscellaneous income. Remaining amount would be received at the end of the contract. Services are rendered evenly throughout the contract period.
- Maintenance services for Rs. 150 were rendered in December 2017 but income has been recorded in January 2018 on receipt of the amount.

Calculate "Prepayments and advances" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. ______________

26. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Accrual and other payables		1,320
Miscellaneous income		940

Additional information:

- On 1 October 2017, 50% advance received for an annual maintenance contract of Rs. 480 was credited to miscellaneous income. Remaining amount would be received at the end of the contract. Services are rendered evenly throughout the contract period.
- Maintenance services for Rs. 150 were rendered in December 2017 but income has been recorded in January 2018 on receipt of the amount.

Calculate "Accrual and other payables" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. _______________

27. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Accrual and other payables		1,320
Miscellaneous income		940

Additional information:

- On 1 October 2017, 50% advance received for an annual maintenance contract of Rs. 480 was credited to miscellaneous income. Remaining amount would be received at the end of the contract. Services are rendered evenly throughout the contract period.
- Maintenance services for Rs. 150 were rendered in December 2017 but income has been recorded in January 2018 on receipt of the amount.

Calculate "Miscellaneous income" that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. _______________

28. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Financial charges	700	
12% long term loan		5,150

Additional information:

Interest on the loan is paid in arrears on 1 April and 1 October each year. Interest accrued for the quarter ended 31 December 2017 has been credited to loan account.

Calculate "Financial charges" that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. _______________

29. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Financial charges	700	
12% long term loan		5,150

Additional information:

Interest on the loan is paid in arrears on 1 April and 1 October each year. Interest accrued for the quarter ended 31 December 2017 has been credited to loan account.

Calculate "Long term loan" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. _______________

30. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Rent and insurance	2,900	
Drawings	490	

Rent and insurance include:

- annual insurance premium of Rs. 800 for the health policy arranged by TE for the department heads and the owner's family members. Premium pertaining to the owner's family members is Rs. 200. The policy is valid up to 30 June 2018.
- Rs. 1,200 paid against the annual rent agreement expiring on 31 August 2018. According to the rent agreement, the rent paid would not be refunded in case the building is vacated earlier.

Calculate "Drawings" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. _______________

31. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Rent and insurance	2,900	
Drawings	490	

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Rent and insurance include:

- annual insurance premium of Rs. 800 for the health policy arranged by TE for the department heads and the owner's family members. Premium pertaining to the owner's family members is Rs. 200. The policy is valid up to 30 June 2018.
- Rs. 1,200 paid against the annual rent agreement expiring on 31 August 2018. According to the rent agreement, the rent paid would not be refunded in case the building is vacated earlier.

Calculate "Prepayment and advances" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. ______________

32. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Prepayments and advances	1,290	
Rent and insurance	2,900	
Drawings	490	

Rent and insurance include:

- annual insurance premium of Rs. 800 for the health policy arranged by TE for the department heads and the owner's family members. Premium pertaining to the owner's family members is Rs. 200. The policy is valid up to 30 June 2018.
- Rs. 1,200 paid against the annual rent agreement expiring on 31 August 2018. According to the rent agreement, the rent paid would not be refunded in case the building is vacated earlier.

Calculate "Rent and insurance" that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. ______________

33. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Trade receivables	4,400	
Bad debts expense	230	
Allowance for doubtful debts		220

TE maintains provision for doubtful receivables according to the age analysis of the outstanding balances. Relevant details are as under:

	Trade receivables as on 31 December 2017				Total
	Less than 3 months	4-6 months	7-12 months	More than 1 year	
Outstanding balances ***(Rs.)***	1,970	1,000	900	530	4,400
Required provision	–	5%	10%	20%	

Calculate "Bad and doubtful debts expense" that would be presented in statement of comprehensive income of TE for the year ended 31 December 2017.

Rs. ______________

34. Following is an extract from the trial balance of Tulip Enterprises (TE) for the year ended 31 December 2017:

	Debit	Credit
	Rs.	
Trade receivables	4,400	
Bad debts expense	230	
Allowance for doubtful debts		220

TE maintains provision for doubtful receivables according to the age analysis of the outstanding balances. Relevant details are as under:

	Trade receivables as on 31 December 2017				Total
	Less than 3 months	4-6 months	7-12 months	More than 1 year	
Outstanding balances ***(Rs.)***	1,970	1,000	900	530	4,400
Required provision	–	5%	10%	20%	

Calculate "Trade receivables (net)" that would be presented in statement of financial position of TE as at 31 December 2017.

Rs. ______________

35. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs.	
Revenue		1,200,000
Inventory 1 January 2021	48,000	
Purchases	480,000	
Carriage inwards	4,000	
Carriage outwards	6,000	
Administrative expenses	360,000	
Distribution costs	150,000	
Return inwards	1,000	

Inventory valuation at 31 December 2021 was Rs. 60,000

Calculate "Administrative expenses" that would be presented in statement of comprehensive income of GE for the year ended 31 December 2021.

Rs. ______________

36. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs.	
Revenue		1,200,000
Inventory 1 January 2021	48,000	
Purchases	480,000	
Carriage inwards	4,000	
Carriage outwards	6,000	
Administrative expenses	360,000	
Distribution costs	150,000	
Return inwards	1,000	

Inventory valuation at 31 December 2021 was Rs. 60,000

Calculate "Distribution costs" that would be presented in statement of comprehensive income of GE for the year ended 31 December 2021.

Rs. ______________

37. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs.	
Revenue		1,200,000
Inventory 1 January 2021	48,000	
Purchases	480,000	
Carriage inwards	4,000	
Carriage outwards	6,000	
Administrative expenses	360,000	
Distribution costs	150,000	
Return inwards	1,000	

Inventory valuation at 31 December 2021 was Rs. 60,000

Calculate "Cost of sales" that would be presented in statement of comprehensive income of GE for the year ended 31 December 2021.

Rs. ______________

38. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs.	
Revenue		1,200,000
Inventory 1 January 2021	48,000	
Purchases	480,000	
Carriage inwards	4,000	
Carriage outwards	6,000	
Administrative expenses	360,000	
Distribution costs	150,000	
Return inwards	1,000	

Inventory valuation at 31 December 2021 was Rs. 60,000

Calculate "Gross profit" that would be presented in statement of comprehensive income of GE for the year ended 31 December 2021.

Rs. _______________

39. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs. million	
Freehold land and building – cost (Land Rs. 70 million)	120	
Accumulated depreciation (Land and building) 1 Jan 2021		20
Plant and equipment – Cost	120	
Accumulated depreciation (plant & equipment) 1 Jan 2021		15

The freehold building is depreciated on a straight line basis over its estimated useful life of 50 years. The plant and equipment is depreciated on a reducing balance basis at the rate of 15%. There were no purchases or disposals of non-current assets during the year.

Calculate "Depreciation expense" that would be presented in statement of comprehensive income of GE for the year ended 31 December 2021.

Rs. _______________ (million)

40. The following is an extract from the trial balance of Game Enterprises (GE) as at 31 December 2021:

	Debit	Credit
	Rs. million	
Freehold land and building – cost (Land Rs. 70 million)	120	
Accumulated depreciation (Land and building) 1 Jan 2021		20
Plant and equipment – Cost	120	
Accumulated depreciation (plant & equipment) 1 Jan 2021		15

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The freehold building is depreciated on a straight line basis over its estimated useful life of 50 years. The plant and equipment is depreciated on a reducing balance basis at the rate of 15%. There were no purchases or disposals of non-current assets during the year.

Calculate "Property, plant and equipment" that would be presented in statement of financial position of GE as at 31 December 2021.

Rs. ______________ (million)

41. The following is an extract from the trial balance of Moon Trading (MT) as at 31 December 2015:

	Debit	Credit
	Rs. million	
Prepayments and other receivables	9	
Accrued expenses and unearned income		25
Other income		15

Review of other income revealed the following information:

- Services for certain contracts amounting to Rs. 1.2 million were rendered in December 2015 but invoices thereof were processed in January 2016.
- On 1 August 2015, MT received an amount of Rs. 1.8 million as 50% advance against a maintenance contract covering the period from 1 September 2015 to 31 May 2016 and was credited to other income. The balance amount would be paid on completion of the contract.

Calculate "Prepayments and other receivables" that would be presented in statement of financial position of MT as at 31 December 2015.

Rs. ______________ (million)

42. The following is an extract from the trial balance of Moon Trading (MT) as at 31 December 2015:

	Debit	Credit
	Rs. million	
Prepayments and other receivables	9	
Accrued expenses and unearned income		25
Other income		15

Review of other income revealed the following information:

- Services for certain contracts amounting to Rs. 1.2 million were rendered in December 2015 but invoices thereof were processed in January 2016.
- On 1 August 2015, MT received an amount of Rs. 1.8 million as 50% advance against a maintenance contract covering the period from 1 September 2015 to 31 May 2016 and was credited to other income. The balance amount would be paid on completion of the contract.

Calculate "Accrued expenses and unearned income" that would be presented in statement of financial position of MT as at 31 December 2015.

Rs. ______________ (million)

43. The following is an extract from the trial balance of Moon Trading (MT) as at 31 December 2015:

	Debit	Credit
	Rs. million	
Prepayments and other receivables	9	
Accrued expenses and unearned income		25
Other income		15

Review of other income revealed the following information:

- Services for certain contracts amounting to Rs. 1.2 million were rendered in December 2015 but invoices thereof were processed in January 2016.
- On 1 August 2015, MT received an amount of Rs. 1.8 million as 50% advance against a maintenance contract covering the period from 1 September 2015 to 31 May 2016 and was credited to other income. The balance amount would be paid on completion of the contract.

Calculate "Other income" that would be presented in statement of comprehensive income of MT for the year ended 31 December 2015.

Rs. _______________ (million)

44. The following is an extract from the trial balance of Qambar Enterprises (QE) as at 31 December 2018:

	Debit	Credit
	Rs.	
Rent and insurance	545,000	

Rent and insurance includes Rs. 75,000 paid for a photocopy machine. The machine was obtained on 1 November 2018 at a fixed rent of Rs. 75,000 per quarter and an additional Re. 0.40 for each copy. 40,000 copies have been made by QE up to 31 December 2018.

Calculate "Rent and insurance" that would be presented in statement of comprehensive income of QE for the year ended 31 December 2018.

Rs. _______________

45. The following is an extract from the trial balance of Qambar Enterprises (QE) as at 31 December 2018:

	Debit	Credit
	Rs.	
Office and sales supplies	210,000	

Office and sales supplies costing Rs. 90,000 are still unused. However, 30% of these supplies are not usable due to deterioration in quality.

Which of the following is correct presentation in financial statements in respect of above?

(a) Current assets Rs. 63,000 and Expense Rs. 210,000

(b) Current assets Rs. 90,000 and Expense Rs. 237,000

(c) Current assets Rs. 63,000 and Expense Rs. 147,000

(d) Current assets Rs. 90,000 and Expense Rs. 237,000

AT A GLANCE

SPOTLIGHT

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46. The following is an extract from the trial balance of Qambar Enterprises (QE) as at 31 December 2018:

	Debit	Credit
	Rs.	
Capital at 1 Jan 2018		5,223,000
Goods withdrawn	644,000	

Cost of office repairs amounting to Rs. 85,000 was paid by the owner from personal cash. After adjusting for this, net profit has been correctly calculated as Rs. 880,000.

At year end, a vehicle was invested into the business by the owner at a value of Rs. 960,000

Calculate "Capital" that would be presented in statement of financial position of QE as at 31 December 2018.

Rs. ______________

47. The following is an extract from the trial balance of Delta Enterprises (DE) as at 30 June 2019:

	Debit	Credit
	Rs. 000	
Property, plant and equipment (Cost)	230,600	
Prepayments	3,000	
Administration expenses	25,900	
Trade and other payables		41,400

On 1 October 2018, a printer was acquired on rent from Qazi & Co. The annual rent of Rs. 480,000 was paid in advance and debited to prepayments. However, the printer was purchased by DE on 1 April 2019 for Rs. 1,240,000. The payment net of rent adjustment was made in July 2019. The purchase has not been accounted for. Ignore depreciation.

Calculate "Property, plant and equipment (Cost)" that would be presented in statement of financial position of DE as at 30 June 2019.

Rs. ______________

48. The following is an extract from the trial balance of Delta Enterprises (DE) as at 30 June 2019:

	Debit	Credit
	Rs. 000	
Property, plant and equipment (Cost)	230,600	
Prepayments	3,000	
Administration expenses	25,900	
Trade and other payables		41,400

On 1 October 2018, a printer was acquired on rent from Qazi & Co. The annual rent of Rs. 480,000 was paid in advance and debited to prepayments. However, the printer was purchased by DE on 1 April 2019 for Rs. 1,240,000. The payment net of rent adjustment was made in July 2019. The purchase has not been accounted for. Ignore depreciation.

Calculate "Prepayments" that would be presented in statement of financial position of DE as at 30 June 2019.

Rs. ______________

49. The following is an extract from the trial balance of Delta Enterprises (DE) as at 30 June 2019:

	Debit	Credit
	Rs. 000	
Property, plant and equipment (Cost)	230,600	
Prepayments	3,000	
Administration expenses	25,900	
Trade and other payables		41,400

On 1 October 2018, a printer was acquired on rent from Qazi & Co. The annual rent of Rs. 480,000 was paid in advance and debited to prepayments. However, the printer was purchased by DE on 1 April 2019 for Rs. 1,240,000. The payment net of rent adjustment was made in July 2019. The purchase has not been accounted for. Ignore depreciation.

Calculate “Trade and other payables” that would be presented in statement of financial position of DE as at 30 June 2019.

Rs. ________________

50. The following is an extract from the trial balance of Delta Enterprises (DE) as at 30 June 2019:

	Debit	Credit
	Rs. 000	
Property, plant and equipment (Cost)	230,600	
Prepayments	3,000	
Administration expenses	25,900	
Trade and other payables		41,400

On 1 October 2018, a printer was acquired on rent from Qazi & Co. The annual rent of Rs. 480,000 was paid in advance and debited to prepayments. However, the printer was purchased by DE on 1 April 2019 for Rs. 1,240,000. The payment net of rent adjustment was made in July 2019. The purchase has not been accounted for. Ignore depreciation.

Calculate “Administration expenses” that would be presented in statement of comprehensive income of DE for the year ended 30 June 2019.

Rs. ________________

ANSWERS

01.	**(c)**	Aging analysis of receivables in not a financial statement.
02.	**(d)**	Prepaid insurance is deducted from the amount shown in trial to arrive at expense for the year.
03.	**(a)**	Debit Inventory Rs. 237,500,000 Credit Cost of sales Rs. 237,500,000
04.	**(d)**	Drawings = Rs. 30,500 – (150x12) = Rs. 28,700
05.	**(c)**	Purchases = 105,950 – 4,000 = Rs. 101,950
06.	**(c)**	**Rs. 000** Sales 353,300 – 2,432 *trade discount – 4,500 settlement discount* 346,368 Less: sales return (10,000) 336,368
07.	**(a)**	160 x 10% x 3/12 = 4 million
08.	**(c)**	Total contract price 1.8 + 1.8 = 3.6 x 4/9 months = 1.6 less advance 1.8 = 0.2 million unearned
09.	**(b)**	Other income = 15 – 0.2 (unearned income) = 14.8 Total contract price 1.8 + 1.8 = 3.6 x 4/9 months = 1.6 less advance 1.8 = 0.2 million unearned
10.	**(a)**	Inventory is large percentage of assets in trading or manufacturing businesses.
11.	**(a)**	Closing provision **Rs. million** Receivables as per trial 100 Bad debts (1) Receivables 99 Provision @ 6% 5.94
12.	**(b)**	Bad and doubtful debts expense **Rs. million** Bad debts 3+1 4 Increase in provision = 5.94 – 4.5 1.44 5.44 Closing provision **Rs. million** Receivables as per trial 100 Bad debts (1) Receivables 99 Provision @ 6% 5.94

13.	**(d)**	**Rs. million** Receivables as per trial 100 Bad debts 3+1 (4) 96 Closing provision (5.94) 90.06 Closing provision Receivables as per trial 100 Bad debts (1) Receivables 99 Provision @ 6% ***5.94***
14.	**(a)**	= Rs. 150 + 1.5 -1.2 = Rs. 150.3 million
15.	**(b)**	Accrued expenses of Electricity Rs. 1.5 million Prepayment of rent Rs. 1.2 million
16.	**Rs. 391,000**	Depreciation charge = [6,650 – 330-2,414] x 10% = Rs. 391,000
17.	**Rs. 3,515,000**	= 6,650 – 330 – 2,414 - 391 = 3,515 Depreciation charge = [6,650 – 330-2,414] x 10% = Rs. 391,000
18.	**Rs. 50,000**	Interest classified to current liabilities 600 x 1/12 = 50
19.	**Rs. 41 million**	Misc. income = Rs. 45 million – 4 million = Rs. 41 million Unearned income = 12 million x 4/12 = Rs. 4 million
20.	**Rs. 4 million**	Unearned income = 12 million x 4/12 = Rs. 4 million
21.	**Rs. 23,650**	Cost of sales as given Rs. 23,580 + write down Rs. 70 = Rs. 23,650 Cost Rs. 1,000 and NRV Rs. 930 (i.e.) Rs. 1,130 – 200 Write down Rs. 70
22.	**Rs. 3,160**	Inventory as given Rs. 3,900 – write down Rs. 70 – return to supplier Rs. 670 = Rs. 3,160
23.	**Rs. 1,197**	On opening assets (Rs. 12,500 – 4,630) x 15% = Rs. 1,180 On additions Rs. 450 x 15% x 3/12 = Rs. 17 Total Rs. 1,197
24.	**Rs. 7,123**	At cost Rs. 12,500 + 450 = Rs. 12,950 Accumulated depreciation Rs. 4,630 + 1,197 = Rs. 5,827 Net Rs. 7,123
25.	**Rs. 1,440**	Rs. 1,290 + 150 income receivable = Rs. 1,440
26.	**Rs. 1,440**	Rs. 1,320 + 120 unearned income = Rs. 1,440 Unearned income Rs. 480 x 50% x 3/6 months = Rs. 120
27.	**Rs. 970**	Rs. 940 – 120 unearned + 150 accrued = Rs. 970
28.	**Rs. 700**	Financial charges need not be adjusted because interest expense has already been correctly accounted for, just credited in loan account rather than interest payable.
29.	**Rs. 5,000**	12% per annum → 3% for each quarter Currently the loan figure is @103% i.e. 100% + 3% Rs. 5,150 x 100 / 103 = Rs. 5,000

		Interest expense has already been correctly accounted for, just credited in loan account rather than interest payable. Rs. 150 shall be presented as interest payable under current liabilities.
30.	**Rs. 690**	As given Rs. 490 + Rs. 200 included in rent and insurance = Rs. 690
31.	**Rs. 2,390**	As given Rs. 1,290 Prepaid insurance Rs. 800 – 200 drawings = Rs. 600 x 6/12 = Rs. 300 Prepaid rent Rs. 1,200 x 8/12 = Rs. 800 Total Rs. 2,390
32.	**Rs. 1,600**	As given Rs. 2,900 Less: Insurance of owner's residence Rs. 200 Less: Prepaid insurance Rs. 600 x 6/12 = Rs. 300 Less: Prepaid rent Rs. 1,200 x 8/12 = Rs. 800 Net expense Rs. 1,600
33.	**Rs. 256**	Bad debts written off Rs. 230 Increase in allowance Rs. 246 – 220 = Rs. 26 Total Rs. 256 Required balance of allowance Rs. 1,000 x 5% + 900 x 10% + 530 x 20% = Rs. 246
34.	**Rs. 4,154**	Trade receivables Rs. 4,400 – required allowance 246 = Rs. 4,154 Required balance of allowance Rs. 1,000 x 5% + 900 x 10% + 530 x 20% = Rs. 246
35.	**Rs. 360,000**	No adjustment in administrative expenses is required.
36.	**Rs. 156,000**	Rs. 150,000 + Rs. 6,000 Carriage outwards = Rs. 156,000
37.	**Rs. 472,000**	**Cost of sales** Rs. Inventory 1 January 2021 48,000 Purchases 480,000 Carriage inwards 4,000 Inventory 31 December 2021 (60,000) ***472,000***
38.	**Rs. 727,000**	Revenue Rs. 1,200,000 – 1,000 return inwards = Rs. 1,199,000 Cost of sales Rs. 472,000 **Cost of sales** Rs. Inventory 1 January 2021 48,000 Purchases 480,000 Carriage inwards 4,000 Inventory 31 December 2021 (60,000) ***472,000*** Gross profit Rs. 727,000
39.	**Rs. 16.75 million**	Depreciation on building Rs. 120 – 70 = Rs. 50 / 50 years = Rs. 1 Depreciation on P&E Rs. 120 – 15 = Rs. 105 x 15% = Rs. 15.75

40.	**Rs. 188.25 million**	Land and building Rs. 120 – (20 + 1) = Rs. 99 Plant and equipment Rs. 120 – (15 + 15.75) = Rs. 89.25 Total Rs. 188.25
41.	**Rs. 11.2million**	As given Rs. 9 + 1.2 accrued income = Rs. 11.2 million
42.	**Rs. 25.2 million**	As given Rs. 25 + 0.2 unearned = Rs. 25.2 million Total contract price = Rs. 1.8 + 1.8 = Rs. 3.6 million Earned till year end = Rs. 3.6 x 4/9 months = Rs. 1.6 million Unearned = Rs. 1.8 advance – 1.6 earned = Rs. 0.2 million
43.	**Rs. 16 million**	Rs. 15 as given + 1.2 accrued – 0.2 unearned = Rs. 16 million Total contract price = Rs. 1.8 + 1.8 = Rs. 3.6 million Earned till year end = Rs. 3.6 x 4/9 months = Rs. 1.6 million Unearned = Rs. 1.8 advance – 1.6 earned = Rs. 0.2 million
44.	**Rs. 536,000**	As given Rs. 545,000 Less: Prepaid Rs. 75,000 x 1/3 month = Rs. 25,000 Add: Accrual of photocopies 40,000 x Re. 0.40 = Rs. 16,000 Net total Rs. 536,000
45.	**(c)**	Unused stock in usable condition is current asset = Rs. 63,000 (i.e. Rs. 90,000 x 70%) Remaining amount of Rs. 147,000 (i.e. Rs. 210,000 – 63,000) is charges as an expense.
46.	**Rs. 6,504,000**	**Capital** — Rs. As given — 5,223,000 Repair bill paid from personal cash — 85,000 Vehicle invested — 960,000 6,268,000 Net profit — 880,000 Drawings — (644,000) ***6,504,000***
47.	**Rs. 231,840,000**	As given Rs. 230,600,000 + purchased Rs. 1,240,000 Total Rs. 231,840,000
48.	**Rs. 2,520,000**	As given Rs. 3,000,000 Less: adjusted against rent and purchase Rs. 480,000 Net Rs. 2,520,000
49.	**Rs. 42,400,000**	As given Rs. 41,400,000 + Payable to Qazi & Co. Rs. 1,000,000 = Rs. 42,400,000 Payable to Qazi & Co. Rs. 1,240,000 – 240,000 advance adjusted =Rs. 1,000,000 Adjustable advance Rs. 480,000 – 480,000 x 6/12 = Rs. 240,000
50.	**Rs. 26,140,000**	As given Rs. 25,900,000 Advance utilised Rs. 480,000 x 6/12 months = Rs. 240,000 Total expense Rs. 26,140,000

STICKY NOTES

Statement of financial position (Minimum face items)

Assets

- **Property, plant and equipment**
- **Investment property**
- **Intangible assets**
- **Long-term investments**
- **Investment in associate**
- **Biological assets**
- **Inventories**
- **Trade and other receivables**
- **Cash and cash equivalents.**

Liabilities

- **Trade and other payables**
- **Provisions**
- **Financial liabilities, loan etc.**
- **Current tax liabilities (but possibly assets)**
- **Deferred tax liabilities (but possibly assets). These are always non-current.**

Equity

- **Issued capital and reserves attributable to the owners of the entity. (The term 'owners', refers to the equity holders.)**

Statement of comprehensive income (Minimum face items)

As a minimum, IAS 1 requires that the statement of comprehensive income should include line items showing the following amounts for the financial period:

- **revenue**
- **finance costs (for example, interest costs)**
- **tax expense**
- **profit or loss**
- **each component of 'other comprehensive income**
- **total comprehensive income.**

AT A GLANCE

SPOTLIGHT

STICKY NOTES

CHAPTER 10

BANK RECONCILIATIONS

IN THIS CHAPTER:

AT A GLANCE

The purpose of a bank reconciliation statement is to reconcile the difference between the cash book balance (business' record of their bank account) and the bank statement balance (the bank's record of the bank account of that particular business.

The debits and credits are reversed in bank statements because the bank records the transaction from its point of view for each of its customers' accounts separately.

Ideally, the bank balance amount from both sources should match but it is not usually the case.

The difference arises due to any of the following:

- Errors and omissions (unrecorded items) in cash book.
- Errors and omissions by bank (these are quite rare but do happen.
- Timing differences (unpresented cheques and uncredited cheques).

The preparation of bank reconciliation statement ensures that all differences are known and accounted for and there is no embezzlement of funds or uncorrected errors in accounting records relating to bank balance.

The reconciliation is carried out frequently, usually at the end of each month.

1. BANK BALANCE: SOURCES AND DIFFERENCES

METHODS OF RECEIPTS AND PAYMENTS

There are many different methods by which a business might make payment to suppliers and receive payment from customers. These methods may include:

- Cash is ready money. For accounting purposes, cash includes money in hand and petty cash.
- Cheques - A cheque is an agreement of payment between two individuals or organizations. So when you write a cheque, you are agreeing to pay another individual or organization money that you owe them and you are instructing your bank to make that payment.
- Pay order – It is a issued by the bank on behalf of customer stating an order to pay a specified amount to a specified person. A pay order is pre-printed with the word "Not Negotiable". There is no chance of dishonouring as the amount is prepaid. Once issued pay order is valid for certain period.
- Bank transfers – An amount transferred directly from a bank account holder's account to the bank account of another party on the instruction of the first person.
- Credit and debit cards – People often use these to pay for goods and services purchased from businesses. Once a sale is made the business asks the credit (debit) card company to make the payment on behalf of the card holder. The credit (debit) card company then recovers the cash from the card holder.
- Online payments – Many modern businesses now accept online payment for sales of goods and provision of services. Payment is often received through the use of credit cards and debit cards in the usual way or thorough the action of a third party (for example, Pay pal).
- Standing order – An instruction a bank account holder (the payer) gives to their bank to pay a set amount at regular intervals to another party's (the payee's) account.
- Direct debit – A method of payment in which, a person (payer) allows another party to collect different amount from payer's account on regular basis on specific date.

CASH BOOK / BANK BOOK

The cash book provides us with the balance we have in our bank account and for each bank account separate record is maintained.

The balance as per cash book is:

- Normal or favourable balance ➔ Debit
- Overdrawn, overdraft or unfavourable balance ➔ Credit

► *Illustration: Cash Book*

The cash book (bank transactions only) maintained by Maria Traders is as follows for the month of January 2022:

Cash Book (Bank Column)					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Jan	Balance b/d	300,000	6 Jan	Supplier Y	900,000
3 Jan	Customer A	1,200,000	10 Jan	Rent	400,000
21 Jan	Customer B	1,300,000	23 Jan	Supplier Z	1,000,000
			31 Jan	Bank charges	3,000
				Balance c/d	497,000
		2,800,000			**2,800,000**

BANK STATEMENT / PASS BOOK

The bank also provides us with a statement of our account. This statement records transactions from bank's point of view, therefore, the amounts are same but debits and credits are opposite from that of cash book.

The balance as per bank statement is:

- Normal or favourable balance ➔ Credit
- Overdrawn, overdraft or unfavourable balance ➔ Debit

▶ *Illustration: Bank Statement*

Maria Traders received this bank statement from their bank for the month of January 2022:

Date	Details	Debit Rs.	Credit Rs.	Balance Rs.
1 Jan	Opening balance			300,000 Cr.
3 Jan	Deposit: A		1,200,000	1,500,000 Cr.
6 Jan	Withdrawal: Y	900,000		600,000 Cr.
10 Jan	Withdrawal: Rent	400,000		200,000 Cr.
21 Jan	Deposit: B		1,300,000	1,500,000 Cr.
23 Jan	Withdrawal: Z	1,000,000		500,000 Cr.
31 Jan	Bank charges	3,000		497,000 Cr.

CAUSES OF DIFFERENCES

In ideal situation, the amount of bank balance obtained from both of above sources should match with only difference of debit and credit as what is an asset (positive balance) for a business is a liability for the bank to pay back to its customer.

However, the balance from two sources may not match due to following factors:

- Errors or omissions in cash book: Bank charges, interest, etc. may appear on bank statement but the business was not aware of the transaction date and/or amount until it receives and reviews the bank statement.
- Timing differences (unpresented cheques): A cheque payment is recorded in cash book when the cheque is despatched. The bank only records it when it is paid by bank, which may be few days later.
- Timing differences (uncredited items): A cheque deposit is recorded in cash book at the date of deposit. The bank only records it in customer's account when it goes through clearing process, which may take few days.
- Errors or omissions by the bank (rare, but may happen).

PURPOSE OF RECONCILIATION

The balance as per cash book and as per bank statements must be reconciled to ensure that all of known cause of difference have been recorded, corrected or reconciled. If the balance is not reconciled even after incorporating all the available information, it indicates either uncorrected errors/omissions or embezzlement, which should be investigated.

2. RECONCILING THE BALANCE

RECORDING AND CORRECTIONS IN CASH BOOK

The logical way to deal with errors and omission in cash book is to record the unrecorded items and correct the errors in accounting records.

One or more of the following adjustments may be required:

(a) Bank charges: This should be recorded on payment side of cash book.

(b) Dividend/interest received: This should be recorded on receipt side of cash book.

(c) Interest on overdraft balance charged by bank: This should be recorded on payment side of cash book.

(d) Standing orders: This is an instruction by account-holder to its bank to pay/transfer a same amount at regular intervals to another party's (the payee's) account. This method is usually used for monthly rent payments and periodic subscriptions. This should be recorded on payment side of the cash book.

(e) Direct debits: In this method, an account-holder allows another party to directly collect amounts on regular basis from its bank, amount may be different in different periods. This method is usually used for monthly utility bills or credit card bills. This should be recorded on payment side of the cash book.

(f) Direct credits: These are amounts directly credited into accounts by another party. For example, a customer deposits/transfers the amount due directly into the bank account of the business. This should be recorded on receipt side of cash book.

(g) Dishonoured cheques received from customers: These should be reversed in cash book. As when deposited, these are included on the receipt side, on reversal, these are recorded on payment side.

(h) Errors in cash book: There may be casting errors, balancing errors, etc. in cash book. These need to be adjusted on receipt side or payment side accordingly. When an item is incorrectly included on the other side of cash book (debit instead of credit or vice versa), the correction is made by adjusting twice the amount on correct side.

(i) Post-dated cheques: If these have been included in cash book, a reversal should be made.

(j) Time-barred cheques: A cheque becomes time-barred after six month have passed from the date mentioned on it and the bank might not pay it anymore. Therefore, these are cancelled and reversal is to be recorded.

(k) Cancelled cheques: A cheque may also be cancelled for other reasons, for example, incorrect name was mentioned, the payment was made using another method, a replacement cheque has been issued and parties intend to cancel the old one. In these cases, a reversal should be recorded in cash book.

Adjusted Balance

This is the balance as per cash book after all the errors and omissions in the cash book have been corrected and adjusted. This is also called true balance of cash and this is the amount to be presented in the statement of financial position.

This amount is also used for reconciling balance with bank statement's balance in bank reconciliation statement.

BANK RECONCILIATION STATEMENT (BRS)

The following items are reconciled in bank reconciliation statement:

- Unpresented cheques (also called outstanding cheques): This timing difference will come to an end when bank eventually records payment of the cheques. The amount to be reconciled in BRS must exclude post-dated, cancelled and time-barred cheques.
- Uncredited items (also called outstanding deposits or lodgements): This timing difference will come to an end when the cheque is cleared/collected/ credited by the bank. The amount to be reconciled in BRS must exclude post-dated, cancelled, time-barred and dishonoured cheques.
- Error or omission by bank: The identified error is communicated to the bank for correction. The correction process may take some time, meanwhile the error is mentioned in BRS as a reconciling item.

Format

Bank Reconciliation Statement as at ______________________________

Particulars		Rs.
Balance as per bank statement	**(Dr) / Cr**	**500,000**
Less: Unpresented cheques		(40,000)
Add: Uncredited items		60,000
Less: Amounts incorrectly credited by bank		(18,000)
Add: Amounts incorrectly debited by bank		10,000
Adjusted balance as per Cash Book	**Dr / (Cr)**	**512,000**

Alternative Format

Bank Reconciliation Statement as at ______________________________

Particulars		Rs.
Adjusted balance as per Cash Book	**Dr / (Cr)**	**512,000**
Add: Unpresented cheques		40,000
Less: Uncredited items		(60,000)
Add: Amounts incorrectly credited by bank		18,000
Less: Amounts incorrectly debited by bank		(10,000)
Balance as per bank statement	**(Dr) / Cr**	**500,000**

▶ *Example 01:*

The bank transactions records of Adeel Traders for the month of August are as follows:

Cash at Bank					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1 Aug	b/d	37,000	1 Aug	Kashif & Co [Chq. 33]	35,000
3 Aug	Rizwan & Co.	90,000	7 Aug	Jazib & Co [Chq. 34]	45,000*
11 Aug	Ahmad & Co.	11,000	15 Aug	Ghalib & Co [Chq. 35]	55,000
11 Aug	Chenab Traders	27,000	17 Aug	Asif & Co [Chq. 36]	12,000
15 Aug	Din Enterprises	50,000	25 Aug	Asim & Co [Chq. 37]	8,000
21 Aug	Salman & Co	40,000	28 Aug	Rent [Chq. 38]	28,000
24 Aug	Sales	6,000			
29 Aug	Hamid Traders	20,000	31 Aug	c/d	98,000
		281,000			**281,000**

Bank Statement

Date	Details	Debit Rs.	Credit Rs.	Balance Rs.
1 Aug	Opening balance			40,000 Cr.
3 Aug	Cheque # 31: Anwar & Co.	12,000		28,000 Cr.
3 Aug	Cheque # 32: Akbar & Co.	13,000		15,000 Cr.
3 Aug	Deposit: Jam Enterprises		22,000	37,000 Cr.
8 Aug	Cheque # 33: Kashif & Co.	35,000		2,000 Cr.
8 Aug	Deposit: Rizwan & Co.		90,000	92,000 Cr.
8 Aug	Bank charges	2,000		90,000 Cr.
11 Aug	Deposit: Ahmad & Co.		11,000	101,000 Cr.

Date	Details	Debit Rs.	Credit Rs.	Balance Rs.
12 Aug	Standing order: lease payment	45,000		56,000 Cr.
13 Aug	Cheque # 34: Jazib & Co.	54,000		2,000 Cr.
16 Aug	Deposit: Chenab Traders		27,000	29,000 Cr.
16 Aug	Deposit: Din Enterprises		50,000	79,000 Cr.
17 Aug	Cheque # 35: Ghalib & Co.	55,000		24,000 Cr.
22 Aug	Direct credit: Mansoor & Co.		26,000	50,000 Cr.
22 Aug	Deposit: Salman & Co.		44,000*	94,000 Cr.
24 Aug	Deposit: Cash		6,000	100,000 Cr.
30 Aug	Cheque # 36: Asif & Co.	12,000		88,000 Cr.

*These amounts have been incorrectly recorded.

Required:

For Adeel Traders:

(a) Prepare bank reconciliation statement as at 1 August.

(b) Update cash book for the month of August.

(c) Prepare bank reconciliation statement as at 31 August.

▶ *ANSWER*

Bank Reconciliation Statement as at 1 August

Particulars		Rs.
Balance as per bank statement	**(Dr) / Cr**	**40,000**
Less: Unpresented cheque #31: Anwar & Co.		(12,000)
Less: Unpresented cheque #32: Akbar & Co.		(13,000)
Add: Uncredited item: Cheque by Jam Enterprises		22,000
Adjusted balance as per Cash Book	**Dr / (Cr)**	**37,000**

The bank transactions records of Adeel Traders for the month of August are as follows:

Cash at Bank					
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
31 Aug	b/d (as given)	98,000	31 Aug	Jazib & Co. [54,000 – 45,000]	9,000
	Mansoor & Co.	26,000		Bank charges	2,000
				Standing order	45,000
				c/d (Adjusted)	68,000
		124,000			**124,000**

Bank Reconciliation Statement as at 31 August

Particulars		Rs.
Balance as per bank statement	**(Dr) / Cr**	**88,000**
Less: Unpresented cheque # 37: Asim & Co.		(8,000)
Less: Unpresented cheque # 38: Rent		(28,000)
Add: Uncredited item: Cheque by Hamid Traders		20,000
Less: Reversal of extra credited by bank [44,000 – 40,000]		(4,000)
Adjusted balance as per Cash Book	**Dr / (Cr)**	**68,000**

3. CORRECTIONS IN BOOKS OF ACCOUNTS

It is important to notice that unpresented cheques and uncredited items are not required to be corrected in books of accounts of the entity as these are simply timing differences and such differences will be eliminated later when cheques are presented or credited. Similarly, any error or omission in the bank statement is to be corrected in the records of the bank and not in the books of the entity.

However, the process of preparing bank reconciliation statement also highlights the errors and omissions in books of accounts. These identified errors and omissions need to be corrected in the books of accounts. The following guidance is relevant in this context:

COMPLETE OMISSION OF A RECEIPT OR PAYMENT

While reconciling the bank balance, it may be identified that some receipts or payments have been omitted from being recorded in the cash book. The examples may include bank charges, dividend or interest received, interest on bank overdraft, standing order payments, direct debits and direct credits.

The logical way to correct and update the records of the entity is to simply record these transactions.

▶ *Example 02:*

The accountant of Irfan Traders identified the following omissions in the records while preparing bank reconciliation statement:

(i) Bank charges of Rs. 500 shown in bank statements are not yet recorded in cash book.

(ii) Interest received of Rs. 15,800 on fixed deposits is shown on credit side of bank statement but not recorded yet in cash book.

(iii) Interest charged by the bank on last month overdraft balance amounting to Rs. 7,300 has not been recorded in cash book.

(iv) Irfan Traders had given the bank standing order instructions to pay monthly rent of Rs. 85,000 on 5th of each month. The amount is included in bank statement but not yet recorded in cash book for last month.

(v) Electricity bill of Rs. 32,550 was paid by the bank on direct debit instructions of Irfan Traders. However, this was omitted in the cash book.

(vi) The bank statement showed a direct credit. On inquiry, it was revealed that customer Jamal Enterprises had directly deposited Rs. 90,000 in the bank account of Irfan Traders. This amount is yet to be recorded in books of accounts.

Required:

Briefly discuss the accounting treatment in cash book's bank column of Irfan Traders in respect of above issues.

▶ *ANSWER*

(i) Bank charges of Rs. 500 shall be recorded on payment side of cash book.

(ii) Interest income of Rs. 15,800 shall be recorded on receipt side of cash book.

(iii) Interest expense of Rs. 7,300 shall be recorded on payment side of cash book.

(iv) Rent expense of Rs. 85,000 shall be recorded on payment side of cash book.

(v) Electricity bill of Rs. 32,550 shall be recorded on payment side of cash book.

(vi) The cash received from customer/receivable of Rs. 90,000 shall be recorded on receipt side of cash book.

EVENTS REQUIRING COMPLETE REVERSAL

Some events require that an entry recorded earlier in cash book is now completely reversed. The examples may include dishonoured cheques, inclusion of post-dated cheques, cheques becoming time-barred, cancellation of cheques and recording the entries that should not have been recorded in cash book.

In such case, the records are corrected and updated by passing the exact opposite/reversal of entries that was recorded when such cheques were initially recorded.

- *Example 03:*

The accountant of Zahra Traders identified the following issues while preparing bank reconciliation statement as at 30 June 2022:

(i) A cheque of Rs. 25,000 was received from Yum Traders and was deposited and recorded in the bank account on 25th June 2022. Few days later, the bank informed that the cheque has been dishonoured due to insufficient balance in bank account of the customer.

(ii) A cheque issued on 20th June 2022 (but dated 15th July 2022) Rs. 56,000 has been recorded on payment side of cash book.

(iii) A cheque of Rs. 37,000 was issued to supplier on 27th December 2021. This cheque has not been presented yet (cheques become time-barred after six months).

(iv) A cheque of Rs. 20,000 was issued to a supplier on 18th June 2022 and recorded correctly on the same date. However, on 28th June 2022, supplier was paid in cash and cheque issued earlier was returned and cancelled.

(v) Drawings of goods amounting to Rs. 18,000 was recorded on payment side of cash book.

Required:

Briefly discuss the accounting treatment in cash book's bank column of Zahra Traders in respect of above issues.

- *ANSWER*

(i) In order to reverse the receipt of cheque recorded earlier, Rs. 25,000 shall be recorded on payment side of cash book when intimation of dishonoured cheque is received.

(ii) The post-dated cheque should not have been recorded in the month of June 2022. Now, Rs. 56,000 shall be recorded on receipt side of cash book to reverse the incorrect recording of this cheque.

(iii) The time-barred cheque must be cancelled. This requires reversing the amount recorded on payment side earlier. Now, Rs. 37,000 shall be recorded on receipt side of cash book to account for cancellation of the cheque.

(iv) The cancelled cheque must be reversed. Now, Rs. 20,000 shall be recorded on receipt side of cash book to reverse the earlier payment recorded.

(v) Drawings of goods is not a cash transaction. Now Rs. 18,000 shall be recorded on receipt side to record the reversal.

UNDER-CASTING AND OVERCASTING ERRORS

Incorrect amounts may be calculated while totalling or balancing the cash book. Similarly, it is possible that incorrect amount of receipt or payment is recorded on correct side (debit or credit).

In case of understatement, include the differential amount on same side and in case of overstatement, include the differential amount on opposite side.

▶ *Example 04:*

The accountant of Maria Enterprises identified following errors while preparing bank reconciliation statement as at June 30, 2022:

(i) The receipt side of cash book had been totalled as Rs. 45,000 (correct total would have been Rs. 48,000).

(ii) The payment side of cash book had been totalled as Rs. 37,000 (correct total would have been Rs. 33,000).

(iii) The opening balance (debit) brought forward was recorded on 1st June 2022 at Rs. 45,000. The closing balance carried forward on 31st May 2022 was correctly calculated as Rs. 54,000.

(iv) A cheque issued of Rs. 27,000 was incorrectly recorded at Rs. 17,000 on payment side of cash book.

(v) A cheque received of Rs. 36,000 was incorrectly recorded at Rs. 63,000 on receipt side of cash book.

Required:

Briefly discuss the accounting treatment in cash book's bank column of Maria Enterprises in respect of above issues.

▶ *ANSWER*

(i) The receipt side has been understated by Rs. 3,000 i.e. Rs. 48,000 – 45,000. Now, Rs. 3,000 (more) shall be recorded on receipt side.

(ii) The payment side has been overstated by Rs. 4,000 i.e. Rs. 37,000 – 33,000. Now, Rs. 4,000 shall be recorded on receipt side to reverse the overstatement.

(iii) The receipt side has been understated by Rs. 9,000 i.e. Rs. 54,000 – 45,000. Now, Rs. 9,000 (more) shall be recorded on receipt side.

(iv) The payment side has been understated by Rs. 10,000 i.e. Rs. 27,000 – 17,000. Now, Rs. 10,000 (more) shall be recorded on payment side.

(v) The receipt side has been overstated by Rs. 27,000 i.e. Rs. 63,000 – 36,000. Now, Rs. 27,000 shall be recorded on payment side to reverse the overstatement.

ERRORS OF CORRECT AMOUNT ON OPPOSITE SIDE

Sometimes, the correct amount may be recorded but on incorrect side of cash book i.e. debit entry recorded on credit side or credit entry recorded on debit side.

In order to correct such errors, the double amount is included on correct side, once for reversal of incorrect recording and once for recording the correct entry.

▶ *Example 05:*

The accountant of Mansoor Traders identified the following errors in the records while preparing bank reconciliation statement as at 30 June 2022:

(i) A cheque received of Rs. 32,000 was incorrectly recorded on payment side of cash book.

(ii) A cheque issued of Rs. 28,000 was incorrectly recorded on receipt side of cash book.

Required:

Briefly discuss the accounting treatment in cash book's bank column of Mansoor Traders in respect of above issues.

▶ *ANSWER*

(i) In order to correct this error, now Rs. 64,000 (i.e. Rs. 32,000 x 2) shall be recorded on receipt side of cash book.

(ii) In order to correct this error, now Rs. 56,000 (i.e. Rs. 28,000 x 2) shall be recorded on payment side of cash book.

ERRORS OF INCORRECT AMOUNT ON OPPOSITE SIDE

It is possible that a combination of errors occur at once, for example, not only the amount recorded is incorrect but it is also recorded on incorrect side of cash book i.e. debit entry recorded on credit side or credit entry recorded on debit side.

In order to correct such errors, the amount to be included on correct side of cash book is:

= Correct amount + Incorrect amount

▶ *Example 06:*

The accountant of Salman Traders identified the following errors in the records while preparing bank reconciliation statement as at 30 June 2022:

(i) A cheque received of Rs. 32,000 was incorrectly recorded on payment side of cash book at Rs. 23,000.

(ii) A cheque issued of Rs. 28,000 was incorrectly recorded at Rs. 38,000 on receipt side of cash book.

Required:

Briefly discuss the accounting treatment in cash book's bank column of Salman Traders in respect of above issues.

▶ *ANSWER*

(i) In order to correct this error, now Rs. 55,000 (i.e. Rs. 32,000 + 23,000) shall be recorded on receipt side of cash book.

(ii) In order to correct this error, now Rs. 66,000 (i.e. Rs. 28,000 + 38,000) shall be recorded on payment side of cash book.

4. COMPREHENSIVE EXAMPLES

- *Example 07:*

On 31 December 2014 the bank book of Badami Enterprise (BE) reflected a favourable balance of Rs. 34,000 while the bank statement showed an overdraft of Rs. 1,712,000.

On scrutinizing the two records, following discoveries were made:

(i) Cheques of Rs. 325,000 issued to suppliers were not yet presented to the bank.

(ii) Bank made payment of Rs. 35,000 in relation to e-payment charges on BE's account.

(iii) BE had instructed the bank to transfer interest of Rs. 45,000 earned on a deposit account to its current account. The bank did not transfer the amount till 15 January 2015 whereas the amount had already been recorded in the bank book.

(iv) Cheques of Rs. 630,000 received from customers and deposited to the bank had not been credited by the bank.

(v) The receipt side of the bank book was over-casted by Rs. 90,000.

(vi) The payment side of the bank book was under-casted by Rs. 42,000.

(vii) BE made e-payments of Rs. 720,000 to overseas suppliers. However, these payments were not posted to the bank book.

(viii) A cheque of Rs. 30,000 drawn in favour of a supplier was recorded in the bank statement as Rs. 300,000.

(ix) A cheque of Rs. 65,000 issued to one of the suppliers had been wrongly posted on the receipt side of the bank book.

(x) A cheque of Rs. 80,000 received from Mr. Barkat had been entered twice in the bank book.

(xi) Dividend of Rs. 54,000 collected by the bank was recorded at Rs. 63,000 in the bank book.

(xii) A standing order for payment of annual subscription fees of Rs. 20,000 for a magazine had not been recorded in the bank book.

Required:

Determine the correct balance that should be reported in the bank book and prepare a bank reconciliation statement reconciling the amended balance with that shown in the bank statement.

- *ANSWER*

Cash Book (Bank)			
Particulars	**Rs.**	**Particulars**	**Rs.**
b/d (as given)	34,000	e-payment charges (ii)	35,000
		Over-casting receipts (v)	90,000
		Under-casting payments (vi)	42,000
		Overseas e-payments (vii)	720,000
		Wrong posting [65,000 x 2] (ix)	130,000
		Deposit duplication (x)	80,000
		Dividend [63,000 – 54,000] (xi)	9,000
c/d (adjusted balance)	1,092,000	Subscription fees (xii)	20,000
	1,126,000		**1,126,000**

Bank Reconciliation Statement as at 31 December 2014

Particulars		Rs.
Balance as per bank statement	**(Dr) / Cr**	**(1,712,000)**
Less: Unpresented cheques (i)		(325,000)
Add: Interest on deposit not yet posted by bank (iii)		45,000
Add: Uncredited items (iv)		630,000
Add: Incorrectly debited [300,000 – 30,000] (viii)		270,000
Adjusted balance as per Cash Book	**Dr / (Cr)**	**(1,092,000)**

- *Example 08:*

Following information has been extracted from the records of Unique Traders:

Bank book for the month of February 2018

Date	Receipts	Rupees	Date	Payments	Cheque	Rupees
01	Balance	133,500	03	Salaries	X09	225,000
05	Debtors	315,000	05	Utilities	X10	352,000
09	Sales	525,000	08	Purchases	X11	622,000
12	Rentals	615,000	15	Rental	X12	608,000
18	Security deposit	200,000	20	Purchases	X13	71,000
25	Advance from customers	182,000	28	Balance		441,500
26	Debtors	294,000				
28	Cash deposited in bank	55,000				
		2,319,500				**2,319,500**

Bank statement for the month of February 2018

Date	Description	Cheque	Withdrawals	Deposits	Balance
			-------------- **Rupees**	--------------	
01	Balance				127,500
03	Cheque withdrawal	X09	225,000		(97,500)
05	Reversal of credited mistakenly		48,000		(145,500)
09	Cheque withdrawal	X05	63,000		(208,500)
14	Outward cheque clearing			315,000	106,500
20	Outward cheque clearing			525,000	631,500
22	Cheque withdrawal	X10	325,000		306,500
24	Payment – standing instructions		15,000		291,500
25	Outward cheque clearing			615,000	906,500
26	Outward cheque clearing			200,000	1,106,500
26	Transfer (from a debtor)			38,000	1,144,500
27	Cheque returned		200,000		944,500
28	Cheque withdrawal	X12	608,000		336,500
28	Cheque withdrawal	X13	71,000		265,500
28	Cash deposit			55,000	320,500
28	Bank charges		4,500		316,000
			1,559,500	**1,748,000**	

(All amounts appearing in the above bank statement are correct)

Bank reconciliation statement as on 31 January 2018

Description	Bank book	Bank Statement
	---------- Rupees ----------	
Balance	(133,500)	127,500
Un-presented cheques:		
Cheque X05 dated 28 January 2018		(63,000)
Cheque X06 dated 31 January 2018		(150,000)
Amount mistakenly credited by bank		(48,000)
Corrected balance	**(133,500)**	**(133,500)**

Required:

Prepare bank reconciliation statement as on 28 February 2018, showing the correct balance as per bank book and bank statement.

- *ANSWER*

Cash Book (Bank)			
Particulars	**Rs.**	**Particulars**	**Rs.**
b/d (as given)	441,500	Opening balance correction [133,500 x 2 times]	267,000
Chq. X10 [352,000 – 325,000]	27,000	Standing order	15,000
Direct transfer	38,000	Dishonoured cheque	200,000
		Bank charges	4,500
		c/d (Corrected)	20,000
	506,500		**506,500**

Bank Reconciliation Statement as at 28 February 2018

Particulars		Rs.
Balance as per bank statement	**(Dr) / Cr**	**316,000**
Less: Unpresented cheque X06		(150,000)
Less: Unpresented cheque X11		(622,000)
Add: Uncredited items: Advance from customer		182,000
Add: Uncredited items: Cheque from debtor		294,000
Adjusted balance as per Cash Book	**Dr / (Cr)**	**20,000**

- *Example 09:*

Lamda Establishment is preparing bank reconciliation statement on 30 June 2019. In this respect, the following information is available:

(i) Cash book showed an overdrawn balance of Rs. 3,928,000.

(ii) Cheques outstanding as at 30 June 2019 amounting to Rs. 1,250,000 included:

- a cheque of Rs. 10,000 dated 8 December 2018 issued to a welfare organization for donation.
- a cheque of Rs. 150,000 dated 20 June 2019 mailed to a supplier on 10 July 2019.

(iii) A cheque of Rs. 391,000 issued to a supplier was recorded in the cash book as Rs. 319,000.

(iv) (Cheques received from customers amounting to Rs. 670,000 were recorded in the cash book but not credited in bank statement. These cheques included a cheque dated 10 July 2019 amounting to Rs. 25,000 received from a customer on 28 June 2019.

(v) A bank debit advice dated 30 June 2019 for interest charges amounting to Rs. 80,000 was received in July 2019.

Required:

(a) Compute the corrected cash book balance as at 30 June 2019.

(b) Compute the bank balance as would be appearing in the bank statement as at 30 June 2019.

▶ *ANSWER*

Cash Book (Bank)			
Particulars	**Rs.**	**Particulars**	**Rs.**
Donation (time-barred)	10,000	b/d (as given)	3,928,000
Payables (despatched later)	150,000	Payables [391,000 – 319,000]	72,000
		Receivables (post-dated)	25,000
c/d	3,945,000	Interest charges	80,000
	4,105,000		**4,105,000**

Bank Reconciliation Statement as at 30 June 2019

Particulars		Rs.
Adjusted balance as per Cash Book	**Dr / (Cr)**	**(3,945,000)**
Add: Unpresented cheques 1,250,000 – 10,000 – 150,000		1,090,000
Less: Uncredited items 670,000 – 25,000		(645,000)
Balance as per bank statement	**(Dr) / Cr**	**(3,500,000)**

5. OBJECTIVE BASED Q&A

01. The following bank reconciliation statement has been prepared by a business.

Bank reconciliation statement as at April 30, 2018	***Rs.***
Balance as per bank statement (Cr)	45,200
Add: Outstanding cheques	11,500
Less: Uncleared lodgements	13,100
Balance as per cash book (Dr)	43,600

Assuming that all items other than balance as per cash book is correct; what is the correct balance as per cash book?

(a) Rs.43,600 Dr as per statement in question

(b) Rs.43,600 Cr

(c) Rs.46,800 Dr

(d) Rs.46,800 Cr

02. Debit balance of Rs.5,000 as per bank statement means:

(a) Rs.5,000 payable to business by the bank

(b) Rs.5,000 receivable from business by the bank

(c) Rs.5,000 deposited by the business during the month

(d) Rs.5,000 withdrawn from the bank by business during the year

03. The following bank reconciliation statement has been prepared by a trainee accountant:

	Rs.
Overdraft as per bank statement	6,980
Less: Outstanding cheques	10,460
	3,480
Add: Deposits credited after date	11,800
Cash at bank as per cash book	15,280

What should be the correct balance as per cash book?

(a) Rs.15,280 balance at bank as stated

(b) Rs.5,640 balance at bank

(c) Rs.15,280 overdrawn

(d) Rs.5,640 overdrawn

AT A GLANCE SPOTLIGHT STICKY NOTES

04. At the end of 31 March 2019, balance as per cash book of Imtiaz is Rs.10,200 (Dr) which did not agree with the balance as per the bank statement. On investigation following information was identified;

- A standing order of Rs.350 was paid by the bank did not appear in the cash book.
- Dividend received directly in the bank was Rs.30
- Bank credited interest for the quarter Rs.350; it was included in cash book as Rs.530
- A customer cheque deposited in the bank Rs.120 was dishonoured

What is the corrected balance as per cash book?

(a) Rs.10,170 Dr

(b) Rs.10,170 Cr

(c) 9,580 Dr

(d) 9,580 Cr

05. A business identified that there is a difference between balance of cash book and the balance as per bank statement at end of 28 February 2019. On investigation it was revealed that:

- Bank debits account of business for bank charges Rs.30 and standing order Rs.150.
- Bank erroneously debits bank account of business for a cheque of Rs.40.
- Business has credited the bank account for quarterly interest income Rs.150.

What is the total amount of adjustment to be made in cash book of business?

(a) Rs.180 Cr and Rs.150 Dr

(b) Rs.180 Cr and Rs.300 Dr

(c) Rs.220 Cr and Rs.300 Dr

(d) Rs.220 Dr and Rs.300 Cr

06. Balance of bank account as per cash book is Rs.35,000 (Dr) while balance as per bank statement is Rs.32,500 (Cr). Difference is explained as Uncleared lodgements of Rs.2,500 not included in the bank statement.

What is the amount of bank balance to be reported in Statement of financial Position?

(a) Rs.35,000 Cash at bank

(b) Rs.35,000 Overdraft

(c) Rs.32,500 Cash at bank

(d) Rs.32,500 Overdraft

07. A business is in process of reconciling its cash book with banks statement. Which of the following item require entry in cash book?

(a) Bank service charges

(b) Deposits credited by the bank after the date of the bank statement

(c) Cheque of another account erroneously credited by bank

(d) Cheques presented by suppliers after the date of bank statement

08. A business is in process of preparing its bank reconciliation statement. The balance of cash book did not agree with the balance in bank statement. The following information is available:

- Balance as per cash book before comparing bank statement Rs. 11,000 (Dr)
- Outstanding Cheques Rs.1,550
- Outstanding lodgements Rs.1,200
- Bank charges Rs.50
- Bank interest income Rs.100

What is the balance as per bank statement?

(a) Rs.11,200 Dr

(b) Rs.11,400 Dr

(c) Rs.11,400 Cr

(d) Rs.11,200 Cr

09. A business received a bank statement showing a credit balance of Rs.7,400. On investigation its accountant discovered that the bank statement does not show cheques received from customers Rs.16,200 and banked and same for cheque payments to suppliers Rs.18,500. The bank statement also shows bank charges of Rs.250 which has not yet been recorded in ledger.

What is the current balance as per cash book?

(a) Rs.5,350 Cr

(b) Rs.5,350 Dr

(c) Rs.5,100 Dr

(d) Rs.5,100 Cr

10. Following information has been collected from the books of Murtaza as at 31 January 2019:

Balance as per cash book Rs.15,000 (Dr)

On scrutiny of bank statement it was found:

- Unpresented Cheques Rs.2,500
- Uncredited lodgements Rs.1,500
- Bank charges Rs.200
- Bank debits Murtaza for bank interest Rs.120 instead of Rs.150. No amount was recorded in cash book of Murtaza

Further it was found that:

- Receipt of Rs.1,500 was recorded on credit side of cash book
- Payment of Rs.1,200 was recorded on debit side of cash book

What is the corrected cash book balance of Murtaza?

(a) Rs.15,370 Dr

(b) Rs.15,250 Dr

(c) Rs.15,250 Cr

(d) Rs.15,370 Cr

AT A GLANCE

SPOTLIGHT

STICKY NOTES

11. A bank statement shows a balance of Rs.4,000 in credit. On examining the bank statement, it was found that the cheques of Rs.600 deposited in bank as per the cash book not yet on the bank statement and cheques of Rs.1,000 issued out but not yet appeared on the bank statement.

Furthermore, the cash book shows deposit interest received of Rs.100 but this is not yet on the statement. This was duly communicated to bank and is to be considered as an omission by the bank.

What is the balance as per cash book?

(a) Rs.3,700

(b) Rs.4,500

(c) Rs.5,000

(d) Rs.3,900

12. If it was found that the receipt side of the cash book has been under-casted, then in preparing bank reconciliation statement, it should be:

(a) Deducted from balance as per cash book

(b) Added in balance as per bank statement

(c) Added in balance as per cash book

(d) Deducted from balance as per bank statement

13. Which of the following statements is correct?

(a) Credit balance as per bank statement means a bank overdraft

(b) Debit balance as per bank statement means a bank overdraft

(c) Debit balance as per cash book means a bank overdraft

(d) Credit balance as per cash book means an asset

14. Which of the following require deduction from cash book balance while preparing bank reconciliation statement?

(a) Direct deposit by a customer into bank but not yet entered in cash book

(b) Standing orders paid by the bank not yet entered in cash book

(c) Unpresented cheques not yet paid by bank

(d) Bank debits interest Rs. 2,500 instead of Rs. 5,200, the correct amount has been included in cash book.

15. The following information relates to bank reconciliation:

- The bank balance in the cash book before taking the items below into account was Rs.9,870 overdrawn
- Bank charges of Rs.750 on the bank statement have not been entered in the cash book
- The bank has credited the account in error with Rs.645 which belongs to another customer
- Cheque payments totalling Rs.4,385 have been entered in the cash book but have not been presented by payment
- Cheques totalling Rs.6,500 have been correctly entered on the debit side of the cash book but have not been paid in at the bank

What was the balance as shown by the bank statement?

- **(a)** Rs.10,970 overdrawn
- **(b)** Rs.12,200 overdrawn
- **(c)** Rs.12,090 overdrawn
- **(d)** Rs.11,550 overdrawn

16. Balance as per bank statement of Asim was Rs.11,600 credit as on April 30, 2018, which was not in agreement with the balance as per cash book.

On investigation the following items were detected:

- Cheques issued and paid by the bank for Rs.5,500 but recorded in the cash book as Rs.500
- Bank service charges not entered in the cash book Rs.420
- Outstanding lodgements Rs.1,300
- Bank has erroneously debited a cheque of Rs.900 to Asim actually the cheque was issued by Asif.
- Unpresented cheques Rs.1,200

What should be the balance as per cash book before adjustments?

- **(a)** Rs. 18,020 Debit
- **(b)** Rs. 18,020 Credit
- **(c)** Rs. 12,600 Debit
- **(d)** Rs. 12,600 Credit

17. Following information is available regarding cash at bank of a business:

- Cash at bank as per bank column of the cash book Rs.4,910
- Unpresented cheques Rs.630
- Cheques received & paid into the bank, but not yet entered on the bank statement Rs.460
- Credit transfers from customers entered on the bank statement but not entered in the cash book Rs.340

What is Cash at bank as per bank statement?

- **(a)** Rs. 5,420 Debit
- **(b)** Rs. 5,420 Credit
- **(c)** Rs. 5,250 Debit
- **(d)** Rs. 5,250 Credit

18. The bank column of a cash book showed a credit balance of Rs.8,000. There were unpresented cheques amounting to Rs.2,500. The bank statement showed bank charges, Rs.900, which were not recorded in the cash book.

What is the balance on the bank statement?

- **(a)** Rs. 6,400 Normal
- **(b)** Rs. 6,400 Overdraft
- **(c)** Rs. 8,900 Normal
- **(d)** Rs. 8,900 Overdraft

19. When preparing a bank reconciliation statement the following information is available.

- Balance as per cash book Rs.25,000 (Dr)
- Outstanding cheques Rs.1,500
- uncleared lodgements 1,300
- Standing order shown on the bank statement (not appearing in a cash book) Rs.200
- Dividend directly deposited in the bank (not appearing in the cash book) Rs.25

What is the balance as per bank statement?

(a) Rs. 25,025 Normal

(b) Rs. 25,025 Overdraft

(c) Rs. 24,825 Normal

(d) Rs. 24,825 Overdraft

20. Balance as per bank statement was Rs.1,000 in debit. Comparison of bank statement with cash book revealed that cheques of Rs.3,200 paid in per the cash book but not yet on the bank statement and cheques of Rs.500 paid out but not yet appeared on the bank statement. In addition the bank statement shows direct deposit of Rs.800 by a customer but it is not recorded in cash book.

What is the balance as per cash book after adjustments?

(a) Rs. 2,500 Overdraft

(b) Rs. 2,500 Positive Balance

(c) Rs. 1,700 Overdraft

(d) Rs. 1,700 Positive Balance

21. The main purpose of preparing a bank reconciliation statement is?

(a) To know the bank balance

(b) To know the balance of bank statement

(c) To correct the cash book

(d) To identify causes of difference between cash book balance and bank statement balance

22. Bank Reconciliation Statement is prepared by

(a) Bank of the business entity

(b) Accountant of the business entity itself

(c) Major customer of the business

(d) Auditors of the business

23. Bank reconciliation statement is

(a) Part of bank statement

(b) Part of the cash book

(c) A separate statement

(d) A sub-division of journals (day books)

24. Favourable bank balance means?

(a) Credit balance in the cash book

(b) Credit balance in Bank statement

(c) Debit balance in cash book

(d) Both (b) and (c)

25. Unfavourable bank balance means (Pick any two)?

(a) Credit balance in the cash book

(b) Credit balance in Bank statement

(c) Debit balance in cash book

(d) Debit balance in Bank Statement

26. When a cheque is not paid by the bank on account of insufficient balance, it is called?

(a) Stale cheque

(b) Dishonoured cheque

(c) Bearer cheque

(d) None of the above

27. Which of the following would not affect bank reconciliation?

(a) Cancelled cheques

(b) Time barred cheques

(c) Post-dated cheques

(d) All of above

28. An amount of Rs. 1,000 is debited twice in the bank statement instead of once. When overdraft balance as per the cash book of Rs. 5,000 is the starting point for preparing bank reconciliation statement, what will be the balance as per bank statement containing the above error?

(a) Rs. 5,000 + 1,000 = Rs. 6,000 Overdraft

(b) Rs. 5,000 – 1,000 = Rs. 4,000 Overdraft

(c) Rs. 5,000 + 2,000 = Rs. 7,000 Overdraft

(d) Rs. 5,000 – 2,000 = Rs. 3,000 Overdraft

29. Bank sent debit advice of Rs. 50,000 to company being interest on overdraft. It was not entered in cash book.

Identify the correct adjustment in cash book?

(a) Rs. 50,000 will be debited

(b) Rs. 50,000 will be credited

(c) No adjustment

(d) Rs. 100,000 will be subtracted

30. A customer paid Rs. 80,000 but the cashier entered Rs. 88,000 in cash book.

What should be the adjustment in cash to work out the correct balance of cash book?

- **(a)** Rs. 8,000 will be debited in cash book
- **(b)** Rs. 8,000 will be credited in cash book
- **(c)** Rs. 16,000 will be debited in cash book
- **(d)** Rs. 16,000 will be credited in the cash book

31. A business deposited Rs. 50,000 cash into its bank account after banking hours on 30th June 2021 and recorded the deposit on same date. The bank manager accepted the cash and issued the deposit slip of next working day stating that entry will be posted immediately on next working day. Which of the following would be appropriate way to account for this deposit?

- **(a)** Include this item in BRS just like outstanding cheques are included.
- **(b)** Include this item in BRS just like uncredited items are included.
- **(c)** Debit Suspense and Credit Bank (Reverse when entry is posted by bank)
- **(d)** The business may choose any of the above methods as per its own discretion.

32. Monthly interest credited in the bank statement but not appearing in cash book should be dealt in following ways:

- **(a)** Record as receipts in cash book
- **(b)** Record as payment in cash book
- **(c)** Record in BRS as uncredited item
- **(d)** Inform the bank to reverse the entry as this does not match the cash book

33. While reviewing bank statement you noticed that bank inadvertently charged your bank account for another business' bank charges. Which of the following action would be appropriate?

- **(a)** Record these bank charges on payment side of cash book and wait if bank notices the error itself and corrects it in future.
- **(b)** Record these bank charges on payment side of cash book and formally inform the bank about error and request the correction of it.
- **(c)** Include these bank charges in BRS and wait if bank notices the error itself and corrects it in future.
- **(d)** Include these bank charges in BRS and formally inform the bank about error and request the correction of it.

34. A company had a receipt of Rs.989,000 and correctly prepared its bank deposit slip for Rs.989,000. However, the company recorded the receipt in its Cash account as Rs.998,000.

How is the difference of Rs.9,000 handled on the bank reconciliation?

- **(a)** Include on receipt side of cash book
- **(b)** Include on payment side of cash book
- **(c)** Add to bank statement balance in BRS
- **(d)** Deduct from bank statement balance in BRS

35. For reconciling bank balances, unpresented cheques should be:

(a) added to balance of bank statement and deducted from balance of cash book

(b) deducted from balance of bank statement or added to balance of cash book

(c) deducted from balance of bank statement and added to balance of cash book

(d) added to balance of bank statement or deducted from balance of cash book

36. Determine the balance as per bank statement using the following information:

- Balance as per cash book Rs. 49,100
- Cheques received and deposited into the bank, but not yet credited in the bank statement Rs. 4,600
- Unpresented cheques Rs. 6,300
- Credit transfers appearing in the bank statement but not entered in the cash book Rs. 3,400

(a) Rs. 52,500

(b) Rs. 54,200

(c) Rs. 58,800

(d) Rs. 50,800

37. Following information has been extracted from the records of Eden Garments (EG), as at 30 June 2016:

Balance as per bank statement (overdraft) Rs. 1,490,850

Outstanding cheques amount to Rs. 3,856,300 and include:

- a cheque of Rs. 50,000 issued to a supplier bearing an incorrect payee's name. The cheque was returned and recorded on 15 July 2016.
- a cheque issued to a supplier for Rs. 85,000 (included in above amount correctly) was recorded in bank book as Rs. 58,000.
- a cheque dated 20 December 2015 for Rs. 4,630 issued for repair of a car was misplaced. The repair charges were paid in cash and the misplacement of the cheque was not recorded.

Assuming that cash book balance has been corrected and adjusted, what amount of bank balance shall be reported in statement of financial position?

(a) Rs. 5,292,520 Overdraft

(b) Rs. 2,310,820 Positive balance

(c) Rs. 5,347,150 Overdraft

(d) Rs. 2,365,450 Positive balance

38. Following information has been extracted from the records of Eden Garments (EG), as at 30 June 2016:

Balance as per bank statement (overdraft) Rs. 1,490,850

Un-cleared cheques amount to Rs. 6,460,000 and include:

- a cheque of Rs. 366,000 received from a customer was returned by the bank as amount in words was not in conformity with the amount in figures. The return was not recorded and the cheque was sent to the customer for replacement.
- a cheque of Rs. 76,000 received from a customer in settlement of an invoice availing payment discount of 5%. The collection was recorded by EG at gross amount of invoice.

Assuming that cash book balance has been corrected and adjusted, what amount of bank balance shall be reported in statement of financial position?

(a) Rs. 7,584,850 Overdraft

(b) Rs. 4,603,150 Positive balance

(c) Rs. 7,950,850 Overdraft

(d) Rs. 4,969,150 Positive balance

39. Following information has been extracted from the records of Eden Garments (EG), as at 30 June 2016:

Balance as per bank statement (overdraft) Rs. 1,490,850

An unidentified credit of Rs. 354,000 was appearing in the bank statement. It was found that a customer had made an online transfer by 30 June 2016.

Following debit/credit advice dated 30 June 2016 were received from the bank on 5 July 2016:

- Bank charges amounting to Rs. 7,850. It has been noted that the bank had over charged EG by Rs. 1,250.
- Dividend collected by the bank amounting to Rs. 50,000.
- Payment on EG's standing instruction of an annual subscription for a magazine amounting to Rs. 12,000.

Assuming that cash book balance has been corrected and adjusted, what amount of bank balance shall be reported in statement of financial position?

(a) Rs. 1,489,600 Overdraft

(b) Rs. 760,000 Positive balance

(c) Rs. 1,492,100 Overdraft

(d) Rs. 803,030 Positive balance

40. The bank statements showed that cheques for Rs. 70,000, Rs.90,000 and Rs.100,000 had not been presented for payment and that lodgements totalling Rs.210,000 had not been cleared. The balance on the bank statement at 30 June was Rs. 1,550,000.

What is balance as per cash book?

(a) Rs. 1,600,000 debit

(b) Rs. 1,600,000 credit

(c) Rs. 1,500,000 debit

(d) Rs. 1,500,000 credit

41. The balance in Jabbar's cash account at 30 June showed an asset of Rs.1,660,000 (unadjusted). His bank statement showed an overdraft of Rs.450,000.

On reconciling the cash account he discovers the following:

- The debit side of the cash account had been undercast by Rs.200,000.
- A total on the receipts side of the cash account of Rs.2,475,000 had been brought forward as Rs.4,275,000.
- A cheque received by Jabbar for Rs.220,000 had bounced. No entry was made in records by Jabbar.
- Bank charges of Rs.184,000 had been omitted from the cash account.
- Un-presented cheques totalled Rs.520,000 and un-cleared lodgements Rs.626,000.

Determine the balance as per cash book as to be reported in statement of financial position?

(a) Rs. 344,000 in current assets

(b) Rs. 344,000 in current liabilities

(c) Rs. 970,000 in current assets

(d) Rs. 970,000 in current liabilities

42. The balance in Jabbar's cash account at 30 June showed an asset of Rs.1,660,000 (unadjusted). His bank statement showed an overdraft of Rs.450,000.

On reconciling the cash account he discovers that un-presented cheques totalled Rs.520,000 and un-cleared lodgements Rs.626,000.

Determine the balance as per cash book as to be reported in statement of financial position?

(a) Rs. 344,000 in current assets

(b) Rs. 344,000 in current liabilities

(c) Rs. 970,000 in current assets

(d) Rs. 970,000 in current liabilities

43. While reconciling the bank statement with the cash/bank book of ABC Textiles for the year ended December 31, 2013, you noted the following:

Balance as per bank statement at December 31, 2013, overdrawn	Rs. 806,436
Cheques drawn but not presented till December 31, 2013,	Rs. 377,784

A time-barred cheque of Rs. 5,000 was replaced with a new cheque on December 30, 2013, and entered in the cash/bank book without the previous cheque being cancelled / reversed. Both the cheques are included in above unpresented cheques.

Assuming that cash book balance has been corrected and adjusted, what amount of bank balance shall be reported in statement of financial position?

(a) Rs. 1,179,220 debit

(b) Rs. 1,179220 credit

(c) Rs. 433,652 debit

(d) Rs. 433,652 credit

44. While reconciling the bank statement with the cash/bank book of ABC Textiles for the year ended December 31, 2013, you noted the following:

Balance as per bank statement at December 31, 2013, overdrawn Rs. 806,436

Cheques drawn but not presented till December 31, 2013, Rs. 377,784

The above unpresented cheques include a cheque of Rs. 25,000 issued to supplier that is time barred as of January 3, 2014.

Assuming that cash book balance has been corrected and adjusted, what amount of bank balance shall be reported in statement of financial position?

(a) Rs. 1,159,220 credit

(b) Rs. 453,652 credit

(c) Rs. 428,652 credit

(d) Rs. 1,184,220 credit

45. While reconciling the bank statement with the cash/bank book of ABC Textiles for the year ended December 31, 2013, you noted the following:

(i) A cheque for Rs. 125,000 drawn by the company to pay for a new item of plant had been mistakenly entered in the cash/bank book as Rs. 12,500

(ii) A cheque issued of Rs. 13,200 by the company has been entered in the credit column of the bank statement.

What would be appropriate action for above issues while reconciling the bank balance?

(a) Record Rs. 112,500 on receipt side, item (ii) has already been accounted for correctly.

(b) Record Rs. 112,500 on payment side, item (ii) has already been accounted for correctly.

(c) Record Rs. 112,500 on payment side, include adjustment of Rs. 13,200 in bank reconciliation statement.

(d) Record Rs. 112,500 on payment side, include adjustment of Rs. 26,400 in bank reconciliation statement.

46. On 30 June 2015, the bank book and bank statement of Ranjha Enterprises (RE) reflected overdraft but with different amounts. On scrutinizing the record, it was discovered that cheques deposited in bank in the last week of June 2015, amounting to Rs. 1,550,000 were wrongly credited in the bank book. Out of these, cheques amounting to Rs. 1,050,000 were cleared by the bank in July 2015 whereas a cheque of Rs. 500,000 deposited on 29 June 2015 was dishonoured by the bank on 2 July 2015.

What will be appropriate action to reconcile or adjust the above issue?

(a) Include Rs. 1,550,000 on receipt side of cash book and adjust uncredited cheques of Rs. 1,550,000 in bank reconciliation statement

(b) Include Rs. 3,100,000 on receipt side of cash book and adjust uncredited cheques of Rs. 1,550,000 in bank reconciliation statement

(c) Include Rs. 3,100,000 on receipt side of cash book and Rs. 500,000 on payment side of cash book and adjust uncredited cheques of Rs. 1,550,000 in bank reconciliation statement

(d) Include Rs. 3,100,000 on receipt side of cash book and Rs. 500,000 on payment side of cash book and adjust uncredited cheques of Rs. 1,050,000 in bank reconciliation statement

47. On 30 June 2015, the bank book and bank statement of Ranjha Enterprises (RE) reflected overdraft but with different amounts. On scrutinizing the record, it was discovered that financial charges on bank overdraft amounting to Rs. 750,000 were recorded in the bank statement. However, review by the Accounts Officer indicated an error and RE recorded the correct amount of Rs. 510,000 in the bank book. The error was corrected by the bank on 10 July 2015.

What will be appropriate action to reconcile or adjust the above issue?

(a) Record Rs. 510,000 bank charges on payment side of cash book

(b) Record reversal of bank charges of Rs. 240,000 on receipt side of cash book

(c) Include Rs. 240,000 as reconciling item in bank reconciliation statement due to error by bank

(d) Include Rs. 750,000 as reconciling item in bank reconciliation statement due to error by bank

48. On 30 June 2015, the bank book and bank statement of Ranjha Enterprises (RE) reflected overdraft but with different amounts. On scrutinizing the record, it was discovered that a cheque issued to a supplier amounting to Rs. 4,005,000 was entered in the bank book as Rs. 4,050,000. However, the bank erroneously recorded the amount as Rs. 4,500,000.

What will be appropriate action to reconcile or adjust the above issue?

(a) Include Rs. 45,000 on payment side of cash book and also include Rs. 495,000 as reconciling item in the bank reconciliation statement

(b) Include Rs. 45,000 on receipt side of cash book and also include Rs. 45,000 as reconciling item in the bank reconciliation statement

(c) Include Rs. 45,000 on receipt side of cash book and also include Rs. 495,000 as reconciling item in the bank reconciliation statement

(d) Include Rs. 495,000 on payment side of cash book and also include Rs. 495,000 as reconciling item in the bank reconciliation statement

49. On 30 June 2015, the bank book and bank statement of Ranjha Enterprises (RE) reflected overdraft but with different amounts. On scrutinizing the record, it was discovered that a supplier was issued a cheque of Rs. 125,000 in place of a time barred cheque on 25 June 2015 and was cleared on the next day. However, the cancellation of time barred cheque was not recorded by RE.

What will be appropriate action to reconcile or adjust the above issue?

(a) Include Rs. 125,000 on receipt side of cash book and unpresented cheques in BRS shall be Rs. Nil.

(b) Include Rs. 125,000 on payment side of cash book and unpresented cheques in BRS shall be Rs. 125,000

(c) Include Rs. 250,000 on receipt side of cash book and unpresented cheques in BRS shall be Rs. 125,000

(d) Include Rs. 250,000 on payment side of cash book and unpresented cheques in BRS shall be Rs. 125,000

50. On 30 June 2015, the bank book and bank statement of Ranjha Enterprises (RE) reflected overdraft but with different amounts. On scrutinizing the record, it was discovered that a payment of Rs. 50,000 through cheque was recorded twice in the bank book.

What will be appropriate action to reconcile or adjust the above issue?

(a) Include Rs. 50,000 on receipt side of cash book

(b) Include Rs. 50,000 on payment side of cash book and inform the bank about double payment and request for necessary correction in their record

(c) Include Rs. 100,000 on receipt side of cash book and inform the bank about double payment and request for necessary correction in their record

(d) Include Rs. 100,000 on payment side of cash book

ANSWERS

01.	**(c)**	Bank Reconciliation Statement: Rs. 45,200 Bank Statement – 11,500 Unpresented + 13,100 Uncredited = Rs. 46,800 Cash Book (Adjusted)
02.	**(b)**	The debit balance as per bank statement means credit balance as per cash book i.e. a liability of the business and an asset (receivable) of the bank.
03.	**(d)**	Bank Reconciliation Statement: Rs. (6,980) Bank Statement – 10,460 Unpresented + 11,800 Uncredited = Rs. (5,640) i.e. overdrawn or negative balance
04.	**(c)**	Cash Book: Rs. 10,200 (unadjusted) – 350 Standing order + 30 Dividend received – 180 correction of interest income – 120 dishonoured cheque = Rs. 9,580 (Adjusted)
05.	**(b)**	Adjustments in cash book On debit side Rs. 150 interest income x 2 = Rs. 300 On credit side Rs. 30 bank charges + Rs. 150 Standing order = Rs. 180
06.	**(a)**	The balance as per cash book i.e. Rs. 35,000 Debit.
07.	**(a)**	Bank service charges are to be recorded in cash book. All other items shall be included in bank reconciliation statement.
08.	**(c)**	Cash Book: Rs. 11,000 (unadjusted) – 50 bank charges + 100 interest income = Rs. 11,050 (Adjusted) Bank Reconciliation Statement: Rs. 11,050 (Adjusted Cash Book) + 1,550 Unpresented – 1,200 Uncredited = Rs. 11,400 (Bank Statement)
09.	**(b)**	Bank Reconciliation Statement: Rs. 7,400 (Bank Statement) – 18,500 Unpresented + 16,200 Uncredited = Rs. 5,100 (Adjusted Cash Book) Cash Book: Rs. ? (unadjusted) – 250 bank charges = Rs. 5,100 (Adjusted) Unadjusted Balance calculated from above equation = Rs. 5,350 (Positive balance)
10.	**(b)**	Cash Book: Rs. 15,000 (unadjusted) – 200 bank charges - 150 interest charged + 1,500 Receipts x 2 times – 1,200 payments x 2 times = Rs. 15,250 (Adjusted)
11.	**(a)**	Bank Reconciliation Statement: Rs. 4,000 Bank Statement – 1,000 Unpresented + 600 Uncredited + 100 Interest transfer omitted by bank = Rs. 3,700
12.	**(c)**	Under-casting on receipt side has caused cash balance to be reported at lower amount than it actually is, therefore, the amount should be added in balance as per cash book to report it correctly.
13.	**(b)**	Normal positive balance as per bank statement is indicated by Debit and credit balance indicates the negative or overdraft balance.
14.	**(b)**	Standing order shall be recorded as payment. Direct deposit shall not be deducted rather added to cash balance. Unpresented cheques and error by bank shall be included in BRS.
15.	**(c)**	Cash Book: Rs. (9,870) (unadjusted) – 750 bank charges = Rs. (10,620) (Adjusted) Bank Reconciliation Statement: Rs. (10,620) (Adjusted Cash Book) + 4,385 Unpresented – 6,500 Uncredited + 645 error = Rs. (12,090) (Bank Statement)
16.	**(a)**	Bank Reconciliation Statement: Rs. 11,600 (Bank Statement) – 1,200 Unpresented + 1,300 Uncredited + 900 error = Rs. 12,600 (Adjusted Cash Book) Cash Book: Rs. ? (unadjusted) – 5,000 unrecorded payments – 420 bank charges = Rs. 12,600 (Adjusted) Unadjusted Balance calculated from above equation = Rs. 18,020 (Positive balance)

17.	**(b)**	Cash Book: Rs. 4,910 (unadjusted) + 340 Credit transfers = Rs. 5,250 (Adjusted) Bank Reconciliation Statement: Rs. 5,250 (Adjusted Cash Book) + 630 Unpresented – 460 Uncredited = Rs. 5,420 (Bank Statement)
18.	**(b)**	Cash Book: Rs. (8,000) (unadjusted) – 900 Bank charges = Rs. (8,900) (Adjusted) Bank Reconciliation Statement: Rs. (8,900) (Adjusted Cash Book) + 2,500 Unpresented = Rs. (6,400) (Bank Statement)
19.	**(a)**	Cash Book: Rs. 25,000 (unadjusted) – 200 Standing order + 25 Dividend = Rs. 24,825 (Adjusted) Bank Reconciliation Statement: Rs. 24,825 (Adjusted Cash Book) + 1,500 Unpresented – 1,300 Uncredited = Rs. 25,025 (Bank Statement)
20.	**(d)**	Bank Reconciliation Statement: Rs. (1,000) (Bank Statement) – 500 Unpresented + 3,200 Uncredited = Rs. 1,700 (Adjusted Cash Book)
21.	**(d)**	The BRS identifies and reconciles the differences between cash book balance and balance as per bank statement.
22.	**(b)**	The BRS is control tool for the business and business has to prepare itself and almost always this responsibility is given to the accountant.
23.	**(c)**	The BRS is separate statement to identify the difference in bank balances.
24.	**(d)**	Favourable bank balance means debit balance in cash book and credit balance in bank statement.
25.	**(a) & (d)**	Unfavourable bank balance means credit balance in cash book and debit balance in bank statement.
26.	**(b)**	A cheque is refused to be paid (dishonoured) when sufficient balance is not available in the account.
27.	**(d)**	Cancelled cheques, time-barred cheques and post-dated cheques must be excluded from unpresented cheques and uncredited cheques while preparing BRS.
28.	**(a)**	Rs. 1,000 extra debit by bank means overdraft would have been overstated by Rs. 1,000, therefore, the balance would be Rs. 6,000 overdraft.
29.	**(b)**	Debited by bank, will be credited in cash book.
30.	**(b)**	Rs. 8,000 extra incorrectly entered on debit side, for correction will be credited in cash book now.
31.	**(b)**	Include this item in BRS just like uncredited items are included.
32.	**(a)**	This shall be recorded on receipts side of cash book.
33.	**(d)**	Include these bank charges in BRS and formally inform the bank about error and request the correction of it.
34.	**(b)**	Include on payment side of cash book
35.	**(b)**	Deducted from balance of bank statement or added to balance of cash book
36.	**(b)**	Cash Book: Rs. 49,100 (unadjusted) + 3,400 Credit transfers = Rs. 52,500 (Adjusted) Bank Reconciliation Statement: Rs. 52,500 (Adjusted Cash Book) + 6,300 Unpresented – 4,600 Uncredited = Rs. 54,200 (Bank Statement)
37.	**(a)**	Unpresented cheques = Rs. 3,856,300 – 50,000 cancelled – 4,630 cancelled = Rs. 3,801,670

		Bank reconciliation statement: Rs. (1,490,850) bank statement – 3,801,670 unpresented = Rs. (5,292,520) Adjusted cash book
38.	**(b)**	Uncredited items = Rs. 6,460,000 – 366,000 dishonoured cheque = Rs. 6,094,000 Bank reconciliation statement: Rs. (1,490,850) bank statement + 6,094,000 Uncredited = Rs. 4,603,150 Adjusted cash book
39.	**(a)**	Bank reconciliation statement: Rs. (1,490,850) bank statement + 1,250 over-charge of bank charges = Rs. 1,489,600 Adjusted cash book
40.	**(c)**	Total of unpresented cheques = Rs. 70,000 + 90,000 + 100,000 = Rs. 260,000 Bank reconciliation statement: Rs. 1,550,000 bank statement – 260,000 unpresented + 210,000 uncredited = Rs. 1,500,000 Adjusted cash book
41.	**(b)**	Cash Book: Rs. 1,660,000 (unadjusted) + 200,000 under-casting debit side – 1,800,000 transposition error – 220,000 dishonoured cheque – 184,000 bank charges = Rs. (344,000) (Adjusted)
42.	**(b)**	Bank reconciliation statement: Rs. (450,000) bank statement – 520,000 unpresented + 626,000 uncredited = Rs. (344,000) Adjusted cash book
43.	**(b)**	Unpresented cheques = Rs. 377,784 – 5,000 cancelled = Rs. 372,784 Bank reconciliation statement: Rs. (806,436) – 372,784 unpresented = Rs. (1,179,220) Adjusted cash book
44.	**(d)**	Bank reconciliation statement: Rs. (806,436) – 377,784 unpresented = Rs. (1,184,220) Adjusted cash book
45.	**(d)**	Record Rs. 112,500 on payment side, include adjustment of Rs. 26,400 (wrong side error by bank) in bank reconciliation statement.
46.	**(d)**	Include Rs. 3,100,000 (Rs. 1,550,000 x 2 times) on receipt side of cash book and Rs. 500,000 (cheque dishonoured) on payment side of cash book and adjust uncredited cheques of Rs. 1,050,000 (excluding dishonoured cheque) in bank reconciliation statement
47.	**(c)**	Include Rs. 240,000 as reconciling item in bank reconciliation statement due to error by bank. Cash book already incorporated correct amount.
48.	**(c)**	Include Rs. 45,000 (i.e. 4,005,000 – 4,500,000) on receipt side of cash book and also include Rs. 495,000 (i.e. 4,005,000 – 4,500,000) as reconciling item in the bank reconciliation statement
49.	**(a)**	Include Rs. 125,000 on receipt side of cash book and unpresented cheques in BRS shall be Rs. Nil. One cheque has been cancelled and the other has been presented for payment, there is no cheque outstanding.
50.	**(a)**	Include Rs. 50,000 on receipt side of cash book. There is no error in records maintained by bank.

STICKY NOTES

The balance as per cash book is:

Normal or favourable balance ➔ Debit

Overdrawn, overdraft or unfavourable balance ➔ Credit

The balance as per bank statement is:

Normal or favourable balance ➔ Credit

Overdrawn, overdraft or unfavourable balance ➔ Debit

List of common adjustments in cash book

1.	Bank charges	2.	Dividend/interest received
3.	Interest charged on overdraft	4.	Standing order payments
5.	Direct debits	6.	Direct credits (credit transfer)
7.	Dishonoured cheques	8.	Post-dated cheques
9.	Time-barred cheques	10.	Cancelled cheques
11.	Casting errors	12.	Balancing error
13.	Incorrect amount error	14.	Wrong side posting error

Items to be included in Bank Reconciliation Statement

Reconciling item		**Starting point***	
		Bank statement	**Adjusted Cash Balance**
1.	Unpresented cheques	Less	Add
2.	Uncredited items	Add	Less
3.	Errors by Bank: incorrectly debited in bank statement	Add	Less
4.	Errors by Bank: incorrectly debited in bank statement	Less	Add

*in case of overdraft, negative figure is used as starting point.

AT A GLANCE

SPOTLIGHT

STICKY NOTES