Financial Accounting

Notebook

Care!

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1 INTRODUCTION

1.1 BEFORE YOU START

1.2 THE CONTEXT AND PURPOSE OF FINANCIAL REPORTING

1.2.1 Let's start with a story

So, any business, no matter its ownership, its structure, its size or geographical position must report its activity/performance over a certain period of time as well as its financial position at a certain date to its stakeholders, i.e. any person who _____ the business or who _____ by the business.

The Big Tomato's stakeholders are:

- _____
- _____
- _____
- _____
- _____
- _____

The financial information about the company is crucial to its stakeholders as it helps them in their decision-making process. Hence it is very important that this information to be of a _____, _____, _____ by any of the stakeholders.

1.2.2 Financial information

In order to have a good financial information there are rules regarding:

- _____,
- _____ and
- _____.

The International Accounting Standards (IASs) and the International Financial Reporting Standards (IFRSs) help to reduce the _____ in the way that companies from different countries reports their financial statements.

The financial reporting includes the following:

- _____
- _____
- _____
- _____
- _____
- _____

1.2.3 Types of businesses

The characteristics of the main types of businesses are:

1.2.3.1 *Sole trader:*

Investment:

Shareholder's involvement:

Size:

Shareholder's liability:

Administration:

Accounting:

1.2.3.2 *Partnership:*

Investment:

Shareholder's involvement:

Size:

Shareholder's liability:

Administration:

Accounting:

1.2.3.3 *Limited liability company:*
Investment:

Shareholder's involvement:

Size:

Shareholder's liability:

Administration:

Accounting:

1.2.3.4 *Public companies*
Investment:

Shareholder's involvement:

Size:

Shareholder's liability:

Administration:

Accounting:

1.2.4 The users of financial information

The users of the financial statements are the _____ of the company

The main stakeholders are grouped as follows:
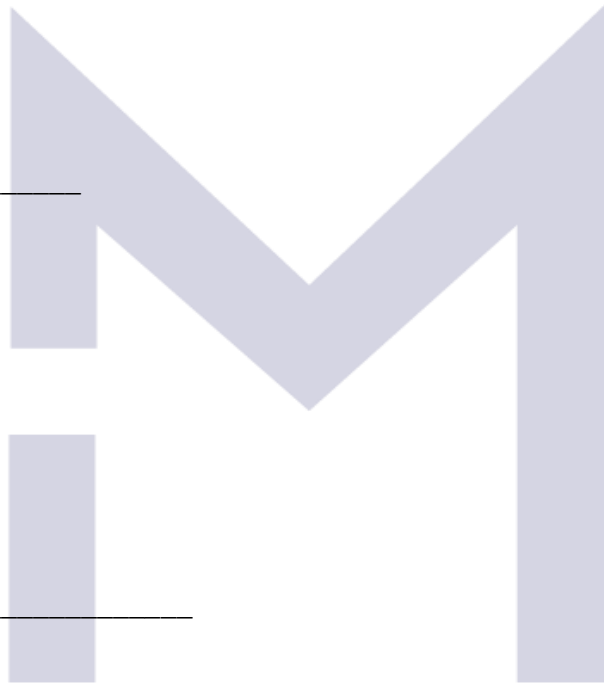
INTERNAL

- _____

CONNECTED

- _____

- _____

- _____

EXTERNAL

- _____

- _____

- _____

1.2.5 The conceptual Framework for Financial Reporting

Financial statements are produces by the _____ to show their _____ how the entity has performed over a period of time and what is the financial position of the company at the end of this period.

The information provided should disclosed:

1. Economic _____ and _____ against the business (or _____ _____)to assist in assessing:
    a. _____
    b. _____
    c. _____
    d. _____
2. Changes in _____ and _____ (or _____) against the business resulting from:
    a. _____
    b. _____

The Conceptual Framework for Financial Reporting is prepared by _____.

The purposes of The Conceptual Framework for Financial Reporting are:

1. To ensure that the _____ of _____ of financial statements are _____ at least at
   _____

2. To ensure that the _____ are both _____ and _____

3. To increase users' _____ in the _____

4. To regulate the _____ of companies and _____ towards their _____

The Framework refers to:

1. The _____ of financial reporting

2. The _____ characteristics of useful financial information

3. The _____, _____ and _____ of the elements from which the _____ are constructed

4. The _____ and _____ and

5. The concept of _____ and _____ .

As per Framework, the main objective of financial information is to be _____ in the
_____ process regarding not only the financial resources of the
entity but also other financial decisions like: _____, _____ or
_____ _____,
_____

In order to satisfy this main objective, the financial information must:

- _____
- _____
- _____
- _____

1.2.6 The International Financial Reporting Standards

1.2.6.1 International Accounting Standards Board (IASB)

IASB is responsible for _____ and _____ of IFRSs and the
_____ of IFRS IC.

IASB has _____ .

1.2.6.2 International Financial Reporting Standards (IFRS) Foundation

IFRS Foundation is the _____ body for IFRS and it is responsible for
_____ issues and for _____ of each member body.

The IFRS Foundation has 4 main objectives:

1. _____
2. _____
3. _____
4. _____

1.2.6.3 The IFRS Interpretation Committee (IFRS IC)

The IFRS IC _____ wide spread accounting _____ in the view of IFRS and
provides authoritative _____ .

1.2.6.4 The IFRS Advisory Council (IFRS AC)

The IFRS AC is the formal advisory body to IFRS Foundation and IASB. The IFRS AC objective is to:

- _____
- _____
- _____

1.2.7 Corporate governance

1.2.7.1 Good corporate governance

The main objective of a good corporate governance is to contribute to _____ corporate performance and _____ in creating long-term value for the shareholders.

The basic elements of a sound corporate governance are:

- _____
- _____
- _____
- _____
- _____
- _____

1.2.7.2 Duties and responsibilities of directors

In order to be accountable to the business, the directors of the business are responsible for _____.

The directors are responsible to ensure that the business has an _____, system in place for adequately _____, _____, and _____, all the transactions and events that take place during the year.

They are responsible to _____, that the _____, that exist within the business are _____, to prevent and detect _____, and _____, within the system.

They are responsible for _____, the system to _____, that the _____, and _____, are being rigorously _____,.

✏️ Now you may test your understanding with the quiz ☺

1.3 THE CHARACTERISTICS OF FINANCIAL INFORMATION AND THE ACCOUNTING PRINCIPLES

1.3.1 The qualitative characteristics:

The qualitative characteristics of financial information are those attributes that makes the financial information useful to others:

These characteristics are:

- Fundamentals:
    - _____

    - _____

- Enhancing characteristics
    - _____

    - _____

    - _____

    - _____

1.3.2 The accounting principles

In the preparation of financial statements there are a number of accounting concepts/principles which have to be respected in order to ensure a good quality of financial information.

These are:

1.3.2.1 _____

1.3.2.2 _____

1.3.2.3 _____

1.3.2.4 _____

1.3.2.5 _____

1.3.2.6 _____

1.3.2.7 _____

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2 THE FLOW OF FINANCIAL INFORMATION

2.1 PRIMARY DOCUMENTS

2.1.1 The main data sources in an accounting system.

In every business occurs a number of transactions and events which affect in a way or other the _____ of the business.

The role of financial accounting is to _____ the effect of all these transactions and events and to show this to the different _____ of financial statements in a way that help them to take decisions.

Most of these transactions and events have supporting documentation that _____ that these have taken place, help to put a _____ to their effect on the business wealth and help us to _____ them.

Such documents may be:

- Invoice
- Goods received note (GRN)
- Receipt
- Payment order
- Goods despatched note (GDN)
- Purchase order
- Sales order
- Statement of supplier
- Credit note
- Debit note
- Quotation
- Etc.

2.1.2 The books of prime entry

The main books of prime entry are:

2.1.2.1 Sales Day Book

2.1.2.2 Purchase Day Book

2.1.2.3 Cash Day Book

2.1.2.4 Sales Returned Day Book

2.1.2.5 Purchases Returned Day Book

2.1.2.6 Journal

2.1.3 The Big Tomato's books of prime entry

Let's fill in the books of prime entry for "The Big Tomato".

Considering that in the first week of business the transactions of "The Big Tomato" were:

Day 1: Mr. John invested $10,000 into the business

Day 2: acquired a bicycle for $1,500 - on credit

bought tomatoes for $50 - cash

sold tomatoes for $300 – cash

sold tomatoes for $100 – on credit

Day 3: bought tomatoes for $150 – on credit

sold tomatoes for $700 – cash

sold tomatoes for $200 – on credit

Day 4: bought tomatoes for $200 – on credit

Day 5: paid $100 – local tax

Cash Day Book								

Journal							

Purchases Day Book				

Sales Day Book				

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2.2 FROM JOURNALS TO LEDGER ACCOUNTS

2.2.1 The double entry concept

After its first week of trading the Big Tomato's books of prime entry shows:

Cash Day Book							
Date	Amount		Description				
	Paid	Receipt		Capital	Sales	Purchases	Expense
Total	$150	$11,000		10,000	$1,000	$50	$100

Journal						
Date	Amount	Invoice	Description	Accounts		
				Vehicles	Supplier	
Total				$1,500	1,500	

Purchases Day Book					
Date	Invoice	Amount	Supplier = trade payable	Date due	Description
Total		$350			

Sales Day Book					
Date	Invoice	Amount	Customer	Date due	Description
Total		$300			

The "the double entry concept" means that: every time an item from the business patrimony is increasing or decreasing, another item will vary as well with _____.

If all the information is recorded and all the changes are operated over the value of the assets and liabilities of "The Big Tomato", we will obtain the following values:

Assets:

      Non Current assets

           Bicycle:

      Current assets:

      Trade receivables:

      Purchases (tomatoes):

      Cash:

      Total assets:

And

Equity:

      Share capital:

      Profit of the period:

      Total equity:

Liabilities:

Trade Payables:

Suppliers:

Total equity and liabilities:

2.2.2 Debit & Credit

In the Statement of Financial Position we have:

-

-

In the Statement of Profit or Loss, the items are:

-

-

For each asset/liability and for each income/expense we have _____ which are used to record the changes in value of the respective asset/liability or income/expense.

DEBIT is called the operation we must do with the related accounting ledger every time when:

- An asset _____
- A liability _____
- An expense _____
- An income _____

CREDIT is called the operation we must do with the related accounting ledger every time when:

- An asset _____
- A liability _____
- An income _____
- An expense _____

2.2.3 The accounting equations for The Big Tomato

The most important rule in Accounting: _____ = _____

From the SDB:

From the PDB:

From the Journal:

From CDB:

Observations:

1) There is no strict rule about how to write an accounting equation

2) We may write very complex equations

2.2.4 The golden equation

Total Assets =

- ⇨ Net assets =
- ⇨ Variation of Net Assets =

2.2.5 Ledger accounts

The flow of financial information is:

Transaction/event ->

To keep the evidence of the changes in value of assets and liabilities or incomes and expenses, the accountants use _____.

In a graphic representation of a ledger account, on the left side will write the _____ movements and on the right side will write the _____ movements.

If a "T" account represents an asset, it will show:

Db			Asset		Cr

If a "T" account represents a liability, it will show:

Db			Liability		Cr

If a "T" account represents an income, it will show:

Db			Income		Cr

If a "T" account represents an expense, it will show:

Db			Expense		Cr

2.2.6 The Big Tomato's ledger accounts

The accounting equations based on the data summarised in the journals/the books of prime entry were:

From the SDB: 1) Db Trade receivable = Cr Revenue $300

From the PDB: 2) Db Purchases = Cr Trade Payable $350

From the Journal: 3) Db Vehicles = Cr Supplier $1,500

From CDB:

                                4) Db Cash = Cr Share capital $10,000

                                5) Db Cash = Cr Revenue $1,000

And also:

                                6) Db Purchases = Cr Cash $50

                                7) Db Expenses = Cr Cash $100

Following the illustration post the accounting equations into the ledger accounts:

Db		Trade Receivable		Cr
	$			$

Db		Revenue from Sales		Cr
				$

	Db		Purchases			Cr	
		$					$

	Db		Trade Payables			Cr	
							$

	Db		Vehicles			Cr	
		$					$

	Db		Suppliers			Cr	
							$

Db		Cash		Cr	
		$			$

Db		Share Capital		Cr	
					$

Db		Expense		Cr	
		$			$

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2.3 FROM LEDGER ACCOUNTS TO FINANCIAL STATEMENTS

2.3.1 Closing the accounts

To close the accounts means to _____.

For The big Tomato accounts this is:

Db		Trade Receivable				Cr
		$				$
1)	Sales on credit (SDB)	300				

Db		Revenue from Sales				Cr
						$
			1)	Sales on credit (SDB)		300
			5)	Cash sales (CDB)		1,000

Db		Purchases				Cr
		$				$
2)	Purchases on credit (PDB)	350				
6)	Cash purchases (CDB)	50				

Db				Trade Payables	Cr
					$
			2)	Purchases on credit (PDB)	350

Db				Vehicles	Cr
		$			$
3)	Bicycle acquisition (Journal)	1,500			

Db				Suppliers	Cr
					$
			3)	Bicycle acquisition (Journal)	1,500

Db				Cash	Cr
		$			$
4)	Capital invested by Mr. John (CDB)	10,000	6)	Cash Purchases	50
5)	Cash sales (CDB)	1,000	7)	Local tax (CDB)	100

Db				Share Capital	Cr
					$
			4)	Capital invested by Mr. John (CDB)	10,000

Db		Expense			Cr
		$			$
7)	Local tax (CDB)	100			

2.3.2 Writing the trial balance

The trial balance is one of the most important _____ to ensure that for every debit entry we had a _____ entry as well.

The trial balance for "The Big Tomato" after the first week of trading is:

Account	Debit	Credit

The trial balance ensures that:

2.3.3 Year-end adjustments - overview

2.3.3.1 Accounting for the "Cost of sales" – the simplest case

Db _____ = Cr _____ $___

2.3.3.2 Closing the "incomes" and "expenses" accounts

Db _____ = Cr _____ $___

The "Profit" account will show:

Db			Profit			Cr
			$			$

2.3.3.3 Transferring the profit of the period to "Retained earnings"

Db _____ = Cr _____ $___

2.3.4 Our first financial statements

Using the data already summarised in the trial balance as well as the information from the "Profit account" and following the illustration, you can write:

Statement of Profit or Loss for "The Big Tomato" for the first week of trading:

Statement of Financial Position for "The Big Tomato" as at ……

2.3.5 The Statement of Financial Position

Financial position = the sum of the _____ as well as the sum of the _____.

The assets represent "everything the business _____"

A common practice when we write the assets of a business is to start from the _____ liquid ones.

By example we may write:

Statement of Financial Position as at _____

ASSETS:

    Non-current assets:

        _____:

            _____

            _____

            _____

            _____

            _____

        _____:

            _____

            _____

    Current assets:

        _____

        _____

        _____

The liabilities represent "everything the business _____"

The two main category of liabilities of a company are _____ and _____.

The liabilities of a company may be written like this:

EQUITY:

        _____

        _____

        _____

LIABILITIES

Long term liabilities

_____

_____

Current liabilities

_____

_____

_____

_____

_____

2.3.6 The Statement of Profit or Loss

The financial performance of a company represents firstly the profit or loss realised by that company in a certain period of time.

Usually the you will find is as:

Statement of Profit or Loss for the period ………

Incomes from sales

Less cost of sales

Profit _____

Other incomes

- Interest income,
- Exceptional incomes

Other expenses

Administrative expenses

Profit _____

- Interest expense

Profit _____

Tax expense

Net profit _____

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3 RECORDING TRANSACTIONS AND EVENTS

3.1 SALES AND PURCHASES

3.1.1 Accounting for sales

Very important!

The sales subject to this lesson are the usual/normal sales of the company. (Not the extraordinary sales like the sales of non-current assets)

In accountancy, a "sale" means that the company realised a _____.

The standard regulating how the revenue from sales has to be recognised is IFRS 15 "Revenues from contracts with customers".

According to IFRS 15:

- income = any increase in economic benefits in the form of _____ /_____ of _____ or _____ of _____ which results in an increase of _____ which is not a _____ from the equity partners.
- the revenue has to be recognised when all the following conditions are satisfied:
  1. the promised goods/services are transferred to the customer
  2. the business knows the consideration it is entitled to receive in exchange for these goods/services

The accounting equation to record a:

- cash sale is:

  Db _____ = Cr _____ $___

- credit sale is:

  Db _____ = Cr _____ $___

When "sales" are returned, the accounting equations are:
- If the money were received from the customer:

  Db _____ = Cr _____ $___

- If the money are still due from the customer:

  Db _____ = Cr _____ $___

3.1.2 Sales - example:

In March, "The Big Tomato" made the following sales:

Day 1 – invoice 34 - $120 cash to Miss Pizza

Day 2 -invoice 35 - $400 on credit to Mr Gazpacho

Day 4 – Miss Pizza is returning tomatoes costing $40 because they were not well done

Day 5 – invoice 36 - $150 cash to Miss Virginia

Day 7 – invoice 37 - $200 cash to Mr Fussili

Day 8 – invoice 38 - $300 on credit to Miss Zacusca

Day 10 – Mr Gazpacho returned a quarter of its tomatoes because he bought too many

Let's write all these transactions in the books of prime entry : ....

Cash receipt book:						
Date	Amount	From	Description			
			Document			

Sales day book:						
Date	Amount	To	Invoice	Due date		

Cash paid book:						
Date	Amount	To	Description			

Sales returned day book:						
Date	Amount	To	Invoice			

At the end of the month the accountant is recording:

From the "Cash receipt book":

From the "Sales day book":

From the "Cash paid book":

From the "Sales returned day book":

The ledger accounts will show:

Db	($)	Cr ($)

Db	($)	Cr ($)

Db	($)	Cr ($)

Db	($)	Cr ($)

3.1.3 Accounting for purchases

When a company is purchasing goods for resale, this is not an _____ but an _____ of the purchases, which are assets of the company.

The accounting equation to record a:

- cash purchase is:

    Db _____ = Cr _____ $____

- credit purchase is:

    Db _____ = Cr _____ $____

When "purchases" are returned, the accounting equations are:

- If the money were paid to the supplier:

    Db _____ = Cr _____ $____

- If the money are still due to the supplier:

    Db _____ = Cr _____ $____

3.1.4 Purchases - example:

"The big Tomato" – continue

The Big Tomato made the following purchases:

Day 1 – purchased tomatoes for $120 in cash from "Iarba verde"

Day 2 - returned tomatoes of $20 to "Iarba Verde"

Day 4 – purchased tomatoes for $300 on credit from "Padurea Neagra"

Day 6 - returned tomatoes costing $50 to Padurea Neagra.

The accounting equations are:

For the cash purchase:

For the credit :

For the purchases returned (which were already paid):

For the purchases on credit:

And the T accounts will show:

Db ($)	Cr ($)

Db	($)	Cr ($)

Db	($)	Cr ($)

Db	($)	Cr ($)

Just to exercise more, let's write a trial balance after both examples (this one and the example from sales):

Account	Debit/(Credit)
Revenues	
Returns	
Trade receivables	
Cash	
Purchases	
Purchases returned	
Trade payables	

3.1.5 Sales tax

The sales tax is a tax on _____.

Sales tax is supported by the _____.

The companies selling goods/supplying services have the role to _____ this tax from their clients when they are selling the goods/supplying the services and _____ it to the state budget.

The sales tax paid by the companies to its suppliers is called _____ tax.

The sales tax collected by the companies from its customers is called _____ tax.

The tax payable by the companies to the state budget = _____ - _____

For example:

If "The Big Tomato" purchases tomatoes of $120 + 10% sales tax => "The Big Tomato" pays $_____.

If "The Big Tomato" sells tomatoes for $470 + 10% sales tax => "The Big Tomato" receives $_____.

The accounting equation to record the purchases when sales tax is applied is:

The accounting equation to record the sales when sales tax is applied is:

The "Sales tax" account will show:

Sales tax	
Db ($)	Cr ($)

3.1.6 Settlement discounts

Businesses use 2 type of discounts:

- Trade discounts –are the discounts negotiated _____.

    Are _____in the accountancy.

- Settlement discounts –might be negotiated at the moment of transaction, but are taken _____

    Are _____in the accountancy.

If "The Big Tomato" buys tomatoes on credit for the regular price of $150 if TBT pays in 1 month, but with a settlement discount of 10% if it pays them in 1 week, then, the accountant has to account for the purchase:

Then, if "The Big Tomato" pays in one week, it will pay $_____ to settle the whole liability.
And the accounting record is:

If TBT sells tomatoes on a 45 days credit for $500 with $30 discount if the client pays in one week.

When the tomatoes are sold the accounting equation is:

If the client takes advantage of the settlement discount and pays in 1 week, it will pay $_____ and "The Big Tomato" has to clear all his.

And the accounting record is:

And the "Sales tax" account will show:

Sales tax		
Db	($)	Cr ($)

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3.2 INVENTORY

3.2.1 Accounting for inventory

Inventory affects both:

- Statement of _____ – through its value at the end of the period
- Statement of _____ – through the cost goods sold

During the year we are _____ the value of the inventory with all the purchases we are doing. During the year "_____" account is used to account for all purchased goods.

Cost of goods sold = _____ + _____ - _____

According to IAS 2 "Inventory", to find out the value of goods in inventory we need to:

1. Count the goods in inventory and establish the _____ of goods in inventory
2. Assess the value of goods in inventory using:
   - _____
   - _____
   - _____

Once the value of closing inventory is assessed, the accounting equations necessary to adjust financial information in order to correctly show the cost of goods sold and the value of closing inventory are:

Step 1: _____

   Db _____ = Cr _____ $___

Step 2: _____

   Db _____ = Cr _____ $___

Step 3: _____

   Db _____ = Cr _____ $___

After these 3 steps, the "Inventory", "Purchases" and "Cost of Sales" accounts will show:

Inventory	
Db ($)	Cr ($)

Purchases	
Db ($)	Cr ($)

Cost of Sales	
Db ($)	Cr ($)

3.2.2 Inventory valuation (FIFO method)

According to IAS 2, the cost of each item in inventory represents everything we paid to bring that item into our _____ in _____ we could make profit by using or selling it. This means that the cost should include:

- _____
- _____
- _____

Let's use the example of "The Big Tomato":

The opening inventory is 10 kg @ $2 each.

Then we buy 200 kg at $2.2 each

We sell 150 kg with $5 each

We buy again 100 kg at $2.8 each

We sell 140 kg with $5 each

We buy again 200 kg with $3 each

And we sell 205 kg with $5 each.

This information is also in the ledger accounts:

Inventory	
Db ($)	Cr ($)

Purchases		
Db	($)	Cr ($)

Revenue		
Db	($)	Cr ($)

The quantity in the closing inventory is _____ kg.

The value of 1 kg from the closing inventory is $___/kg.

⇨ The value of closing inventory is :

And the 3 steps to account for the "Cost of Sales" and closing "Inventory" are:

Step 1: _____

Db _____ = Cr _____ $___

Step 2: _____

Db _____ = Cr _____ $___

Step 3: _____

   Db _____ = Cr _____ $____

The "Cost of Sales" account will show:

Cost of Sales		
Db	($)	Cr ($)

The Gross Profit for the period is:

3.2.3 Inventory valuation (Periodic Weighted Average method)

The FIFO method is best suitable for _____.

The Periodic weighted average method is best suitable for _____.

The valuation method has to be chosen so as best illustrate the way the inventory is _____
_____.

Using the same example of "The Big Tomato":

The opening inventory is 10 kg @ $2 each.

Then we buy 200 kg at $2.2 each

We sell 150 kg with $5 each

We buy again 100 kg at $2.8 each

We sell 140 kg with $5 each

We buy again 200 kg with $3 each

And we sell 205 kg with $5 each.

This information is also in the ledger accounts:

Inventory		
Db	($)	Cr ($)

Purchases		
Db	($)	Cr ($)

Revenue		
Db	($)	Cr ($)

The quantity in the closing inventory is _____ kg.

The value of 1 kg from the closing inventory computed using the periodic weighted average cost =

= _____/_____ = $_____/kg.

⇨ The value of closing inventory is :

And the 3 steps to account for the "Cost of Sales" and closing "Inventory" are:

Step 1: _____

      Db _____ = Cr _____ $____

Step 2: _____

      Db _____ = Cr _____ $____

Step 3: _____

      Db _____ = Cr _____ $____

The "Cost of Sales" account will show:

Cost of Sales	
Db ($)	Cr ($)

The Gross Profit for the period is:

3.2.4 Inventory valuation (Continuous Weighted Average method)

The Continuous weighted average method is best suitable for _____.
_____.

Using the same example of "The Big Tomato":

The opening inventory is 10 kg @ $2 each.

Then we buy 200 kg at $2.2 each =>

    ⇨ The new cost per unit =

We sell 150 kg with $5 each

We buy again 100 kg at $2.8 each =>

    ⇨ The new cost per unit =

We sell 140 kg with $5 each

We buy again 200 kg with $3 each =>

    ⇨ The new cost per unit =

And we sell 205 kg with $5 each.

The ledger accounts show:

Inventory	
Db ($)	Cr ($)

Purchases		
Db	($)	Cr ($)

Revenue		
Db	($)	Cr ($)

⇨ The value of closing inventory is :

And the 3 steps to account for the "Cost of Sales" and closing "Inventory" are:

Step 1: _____

        Db _____ = Cr _____ $____

Step 2: _____

        Db _____ = Cr _____ $____

Step 3: _____

       Db _____ = Cr _____ $___

The "Cost of Sales" account will show:

Cost of Sales	
Db ($)	Cr ($)

The Gross Profit for the period is:

3.2.5 Inventory valuation: Net Realisable Value

By now you should know that:

1. During the year the inventory account is _____.
2. To account for the purchases made in the year, the "_____" account should be used.
3. At the end of the accounting period, the correct quantity of inventory is established by _____ _____
4. The closing inventory value is assessed using the best method allowed by IAS 2: _____ _____
5. The 3 steps to account for the cost of sales are:
   1. _____
   2. _____
   3. _____

Further, IAS 2 request to assess and to ensure that the inventory is valued at its minimum value between the assessed cost and its "net realisable value (NRV)" (for each type of goods from inventory).

NRV = _____

In our example, if "The Big Tomato" uses FIFO method to assess the value of closing inventory then, the computed historical cost of the 15 kg from the closing inventory was: $_____.

Suppose that 10kg of tomatoes can be sold on the market with maximum $2.5/kg and only if they are kept in a refrigerator which will cost a further $0.3/kg =>

The NRV for 1kg of these tomatoes =

⇨ The inventory value has to be _____

The accounting equation required is:

Db _____ = Cr _____ $____

The inventory account will show:

Inventory		
Db	($)	Cr ($)

The gross profit =

🖉 Now you may test your understanding with the quiz ☺

3.3 TANGIBLE NON-CURRENT ASSETS

3.3.1 Definition

Any tangible asset which is meant to last _____ and which value is _____.

Compared to current assets, the non-current assets are:

- _____
- _____
- _____
- _____
- _____

The money spend by a business are of two categories:

- Capital expenditure = _____

- Revenue expenditure = _____

=>
The revenue expenditure relates to _____

but
The capital expenditure relates to _____

3.3.2 Ledger accounts used to keep the evidence of non-current assets

Companies must keep the evidence of their non-current assets so as to be able to provide information about:

- The categories of assets this company has _____
-

- The value of non-current assets per category _____
- The expense of the year from having and using these assets _____
- How used or how old are the assets _____

Cost	
Db ($)	Cr ($)

Depreciation expense	
Db ($)	Cr ($)

Accumulated Depreciation	
Db ($	Cr ($)

The Net Book Value of an asset =

When a non-current asset is acquired, the accounting equation is:

Db _____ = Cr _____ $___

The prime book for this transaction is:

- _____ - if the payment was settled at acquisition, or
- _____ - if the asset was acquired on credit

The investment will be recognised as an expense (in the profit or loss accounts of the company) over the whole period in which we use this equipment in the company, through the depreciation account:

Db _____ = Cr _____ $___

At the end of each accounting period:

- The balance of the "Cost" account shows _____
- The balance of the "Accumulated depreciation" account shows _____
_____
- The expense recognised in the period with the asset will be shown in the _____
_____ account

3.3.3 Accounting for depreciation

The depreciation expense is the expense we need to recognise as a consequence of using the related non-current asset.

The accounting equation to keep the evidence of the depreciation expense is:

Db _____ = Cr _____ $___

IAS 16 "Property, Plant and Equipment" allows 2 methods to compute the depreciation expense:

- Straight line method:

depreciation charge/expense =

- Reducing balance method:

depreciation charge/expense =

The management should use the most adequate method which depicts the way the asset is _____.

Example:

1. A car costing $20,000 – in a training business

    In this case the car is used linearly throughout all its life in the business (5 years). The most adequate depreciation method to be chose by the management of this business is the _____ _____ depreciation.

    The depreciation charge =

    Each year the accountant will record:

    Db _____ = Cr _____ $____

    And the ledger accounts will show:

Car - cost		
Db ($)		Cr ($)

Car - Accumulated depreciation		
Db ($)		Cr ($)

Depreciation expense		
Db	($)	Cr ($)

2. The same car in a "car rental" business

In this case the company is deriving more revenue from this car when it is new and less as the car gets old => the best method to depreciate it is _____.

Assume that the depreciation factor in this type of business is 30%.

Year 1: Depreciation expense =

The accounting record is:
Db _____ = Cr _____ $___

And the net book value of the car = $

Year 2: Depreciation expense =

The accounting record is:
Db _____ = Cr _____ $___

And the net book value of the car = $

Year 3: Depreciation expense =

The accounting record is:
Db _____ = Cr _____ $___

And the net book value of the car = $

Year 4: Depreciation expense =

The accounting record is:
Db _____ = Cr _____ $___

And the net book value of the car = $

Year 5: Depreciation expense =

The accounting record is:
Db _____ = Cr _____ $___

And the net book value of the car = $

And the ledger accounts will show:

Car - cost		
Db ($)		Cr ($)

Car - Accumulated depreciation		
Db ($)		Cr ($)

Depreciation expense		
Db	($)	Cr ($)

The depreciation expense is lower and lower but never _____.

In order to put an end to the depreciation in this method we

- either agree for a useful life for the asset and in the last year we simply consider the depreciation expense = NBV of the asset at the beginning of the year
- either choose a minimum value and when the NBV arrive below this minimum we simply consider the depreciation expense = that NBV

3.3.4 A subsequent expense over a non-current asset

By definition, if a subsequent expense made over a non-current asset is qualifying as "capital expenditure", then this expense is _____.

Example 1:

Equipment

Cost = $30,000

Life = 5 years

Straight depreciation

Case 1:

In year 2 we spend $10,000 to double the productivity of this equipment over its remaining useful life.

In the first 2 years:

The depreciation charge =

And the accounting equation to record the depreciation is:

Db _____ = Cr _____ $___

And the ledger accounts will show:

Equipment - cost	
Db ($)	Cr ($)

Equipment - Accumulated depreciation	
Db ($)	Cr ($)

Depreciation expense		
Db	($)	Cr ($)

At the end of year 2, for this equipment, the accounting data are:

   – cost = $_____

   – accumulated depreciation = $_____

   – NBV = $_____

   – RUL = _____ years

The accounting equation to record the amount spent to double the productivity is:

Db _____ = Cr _____ $____

The new NBV = $_____ to be depreciated over ____ years.

The new depreciation charge =

And the accounting equation to record the depreciation is:

Db _____ = Cr _____ $____

Case 2:

Equipment

Cost = $30,000

Life = 5 years

Straight depreciation

In year 2 we spend $10,000 to double the remaining useful life.

In the first 2 years:

The depreciation charge =

And the accounting equation to record the depreciation is:

Db _____ = Cr _____ $____

And the ledger accounts will show:

Equipment - cost	
Db ($)	Cr ($)

Equipment - Accumulated depreciation	
Db ($)	Cr ($)

Depreciation expense	
Db ($)	Cr ($)

At the end of year 2, for this equipment, the accounting data are:

– cost = $_____

– accumulated depreciation = $_____

– NBV = $_____

– RUL = _____ years

The accounting equation to record the amount spent to double the useful life is:

Db _____ = Cr _____ $____

The new NBV = $_____ to be depreciated over the new RUL of ____ years.

The new depreciation charge =

And the accounting equation to record the depreciation is:

Db _____ = Cr _____ $____

3.3.5 The revaluation of a non-current asset

If the net book value of an asset is materially different from its market value (taking into account the asset's age and usage), then the asset must be re-valued, and its net book value has to be adjusted.

Re-valued amount = _____

Revaluation surplus = _____

Accounting for the revaluation surplus:

Case 1: If it is a first revaluation and a decrease is ascertained the accounting record is:

   Db _____ = Cr _____ $____

   Then, the new NBV =

   The new NBV must be depreciated over the remaining life of the asset.

Case 2: If it is a first revaluation and a decrease is ascertained the accounting record is:

   Db _____ = Cr _____ $____

   Then, the new NBV =

   The new NBV must be depreciated over the remaining life of the asset.

And the revaluation surplus has to be amortised as well:

The amortisation per year =

And the accounting equation to record the amortisation of re-valuation surplus is:

   Db _____ = Cr _____ $____

Case 3: If it is a subsequent revaluation then we have another 4 cases:

Case 3.1 when the subsequent re-valuation is a decrease and the former re-valuation was also a decrease, then:_____

Case 3.2 when the subsequent re-valuation is a decrease and the former re-valuation was an increase, then:_____

Case 3.3 when the subsequent re-valuation is an increase and the former re-valuation was a decrease, then:_____

Case 3.4 when the subsequent re-valuation is an increase and the former re-valuation was also an increase, then:_____

3.3.6 The revaluation – example 1

Building:

Acquisition date: March 20Y2

Useful life = 50 years

Depreciation method: straight line

Cost = $100,000

In December 20Y8 – the building is re-valued and the market value of the building is $85,000

In December 20Z5 – the building is re-valued and the market value of the building is $65,000

From 20Y3 to 20Y8 (inclusive): depreciation charge = _____

And the accounting record is:

   Db _____ = Cr _____ $____

As at the end of 20Y8:

Cost = _____

Accumulated depreciation = _____

NBV = _____

Remaining useful life = _____

In December 20Y8 it is revalued to $85,000

Revaluation surplus = _____

And the accounting record is:

    Db _____ = Cr _____ $____

The new NBV = _____

From 20Y9 to 20Z5 (inclusive):

    The new depreciation charge = _____

The accounting equation to record the depreciation of each of the 7 years is:

    Db _____ = Cr _____ $____

As at the end of 20Z5:

Cost = _____

Accumulated depreciation = _____

NBV = _____

RUL = _____

In December 20Z5 it is re-valued to $65,000:

Revaluation surplus = _____

And the accounting record is:

    Db _____ = Cr _____ $____

The new NBV = _____

The new depreciation charge = _____

3.3.7 The revaluation – example 2

Building:

Acquisition date: March 20Y2

Useful life = 50 years

Depreciation method: straight line

Cost = $100,000

In December 20Y8 – the building is re-valued and the market value of the building is $85,000

In December 20Z5 – the building is re-valued and the market value of the building is $75,000

From 20Y3 to 20Y8 (inclusive): depreciation charge = _____

And the accounting record is:

    Db _____ = Cr _____ $___

As at the end of 20Y8:

Cost = _____

Accumulated depreciation = _____

NBV = _____

Remaining useful life = _____

In December 20Y8 it is revalued to $85,000

Revaluation surplus = _____

And the accounting record is:

    Db _____ = Cr _____ $___

The new NBV = _____

From 20Y9 to 20Z5 (inclusive):

    The new depreciation charge = _____

The accounting equation to record the depreciation of each of the 7 years is:

    Db _____ = Cr _____ $___

As at the end of 20Z5:

Cost = _____

Accumulated depreciation = _____

NBV = _____

RUL = _____

In December 20Z5 it is re-valued to $75,000:

Revaluation surplus = _____

To account for this increase in value:

Step 1: Cancel the previous impairment

    Db _____ = Cr _____ $____

Step 2: Account for the increase in value

    Db _____ = Cr _____ $____

The new NBV = _____

The new depreciation charge = _____

Recorded using the equation:

    Db _____ = Cr _____ $____

The amortisation of revaluation surplus per year = _____

Recorded using the equation:

    Db _____ = Cr _____ $____

3.3.8 The revaluation – example 3

Building:

Acquisition date: March 20Y2

Useful life = 50 years

Depreciation method: straight line

Cost = $100,000

In December 20Y8 – the building is re-valued and the market value of the building is $95,000

In December 20Z5 – the building is re-valued and the market value of the building is $85,000

From 20Y3 to 20Y8 (inclusive): depreciation charge = _____

And the accounting record is:

    Db _____ = Cr _____ $____

As at the end of 20Y8:

Cost = _____

Accumulated depreciation = _____

NBV = _____

Remaining useful life = _____

In December 20Y8 it is revalued to $95,000

Revaluation surplus = _____

And the accounting record is:

Db _____ = Cr _____ $____

The new NBV = _____

From 20Y9 to 20Z5 (inclusive):

The new depreciation charge = _____

The accounting equation to record the depreciation of each of the 7 years is:

Db _____ = Cr _____ $____

AND

The amortisation of revaluation surplus per year = _____

The accounting equation to record the depreciation of each of the 7 years is:

Db _____ = Cr _____ $____

As at the end of 20Z5:

Cost = _____

Accumulated depreciation = _____

NBV = _____

The un-amortised revaluation surplus = _____

RUL = _____

In December 20Z5 it is re-valued to $85,000:

Revaluation surplus = _____

To account for this new increase in value the accounting equation is:

    Db _____ = Cr _____ $____

The new NBV = _____

The new depreciation charge = _____

Recorded using the equation:

    Db _____ = Cr _____ $____

The new amortisation of revaluation surplus per year = _____

Recorded using the equation:

    Db _____ = Cr _____ $____

3.3.9 The revaluation – example 4

Building:

Acquisition date: March 20Y2

Useful life = 50 years

Depreciation method: straight line

Cost = $100,000

In December 20Y8 – the building is re-valued and the market value of the building is $95,000

In December 20Z5 – the building is re-valued and the market value of the building is $75,000

From 20Y3 to 20Y8 (inclusive): depreciation charge = _____

And the accounting record is:

    Db _____ = Cr _____ $____

As at the end of 20Y8:

Cost = _____

Accumulated depreciation = _____

NBV = _____

Remaining useful life = _____

In December 20Y8 it is revalued to $95,000

Revaluation surplus = _____

And the accounting record is:

  Db _____ = Cr _____ $____

The new NBV = _____

From 20Y9 to 20Z5 (inclusive):

  The new depreciation charge = _____

The accounting equation to record the depreciation of each of the 7 years is:

  Db _____ = Cr _____ $____

AND

  The amortisation of revaluation surplus per year = _____

The accounting equation to record the depreciation of each of the 7 years is:

  Db _____ = Cr _____ $____

As at the end of 20Z5:

Cost = _____

Accumulated depreciation = _____

NBV = _____

The un-amortised revaluation surplus = _____

RUL = _____

In December 20Z5 it is re-valued to $75,000:

Revaluation surplus = _____

To account for this decrease in value:

Step 1: The previous un-amortised revaluation surplus has to be cancelled

Db _____ = Cr _____ $____

Step 2: If the decrease in value is above the un-amortised revaluation surplus, the further decrease will be accounted as an impairment: Db impairment expense = Cr Cost of building

The new NBV = _____

The new depreciation charge = _____

Recorded using the equation:

Db _____ = Cr _____ $____

The new amortisation of revaluation surplus per year = _____

Recorded using the equation:

Db _____ = Cr _____ $____

And the ledger accounts will show:

Building - cost		
Db	($)	Cr ($)

Building - Accumulated depreciation	
Db ($)	Cr ($)

Revaluation surplus – for building	
Db ($)	Cr ($)

3.3.10 The disposal of a non-current asset

Disposing a non-current asset means to _____ this asset from our business, hence from the _____ too.

The accounting evidence of any fixed asset is kept through 3 ledger accounts:

- _____

- _____

- _____

The profit from disposal =

IAS 16 recommend the use of a special account in order to keep the evidence of the profit realised through the sale of our fixed assets. This account is a _____ account called "_____" account.

The technique to eliminate a non-current asset and to record the profit or loss from its disposal is the following:

1. Transfer the cost of the asset from the cost account into the disposal account
   Db _____ = Cr _____ $___

2. Transfer the accumulated depreciation of the asset from the accumulated depreciation account into the disposal account
   Db _____ = Cr _____ $___

3. Record the value of anything received in exchange of this asset as an income on the credit side of the disposal account.
   Db _____ = Cr _____ $___

4. If the asset has any Revaluation surplus, then, when the asset is disposed, the "revaluation surplus" is realised and it should be transferred to Retained Earnings:
   Db _____ = Cr _____ $___

At the end, the "Disposal" account will show:

Disposal		
Db	($)	Cr ($)

The balance of the disposal account = _____

3.3.11 The Fixed Assets' Register

The fixed assets register is that register where _____ the fixed assets of a company are recorded.

Its main function is to ensure the _____ over the fixed assets.

In this register, usually are recorded the following information about each fixed asset of the business:

- Name
- Cost
- Date of acquisition
- Description
- Inventory number
- Location
- Depreciation method
- Expected useful life
- Decrease/increase in carrying value
- Carrying value

The accounting information should allow the writing of the financial statements and the information necessary to write the financial statements are:

1. For the statement of financial position:

-_____

-_____

-_____

-_____

-_____

2. For the statement of profit or loss:

-_____

-_____

-_____

-_____

-_____

And the financial statements must include a special note for the fixed assets, disclosing for each category of fixed assets owned by the company the following:

1. Information regarding the cost per category:
   a. _____
   b. _____
   c. _____
   d. _____
2. Information regarding the accumulated depreciation per category:
   a. _____
   b. _____
   c. _____
   d. _____
3. Information regarding the carrying amounts (or the net book values) per category at the beginning and the end of the accounting period

✏ Now you may test your understanding with the quiz ☺

3.4 INTANGIBLE NON-CURRENT ASSETS AND AMORTISATION

3.4.1 Tangible vs intangible non-current assets

Non-current assets may be _____ or _____.

An intangible asset lack _____.

The most common intangible assets are:

- _____,
- _____,
- _____,
- _____,
- _____,
- _____,

While goodwill is treated separate, IAS 38 "Intangible non-current assets" is focusing on the other types of intangible assets:

IAS 38 identifies the key characteristics of an intangible asset:

1. _____
2. _____
3. _____
   _____

And also, the basic principles of recognition:

1. _____
2. _____
3. _____

3.4.2 "Research costs" vs "Development costs"

Development cost is an _____ asset, while research expenditure is an
_____.

Definitions:

Research expenditure = _____
_____
_____.

While

Development cost = _____
_____
_____.

Research expenditure does not directly lead to _____ .

=>the research expenditure should be recognised as an _____.

Still any capital expenditure on research equipment should be _____ and
_____ , in accordance with IAS 16.

Development costs must be capitalised as intangible assets provided that they satisfy the following criteria:

1. P_____
2. I_____
3. R_____
4. A_____
5. T_____
6. E_____

The amortisation of the development cost should commence _____
and charged over _____.

3.4.3 "Research costs" vs "Development costs" - example

Company "Clever" spent:

In 20Y2

- $1 mil to check the chemical composition of some fragments from Mars
- $2 mil to create a new construction material

And in 20Y3

- $0.5 mil to check the chemical composition of some fragments from Mars
- $0.8 mil to create the new construction material

The new construction material is ready for sale in 20Y4 and Clever consider that it will last at least 4 years until another competitor will be able to sell a similar material.

=> The accounting records to be made by Clever to recognise the research expenditure and the development cost in 20Y2 are:

1. For research expenditure:
   Db _____ = Cr _____ $____
2. For development cost:
   Db _____ = Cr _____ $____

The "Development cost" account will show:

Development of new material	
Db ($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

In 20Y3 the accounting equations are:

1. For research expenditure:
   Db _____ = Cr _____ $____

2. For development cost:
   Db _____ = Cr _____ $____

The "Development cost" account will show:

Development of new material	
Db ($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

Starting with 20Y4, Clever starts to sell the new material => Clever must start to amortise the development cost:

Db _____ = Cr _____ $____

The ledger accounts will show:

Development of new material	
Db ($)	Cr ($)

Amortisation of "Development of new material"		
Db	($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

Then in 20Y5, the accounting record is:

Db _____ = Cr _____ $_____

The ledger accounts will show:

Development of new material		
Db	($)	Cr ($)

Amortisation of "Development of new material"	
Db ($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

Then in 20Y6, the accounting record is:

Db _____ = Cr _____$____

The ledger accounts will show:

Development of new material	
Db ($)	Cr ($)

Amortisation of "Development of new material"	
Db ($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

Then in 20Y7, the accounting record is:

Db _____= Cr _____$____

The ledger accounts will show:

Development of new material	
Db ($)	Cr ($)

Amortisation of "Development of new material"	
Db ($)	Cr ($)

This information will be shown:

in the Statement of Financial Position,

in "Non-current assets" as:_____ $_____

and

in the Statement of Profit or loss as:_____ $_____

✏ Now you may test your understanding with the quiz ☺

3.5 ACCRUALS AND PREPAYMENTS

3.5.1 Accruals and prepayments concepts

PRUDENT buys a car in April year X and insured it for a whole calendar year also in April.

PRUDENT pays 1,200 USD to insure the car for 12 months starting with April year X.

The accountant, will record the payment of insurance:

Db _____ = Cr _____ $____

The correct insurance expense for year X =

"Accrued" stands for an expense/income _____ but not yet _____.

"Prepayment" stands for an expense/income _____ but not yet _____.

3.5.2 Example 1: Prepaid expense

Prudent pays to Funnianz 1,200 USD to insure the car for 12 months starting with April year X.

The accountant of Prudent, will record the payment of insurance:

Db _____ = Cr _____ $____

The correct insurance expense for year X =

The adjustment to be done at the year-end to obtain the correct insurance expense is:

Db _____ = Cr _____ $____

This information will be shown in Prudent's financial statements:

in the Statement of Financial Position as at the end of year X:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X:

as _____ $_____

In year X+1:

The account "Prepaid insurance" shows:

Prepaid insurance		
Db	($)	Cr ($)

In year X+1, Prudent pays to Funnianz the insurance for April X+1 to March X+2 of $1,500

The accountant, will record the payment of insurance:

Db _____ = Cr _____ $____

The account "Insurance expense" shows:

Insurance expense		
Db	($)	Cr ($)

The correct insurance expense for year X +1 =

The adjustment to be done at the year-end to obtain the correct the opening balance of "prepaid insurance" is:

Db _____ = Cr _____ $___

The adjustment to be done at the year-end to obtain the correct insurance expense is:

Db _____ = Cr _____ $___

This information will be shown in Prudent's financial statements:

in the Statement of Financial Position as at the end of year X+1:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X +1:

as _____ $_____

3.5.3 Example 2: Prepaid income

Funnianz received from Prudent 1,200 USD to insure Prudet's car for 12 months starting with April year X.

The accountant of Funnianz, will record the money received from Prudent for insurance:

Db _____ = Cr _____ $____

The correct insurance income for year X =

The adjustment to be done at the year-end to obtain the correct insurance income is:

Db _____ = Cr _____ $____

This information will be shown:

in the Statement of Financial Position of Funnianz as at the end of year X:

in _____   as _____ $_____

and

in the Statement of Profit or Loss of Funnianz for the year X:

as _____ $_____

In year X+1:

The account "Prepaid income" shows:

Prepaid insurance income	
Db ($)	Cr ($)

In year X+1, Prudent pays to Funnianz the insurance for April X+1 to March X+2 of $1,500

The accountant of Funnianz, will record Prudent's payment of insurance:

Db _____ = Cr _____ $____

The account "Insurance income" shows:

Insurance income	
Db ($)	Cr ($)

The correct insurance income for year X +1 =

The adjustment to be done at the year-end to obtain the correct the opening balance of "prepaid insurance income" is:

Db _____ = Cr _____ $___

The adjustment to be done at the year-end to obtain the correct insurance income is:

Db _____ = Cr _____ $___

This information will be shown in Funnianz's financial statements:

in the Statement of Financial Position as at the end of year X+1:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X +1:

as _____ $_____

3.5.4 Example 3: Accrued expense

Prudent agreed to Matter 2,400 USD for the maintenance of its car for 12 months starting with June year X. The amount will be paid at the end of the year of service.

The correct maintenance expense for year X =

The adjustment to be done at the year-end to record the correct maintenance expense is:

Db _____ = Cr _____ $___

This information will be shown in Prudent's financial statements:

in the Statement of Financial Position as at the end of year X:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X:

as _____ $_____

In year X+1:

The account "Accrued maintenance expense" shows:

Accrued maintenance expense	
Db ($)	Cr ($)

In year X+1, Prudent pays to Matter the maintenance for June X to May X+1 of $2,400 and agreed the maintenance fee for next year of $2,600.

The accountant of Prudent, will record the payment of maintenance:

Db _____ = Cr _____ $____

The account "Car maintenance expense" shows:

Car maintenance expense	
Db ($)	Cr ($)

The correct maintenance expense for year X +1 =

The adjustment to be done at the year-end to obtain the correct the opening balance of "accrued maintenance expense" is:

Db _____ = Cr _____ $____

The adjustment to be done at the year-end to obtain the correct maintenance expense for the year is:

Db _____ = Cr _____ $____

This information will be shown in Prudent's financial statements:

in the Statement of Financial Position as at the end of year X+1:

in _____ as _____ $_____

and

in the Statement of Profit or Loss for the year X +1:

as _____ $_____

3.5.5 Example 4: Accrued Income

Matter agreed to provide car maintenance services to Prudent for 12 months starting with June year X. Prudent will pay at the end of the year of service $2,400.

For Matter, the correct income for year X =

The adjustment to be done at the year-end to record the correct income is:

Db _____ = Cr _____ $____

This information will be shown in Matter's financial statements:

in the Statement of Financial Position as at the end of year X:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X:

as _____ $_____

In year X+1:

The account "Accrued income" shows:

Accrued income	
Db ($)	Cr ($)

In year X+1, Prudent pays to Matter the maintenance for June X to May X+1 of $2,400 and agreed the maintenance fee for next year of $2,600.

The accountant of Matter, will record the payment from Prudent:

Db _____ = Cr _____ $____

The account "Income" shows:

Income		
Db	($)	Cr ($)

The correct income for year X +1 =

The adjustment to be done at the year-end to obtain the correct the opening balance of "accrued income" is:

Db _____ = Cr _____ $____

The adjustment to be done at the year-end to obtain the correct income for the year is:

Db _____ = Cr _____ $____

This information will be shown in Matter's financial statements:

in the Statement of Financial Position as at the end of year X+1:

in _____   as _____ $_____

and

in the Statement of Profit or Loss for the year X +1:

as _____ $_____

✏️   Now you may test your understanding with the quiz 😊

3.6 RECEIVABLES AND PAYABLES

3.6.1 Identify the benefits and costs of offering credit facilities to customers.

The majority of sales are usually happening on "credit" which means that the goods are sold but the money will be paid later. From accounting point of view once the goods are sold and until the money are received, the seller will account for this as a "receivable" and the client will consider it a "payable".

The seller record:

Db _____ = Cr _____ $_____

The buyer record:

Db _____ = Cr _____ $_____

A receivable is an _____.

A payable is a _____.

The benefits of offering credit facilities to customers are:

- it helps the business to _____ sales,

- it helps to _____

- it helps to _____

- it helps to encourage customer _____ and _____.

The drawbacks of selling on credit are due to

- _____.
- _____.
- _____.

An incentive used to make the customer pays faster is the _____.

A credit policy may be:

- to convince customer to pay faster by allowing them _____

- to establish credit limits per client/type of client which also:

- Reduce the risk of _____ debts
- Build up the _____ of a new customer/favours _____ customers

Consequently, a good manager should periodically review its receivables and:

- Should _____ (and assume the loss) all receivables considered irrecoverable and
- Should asses how much of the remaining receivable is _____ to be cashed, because:
    o There might be specific receivables which are not sure to be cash
    o Even on the remaining receivables there might be payments default and a good manager has to be able to estimate how much of these receivables is a "probable" loss.

The accounting equation to write-off a receivable (bad debt) is:

Db _____ = Cr _____ $_____

The accounting equation to record the possible loss from doubtful receivables is:

Db _____ = Cr _____ $_____

In the Statement of Financial Position, the trade receivable are shown at their _____ value and in the "notes to the financial statements", in the note dedicated to trade receivable will be shown both: the full amount of trade receivables and the allowance.

A good practice means to:

1. record all transactions in their correct _____
2. record the daily summaries in _____
3. record each transaction in the related "Client Statement/Memorandum". This is a _____ list for each client which is kept in order to know how much the company has to receive from each of its clients.
4. the balance shown in the receivable account or also called "Receivable Ledger Control Account (RLCA)" should match the total from the "Client Statement"
5. assess and account for the bad and doubtful receivables

3.6.2 Computing and accounting for bad debts

Example:

The Sales Day Book of company Snow White presents the following sub-totals:

- For quarter 1: $175,000
⇨ The accounting record is:
    Db _____ = Cr _____ $_____

    Which must be posted in the ledger account below:

- For quarter 2: $186,000
    The accounting record is:

Db _____ = Cr _____ $_____

Which must be posted in the ledger account below:

- For quarter 3: $165,000
  The accounting record is:
  Db _____ = Cr _____ $_____

Which must be posted in the ledger account below:

- For quarter 4: $175,000
  The accounting record is:
  Db _____ = Cr _____ $_____

Which must be posted in the ledger account below:

Trade Receivable		
Db	($)	Cr ($)

The evidence kept by the credit department shows the following componence of trade recevables as at the year-end:

- Grumpy $100,000
- Sleepy $ 85,000
- Sneezy $ 63,000
- Bashful $ 60,000
- Dopey $ 56,000

-	Doc	$ 47,000
-	Happy	$ 45,000
-	Other small receivables	$245,000
	Total	$701,000

A review of this receivable reveal that Bashful become bankrupt and its receivable should be considered irrecoverable:

The accounting equation to record the bad debt (Bashful) is:

Db _____ = Cr _____ $_____

Which must be posted in the ledger account above.

And the balance of "Trade receivable" account became: $_____

⇨ The Statement of Financial Position will present:

Current assets:

Trade receivables $_____

⇨ The Statement of Profit or Loss will present:

Bad debts expense $_____

3.6.3 Computing and accounting for doubtful debts

Continuing the example:

On the remaining receivables, the necessary "allowance" for doubtful receivables has to be assessed and accounted for.

Step 1: Assess the _____ "doubtful" amounts (Here the receivable from Doc is considered doubtful).

Step 2: On the remaining amounts, the _____ allowance has to be assessed (Here assume a 5% general allowance).

The necessary allowance = _____

The accounting equation to record the allowance for doubtful receivable is:

Db _____ = Cr _____ $_____

Allowance for Trade Receivable	
Db ($)	Cr ($)

⇨ The Statement of Financial Position will present:

Current assets:

Trade receivables $_____

⇨ The Statement of Profit or Loss will present:

Bad debts expense $_____

The note dedicated to Trade Receivables will present:

	$
Trade receivables gross	_____
Less allowance for trade receivables	_____
Trade receivables (net)	_____

3.6.4 Allowance for trade receivables

Continuing the example:

The next year (year ended 31 March 20X2) we start with the "Allowance for Trade Receivable:

Allowance for Trade Receivable	
Db ($)	Cr ($)

The new year-end balance for Trade Receivable is $854,000

The necessary allowance for trade receivable is $97,000 => the existing allowance for trade receivable has to be _____ by $_____ =

And the accounting equation is:

Db _____ = Cr _____ $_____

Which must be posted in the ledger account above.

⇨ The Statement of Financial Position will present:

Current assets:

Trade receivables $_____

⇨ The Statement of Profit or Loss will present:

Bad debts expense $_____

The note dedicated to Trade Receivables will present:

                                                                    $

Trade receivables gross   _____

Less allowance for trade receivables   _____

Trade receivables (net)   _____

Now we are in the following accounting year (year ended 31 March 20X3) and Snow White cashed $40,000 from Bashfull.

The receipt of this money has to be recorded:

Db _____ = Cr _____ $_____

And if the balance of trade receivable is now $1,200,000 and the necessary allowance for trade receivable is computed to be $77,000 => the existing allowance for trade receivable has to be _____ by $_____ =

And the accounting equation is:

Db _____ = Cr _____ $_____

Which must be posted in the ledger account above.

⇨ The Statement of Financial Position will present:

Current assets:

Trade receivables $_____

⇨ The Statement of Profit or Loss will present:

Bad debts expense $_____

The note dedicated to Trade Receivables will present:

	$
Trade receivables gross	_____
Less allowance for trade receivables	_____
Trade receivables (net)	_____

3.6.5 Contras

Hansel is selling sweets and Gretel is selling backing paper.

Hansel bought backing paper from Gretel for $15,000 payable in one month.

Hansel accountant records:

Db _____ = Cr _____ $_____

Gretel noticed that the sweets made by Hansel are very good and bought sweets from Hansel for $200 on credit.

Hansel accountant records:

Db _____ = Cr _____ $_____

The Trade Receivables and Trade payables accounts of Hansel will show:

Trade Receivable	
Db ($)	Cr ($)

Trade Receivable	
Db ($)	Cr ($)

If the companies may agree to net off their balances and to settle for the difference. => Hansel will pay just to Gretel $_____

This type of transaction is called "contras" = the net off of the balances (from trade receivables and trade payables) with the _____ between the two amounts and the accounting equation is:

Db _____ = Cr _____ $_____

Which may be posted in the above accounts.

3.6.6 The suppliers' statement

The benefits of keeping a suppliers' statement is that:

- It facilitates _____
- It helps to _____
- It helps to _____
- It is used to _____

✏️ Now you may test your understanding with the quiz ☺

3.7 PROVISIONS AND CONTINGENCIES

3.7.1 Concepts and accounting treatment

According to IAS 37 "Provisions, Contingent Liabilities and Contingent assets" a provision has to be recognised in the financial statements if the following criteria are met:

- There is a _____ obligation that exists as a result of a _____
- There is a _____ transfer of economic benefit
- There is a _____ of the potential cost

If these conditions are fulfilled, the accounting equation to record a provision is:

Db _____ = Cr _____ $_____

The contingent liability is a _____ obligation that arises from a _____ or it may be a _____ obligation which cannot be _____ with sufficient reliability.

The "contingent liabilities" have to be _____ it in the financial statements.

A "contingent asset" is a _____ asset that arises as a consequence of a _____. As long as this asset is just possible, the prudency principle requires to ignore it but as soon as it becomes _____, the contingent asset may be _____ in the financial statements. If the contingent asset is virtually sure then it is recognised in the financial statements.

3.7.2 Example

Company Frozen is transporting chemical substances. In December 20Y2, an accident happened and one of their truck slipped on ice and the whole loading (an acid) was spilled on the road.

At the date of event, the specialists agreed that probably the acid did not harm the environment in any way, but the check has to be done again after a few months.

From accounting point of view, this would be a _____ .

=> in the FS for the year ended 31 December 20Y2 _____

_____

In 20Y3, the next check is performed, and it was established that the acid actually destroyed the road and Frozen is liable to pay for the repairs. The first estimate of the roads' company is that Frozen has to pay around $500,000.

- ⇨ A _____ need to be recorded:

Db _____ = Cr _____ $_____

In 20Y4 Frozen's activity increased very much but also the accidents its trucks were involved, so as at the end of 20Y4, the lawyers of Frozen concluded that Frozen will probably have to have a provision of $650,000.

⇨ The provision liability of Frozen has to be _____ by $_____
And the accounting record is:

Db _____ = Cr _____ $_____

BUT, if the provision needed would have been assessed to $450,000=> the balance of the provision account would need to be _____ by $_____ and the accounting equation is:

Db _____ = Cr _____ $_____

3.7.3 Summary

A construction company signed a contract. And if:

1. Cash will be received with 95% probability =>

2. Cash will be probably received but this is not virtually sure =>

3. It is possible to receive the money but not probable =>

4. The probability to receive the money is less then 5% =>

The construction company made a building for which:

1. The probability to pay for possible damages is less than 5% =>

2. It is possible to pay damages but not probable =>

3. The possibility to pay for damages is above 50% =>

4. It is virtually sure that the company will have to pay for damages =>

✏ Now you may test your understanding with the quiz ☺

3.8 CAPITAL STRUCTURE AND FINANCE COSTS

3.8.1 The finances of a liability company

The capital is the _____, the owners are providing to the business in order to obtain _____ from the business (under the form of _____ or as an increase of the value of their _____in the business).

The most common finances of a business are:

- _____

- _____

The shares of a company are characterised by:

1. The _____ value

2. The _____ value

3. The _____ price

4. The share _____ =

Regarding the share capital of a company we may have:

The issued share capital =

The called-up share capital =

Paid-up share capital =

A company may obtain equity finances also through:
- Rights issue:

- Bonus issue:

3.8.2 Ordinary shares

Ordinary shares are the most _____ form of equity finance.

The share capital of a company =

An ordinary share gives the right to have a _____from the company which means that if the company ceases to exist, the shareholder will be entitled to receive his _____of the company's _____.

Ordinary shares are shown under the "_____" heading in the statement of financial position.

Each shareholder is entitled also to receive his/her share of the _____ approved in the shareholders meeting.

The distributed dividend is NOT a _____from the company's _____.

The dividend is a distribution of profit to its rightful owners.

When the shareholders acquire their shares from the company, paying the nominal value of shares, the accounting equation is:

    Db _____ = Cr _____ $_____

If the shareholders acquire their shares from the company, paying more than the nominal value of shares, the accounting equation is:

Db _____ = Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

For example,

A company may issue at its establishment 100 shares at their nominal value of $10 each.

The investors buy these shares and the accounting record is:

Db _____ = Cr _____ $_____

After a while, the company issues another 100 shares and sell them for $15 each. Now the accounting equation to record the acquisition of these shares is:

Db _____ = Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

The accounting equation to record the distributed dividend is:

Db _____ = Cr _____ $_____

3.8.3 Preference shares

The preference shares are special because their owner is entitled to a "_____", which is paid _____

and _____.

The preference shares do not give to their owners _____.

The preference shares might be _____ or _____.

An owner of redeemable preference shares is entitled to _____

_____.

⇨ A redeemable preference share is in fact a _____

⇨ As such, the redeemable preference shares are not included in the _____ but are treated as _____ in the statement of financial position

⇨ And the dividend payable to their owners is treated as _____.

⇨ The accounting equation to record the distribution of preference dividend paid for the redeemable preference shares is:

Db _____ = Cr _____ $_____

The irredeemable preference shares are like ordinary shares with the exception that the owner of such a share is entitled to receive a fix _____, every year, no matter the performance of the business.

⇨ These shares, being irredeemable are part of the _____ of the company but they will be under a separate heading, because the owner of such shares is receiving the preference dividend and has no right to the residual interest.

⇨ The preference dividend is also considered a _____ of profit to its rightful owners and does not affect the profit of the company.

⇨ The accounting equation to record the distribution of preference dividend paid for the irredeemable preference shares is:

Db _____ = Cr _____ $_____

For example:

Company Gaga has at the end of 20Y4:

Equity:	$
Share capital @$1	200,000
Share premium	200,000
Retained earnings	480,000
	880,000

Gaga issues 100,000 irredeemable preference shares for $0.5 each.

When the company receives the money, the accounting equation is:

Db _____ = Cr _____ $_____

=> The new equity is:

Equity: $

Share capital @$1- ordinary shares

Share capital @$0.5 – preference shares

Share premium

Retained earnings

If in 20Y5, the equity is:

Equity:	$
Share capital @$1- ordinary shares	200,000
Share capital @$0.5 – preference shares	50,000
Share premium	200,000
Retained earnings	680,000
	1,130,000

Gaga decide to issue 50,000 redeemable preference shares.

The accounting equation is:

Db _____ = Cr _____ $_____

3.8.4 Loan notes.

Loan notes are _____.

It should be recorded as a _____ in the statement of financial position and the interest is _____ and affects the profit of the period.

The term "loan note" refers to the _____ issue by the company to each investor.

The loan note has a _____ value, written on the note.

The investors may buy the loan notes at an _____ price, which may be _____ from the nominal value.

The life of the loan note is also _____ on the note and represent the term at which the company will have to _____ the investor the nominal value.

The company issuing the loan notes will have to pay an interest which is = _____
_____.

For example, if Gaga issues 50 loan notes @ nominal value of $100 for $90 for 2 years.

When the loan notes are issued, Gaga receives $_____

And the accounting record is:

$_____ Db _____ = Cr _____ $_____
$_____ Db _____
$_____ Db _____

3.8.5 Bonus issue

A bonus issue means issue _____ shares for _____ to the _____ shareholders, the main advantage of a bonus issue is that the share capital is _____ into a _____ number of shares, consequently the market value of each share will _____.

The bonus issue means issuing new shares to the existing shareholders in accordance to _____ shareholding so, the wealth of shareholders is _____.

Because no cash is received from a bonus issue, the bonus issue is funded from _____.

From the accounting point of view, there is _____ in the total equity and the share capital is _____.

The only disadvantage of this issue is the administrative cost.

For example,

Gaga at the end of 20Y6 has:

Equity: $

Share capital @$1- ordinary shares	200,000
Share capital @$0.5 – preference shares	50,000
Share premium	200,000
Retained earnings	<u>750,000</u>
	1,200,000

Gaga's management decide to make a bonus issue at 2 for 5 =>

For each _____, a shareholder will receive _____.

⇨ The new shares issued are:

⇨ The   share   premium   will   _____ by $_____
from_____

⇨ The accounting equation is:
Db _____ = Cr _____ $_____

Now Gaga's equity will be:

Equity: $

Share capital @$1- ordinary shares

Share capital @$0.5 – preference shares

Share premium

Retained earnings

3.8.6 Rights issue

A rights issue is the _____ way a company can raise _____.

A rights issue made to _____.

Rights issue is an issue of _____ shares at a price which is usually _____ than the nominal value but _____ than the market value with a condition: in order to by such shares you have to own a number "n" of the existing shares.

For example,

Gaga in 20Y8 has:

Equity:	$
Share capital @$1- ordinary shares	280,000
Share capital @$0.5 – preference shares	50,000
Share premium	120,000
Retained earnings	900,000
	1,350,000

Gaga makes a rights issue of 1 for 4 @$4 each.

⇨ The new number of shares =

⇨ The cash will increase by $_____

⇨ The share capital will _____ by $_____

⇨ The share premium will _____ by $_____

The accounting record is:

Db _____ = Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

The new equity is:

Equity: $

Share capital @$1- ordinary shares

Share capital @$0.5 – preference shares

Share premium

Retained earnings

✏ Now you may test your understanding with the quiz ☺

4 FINALISING THE FINANCIAL STATEMENTS

4.1 THE TRIAL BALANCE

4.1.1 The closing exercise

At the end of our accounting period, all accounts are balanced off and all closing balances are summarised in a list of balances which we use to call _____.

Due to the nature of double entry, the total of debit balances should _____ the total of credit balances.

The steps necessary to complete the financial statements are:

1. _____
2. _____
3. _____
4. _____
   a. _____
   b. _____
   c. _____
   d. _____
   e. _____
   f. _____
   g. _____
   h. _____
   i. _____
   j. _____
5. _____

We are now at step 3 when we have to perform a check over all our records in order to be sure they are correct and the trial balance is one of our most important tool in this stage.

The next step is to perform the year-end adjustments but before doing it please go no through the illustrations and through the practice session to make sure you understand correctly how a trial balance is extracted and what type of errors we may discover at this stage.

4.1.2 Case Study 1 – Shalep SRL

The company Shalep SRL is specialised in trade with tennis balls. The company's trial balance of as at 31 March 20Y6 shows the following information:

Account	Note	Balance ($)
		Db/(Cr)
Cash		12.000

Inventories	1,10	2.000
Purchases		32.000
Trade receivables	2,3	58.500
Car	4	30.000
Computer	5	5.000
Software	6	3.000
Long term deposit	7	25.000
Accumulated depreciation of car	4	(5.000)
Accumulated depreciation of computer	5	(1.000)
Accumulated amortisation of software	6	(300)
Allowance for trade receivables	2,3	(1.800)
Rent expense	8	15.000
Revenue		(125.000)
Trade payables		(30.000)
Share capital ($1)		(10.000)
Retained earnings		(9.400)
Profit for the year		0
Cost of sales		0
Depreciation expense		0
Amortisation expense		0
Impairment expense		0
Bad and doubtful debts expense		0
Prepaid rent		0
Interest income		0
Receivable interest		0
Provision expense	9	0
Provision		0
Check		-

The following information for the year ended 31 March 20Y6 was also considered relevant:

1. At the year end, the closing inventory was counted and valued at $3,000.

2. At an audit of the trade receivables, one client (owing $4,000) was revealed older than 360 days and should be considered irrecoverable and another client (owing $1,000), older than 150 days, is to be considered doubtful.

3. On the remaining trade receivables' balances 5% are usually not paying.

4. The company's car is straight line depreciated and its remaining useful life at 31 March 20Y5 is 5 years.

5. The computer is depreciated using the reducing balance method at 30% per annum.

6. The software is straight line depreciated over 3 years.

7. The deposit was created on 1 June 20Y5 @10% per annum.

8. The rent expense recorded is the rent paid for 1 April 20Y5 to 30 June 20Y6.

9. One of the clients of Shalep SRL who bought tennis balls for a tournament discovered that all the balls presented some faults and had to be replaced. The client sued Shalep and the damages payable, if Shalep will be considered liable are $30,000. The lawyers of Shalep consider that the chances to win this trial are 35%.

10. Following this scandal, the management decided that all remaining balls will be sold at maximum 85% of their cost.

Requirement:

Perform all the necessary closing adjustments and write the final trial balance for Shalep SRL in order to complete the financial statements for the year ended 31 March 20Y6.

Solution

Step 1: Perform the closing adjustments:

Adjustment 1: Account for the cost of sales and closing inventory:

Db_____ = Cr_____ $_____

Db_____ = Cr_____ $_____

Db_____ = Cr_____ $_____

Now the balance of the account:

- "Purchases" is $_____
- "Cost of Sales" is $_____

- "Inventory" is $_____

Adjustment 2: Account for the bad debts:

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Bad and doubtful debts expense" is $_____
- "Trade Receivables" is $_____

Adjustment 3: Account for the doubtful debts:

The new allowance for trade receivable =

The allowance for trade receivable has to be _____ by $_____.

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Bad and doubtful debts expense" is $_____
- "Allowance for Trade Receivables" is $_____

Adjustment 4: Compute and account for the car depreciation:

Depreciation charge =

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Depreciation expense" is $_____
- "Accumulated depreciation of car" is $_____

Adjustment 5: Compute and account for the computer depreciation:

Depreciation charge =

    Db _____ =   Cr _____ $_____

Now the balance of the account:
- "Depreciation expense" is $_____
- "Accumulated depreciation of computer" is $_____

Adjustment 6: Compute and account for the software amortisation:

Amortisation charge =

    Db _____ =   Cr _____ $_____

Now the balance of the account:
- "Amortisation expense" is $_____
- "Accumulated amortisation of software" is $_____

Adjustment 7: Compute and account for the interest income:

Accrued interest income =

    Db _____ =   Cr _____ $_____

Now the balance of the account:
- "Interest income" is $_____
- "Accrued interest " is $_____

Adjustment 8: Compute and account for the rent expense:

Prepaid rent =

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Rent expense" is $_____
- "Prepaid rent" is $_____

Adjustment 9: Compute and account for the provision:

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Provision expense" is $_____
- "Provision" is $_____

Adjustment 10: Compute and account for the impairment of inventory:

impairment =

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Impairment expense" is $_____
- "Inventory" is $_____

After all above adjustments, the final trial balance is:

Account	Balance ($)Db/(Cr)
Cash	
Inventories	
Purchases	
Trade receivables	
Car	
Computer	
Software	
Long term deposit	
Accumulated depreciation of car	
Accumulated depreciation of computer	
Accumulated amortisation of software	
Allowance for trade receivables	
Rent expense	
Revenue	
Trade payables	
Share capital ($1)	
Retained earnings	
Profit for the year	
Cost of sales	
Depreciation expense	
Amortisation expense	
Impairment expense	
Bad and doubtful debts expense	
Prepaid rent	
Interest income	
Receivable interest	
Provision expense	
Provision	
Check	

Final adjustments required:

Adjustment 11: Close the incomes accounts:

$_____Db _____ = Cr _____ $_____

$_____Db _____

$_____Db _____

Adjustment 12: Close the expenses accounts:

$_____Db _____ = Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

Cr _____ $_____

And the "Profit account" will show:

Profit	
Db ($)	Cr ($)

Adjustment 13: To transfer the profit of the year to the retained earnings:

Db _____ = Cr _____ $_____

Now the balance of the account:
- "Profit" is $_____
- "Retained earnings" is $_____

4.1.3 The suspense account

If the trial balance doesn't balance this may be the consequence of one of the following errors:

- _____

- _____

- _____

- _____

- _____

A tool used to correct these errors is to create a "_____" equal to _____
_____.

4.1.4 Case Study 2

The trial balance of a company is:

ACCOUNT	BALANCE ($)	CORRECT BALANCE
	Db/(Cr)	Db/(Cr)
CASH	18,000	
INVENTORIES	2,000	
PURCHASES	35,000	
TRADE RECEIVABLES	58,500	
LONG TERM ASSETS	45,800	
ACCUMULATED DEPRECIATION OF ASSETS	(8,900)	
ALLOWANCE FOR TRADE RECEIVABLES	(1,800)	
RENT EXPENSE	15,000	
REVENUE	(125,000)	
TRADE PAYABLES	(30,000)	
SHARE CAPITAL ($1)	(10,000)	
RETAINED EARNINGS	(9,400)	
SUSPENSE ACCOUNT		
CHECK	(10,800)	

The value of the suspense account to be created to keep the evidence of the "imbalance" is $_____.

The errors discovered are:

1. A cash sale of $430 was recorded only in the "Revenue" account.
   To correct this error the accounting entry is:

   Db _____ = Cr _____ $_____

2. The payment of rent of $15,000 was correctly recorded in the "Rent expense" account, but the "Cash" account was credited with $18,000
   To correct this error the accounting entry is:

Db _____ = Cr _____ $_____

3. The correct balance of "Accumulated depreciation" is $9,800.
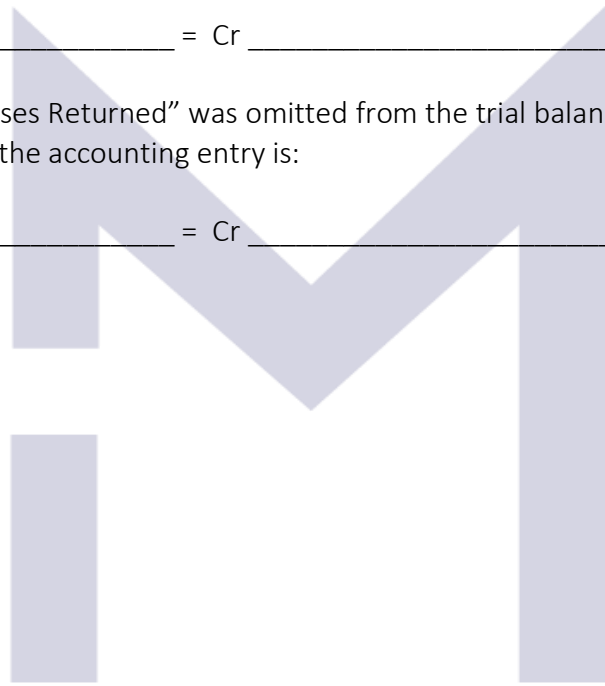   To correct this error the accounting entry is:

   Db _____ = Cr _____ $_____

4. The opening balance of "Trade Receivable" account was omitted
   To correct this error the accounting entry is:

   Db _____ = Cr _____ $_____

5. The account "Purchases Returned" was omitted from the trial balance
   To correct this error the accounting entry is:

   Db _____ = Cr _____ $_____

Now you may test your understanding with the quiz ☺

4.2 CORRECTION OF ERRORS

4.2.1 The control accounts

The trial balance may balance and still the accounting information may present errors. These types of errors fall into the following categories:

Errors of omission:

Errors of commission:

Compensating errors:

Errors of original entry:

Reversal of entries:

Errors of principles:

In order to correct these errors a correct approach could be to:

1. _____
2. _____
3. _____

The most useful tool to avoid and correct the errors are the _____.

Control accounts are those accounts in which a large number of transactions are recorded and for which the companies have another evidence, _____ the accounting department.

The main control accounts are:

- The Receivable Ledger Control Account

- The Payable Ledger Control Account

- The Bank account

4.2.2 Case Study 1

The trial balance of the company is:

ACCOUNT	BALANCE ($)		CORRECT BALANCE
	Db/(Cr)		
CASH	19,300		
INVENTORIES	2,000		
PURCHASES	35,000		
TRADE RECEIVABLES	70,500		
LONG TERM ASSETS	45,800		
ACCUMULATED DEPRECIATION OF ASSETS	(9,800)		
ALLOWANCE FOR TRADE RECEIVABLES	(1,800)		
RENT EXPENSE	15,000		
REVENUE	(126,200)		
TRADE PAYABLES	(30,000)		
SHARE CAPITAL ($1)	(10,000)		
RETAINED EARNINGS	(9,400)		
PURCHASES RETURNED	(1,600)		
B&D DEBTS EXPENSE	1,200		
CHECK	-	-	

After the check of the control accounts the following errors are discovered:

1. The balance of Payable Ledger Control account ($30,000) does not match with the balance of payables kept in the control department because a payment to a supplier was omitted from the books of prime entry.
   To correct this error the accounting entry is:

   Db _____ =   Cr _____ $_____

2. The balance of Receivable Ledger Control account ($70,500) does not match with the balance of receivable kept in the Credit control department because a cash sale was recorded in the books of prime entry as a credit sale.

The original record was

Db _____ = Cr _____ $_____

The correct record had to be:

Db _____ = Cr _____ $_____

The accounting equation to correct the balances is:

Db _____ = Cr _____ $_____

3. The acquisition of a mobile shop through a 10 years loan was omitted and the company recorded as "Rent expense" the annual instalment for the mobile shop of $15,000.

The original record was

Db _____ = Cr _____ $_____

The correct record had to be:

Db _____ = Cr _____ $_____

Db _____ = Cr _____ $_____

The accounting equation to correct the balances is:

Db _____ = Cr _____ $_____

Db _____ = Cr _____ $_____

4. Both a receipt from a customer and a payment to a supplier of the same amount ($5,400) were omitted from the cash book.

The accounting equation to correct the balances is:

Db _____ = Cr _____ $_____
Db _____ = Cr _____ $_____

5. A purchase returned to the supplier (of $300) was omitted from the Purchases Returned Day Book

The accounting equation to correct the balances is:

Db _____ = Cr _____ $_____

6. Instead of increasing the allowance for trade receivable by $350, the junior accountant decreased it.

The original record was

Db _____ = Cr _____ $_____

The correct record had to be:

Db _____ = Cr _____ $_____

The accounting equation to correct the balances is:

Db _____ = Cr _____ $_____

Now, after auditing all the accounts and correcting all errors we can close the accounts and write the final trial balance.

4.2.3 Bank reconciliations

A "petty cash transaction" is

While

A cash at bank transaction is

The balance of "petty cash" account has to be physically checked through cash count.

The balance of "cash at bank" account has to be checked using the _____.

The balance of the "cash at bank" account and the balance shown by the bank statement may differ due to:

- _____ – all these will have to be corrected in the accounting books too
- _____ differences like
    o _____ checks:

    o _____ lodgements:

- Errors in our cash book/bank account – which will need to be corrected or errors in the bank statements – which will need to be reported to the bank in order to be corrected

4.2.4 Case Study 2

The balance as per bank statement is $20,727 Credit.

The balance of the bank account is $34,258 Debit.

The following differences were discovered:

1. Unrecorded items:
   a. Interest: $132
      To correct this error, the accounting entry is:

      Db _____ = Cr _____ $_____

   b. Bank charges: $263
      To correct this error:

      Db _____ = Cr _____ $_____

   c. Dishonoured cheques: $3,400
      To correct this error, the accounting entry is:

      Db _____ = Cr _____ $_____

2. Timing differences:
   a. Unpresented cheques: $15,300
   b. Outstanding lodgements: 27,100
3. Other errors:
   a. A cash sale of $1,800 was recorded as a credit sale
      To correct this error, the accounting entry is:

      Db _____ = Cr _____ $_____

After correcting all errors the balance of the "Cash at bank account" is: $_____.

And the bank reconciliation to be shown in the financial statements is

Balance as per bank statement:

- Unpresented cheques:
- Outstanding lodgements

Balance of "Cash at bank" account:

4.2.5 Incomplete records

The errors due to "incomplete records" may be find out and corrected using:

1. _____

2. _____

3. _____

4. _____

✏ Now you may test your understanding with the quiz ☺

4.3 WRITING THE FINANCIAL STATEMENTS.

4.3.1 Statements of profit or loss and other comprehensive income

Co ….

Statement of Profit or Loss and Other Comprehensive Income for the period ….

	Note	Current period	Previous period
Revenue			
Cost of sales			
Gross profit			
Distribution costs			
Administrative expenses			
Operating profit			
Exceptional incomes			
Exceptional expenses			
Financial/investment incomes			
Profit before interest and tax			
Interest expense			
Profit before tax			
Tax expense			
Profit for the period			
Other comprehensive incomes			
Revaluation surplus			
Other			
Total comprehensive incomes			

4.3.2 Statements of profit or loss and other comprehensive income for SHALEP SRL

For example:

Shalep SRL has the below "Profit" account:

Profit account

Db		Cr	
Cost of sales	31.000	Revenue	125.000
Rent expense	12.000	Interest income	2.083
Depreciation expense	6.200		
Amortisation expense	1.000		
Impairment expense	450		
Bad and doubtful debts expense	5.875		
Provision expense	30.000		
Retained earnings	40.558		0
	127.083		127.083

Using the information above we can write:

Statement of Profit or Loss and Other Comprehensive Incomes for Shalep SRL for the year ended 31 March:

	Note	20Y6	20Y5
Revenue			
Cost of sales			
Gross profit			
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4.3.3 Statements of financial position

Co …..

Statement of Financial Position as at ….

	Note	End of current period	End of previous period
ASSETS			
Non current assets			
- Tangible non-current assets			
- Intangible non-current assets			
Current assets:			
- Inventories			
- Trade receivables			
- Other receivables			
- Cash equivalents			
- Cash			

TOTAL ASSETS

EQUITY AND LIABILITIES

Equity

- Share capital
- Share premium
- Revaluation reserve
- Other reserves
- Retained earnings

Long term liabilities

- Long term debt

Current liabilities

- Trade payables
- Dividend payable
- Salaries
- Other payables
- Tax payable

TOTAL EQUITY AND LIABILITIES

4.3.4 Statements of financial position for SHALEP SRL

For example:

Shalep's SRL final trial balance as at 31 March 20Y6 is:

Account	Closing TB
Cash	12.000
Inventories	2.550
Trade receivables	54.500
Car	30.000
Computer	5.000
Software	3.000

Long term deposit	25.000
Accumulated depreciation of car	(10.000)
Accumulated depreciation of computer	(2.200)
Accumulated amortisation of software	(1.300)
Allowance for trade receivables	(3.675)
Trade payables	(30.000)
Share capital ($1)	(10.000)
Retained earnings	(49.958)
Profit for the year	-
Prepaid rent	3.000
Accrued interest	2.083
Provision	(30.000)
Check	-

Using the information above we can write:

Statement of Financial Position for Shalep SRL as at 31 March:

	Note	20Y6	20Y5

ASSETS

Non-current assets:

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4.3.5 Statements of changes in equity

The statement of changes in equity is describing _____

STATEMENT OF CHANGES IN EQUITY

DESCRIPTION	SHARE CAPITAL	SHARE PREMIUM	REVALUATION RESERVE	OTHER RESERVES	RETAINED EARNINGS	TOTAL
BALANCE AS AT BEGINNING OF PERIOD:						
MOVEMENTS IN THE PERIOD:						
- ISSUE OF SHARES - BONUS ISSUE - REVALUATION SURPLUS - TRANSFER OF REVALUATION SURPLUS TO RETAINEAD EARNINGS - PROFIT OF THE YEAR - DISTRIBUTED DIVIDENDS						
BALANCE AS AT END OF PERIOD:						

4.3.6 Statements of changes in equity for SOLID SA

In the Statement of Financial Position as at 30 June 20Y7 of SOLID SA the componence of the equity is:

Equity $

Share capital ($1)	150,000
Share premium	35,000
Revaluation reserve	42,600
Retained earnings	124,569
	352,169

In the year ended 30 June 20Y8, the following transactions had impact over the equity accounts:

1. In March, the company made a bonus issue of 1:5 using the available share premium.

2. In May it made a rights issue of 1:4 for $1.5 and all the issued shares were sold

3. The buildings of the company recorded a revaluation surplus of $16,000

4. In April year the company distributed 15% dividend.

The Statements of Changes in Equity for SOLID SA for the year ended 30 June 20Y8.

DESCRIPTION	SHARE CAPITAL	SHARE PREMIUM	REVALUATION RESERVE	RETAINED EARNINGS	TOTAL
BALANCE AS AT BEGINNING OF PERIOD:					
MOVEMENTS IN THE PERIOD:					
- ISSUE OF SHARES - BONUS ISSUE					

- REVALUATION SURPLUS
- TRANSFER OF REVALUATION
  SURPLUS TO RETAINEAD
  EARNINGS
- PROFIT OF THE YEAR
- DISTRIBUTED DIVIDENDS	

BALANCE AS AT END OF PERIOD:	

4.3.7 The disclosure notes

The purposes of disclosure notes are to:

1. _____

2. _____

3. _____

4. _____

4.3.8 Events after the reporting date

A very important disclosure notes relates to the events AFTER the reporting date.

Some of the events after balance sheet date are called _____ EVENTS. These are the events providing _____ of conditions _____ by the reporting date. When such an event happens then we have to _____ the financial statements.

A very important adjusting event is the _____ event, i.e. an event which may lead to _____

Other events after balance sheet date are the _____ EVENTS. These concern conditions which did not exist at the reporting date but may have a _____ impact over the financial performance of the business

A special non-adjusting event is the declaration of _____.

✏ Now you may test your understanding with the quiz ☺

4.4 THE CASH FLOW STATEMENT

4.4.1 Why we need cash flow

IAS 7 "Statement of cash flow" _____ companies to prepare a statement of cash flow as part of their annual financial statements.

The cash flow statement shows the _____ of cash as well as the _____ and _____ of cash in three areas of activity:

- _____
- _____
- _____

4.4.1.1 Profit or Loss statement vs Cash Flow statement

1. The profit of the company is computed using _____ while the cash flow is computed _____
2. The elements of the profit or loss statement are computed based on _____ _____ while the cash flow elements are _____ _____

4.4.1.2 The drawbacks of cash flow:

1. Cash flows is based on _____ figures therefore it is of little help as the users of financial statements are interested in the future of the business
2. There is no _____ of the cash flows, users are required to draw their own conclusions
3. Non-cash transactions are _____

4.4.1.3 The benefits of cash flow:

1. The cash flow statements allows to see _____
2. It helps to assess the company's _____
3. It helps to assess the possible _____

4.4.2 Preparing the statement of cash flows

Statement of cash flow for the period ended …

Cash flows from operating activities

Cash generated from operations (can be deducted from SOPOL)	X
Interest paid	(X)
Income tax paid	(X)
Net cash from operating activities	**X or (X)**

Cash flows from investing activities

Purchase of Property, plant and equipment	(X)
Proceeds from sale of equipment	X
Interest received	X
Dividends received	X
Net cash from investing activities	**X or (X)**

Cash Flows from financing activities

Proceeds from issue of new shares	X
Receipts from new loans	X
Repayment of loans	(X)
Dividend paid	(X)
Net cash from financing activities	**X or (X)**
Net increase/decrease in cash and cash equivalents:	**X OR (X)**
Cash and cash equivalents at the beginning of the period:	X or (X)
Cash and cash equivalents at the end of the period:	X or (X)

4.4.2.1 Cash flows from operating activities

Shows the cash flow from the _____ revenue-producing activities of the company.

Cash equivalents are all items which are so _____ that can be equivalent to _____.

The cash generated from operations may be assessed using:

- The _____ method

- The _____ method

4.4.2.2 Cash flows from investing activities

Investing activities relates to the activities of the company focused on _____ to derive more income from the _____ of the business.

4.4.2.3 Cash flows from financing activities

The financing activities means everything the company is doing to _____.

4.4.3 Preparing the cash flow from operating activities using the indirect method

Consider SID SA which has the following financial statements:

Statement of financial position as at 31 December 20Y8

	31.12.20Y8	31.12.20Y7
ASSETS		
Non-current assets:		
Property plant and equipment	628	514
Current assets:		
Inventories	214	210
Trade receivables	168	147
Cash	7	-
Equity		
Share capital	(250)	(200)
Share premium	(70)	(60)
Retained Earnings	(314)	(282)
Revaluation Reserve	(110)	(100)
Non-current liabilities		
Long term loan	(80)	(50)
Current liabilities		
Trade payables	(136)	(121)
Tax payable	(39)	(28)
Dividend payable	(18)	(16)
Overdraft	-	(14)

Statement of profit or loss and other comprehensive incomes for the year ended 31 December 20Y8:

Revenue	653
Cost of sales	(347)
Gross profit	306
Depreciation	(42)
Other administrative expenses	(169)
Operating profit	95
Finance cost (= interest paid)	(8)
Profit before tax	87
Tax expense	(31)
Profit for the year	56
Other comprehensive incomes:	
Revaluation surplus for the year	10
Total comprehensive incomes	66

Statement of changes in equity for the year ended 31 December 20Y8:

	Share capital	Share premium	Revaluation reserve	Retained earnings	Total
Balance as at 1 January 20Y8	200	60	100	282	642
Issue of shares for cash	50	10			60
Revaluation of assets			10		10
Profit for the year				56	56
Distributed dividends				(24)	(24)
Balance as at 31 December 20Y8	250	70	110	314	744

To prepare the cash generated from operations using the indirect method we start with the Operating Profit or with the Profit Before Interest and Tax:

Operating profit:

Adjustments for non-cash items/non-operating items:

Adjustments for the movements in current assets and liabilities:

Cash generated from operations

Less:

- Interest paid
- Tax paid

Net cash flow from operating activities

Cash flows from investing activities

Payments to acquire property, plant and equipment

Receipts from sale of equipment

Net cash from investing activities

Cash Flows from financing activities

Proceeds from issue of new shares

Dividend paid

Proceeds from new long-term loans

Net cash from financing activities

Net increase/decrease in cash and cash equivalents:

Cash and cash equivalents at the beginning of the period:

Cash and cash equivalents at the end of the period:

4.4.4 Preparing the cash flow from operating activities using the direct method

Considering the same, SID SA, the cash from operating activities computed with the direct method is:

Cash received from sales:

Payments for operating activities

Cash generated from operations:

Less:

- Interest paid
- Tax paid

Net cash flow from operating activities

✏️ Now you may test your understanding with the quiz ☺

4.5 INTERPRETATION OF FINANCIAL STATEMENTS

4.5.1 Ratios

The financial statements help to assess the performance of a company using the values presented in the main financial statements or computing some ratios.

The main ratios used to assess the evolution of a business are:

1. _____ ratios:

   a. _____
   b. _____
   c. _____
   d. _____
   e. _____

2. _____ ratios:

   a. _____
   b. _____

3. _____ ratios:

   a. _____
   b. _____
   c. _____
   d. _____

4. _____ ratios:

   a. _____
   b. _____

4.5.2 Profitability ratios

1. Gross profit margin =

2. Operating profit margin

3. Net profit margin

4. Asset turnover

5. Return on Capital Employed

In the next illustrations we will use the data from Brangelina and Braga, two companies who's financial statements present the following information:

Statements of Financial position:

	Brangelina Co		Braga Ltd	
	20X2	20X1	20X2	20X1
Non- current assets:	693	882	498	393
Current assets:				
Inventories	198	232	195	257
Trade receivables	345	289	234	98
Cash	235	302	113	84
Total current assets	778	823	542	439

	Brangelina Co 20X2	Brangelina Co 20X1	Braga Ltd 20X2	Braga Ltd 20X1
Total assets	1471	1705	1040	832
Equity	747	634	579	392
Long term loans	300	200	300	300
Current liabilities				
Tax payable	234	212	23	19
Trade payables	190	659	138	121
Total current liabilities	424	871	161	140
Total equity and liabilities	1471	1705	1040	832

Statements of profit or loss:

	Brangelina Co		Braga Ltd	
	20X2	20X1	20X2	20X1
Revenue	2345	1980	2780	1846
Cost of sales	-1589	-1280	-1655	-1450
Gross profit	756	700	1125	396
Admin expenses	-340	-340	-298	-173
Operating profit	416	360	827	223
Profit from disposal of assets	-45	67	0	0
Investment income	0	0	34	12
Profit before interest and tax	371	427	861	235
Interest expense	-25	-15	-27	-25
Profit before tax	346	412	834	210
Tax expense	-178	-189	-584	-105
Net profit	168	223	250	105

4.5.3 Profitability ratios for Brangelina and Braga

Company	Brangelina		Braga	
Year	20X2	20X1	20X2	20X1
1. Gross profit margin =				
2. Operating profit margin				
3. Net profit margin				
4. Asset turnover				
5. Return on Capital Employed				

4.5.4 Liquidity ratios for Brangelina and Braga

Company	Brangelina		Braga	
Year	20X2	20X1	20X2	20X1
1. Current ratio =				
2. Acid test/Quick ratio =				

4.5.5 Working capital ratios

1. Inventory days =

2. Receivable days =

3. Payable days =

4. Length of cash flow cycle =

4.5.6 Working capital ratios for Brangelina and Braga

Company	Brangelina		Braga	
Year	20X2	20X1	20X2	20X1
1. Inventory days =				
2. Receivable days =				
3. Payable days =				
4. Length of cash flow cycle =				

4.5.7 Financial position ratios for Brangelina and Braga

Company	Brangelina		Braga	
Year	20X2	20X1	20X2	20X1
5. Gearing =				
6. Interest cover =				

🖉 Now you may test your understanding with the quiz ☺

5 GROUPS' FINANCIAL STATEMENTS

5.1 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

5.1.1 Subsidiary = control

A group exist when one company, "_____", _____ another one, "_____".

If an _____ is an entity which owns a shareholding in another entity and an _____ is an entity in which another entity has a shareholding, "Parent – Subsidiary" relationship is that special case of Investor-Investee relationship in which there is _____.

In accordance with IFRS 10 "Consolidated Financial Statements" control means 3 elements:

1. _____
2. _____
3. _____

According to IFRS 10, all "groups" must to prepare not only the independent sets of financial statements of each of the member companies, but also a consolidated set of financial statements of the GROUP.

The shareholders owning the remaining shares of the subsidiary are called _____ or _____.

5.1.2 The consolidated statement of financial position

In order to prepare the consolidated statement of financial position the following steps are to be followed:

1. _____

2. _____

3. _____

4. _____

5. _____

6. _____

7. _____

5.1.3 The consolidated statement of financial position – Prometheus Group

Prometheus acquired 100% of the share capital of Sophia on 1 January 20X1 for $1,300,000 in cash.

The statement of financial position of Prometheus and Sophia as at 1 January 20X1 are set out below:

	Prometheus $'000	Sophia $'000	Consolidated $'000
ASSETS			
Non-current assets			
Property, plant and equipment	22,500	900	
Investment in Sophia	1,300	-	
	23,800	900	
Current assets			
Inventories	2,500	400	
Trade receivables	3,800	175	
Cash	500	125	
	6,800	700	
	30,600	1,600	
EQUITY AND LIABILITIES			
Equity			
Share capital	5,000	100	
Retained earnings	19,900	1,200	
	24,900	1,300	
Current liabilities			
Trade payables	4,150	260	
Income tax payable	1,550	40	
	5,700	300	
	30,600	1,600	

The steps to write the consolidated statement of financial position for Prometheus Group are:

Step 1:

Fair value of consideration paid by Prometheus =

Fair value of consideration paid by Non-Controlling Interest =

Fair value of Net Assets of Sofia at the acquisition date =

Goodwill at acquisition =

The Retained Earnings of Sofia at acquisition date =

Step 2:

Step 3:

Step 4:

Step 5:

Consolidated Share Capital =

Step 6:

Post-acquisition Retained Earnings of Sofia =

Consolidated Retained Earnings =

Step 7:

5.1.4 The consolidated statement of financial position – Prometheus Group after 3 years

After 3 years, as at 31 December 20X3, the statements of financial position of Prometheus and Sofia are:

	Prometheus	Sophia
	$'000	$'000
ASSETS		
Non-current assets		
Property, plant and equipment	34.000	4.500
Investment in Sophia	1.300	-
	35.300	4.500
Current assets	9.700	2.450
	45.000	6.950
EQUITY AND LIABILITIES		
Equity		
Share capital	5.000	100
Retained earnings	31.500	5.200
	36.500	5.300
Current liabilities	8.500	1.650
	45.000	6.950

The steps to write the consolidated statement of financial position for Prometheus Group are:

Step 1:

Fair value of consideration paid by Prometheus =

Fair value of consideration paid by Non-Controlling Interest =

Fair value of Net Assets of Sofia at the acquisition date =

Goodwill at acquisition =

The Retained Earnings of Sofia at acquisition date =

Step 2:

Step 3:

Step 4:

Step 5:

Consolidated Share Capital =

Step 6:

Post-acquisition Retained Earnings of Sofia =

Consolidated Retained Earnings =

Step 7:

5.1.5 The consolidated statement of financial position – Pick Group

Pick acquired the entire share capital of Sock for $9m on 1st February 20X0, when the statements of financial position of the two companies were:

	Pick	Sock
	$m	$m
Investment in Sock	9	-
Other assets	16	7
	25	7
Share capital	9	3
Retained earnings	14	2
	23	5
Liabilities	2	2
	25	7

The steps to write the consolidated statement of financial position for Pick Group are:

Step 1:

Fair value of consideration paid by Prometheus =

Fair value of consideration paid by Non-Controlling Interest =

Fair value of Net Assets of Sofia at the acquisition date =

Goodwill at acquisition =

The Retained Earnings of Sofia at acquisition date =

Step 2:

Step 3:

Step 4:

Step 5:

Consolidated Share Capital =

Step 6:

Post-acquisition Retained Earnings of Sofia =

Consolidated Retained Earnings =

Step 7:

5.1.6 The consolidated statement of financial position – Pipi Group

Pipi acquired 75% of the issued share capital of Sisi on 1st January 20X8 when Sisi' retained earnings were $1m.

The value of non-controlling interest at that date was $1.5.

One year later, the two companies had the following statements of financial position:

	Pipi	Sisi
	$'m	$m
Investment in Sisi	6,0	-
Other assets	11,0	8,0
	17,0	8,0
Share capital	10,0	4,0
Retained earnings	3,0	2,5
	13,0	6,5
Liabilities	4,0	1,5
	17,0	8,0

The steps to write the consolidated statement of financial position for Pipi Group are:

Step 1:

Fair value of consideration paid by Prometheus =

Fair value of consideration paid by Non-Controlling Interest =

Fair value of Net Assets of Sofia at the acquisition date =

Goodwill at acquisition =

The Retained Earnings of Sofia at acquisition date =

Step 2:

Step 3:

Step 4:

Step 5:

Consolidated Share Capital =

Step 6:

Post-acquisition Retained Earnings of Sofia =

Consolidated Retained Earnings =

Step 7:

5.1.7 The consolidated statement of financial position – Panda Group

Panda acquired 60% of the share capital of Sanda at its incorporation.

The statements of financial position of the two companies as at 31 December 20X8 are:

	Panda	Sanda
	$'000	$'000
Non-current assets		
Property, plant and equipment	215	50
Investment in Sanda	6	-
	221	50
Current assets		
Inventories	22	18
Receivables	96	54

Cash	<u>4</u>	<u>15</u>
	<u>122</u>	<u>87</u>
	<u>343</u>	<u>137</u>
Equity		
Share capital	110	10
Retained earnings	<u>134</u>	<u>68</u>
	244	78
Current liabilities:		
Trade balances	<u>99</u>	<u>59</u>
	<u>99</u>	<u>59</u>
	<u>343</u>	<u>137</u>

Notes:

(i) The fair value of the non-controlling interest in Sanda at acquisition was $4,000.
(ii) Sanda sells goods to Panda at a profit margin of 25% on selling price. At year end, $12,000 of the goods that Panda had purchased from Sanda remained in inventories.
(iii) In the receivables of Sanda, $30,000 are due by Panda
(iv) In the trade liabilities of Panda $30,000 are due to Sanda

The steps to write the consolidated statement of financial position for Panda Group are:

Step 1:

Fair value of consideration paid by Prometheus =

Fair value of consideration paid by Non-Controlling Interest =

Fair value of Net Assets of Sofia at the acquisition date =

Goodwill at acquisition =

The Retained Earnings of Sofia at acquisition date =

Step 2:

Step 3:

Step 4:

Step 5:

Consolidated Share Capital =

Step 6:

Post-acquisition Retained Earnings of Sofia =

Consolidated Retained Earnings =

Step 7:

Now you may test your understanding with the quiz ☺

5.2 CONSOLIDATED STATEMENT OF PROFIT OR LOSS

5.2.1 The steps to write the Consolidated Statement of Profit or Loss and Other Comprehensive incomes

The mechanic of consolidation of Profit or loss statement has the same philosophy as that one for the statement of financial position:

1. _____

2. _____

3. _____

4. _____

5. _____

5.2.2 The Consolidated Statement of Profit or Loss and Other Comprehensive incomes – Proust Group

On 1 July 20X4 Proust acquired 90% of Sartre at a cost of $55,000.

The statements of profit or loss and other comprehensive income for both companies for the year ended 30 June 20X9 are:

	Proust $'000	Sartre $'000	Consolidated $'000
Revenue	100	90	
Cost of sales	-75	-55	
Gross profit	25	35	
Distribution costs	-5	-6	
Administrative expenses	-8	-10	
Dividend from subsidiary	4,5	0	
Profit before tax	16,5	19	
Income tax expense	-4	-6	
PROFIT FOR THE YEAR	12,5	13	
Other comprehensive income for the year, net of tax	20	10	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	32,5	23	

The steps to write the consolidated statement of profit or loss for Proust Group are:

Step 1:

Non-Controlling interest's share =

Step 2:

Step 3:

Step 4:

Step 5:

Profit attributable to the Non-Controlling Interest =

Total comprehensive income attributable to the Non-Controlling Interest =

5.2.3 The Consolidated Statement of Profit or Loss and Other Comprehensive incomes – Poe Group

E.A. Poe acquired 75% of the issued share capital of G.B. Shaw on 1 January 20X2.

Shaw had sold goods to Poe during the year for $8,000,000 at a mark-up of 25%.

At the year end, three quarters of theses goods had been sold on to third parties.

The statements of profit or loss and other comprehensive income for the year ended 31 December 20X2 of the two companies are:

	Poe	Shaw	Consolidated
	$'m	$'m	$'m
Revenue	24,5	15,6	
Cost of sales	-14	-10	
Dividend from subsidiary	1,5	-	
Profit before tax	12	5,6	
Income tax expense	-5	-1,6	
PROFIT FOR THE YEAR	7	4	
Other comprehensive income for the year	2	1	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	9	5	

The steps to write the consolidated statement of profit or loss for Poe Group are:

Step 1:

Non-Controlling interest's share =

Step 2:

Step 3:

Step 4:

Step 5:

Profit attributable to the Non-Controlling Interest =

Total comprehensive income attributable to the Non-Controlling Interest =

5.2.4 The Consolidated Statement of Profit or Loss and Other Comprehensive incomes – Preda Group

Preda acquired 80% of the issued share capital of Stanescu on 1 January 20X5.

The statements of profit or loss for the two companies for the year ended 30 September 20X5 are as follows:

	Preda	Stanescu	Consolidated
	$'000	$'000	$'000
Revenue	10,000	1,000	
Cost of sales	-6,000	-700	
Profit before tax	4,000	300	
Income tax expense	-1,400	-120	
PROFIT FOR THE YEAR	2,600	180	

The steps to write the consolidated statement of profit or loss for Poe Group are:

Step 1:

Non-Controlling interest's share =

Step 2:

Step 3:

Step 4:

Step 5:

Profit attributable to the Non-Controlling Interest =

Total comprehensive income attributable to the Non-Controlling Interest =

✎ Now you may test your understanding with the quiz ☺

5.3 ACCOUNTING FOR ASSOCIATES

5.3.1 Associate = significant influence

Significant influence, as defined by IAS 28 "Accounting for investment in associates and joint ventures" is the power to _____ in the financial and operating policy decisions of the investee but is not _____ or _____ over those policies.

Please note that joint ventures are not subject of this course.

An investor is presumed to have significant influence over investee when it has a shareholding between _____% and _____%.

Significant influence may be considered also when:

- _____

- _____

- _____

- _____

- _____

If an investor has some shareholding in an investee (which is below 20%), the accounting treatment of the acquisition is:

Db _____ = Cr _____ $_____

At the end of each accounting period the "investment" is re-valued.

If there is an increase, we'll have an income, and the accounting equation is:

Db _____ = Cr _____ $_____

If there is a decrease, we'll have a loss, and the accounting equation is:

Db _____ = Cr _____ $_____

In the case of an associate, the method of accounting is the equity method.

At the acquisition, the accounting equation is:

Db _____ = Cr _____ $_____

Then, at the end of each accounting period, the value of investment must be adjusted with the investor's share of the post-acquisition change in the associate's net assets.

Db _____ = Cr _____ $_____

In the statement of profit or loss will be created a separate line/item called _____.

5.3.2 Accounting for associates: Statement of Financial Position

Manda acquired 40% of the share capital of Anda on its incorporation for $4,000. The statements of financial position of the two companies as at 31 December 20X8 are as follows:

	Manda	Anda	Consolidated
	$'000	$'000	$'000
Non-current assets			
Property, plant and equipment	345	50	345
Investment in Anda	4	-	31
	349	50	376
Current assets			
Inventories	176	18	176
Receivables	289	54	289
Cash	143	15	143
	608	87	608
	957	137	984
Equity			
Share capital	300	10	300

Retained earnings	558	68	585
	858	78	885
Current liabilities			
Trade balances	99	59	99
Total liabilities	99	59	99
Total equity and liabilities	957	137	984

The steps to write the Consolidated Statement of Financial Position in the case of associates are:

Step 1:

The Retained Earnings of Anda at acquisition date =

Step 2:

Post-acquisition retained earnings of Anda =

5.3.3 Accounting for associates: Statement of Profit or Loss and other Comprehensive Incomes

Manda acquired 40% of the share capital of Anda on its incorporation for $4,000. The statements of profit or loss and other comprehensive incomes of the two companies as at 31 December 20X8 are as follows:

	Manda	Anda	Consolidated
	$'000	$'000	$'000
Revenues	54	33	
Cost of sales	-23	-13	
Gross profit	31	20	
Distribution costs	-5	0	
Other administrative expenses	-7	-4	
Profit before tax	19	16	
Tax expense	-4	-5	
Profit after tax	15	11	
Revaluation surplus	34	13	
Total comprehensive incomes	49	24	

The steps to write the Consolidated Statement of Profit or Loss and Other Comprehensive Income in the case of associates are:

Step 1:

Step 2:

Step 3:

Now you may test your understanding with the quiz ☺

Then, don't forget to revise all you have learned! ☺

GOODLUCK!