**FINANCIAL ACCOUNTING SS 2**

**FIRST TERM**

**SCHEME OF WORK**

**WEEK TOPIC**

1 Final Accounts – Special transactions; Bad Debts, Closing entries e.t.c.

2 Final Accounts – Provision for doubtful debts

3 Final Accounts – Provision for discounts

* 1. Final Accounts – Accruals and Prepayments

6 Depreciation of Fixed Assets

7-8 Depreciation of Fixed Assets

9 Depreciation of Fixed Assets

10 Final Accounts – Working exercises

**WEEK ONE**

**FINAL ACCOUNTS – SPECIAL TRANSACTIONS; BAD DEBTS, CLOSING ENTRIES**

**CONTENT**

* SPECIAL ITEMS OF EXPENSES/LOSSES
* BAD DEBTS RECOVERED
* CLOSING ENTRIES
* ADJUSTMENTS IN THE FINAL ACCOUNT

**SPECIAL ITEMS OF EXPENSES /LOSSES**

1. Goods Stolen or Destroyed

Goods may have been stolen or destroyed during the financial year. In such cases, the following entries should be made:

- Debit: Profit and Loss Account

- Credit: Purchases Account

2. Goods Withdrawn by the Owner for Personal Use

The owner of the business might withdraw goods for personal use. These goods are recorded at their cost price. The accounting entries for this transaction are as follows:

- Debit: Drawings Account

- Credit: Purchases Account

3. Bad Debts

Bad debts are debts that have become irrecoverable, meaning they cannot be collected from a customer. This can occur due to various reasons such as customer insolvency, bankruptcy, or poor economic conditions. To account for bad debts, use the following entries:

- Debit: Bad Debts Account

- Credit: Debtors Account

This reduces the value of debtors in the ledger. The Bad Debts Account will have a debit balance and appear in the trial balance. For the final accounts:

- Debit: Profit and Loss Account

- Credit: Bad Debts Account

Bad debts represent a loss to the business.

4. Bad Debts Recovered

Occasionally, a previously written-off bad debt may be paid. In this case, use the following accounting treatment:

(a) Debit: Debtor’s Account

Credit: Bad Debts Recovered Account

This reinstates the debtor's account to its original position before the bad debts were written off.

(b) Debit: Cash/Bank Account

Credit: Debtor’s Account

(c) For the preparation of the final accounts:

Debit: Bad Debts Recovered Account

Credit: Profit and Loss Account

The amount recovered is considered additional income for the period, which is why it is credited to the Profit and Loss Account.

Evaluation

1. Accounting entries when the owner withdraws cash for private use.

2. Accounting entries when the owner withdraws goods for personal use.

Closing Entries

Closing entries are made at the end of the accounting period to close various ledger accounts and transfer their balances to the final accounts.

Adjustments of the Final Account

Adjustments are closing entries or amendments made at the end of the accounting period to properly match costs and expenses with revenue. They are required for the following:

1. Accruals

2. Prepayments

3. Depreciation of fixed assets

4. Provision for doubtful debts

5. Provision for discounts on debtors

6. Bad debts

7. Closing stock

8. Capital and revenue items of income and expenditure

9. Set-offs

10. Correction of errors (e.g., omissions, principles, casting)

11. Provision for contingencies (e.g., legal charges, accountancy charges)

Evaluation

1. Briefly explain Drawings and Bad Debts.

2. Differentiate between closing entries and adjustments in relation to the preparation of final accounts.

General Evaluation

1. Explain the purpose of preparing (i) trading account (ii) profit and loss account (iii) balance sheet.

2. List six items found on the asset and liability sides of the balance sheet of a sole trader.

3. List and explain three classifications of ledger accounts.

4. State ten uses of the General Journal.

5. List ten users of accounting information.

**WEEKEND ASSIGNMENT**

1. At the end of a trading period cost of goods sold is debited to the trading account while cost of services is debited to the (a) balance sheet (b) trading account (c) profit and loss account (d) manufacturing account

2. The purchase of a typewriter for office use for N2,000 is debited to \_\_\_\_\_

(a) creditors (b) bank account (c) purchases account (d) equipment account

3. Books of account are opened by means of a \_\_\_\_\_\_\_\_\_\_\_\_\_\_ journal

(a) purchases (b) principal (c) sales (d) returns inwards

4. Which of the following is recorded on the debit side of the Trial Balance (a) bank overdraft (b) returns outwards (c) purchases (d) capital

5. Which of the following is not shown in the trial balance\_\_\_\_\_\_\_\_

(a) discounts allowed (b) discounts received (c) opening stock (d) closing stock

**THEORY**

1. List any eight components of Trading Account

2.(a) List any five items that may cause adjustments in final accounts.

(b) Outline any four factors that may make a debt to be irrecoverable.

**WEEK TWO**

**FINAL ACCOUNTS – PROVISION FOR DOUBTFUL DEBTS**

**PROVISION FOR DOUBTFUL DEBTS**

Although a debt may not actually have become bad, there may be doubt as to whether it will be paid. It would be misleading to include that debt as an asset in the balance sheet pretending that the amount is not in doubt. On the other hand, since it has not yet become bad, it would be wrong to write it off. A provision is therefore made to cover such doubtful debt.

Provision for doubtful debt is a mere estimate of the total debt that may not be collected from the debtor. This estimated expense for bad debts which cannot be calculated with substantial accuracy is charged to the profit and loss account as an expense.

**HOW TO CREATE AND MAINTAIN A PROVISION FOR DOUBTFUL DEBTS**

**A. When the provision for doubtful debt is first created;**

Debit Profit and Loss Account

Credit Profit for doubtful debts Account

with the full amount of the provision

In the years that follow, the entries in the accounts will be for increases or decreases in the amounts required for the provision.

**B. INCREASING THE PROSIVION FOR DOUBTFUL DEBTS**

Debit Profit and Loss Account

Credit Profit for doubtful debts Account

with increases in the provision.

**C. DECREASING THE PROVISION FOR DOUBTFUL DEBTS**

Debit Profit for doubtful debts Account

Credit Profit and Loss Account

with decreases in the provision.

In all the instances (A-C) as described above, the provision for Doubtful Debts is deducted

from the Debtors in the Balance Sheet.

**EVALUATION**

1. Explain the following terms:

(a) Bad debts (b) Provision for doubtful debts

2. List three types of provisions that could give rise to adjustments in the final accounts.

**Illustration**

A business starts on 1 January, 2002 and its financial year end is 31 December annually. A table of the debtors, the bad debts written off and the estimated doubtful debts at the end of each year is now given.

**Year to Debtors at Bad debts Debts thought**

**31 December end of year written off at end of year**

**(after bad debts during the year to be doubtful to**

**written off) collect**

**N N N**

2002 6,000 423 120

2003 7,000 510 140

2004 8,000 604 155

2005 6,400 610 130

You are required to show for each of the year ended 31st December……

(a) Bad Debts Account

(b) Provision for Doubtful Debts Account

(c) Profit and Loss Account (extracts)

(d) Balance Sheet (extracts)

**Bad Debts**

2002 N 2002 N

Dec. 31 Sundries 423 Dec. 31 Profit and Loss 423

2003 2003

Dec. 31 Sundries 510 Dec. 31 Profit and Loss 510

2004 2004

Dec. 31 Sundries 604 Dec. 31 Profit and Loss 604

2005 2005

Dec. 31 Sundries 610 Dec. 31 Profit and Loss 610

**Provision for Doubtful Debts**

2002 N 2002 N

Dec. 31 Balance c/d 120 Dec. 31 Profit and Loss 120

2003 2003

Dec. 31 Balance c/d 140 Jan 1 Balance b/d 120

Dec 31 Profit and Loss 20

1. 140

2004 2004

Dec. 31 Balance c/d 155 Jan 1 Balance b/d 140

Dec. 31 Profit and Loss 15

1. 155

2005 2005

Dec. 31 Profit and Loss 25 Jan. 1 Balance b/d 155

“ “ Balance c/d 130

155 155

**Profit and Loss Account (extracts) for the year ended 31st December**

N N

2002 Bad Debts 423

Provision for 120

Doubtful debts

2003 Bad Debts 510

Increase in

Provision for

Doubtful debts 20

2004 Bad Debts 604

Increase in provision

For Doubtful debts 15

2005 Bad Debts 610 2005 Reduction in provision

for Doubtful Debts 25

**Balance Sheet (extracts) as at 31st December**

N N

2002 Debtors 6,000

Less: Provision

For Doubtful Debts 120 5,880

2003 Debtors 7,000

Less: Provision for

Doubtful Debts 140 6,860

2004 Debtors 8,000

Less: Provision for

Doubtful Debts 155 7,845

2005 Debtors 6,400

Less: Provision for

Doubtful Debts 130 6,270

**EVALUATION**

1. Differentiate between provision for bad debts and provision for depreciation.

2. List two characteristics of provisions in financial accounting.

**GENERAL EVALUATION**

1. State five differences between cash discount and trade discount
2. Identify any seven prime books of account and highlight the uses of each ofthem where necessary
3. List five advantages of using the imprest system to record petty cash transactions
4. Explain the following types of errors (a) omission (b) principle (c) commission (d) original entry (e) complete reversal of entry (f) compensating error
5. Explain how the following items are treated in Profit and Loss Account and Balance

Sheet (a) provision for doubtful debts (b) bad debts recovered

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting Page 143-150

**WEEKEND ASSIGNMENT**

1. A decrease in the provision for doubtful debts results in \_\_\_\_\_\_\_

(a) an increase in net profit (b) a decrease in gross profit (c) an increase in gross profit (d) a decrease in net profit

2. The term bad debts means debt \_\_\_\_\_\_\_\_

(a) recorded in a wrong account (b) owed by an employee (c) paid with fake currency (d) that cannot be collected again from the debtor

3. The gross profit for a trading period is calculated as \_\_\_\_\_\_\_\_\_

(a) Net sales less net purchases (b) Net sales less cost of sales (c) Net sales less closing stock (d) Net sales plus cost of goods sold

Use the information below to answer questions 4 and 5

**N**

Provision for bad debts 1,000 Cr

Bad Debts 500 Dr

Debtors 50,000 Dr

Additional bad debts to be written off 500

New provision for bad debts to stand at 5% of debtors.

4. In the balance sheet the net figure for debtors is \_\_\_\_\_\_\_\_

(a) N47,025 (b) N46,550 (c) N45,600 (d) N43,225

5. The total amount of bad debts to be charged as expenses in the profit and Loss Account is \_\_\_\_\_\_\_\_\_

(a) N2,000 (b) N1,500 (c) N1,000 (d) N500

**THEORY**

Mr. Okonkwo’sbooks of account shows the information for four years ended 31st December, 2000. The balance of debtors and bad debts were given for the four years.

**Debtors Bad**

**Balance Debts**

**N N**

31st December, 1997 40,000 2,000

31st December, 1998 30,000 1,000

31st December, 1999 50,000 2,500

31st December, 2000 60,000 3,000

Provision for doubtful debts brought forward at 1st January, 1997 was N600.

Mr. Okonkwo makes provision for doubtful debts at the rate of 10% on total debtors outstanding after deducting bad debts for the period.

You are required to prepare the following accounts for the years ended 31st December, 1997, 1998, 1999 and 2000.

(a) Bad Debts Account

(b) Provision for doubtful debts Account

(c) Profit and Loss Account

(d) Balance Sheet (extract)

**WEEK THREE**

**FINAL ACCOUNTS - PROVISION FOR DISCOUNTS**

If a trader usually allows and receives cash discounts the debtors and creditors balances in the

Balance Sheet at the end of the year may be overstated unless it is recognized that discounts

are likely to be deducted from them. This is done by creating provision for discounts on

debtors and provision for discounts on creditors.

**PROVISION FOR DISCOUNTS ON DEBTORS**

This is a charge made against profit in order to provide for an expected loss in the shape of discounts that will have to be allowed to the firms debtors to facilitate prompt payment of their accounts.

The provision for discount on debtors should be calculated on the net amount /figure of debtors after deducting any provision for doubtful debts. This treatment should be obvious in that discounts are not allowed on doubtful debts.

The Accounting entries involved when the provision for discount allowed is first created:

Debit Profit and Loss Account

Credit Profit for discounts allowed with the full amount of the provision.

In the years that follow the entries in the accounts will be for increases or decreases in the amounts required for the provision.

To record these subsequent entries the procedure is similar to the doubtful debts provision.

**EVALUATION QUESTIONS**

1. Explain the following terms

(a) Discounts Allowed (b) Cash Discounts

2. State two differences between Discount Allowed and Discount Received

**PROVISION FOR DISCOUNTS ON CREDITORS**

It is also the practice of some businesses to recognize the fact that the amount of creditors at the balance sheet date does not represent the amount which will be paid. This is because where advantage is taken of cash discount arrangements, a smaller sum will be payable to discharge the debts.

The provision for discounts on creditors thus created is an addition to the profits and is to provide for those discounts expected to be received on payment of the firms creditors.

The accounting entries involved when the provision for discount received is first created:

Debit Profit for discount received

Credit Profit and Loss Account

In the years that follow the entries in the accounts will be for increases or decreases in the amount required for the provision. This will be treated along similar lines as outlined above.

It should be stated that creating a provision for discount received contravenes the accounting convention of conservatism as it clearly anticipates income that has not arisen. However, it can be argued that if a firm creates a provision for discounts on debtors, it should also take into account discounts on creditors.

**EVALUATION QUESTION**

1. Differentiate between provision for bad debts and provision for discounts on debtors.

2. List four items of current assets in the balance sheet of a business.

**GENERAL EVALUATION**

1. What is the effect of understatement of closing stock on: (a) cost of sales (b) grossprofit (c) net profit
2. State five causes of a decline in the net profit of a business
3. Differentiate between ‘‘Discount Allowed” and ‘’Discount Received”
4. State five characteristics of the imprest system of keeping petty cash records
5. List four characteristics of each of the following (a) fixed assets (b) current assets(c) intangible assets

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting Page 143-150

**WEEKEND ASSIGNMENT**

1. The total debtors account of a trading concern is N13,000. Out of this 2% is irrecoverable. 5% of the balance is not likely to be collected. What is the provision for doubtful debts

(a) N910 (b) N650 (c) N637 (d) N260

2. An allowance given to a customer by a supplier for prompt payment is \_\_\_\_\_\_

(a) trade discount (b) discount received (c) cash discount (d) cash rebate

3. Which of the following is the effect of an increase in the provision for discount allowed\_\_\_\_\_\_\_

(a) increase in net profit (b) decrease in gross profit (c) decrease in net profit

(d) increase in gross profit

4. The opening balance of debtors is N100,000 and that of provision is to be at 2 ½ % of debtors, how much would be charged in the Profit and Loss Account

(a) N3,500 (b) N2,500 (c) N1,500 (d) N1,000

5. Omolomo Limited gave Omolope a discount of 10% on purchases. If the discount enjoyed in the year amounted to N250, what is the total purchases \_\_\_\_

(a) N2,750 (b) N2,500 (c) N2,250 (d) N2,000

**THEORY**

The existing provision for doubtful debts in the books of Segun Enterprises was N4,480. On 31STDecember, 2005, the trade debtors stood at N78,400.

Using journal entries and ledger entries, you are required to:

(a) Reduce the provision for doubtful debt to N3,920

(b) Create a provision for discounts on debtors at 2 ½ %.

(c) Show how the items would appear in the Profit and Loss Account and Balance Sheet.

**WEEK FOUR AND FIVE**

**FINAL ACCOUNTS – ACCRUALS AND PREPAYMENTS**

**ACCRUALS**

The accrual concept states that revenue and expenditure of a period should be matched together – whether or not such revenue or expenditure had actually been received or paid for.

This means that items of expenditure or income shown in the final account should be for sums actually related to the period covered by the financial statements prepared in the final account. Therefore statements such as the Trading and Profit and Loss Account should be prepared on the accruals, or matching basis so that expenses are matched to the revenue earned: that is, expenses are shown in the Profit and Loss Account as they have been incurred rather than as they have been paid. Similarly, incomes are shown in the Profit and Loss Account as they have been earned rather than as they have been received.

Accrual can be divided into

(a) Accrued expenses

(b) Accrued income (i.e income received in arrears)

**ACCRUED EXPENSES:** These are expenses which accrued but have not been paid for or

discharged. They are also referred to as expenses owing or creditors for expenses e.g.

Accrued electricity.

**Ilustration:**

Supposing rent for 9 months (says N18,000) had actually been paid, that of the remaining 3

months (say N6,000) not yet paid must also be charged to Profit and Loss Account making the

total rent N24,000 (i.e. N18,000 + N6,000) for the 12 months accounting period for which the

Profit and Loss Account is prepared.

**The Rent Account will appear as follows:**

**Rent**

**N N**

July 2 Cash 18,000 Dec. 31 Profit and Loss 24,000

Dec. 31 Accrued Rent c/d 6,000

24,000 24,000

Jan. 1 Accrued Rent b/d 6,000

The credit balance of N6,000 on the Rent Account is an accrued expenses and is shown as a current liability in the Balance Sheet as at 31st December …….

**ACCRUED INCOME**: These are incomes which are due in respect of the current trading period but such income have not been received at the close of final account preparation. It is also refered to as income receivable e.g. interest receivable, rent receivable, commission receivable.

**Ilustration**

In the year ended 31st December, 2005,Modupe had received interest of N4000 on her fixed

deposit account with First Bank Nig. Plc. At that date, interest for the half year to 31st

December, 2005 was due from the bank. The entries in the Interest Receivable account of

Modupe at 31st December, 2005 are as follows:

**Interest Receivable**

2005 N 2005 N

Dec. 31 Profit and Loss 8,000 Sept. 15 Bank 4,000

Dec. 31 Interest accrued c/d 4,000

8,000 8,000

2006

Jan 1 Balance b/d 4,000

The balance of N4,000 on the Interest Receivable Account is shown as a current asset in the

Balance Sheet as at 31st December, 2005.

**EVALUATION**

1. List six uses of the General Journal.

2. State two similarities and two differences between the Trading Account and the Profit and Loss Account.

**PREPAYMENTS**

Prepayments are payments made in advance of the benefits to be derived from them. It

represents amount paid in current period for services to be received in a subsequent period.

Prepayment can be divided into

(a) Prepaid expenses

(b) Income received in advance

**PREPAID EXPENSES**: These are expenses like rent, insurance etc. which are paid in advance for subsequent period. Only the expenses for the period must be charged to the Profit and Loss Account. Therefore expenses paid in advance are deducted from total payments in line with the requirements of the matching concept.

**Illustration:**

Supposing N15,000 is paid for electricity and it is for 15 months, the amount to be charged to the Profit and Loss Account at the end of the year is not N15,000 but N12,000

i.e. N15,000 x 12 months

15

while the N3,000 balance is regarded as prepayment or payment in advance.

The Electricity (or Lighting and Heating)Account will appear as follows:

**Electricity**

20x5 N 20x5 N

Jan. 23 Cash 15,000 Dec. 31 Profit and Loss 12,000

“ “ Prepaid Electricity c/d3,000

15,000 15,000

20x6

Jan. 1 Prepaid Elect. b/d 3,000

The debit balance of N3,000 on the Electricity Account is a prepaid expense and is shown as a current asset in the Balance Sheet as at 31st December, 20x5.

**INCOME RECEIVED IN ADVANCE**: These are income received by the organization duringthe current period but which relate to the next (or subsequent) trading period e.g. rent received in advance.

**Illustration:**In the year ended 31st December, 2007, Elizabeth had received N30,000 for rent from a tenant. At that date rent for the half year has been prepaid by the tenant. Show the Rent Receivable Account in the books of Elizabeth.

**Rent Receivable**

2007 N 2007 N

Dec. 31 Profit and Loss 20,000 Jul. 8 Bank 30,000

Dec. 31 Balance c/d 10,000

30,000 30,000

2008

Jan 1. Balance b/d 10,000

The credit balance of N10,000 on the Rent Receivable Account is an income received in advance and is shown as a current liability in the Balance Sheet of Elizabeth as at 31st December, 2007.

**EVALUATION**

1. Why is it necessary to make adjustments in the final accounts for accruals and prepayments?

2. How will you account for the following when preparing the final accounts.

(i) Accrued Expenses

(ii) Prepayments

(iii) Rent Receivable Outstanding

b. What accounting concepts underly your treatment of these items.

**GENERAL EVALUATION**

1. Explain the following : (a) bank loan (b) bank overdraft (c) standing order (d) credittransfer
2. List five source documents used in preparing the Cash Book.
3. List four accounts found in each of the following (a) nominal ledger (b) private ledger

(c) general ledger

1. Describe three features of each of the following financial statements: (a) Trading Account (b) Profit and Loss Account (c) Balance Sheet
2. State seven reasons for preparing a bank reconciliation statement.

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting, Page 185-202

**WEEKEND ASSIGNMENT**

1. Prepayment is treated in the balance sheet of a firm as a \_\_\_\_\_\_\_\_

(a) fixed asset (b) long-term liability (c) current asset (d) current liability

2. Rent prepaid as at 1st January, 2002 was N10,000. Annual rent payable is N80,000 and rent accrued as at 31st December, 2002 was N15,000. How much was paid for rent in 2002

(a) N80,000 (b) N75,000 (c) N55,000 (d) N35,000

3. Resources consumed but to be paid for within the next accounting period are classified in the balance sheet as \_\_\_\_\_\_\_\_

(a) current liabilities (b) current assets (c) long-term liabilities (d) capital

Use the following information to answer questions 4 and 5

Rent receivable accrued 1/01/2005 D3,000

Rent received during the year 2005 D5,000

Rent receivable accrued 31/12/2005 D2,500

4. The entry for rent received in the profit and loss account for the year ended 31st December, 2005 is \_\_\_\_\_\_\_\_\_\_

(a) Credit profit and loss account with D4,500 (b) Credit profit and loss account with D2,500 (c) debit profit and loss account with D2,500 (d) debit profit and loss account with D4,500

5. The balance in the rent receivable account as at 31/12/2005 is shown in the balance sheet as (a) fixed asset (b) current asset (c) current liability (d) long term liability

**THEORY**

Write up the ledger accounts of Adesua. Enterprises for the year ended 31st December, 2007.

**(a) Motor Expenses:**

Paid for the year to 31st December 2007 N80,000; Owing at 1st January, 2007 N4000; Prepaid at 31st December, 2007 N5,000

**(b) Rates:**

Paid in the year to 30th June 2005 N4,500; Rates prepaid as at 30th June 2004 N1000

Rates owing at 30th June 2005 N2,500

**WEEK SIX**

**TOPIC: DEPRECIATION OF FIXED ASSETS**

**CONTENT**

* + Causes of Depreciation
  + Reasons for charging depreciation
  + Factors to be considered in the computation of depreciation
  + Methods of providing for depreciation

**NOTES**

Depreciation may be defined as the permanent and continuing diminution (or lessening) in the quality, quantity or value of an asset.

**CAUSES OF DEPRECIATION**

1. Physical factors – Assets may depreciate in value as a result of physical factors like humidity (or dampness), heat, erosion, evaporation of liquids, rust, rot and decay etc
2. Wear and Tear – An asset may depreciate as a result of constant usage.
3. Passage of Time – or Effluxion of Time; Assets like patents, copyrights, leaseholds etc have a fixed period of legal life.They therefore depreciate as a result of passage of time. The depreciation of these intangible assets is known as AMORTISATION
4. Obsolescence – Assets may be rendered out of use as a result of new technology or invention or change in fashion. The value of such obsolete assets (e.g. Black and White TV) will reduce drastically over a short period of time.
5. Inadequacy or Superfluity – Assets may be out of use because of increase in the output of a firm. In such a situation, assets will be replaced with new and bigger ones.
6. Depletion – Some natural resources like gold, crude oil, iron ore deposits, quarries etc reduces in value as they are being exploited or mined. These assets are known as WASTING ASSETS. The more they are extracted, the less the reserve that remains.

**REASONS OR ADVANTAGES OF CHARGING DEPRECIATION**

1. Since it reduces net profit, the tax to be paid will be reduced
2. The business will have fund to replace the asset at the end of the useful life
3. The value of the assets will not be overstated in the Balance Sheet
4. Rather than charging the cost of an asset to the profits in the year of purchase,the cost of an asset is spread over its useful life – this is a demonstration of the matching concept in accounting.
5. To ascertain the profit or loss on the disposal of assets.

**FACTORS TO BE CONSIDERED IN THE COMPUTATION OF DEPRECIATION**

1. The historical (or original) cost of the asset
2. The estimated useful life of the asset
3. The estimated scrap value (or salvage) value of the asset
4. The method of depreciation to be used e.g. straight line, reducing balance, revaluation method etc
5. The internal causes of depreciation
6. The external causes of depreciation .

**METHODS OF PROVIDING FOR DEPRECIATION**

1. Straight line Method
2. Reducing Balance Method (or Diminishing Balance Method)
3. Sum of the years digit
4. Revaluation Method
5. Depletion Unit Method

Other less common methods include:

1. Sinking Fund Method
2. Insurance Policy Method
3. Annuity Method etc

**EVALUATION QUESTIONS**

1 Define the term depreciation

2 State four causes of depreciation of assets.

**STRAIGHT LINE MEHOD**

Under this method, an equal amount is charged for depreciation yearly throughout the useful of an asset.

Formula = Cost – Scrap Value

No. of years

**Illustration:**

The cost of a machine is N50,000. The residual value is N8,000 and is expected to last for 7 years. Calculate the depreciation charge for each of the seven year.

Solution:

Depreciation = Cost – Scrap Value

Estimated Useful life

= 50,000 – 8,000

7

= 42,000

7

= N6,000

N.B. The N6,000 is debited to Profit and Loss Account and credited to the Provision for Depreciation on Machine Account

**ADVANTAGES OF THE STRAIGHT LINE METHOD**

* 1. It is simple (or easy) to calculate
  2. It is widely used
  3. It is time oriented
  4. It is judicially recommended – Edwards v. Sauntons Hotels

**DISADVANTAGES OF THE STRAIGHT LINE METHOD**

1. It is not suitable (or ideal) for all type of fixed assets. For example, it cannot be used for loose tools
2. It is not scientific – as it does not take the efficiency of the asset into consideration
3. The assumption of equal depreciation per year is unrealistic

**EVALUATION**

1. List and explain five factors that would be considered in the computation of the annual depreciation of an asset.
2. Differentiate between the terms – Depreciation and Amortization

**GENERAL EVALUATION**

1. State six characteristics of depreciable assets
2. Explain three differences between a trial balance and a balance sheet
3. List seven errors that will affect the agreement of the trial balance
4. Explain the following : (i) real account (ii) nominal account (iii) personal account
5. List eight items that cause disagreement between Cash Book and bank statement balance

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting Page 151 – 167

**WEEKEND ASSIGNMENT**

. 1 Which of the following fixed assets is not depreciable (a) building (b) tools (c) land (d)

furniture

2 Patents and Trade marks are classified under (a) Fixed Assets (b) Current Assets

(c)Wasting Assets (d) Intangible Assets

3 Which of the following does not lead to depreciation of assets (a) Wear and tear (b)

Devaluation of Naira (c) Obsolescence (d) Usage

4 Which of the following does not belong to the group (a) straight line (b) insurance

policy (c) accumulated depreciation (d) diminishing balance

5 Depreciation is (a) the cost of replacing fixed assets (b) the cost of repairs incurred on a

fixed asset (c) a charge for the wear and tear of a fixed asset (d) the loss incurred on the

sale of a fixed asset

**THEORY**

* 1. Give two examples of assets associated with Depreciation and Amortization
  2. A machine cost N60,000. It will be kept for 5 years and then sold at an estimated figure of N10,000. Show the calculations for depreciation for each year using the Straight Line Method.

**WEEK SEVEN AND EIGHT**

**TOPIC: DEPRECIATION OF FIXED ASSETS**

**CONTENT**

* Methods of providing for depreciation

**REDUCING BALANCE METHOD (or DIMINISHING BALANCE METHOD)**

Under this method, a fixed percentage is written off the reducing (or diminishing) balance of the asset yearly.

This method charges higher depreciation in the early years of the asset and lower in the later years

The depreciation rate (%) to be applied is computed using the formula below:

S

Depreciation rate (%) = 1 - C

where:

n = No. of years

s = Scrap value

c = Cost

**Illustration:**

A machine costing N10,000 will realize N256 in four years time. Show the yearly depreciation to be charged for each of the four years using diminishing balance method.

**SOLUTION:**

S

Depreciation Rate (%) = 1 - C

256

= 1 - 10,000

4

= 1 - 10

= 0.6

= 60%

The depreciation charge applicable to each of the four years will be:

**N**

Cost 10,000

Year 1 Depreciation = (60% X 10,000) 6,000

REDUCED BALANCE (i.e. NBV) 4,000

Year 2 Depreciation = (60% X 4,000) 2,400

REDUCED BALANCE (i.e. NBV) 1,600

Year 3 Depreciation = (60% X 1,600) 960

REDUCED BALANCE (i.e. NBV) 640

Year 4 Depreciation = (60% X 640) 348

SCRAP VALUE ( i.e. NBV) 256

**ADVANTAGES OF THE DIMINISHING BALANCE METHOD**

1. It is widely used.

2. Depreciation is more scientifically provided for.

3. It recognizes the efficiency of an asset by charging higher amounts in the early years and lower amounts in the later years.

4. Higher depreciation amounts and low maintenance cost in the early years even out with low depreciation amounts and higher maintenance cost in the later years

**DISADVANTAGES OF THE DIMINISHING BALANCE METHOD**

1. Calculating the rate of depreciation may be difficult
2. It is not ideal for all fixed assets. For example it cannot be used for loose tools.

**SUM OF THE YEARS DIGIT**

Under this method, the years in the life of the asset are represented with digits and are added. The fraction of the asset cost is then charged to the years in reverse order.

**Illustration:**

A machine cost N10,000 and has a life span of four years after which it can be sold for N256. Calculate the yearly depreciation charge for each of the four year using the sum of the years digit method.

**SOLUTION:**

Amount = Cost - Scrap Value

= N10,000 - N256

= N9,744

No. of years = 4

Add up the years thus: 1 + 2 + 3 + 4 = 10

i.e. Sum of the four years = 10

Reverse the digit for each of the year

**Year Digit**

1 4

2 3

3 2

4 1

Calculation of depreciation charge:

Year 1 = 4 X 9,744 = N3,898

10

Year 2 = 3 X 9,744 = N2,923

10

Year 3 = 2 X 9,744 = N1,949

10

Year 4 =1 X 9,744 = N974

10

**N.B**

The sum of the years digit is similar in some respect to the diminishing balance method as it charges higher depreciation in the early years of the asset.

Therefore the advantages and disadvantages of the sum of the years digit are the same as for the Diminishing Balance Method.

**EVALUATION QUESTIONS**

1. Explain the following methods of depreciation:

(a) reducing balance method (b) sum of the years digit

2. Write short notes on the following:

(a) Depreciation (b) Salvage value (c) Obsolescence

**REVALUATION METHOD**

Under this method the asset is revalued each year, any difference being charged to the profit and loss account.

This method is good for assets which cannot be easily depreciated because of their nature e.g. loose tools (i.e. bolts, nuts, hammer, chisel, screws) livestock, farm crops/plantations e.t.c.The value of the assets at the beginning and end of the year will be estimated and used in the calculation of the depreciation.

**Illustration:**

On 1st January 2005, the value of loose tools was N25,000. Purchases of loose tools during the year was N7,000. On 31st December 2005, the loose tools were revalued at N24,000

Required: Calculate the depreciation on loose tool for the year.

**SOLUTION:**

**N**

Balance of loose tools 1 Jan 2005 25,000

Add : Purchases of loose tools in 2005 7,000

32,000

Less: Balance of loose tools 31 Dec 2005 24,000

Depreciation on loose tools for 2005 8,000

**ADVANTAGES OF THE REVALUATION METHOD**

It is suitable (or ideal ) for loose tools, livestock e.t.c.

**DISADVANTAGES OF THE REVALUATION METHOD**

1. It cannot be used for all classes of assets.

2. Revaluation of assets on yearly basis may be cumbersome

**DEPLETION UNIT METHOD (or PRODUCTION UNIT METHOD )**

This method is used for wasting assets such as quarry, mine, timber, and other assets ( like machines) whose useful life can be estimated in hours.

**Illustration**

A machine costing N100,000 can work for 800 hours. If it works for 120 hours in 2005 and 200hours in 2006. Calculate the depreciation charges for each year.

**SOLUTION**

Calculation of Depreciation on Machine

2005 120 X N100,000 = N15,000

800

2006 200 X N100,000 = N25,000

800

**EVALUATION QUESTIONS**

1. List five methods of providing for depreciation of assets.

2. Mention three characteristics of depreciable assets

**GENERAL EVALUATION**

1. What is depreciation
2. Explain the following methods of calculating depreciation (i) staight line (ii) reducing balance (iii) sum of the years digit
3. What is the difference between depreciation and amortization
4. State ten uses of the general journal
5. Explain the principle of double entry system

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting Page 151 - 167

**WEEKEND ASSIGNMENT**

A machine cost N12,000 and has a useful life of 4 years and an expected disposal valueof N400

1. Using the straight line method, the annual depreciation is (a) N3,100 (b) N3,000

(c)N2,900 (c) 2,300

2. The accumulated depreciation at the end of year three using the straight line method

Is (a) N6,900 (b) N8,700 (c) N9,300 (d) N9,600

3. Using the reducing balance method and ignoring residual value, what will be the depreciation charge for year 2 at 20% (a) N3,000 (b) N2,900 (c) N2,400 (d) N1,920

4. Using the reducing balance method and ignoring residual value, what is the net book value at the end of year 2 (a) N10,480 (b) N10,080 (c) N9,680 (d) N7,680

5.. Which of the following is true of the straight line method of depreciation (a) accurate depreciation charges are made yearly (b) the scrap value is zero (c) yearly depreciation charge decreases (d) yearly depreciation charges are constant

**THEORY**

1. List four advantages enjoyed by a firm that charges depreciation of fixed assets in its final account

2. A motor car cost N51,200. It will be kept for 5 years and then sold at an estimated figure of N12,150. Show the calculations of the figures for depreciation for each year using

(a) Straight line method

(b) Reducing balance method at 25% rate of depreciation

**WEEKNINE**

**TOPIC: DEPRECIATION OF FIXED ASSETS**

**ACCOUNTING TREATMENT OF DEPRECIATION**

There are two ways of treating depreciation in the ledgers. These are the Old Method and the Modern Method. However, the Modern Method which is preferred by accountants will be considered.

**MODERN METHOD**

An asset account is opened and a separate provision for depreciation account is also opened. The depreciation for each year is debited to the Profit and Loss Account and credited to the Provision for Depreciation Account

Therefore the following accounts should be prepared:

1. Asset account ( e.g. Machinery Account)
2. Provision for Depreciation Account
3. Profit and Loss Account
4. Balance Sheet

**Illustration**

A machine cost N100,000. It is expected to have a useful life of five years at the end of which time it is expected to be sold for N20,000 (its residual value)

You are required to show the necessary ledger accounts assuming the machine is depreciated on the straight line basis.

**SOLUTION**

Annual Depreciation Charge = Cost - Scrap Value

Estimated useful life

= 100,000 - 20,000

5

= 80,000

5

. = N16,000

**Ledger Accounts:**

**Machinery**

**N N**

Year 1 Cash 100,000 Year 1 Balance c/d 100,000

Year 2 Balance b/d 100,000 Year 2 Balance c/d 100,000

Year 3 Balance b/d 100,000 Year 3 Balance c/d 100,000

Year 4 Balance b/d 100,000 Year 4 Balance c/d 100,000

Year 5 Balance b/d 100,000 Year 5 Balance c/d 100,000

**Profit Loss Account (extracts)**

**N N**

Year 1 Provision for dep. of machinery 16,000

Year 2 Provision for dep. of machinery 16,000

Year 3 Provision for dep. of machinery 16,000

Year 4 Provision for dep. of machinery 16,000

Year 5 Provision for dep. of machinery 16,000

**Provision for Depreciation of Machinery**

**N N**

Year 1 Balance c/d 16,000 Year 1 Profit and Loss A/c 16,000

Year 2 Balance c/d 32,000 Year 2 Balance b/d 16,000

Profit and Loss A/c 16,000

32,000 32,000

Year 3 Balance c/d 48,000 Year 3 Balance b/d 32,000

Profit and Loss A/c 16,000

48,000 48,000

Year 4 Balance c/d 64,000 Year 4 Balance b/d 48,000

Profit and Loss A/c 16,000

64,000 64,000

Year 5 Balance c/d 80,000 Year 5 Balance b/d 64,000

Profit and Loss A/c 16,000

80,000 80,000

**Notes:**

The fixed asset account continues to show the machine at cost each year of its life. Fixed assets accounts sometimes include the words ‘at cost’ in their titles to emphasise this point.

The balance on the Provision for Depreciation of Machinery Account increases each year.

A provision in accounting is an amount set aside for a particular purpose.

A separate Provision for Depreciation account must be opened for each class of fixed assets.

The balance on the Provision for Depreciation account is deducted from the cost of the fixed asset in the Balance Sheet.

The balance remaining after depreciation has been deducted from cost is known as NET BOOK VALUE (NBV) or WRITTEN DOWN VALUE(WDV) of the asset. It is the amount of the cost of the asset which has not yet been charged against profit in the Profit and Loss Account.

**Balance Sheet (extract)**

**FIXED ASSETS Cost Dep. NBV**

Year 1 Machinery 100,000 16,000 84,000

Year 2 Machinery 100,000 32,000 68,000

Year 3 Machinery 100,000 48,000 52,000

Year 4 Machinery 100,000 64,000 36,000

Year 5 Machinery 100,000 80,000 20,000

**EVALUATION QUESTION**

1. A lorry cost N160,000. It will be kept for 4 years and then sold at a scrap value of N256. Show the necessary accounts using diminishing balance method.

**GENERAL EVALUATION**

1. What are books of prime entry?
2. List any seven books of prime entry
3. State six reasons for keeping accounting records
4. Explain six factors that are taken into consideration in determining annual depreciation charge
5. State six errors that would not affect the agreement of the trial balance

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting, Page 151-167

**WEEKEND ASSIGNMENT**

1. The amount set aside out of profit for a specific purpose is \_\_\_\_\_\_\_

(a) depletion (b) reserve (c) provision (d) depreciation

2. Which of the following terms describes the provision made for the loss in the value of an asset that has a legal life span?

(a) capitalization (b) depreciation (c) depletion (d) amortization

3. Which of the following is not a cause of depreciation?

(a) inflation (b) obsolescence (c) erosion and decay (d) wear and tear

Use the information below to answer questions 4 and 5

A motor van costs N60,000,000 at 1st January, 2004. It was depreciated at 8% using the fixedinstallment method.

4. What was the accumulated depreciation as at December 31st, 2005?

(a) N9,600,000 (b) N9,216,000 (c) N4,800,000 (d) N4,416,000

5. What was the net book value of the motor van as at December 31st, 2005?

(a) N55,584,000 (b) N55,200,000 (c) 50,784,000 (d) N50,400,000

**THEORY**

A machine costing N40,000 and with an expected useful life of five years is to be depreciated by the reducing balance method. The annual rate of depreciation is 30%.

**Required:**

1. Prepare the Provision for Depreciation of Machinery account for years 1 to 5

2. Prepare a Balance Sheet extract to show the fixed asset of machinery at the end of each of the five years.

**WEEK TEN**

**FINAL ACCOUNTS – FULLY WORKED EXERCISES**

**Illustration:**

The following trial balance has been extracted from the ledgers of Mr. Johnson as at 31st

December, 2003.

**DR CR**

**₦ ₦**

Purchases / Sales 142,448 233,120

Returns 5,000 3,000

Discounts 2,412 1,368

Debtors /Creditors 38,600 23,280

Furniture and Fittings 5,000

Carriage inwards 2,500

Carriage outwards 5,176

5% Loan from Co-operative Society 15,000

Drawings 862

Land and Buildings 40,000

Rents, Rates and Insurance 11,946

Postages and Stationery 2,426

Motor Vehicles 20,000

Advertising 3,704

Provision for doubtful debts 500

Salaries and Wages 26,152

Bad Debts 2,468

Cash in Hand 624

Cash at Bank 6,108

Stock as at 1st January, 2003 14,308

Equipment at cost 97,400

Accumulated depreciation on Equipment 43,300

Capital 107,566

427,134 427,134

**Additional Information:**

(a) Stock at close N16,442

(b) **Outstanding expenses**:

Advertising N354

Salaries and wages N848

Interest on loan N750

(c) Rent, Rates and Insurance paid in advance N426

(d) **Depreciation**:

Equipment 10% on cost

Furniture and Fittings 5%

Land and Buildings 10%

Motor Vehicles 25%

(e) Salaries and wages includes N3,600 paid to Mr. Johnson.

(f) Records to typewriter bought on credit on 31st December, 2003 for N10,000 have not been made in the books.

(g) Mr. Johnson decided on 31st December, 2003 to write off a further amount of N2,000 as bad debt.

(h) Mr. Johnson’s children consumed goods worth N5,500 during the year.

(i) Provisions for doubtful debts 5%: discount allowance 10%

**Prepare:**

i. Trading, Profit and Loss Account for the year ended 31st December, 2003.

ii. A Balance Sheet as at that date.

**EVALUATION**

1. Explain the following:

(a) Cost of goods available for sale (b) Cost of goods sold (c) Gross profit

2. Write short notes on the following:

(a) Intangible assets (b) Wasting assets

**SOLUTION:**

**Mr. Johnson**

Trading Profit and Loss Account for the year ended 31st December, 2003

₦ ₦ ₦ ₦

Opening Stock 14,308 Sales 233,120

Add: Purchases 142,448 Less: returns inwards 5,000

228,120

Add: Carriage inwards 2,500

144,948

Less: children consumption 5,500

139,448

Less: returns outwards 3,000 136,448

150,756

Less:Closing stock 16,442

Cost of Goods Sold 134,314

Gross Profit c/d 93,806

228,120 228,120

Discount Allowed 2,412 Gross Profit 93,806

Carriage outwards 5,176 Discount Received 1,368

Postage & Stationery 2,426

Rent, Rates & Insurance (11,946-426) 11,520

Advertising (3,704 + 354) 4,058

Salaries & Wages (26152 + 848 – 3600) 23,400

Loan interest accrued 750

Increase in provision for doubtful debt 1,330

Provision for discounts allowed

(10/100 x (36,600 – 1830) 3,477

Bad debts: 2468 + 2000 4,468

**Depreciation:**

Equipment 9,740

Land and Building 4,000

Motor Vehicle 5,000

Furniture and fittings 250 18,990

Net Profit 17,167

95,174 95,174

Balance Sheet as at 31st December, 2003

**₦ FIXED ASSETS CostDep. NBV**Capital 107,566 N N N

Add Net Profit 17,167 Land & Building 40,000 4,000 36,000

124,733 Motor Vehicles 20,000 5,00015,000

Furniture & fittings5,000 250 4,750

Less: Drawings

(5,500 + 3,600 + 862) 9,962 Equipment 107,40053,040 54,360

114,771 172,40062,290 110,110

**CURRENT LIABILITIES: CURRENT ASSETS:**

5% Co-operative loan 15,000 Stock 16,442

Creditors 23,280 Debtors 38,600

Creditors for Typewriter 10,000 less: Bad Debts 2,000

Outstanding Expenses: 36,600

Interest on loan 750 less: Provision for

Salaries & wages 848 doubtful debts 1,830

Advertising 354 34,770

50,232 less: Provision for

discounts allowed 3,477 31,293

Insurance Prepaid 426

Cash at Bank 6,108

Cash in Hand 624

54,893

165,003 165,003

**EVALUATION QUESTIONS**

1. List six items each found in the asset and liability sides of the balance sheet of a sole proprietor.

2. State four reasons for charging depreciation.

**GENERAL EVALUATION**

1. Explain the following types of accounts and in each case, state the rules regarding the recording of transactions in their debit and credit sides: (a) personal accounts (b) real accounts (c) nominal accounts (d) liabilities account (e) asset account
2. State seven reasons why an accountant will consider end – of – year adjustments while preparing the final accounts
3. State five differences between book – keeping and accounting
4. List seven source documents that are used in preparing the cash book
5. Explain five differences between a trial balance and a balance sheet

**READING ASSIGNMENT**

Simplified and Amplified Financial Accounting, Page 185-202

**WEEKEND ASSIGNMENT**

1. The Salary of a shopkeeper who sells goods would be charged in the \_\_\_\_\_\_\_\_\_\_

(a) balance sheet (b) sales account (c) profit and loss account

(d) trading account

2. The balance of the Sales Account is transferred to the Trading Account by \_\_\_\_\_

(a) debiting the Profit and Loss Account (b) debiting the Trading Account

© debiting the Sales Account (d) crediting the Sales Account

3. Discount allowed is a charge to \_\_\_\_\_\_\_\_\_---

(a) Trading Account (b) Balance Sheet (c) Profit and Loss Account

(d) Current Account

4. Patents and Trade-marks are classified under\_\_\_\_\_\_\_\_\_\_

(a) fixed assets (b) current assets (c) intangible assets

(d) wasting assets

5. Which of the following is a nominal account?

(a) Machinery (b) Debtors (c) Goodwill (c) Salaries

**THEORY**

1. Give five examples each of the following classes of account

(a) Real accounts (b) Nominal accounts (c) Personal accounts

2. State five reasons why a trader would grant discounts to his customers.