ISBN 9789976780789
9 789976 780789

T01 BOOK KEEPING AND ACCOUNTS

BOOK KEEPING AND ACCOUNTS

STUDY TEXT

T01

Accounting Technician Level I

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS TANZANIA (NBAA)

ISBN 9789976780789

T01 BOOK KEEPING AND ACCOUNTS

BOOK KEEPING AND ACCOUNTS

STUDY TEXT

T01

Accounting Technician Level I

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS TANZANIA (NBAA)

T01

BOOK-KEEPING AND ACCOUNTS

STUDY TEXT

NBAA

NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS

MSEMA KWELI

ISBN No 978-9976-78-078-9

Published by

National Board of Accountants and Auditors.
Mhasibu House, Bibi Titi Mohamed Street,
P.O. Box 5128,
DAR ES SALAAM

Printed by

Tanzania Printing Services Ltd.
Chang'ombe Industrial Area
P. O. Box 9661,
Dar es Salaam, Tanzania.

The content writer is grateful to The National Board of Accountants and Auditors, Tanzania for permission to reproduce past examination questions. The answers to past examination questions have been prepared by National Board of Accountants and Auditors.

FOREWORD.

The National Board of Accountants and Auditors is a professional body in Tanzania, established under the Auditors and Accountancy Registration Act No 33 of 1972 (CAP 286 R.E.2002). The Board has been charged with among other things, the responsibility to promote, develop and regulate the accountancy profession in the country.

In fulfilling its statutory obligations, NBAA prepares National Accountancy Examination Scheme for students aspiring to sit for Accounting Technician and Professional Examinations. Further, for effective implementation of the examination scheme and improve examination results, the Board provides Study Guides for all subjects to assist both examination candidates and trainers in the course of learning and teaching.

The Study Guides have been prepared in the form of text books with examples and questions to enable the user to have comprehensive understanding of the topics. The Study Guides cover a wide range of topics in the NBAA syllabi and adequately cover the most comprehensive and complete knowledge base that is required by a leaner to pass the respective examination levels.

Furthermore, the Study Guides have been prepared to match with the Competency Based Syllabi to enable the learners to be exposed to practical understanding of issues rather than memorisation of concepts. In this case, the Study Guides are characterized by the following features:-

1. Focus on outcomes – The outcomes shown in every topic provides clear understanding on what to be learnt.

2. Greater workplace relevance – the guides emphasize on the importance of applying knowledge and skills necessary for effectively performance in a work place. This is different from the traditional training where much concern has been expressed in theoretical perspectives.

3. Assessments as judgments of competence – The assessment questions embedded in the Study Guides are adequate measures of understanding of the subject matter.

Study Guides are also useful to trainers specifically those who are teaching in the review classes preparing learners to sit for the professional examinations. They will make use of these Study Guides together with their additional learning materials from other sources in ensuring that the learners are getting sufficient knowledge and skills not only to enable them pass examinations but also make them competent enough to perform effectively in their respectively workplace.

NBAA believes that these standard Study Guides are about assisting candidates to acquire necessary skills and knowledge that will enable them to perform as professionals. The outcomes to be achieved are clearly stated so that learners may know exactly the skills and knowledge they are supposed to acquire in a particular topic.

NBAA wishes all the best to NBAA Examination candidates, trainers in their review classes, lecturers in the higher learning institutions and all other beneficiaries of these learning materials in making good use of the Study Guides towards promoting the accountancy profession in Tanzania.

CPA. Pius A. Maneno
EXECUTIVE DIRECTOR

JUNE, 2019

CONTENTS

T01 – Book-Keeping and Accounts

Total Page Count: **260**

Features of the book

'The book covers the entire syllabus split into various chapters (referred to as Study Guides in the book). Each chapter discusses the various Learning Outcomes as mentioned in the syllabus.

Contents of each Study Guide

- **'Get Through Intro':** explains **why** the particular Study Guide is important through real life examples.
- **'Learning Outcomes':** on completion of a Study Guide, students will be able to understand all the learning outcomes which are listed under this icon in the Study Guide.

The Learning Outcomes include:

- ✓ **'Definition':** explains the meaning of important terminologies discussed in the learning Outcome.
- ✓ **'Example':** makes easy complex concepts.
- ✓ **'Tip':** helps to understand how to deal with complicated portions.
- ✓ **'Important':** highlights important concepts, formats, Acts, sections, standards, etc.
- ✓ **'Summary':** highlights the key points of the Learning Outcomes.
- ✓ **'Diagram':** facilitates memory retention.
- ✓ **'Test Yourself'**: contains questions on the Learning Outcome. It enables students to check whether they have assimilated a particular Learning Outcome.

- **Self Examination Questions'**: exam standard questions relating to the learning outcomes given at the end of each Study Guide.

EXAMINATION STRUCTURE

The syllabus is assessed by a three hour paper based examination.

The examination will consist of

Two conventional questions of 20 marks each	40 marks
Thirty objective questions of 2 marks each	60 marks
	100 marks

INTRODUCTION TO BOOK-KEEPING AND ACCOUNTING

1

Get Through Intro

Financial accounting is the **'language of business.'** As tomorrow's managers and business people, you need to be fluent and master this 'language' to perfection.

Paper T01 is the foundation of your knowledge: if you can build a solid base, everything you "construct" will be consistent and will last over a long time. By the end of this Study Text, you should be able to understand the underlying principles and concepts of financial accounting and be comfortable with debits and credits. You will have started your career by winning a very important battle – understanding the 'language of business'!!

This Study Guide also explains the **accounting principles, concepts and conventions that financial statements should have**. As an accountant, it is assumed that you understand all the accounting principles and their inter-dependence. Without this basic knowledge it is impossible to efficiently complete the entire accounting exercise – which starts with the source document and ends with the financial statements.

As a student of accounting and a future finance and accounting professional, you should be comfortable with the terms **debit** and **credit** and be able to recognise these two elements in each transaction. These two words are so important that the whole process of accounting and financial reporting rests on them.

We will start by explaining what financial accounting is and the various fields in accounting. We will then discuss various accounting concepts and their applicability in business.

Learning Outcomes

a) Define the terms book-keeping and accounting.
b) List the differences between book-keeping and accounting.
c) Describe field of accounting.
d) Define and state the differences between financial accounting and book-keeping.
e) Define accounting concepts and accounting principles.
f) List the accounting concepts and explain applicability of each accounting concepts in business, covering the following:
   i. Business entity
   ii. Going concern
   iii. Money measurement
   iv. Accrual
   v. Consistency
   vi. Duality
   vii. Matching Concept
   viii. Historical Cost
   ix. Cash basis
   x. Accounting period
   xi. Materiality
   xii. Prudence / conservatism
g) Define accounting standards.
h) State the importance of accounting standards.

1. **Define the terms bookkeeping and accounting.**
2. **List the differences between book-keeping and accounting.**

[Learning Outcomes a and b]

1.1 Financial accounting

Definition

Accounting is the **process of recording and reporting of financial transactions** including the origination of the transaction, its recognition, processing and summarisation in the financial statements**.**

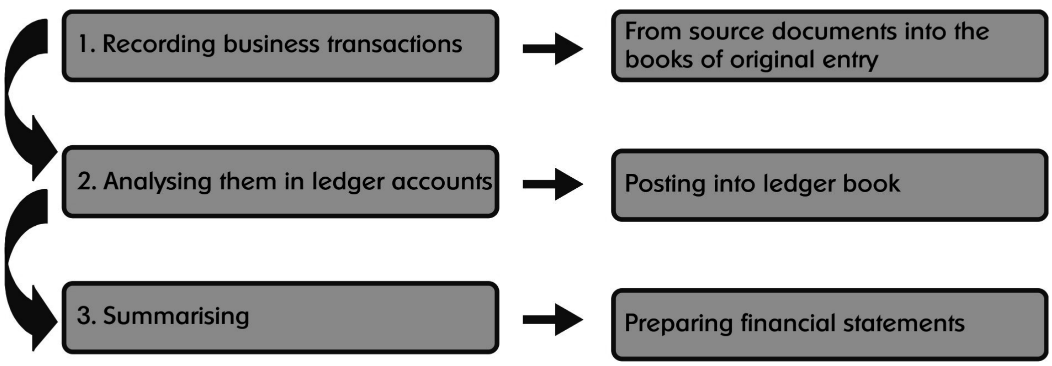
The New York State Society of CPAs

The primary objective of financial accounting is the preparation of financial statements - including the statement of financial position, statement of profit or loss and statement of cash flows. These financial statements will be discussed in detail later in this Study Text.

From the start of a business, various transactions and events take place. All transactions should have as their base, certain original source documents (such as invoices or receipts – you will study these in detail later on in this Study Text) from which we record information in the business accounts. This information is then summarised in the form of financial statements. .

The accountant will be responsible for accounting of business transactions and reporting them to external users. Financial reporting (or accounting) will therefore consist of the following:

Diagram 1: Financial reporting process



1. Recording

However good the memory of a businessman may be, he cannot remember each and every transaction that takes place during the course of business. Hence, there is a need to record the day to day transactions e.g. sales, purchases, expenses made, cash paid to someone, cash received from someone and so on.

Recording refers to the actual writing of the transactions that take place in words and figures so that reliable information regarding the position of the business can be made available at any point of time. The books where this information is recorded are known as the **books of original entry.**

The transactions are recorded in the books of accounts on the basis of documents such as invoices, receipts, vouchers, bank statements, etc.

Example

Lumumba has started a business as a sole trader selling tables that he buys from a craftsman's shop called Table Crafters LLC. He started the business in January 20X9 and the following transactions took place during the year:

1. He deposited Tshs50,000,000 cash into a bank account exclusively for the business
2. Lumumba bought 10 round wooden tables at Tshs20,000 each from Table crafters LLC.
3. Lumumba sold all the tables during the year at Tshs350,000 each for cash.

Required:

What are the documents on the basis of which you could record the above transactions and events?

Answer

1. The business bank statements confirm the receipt and payment of cash into the business account
2. Purchase invoice issued by Table Crafters LLC will be used to record the purchases made
3. Sales invoices issued by Lumumba will document the sales made.

---

2. Analysing

From the books of original entry, the transactions are analysed and posted to the ledgers. The ledger book contains separate categories for each typical business transaction such as purchases account, sales accounts, cash account, expenses account etc. Each of these transactions and its related accounts are explained in more detail in the coming Study Guides.

Every transaction has two effects. For example, when a trader purchases goods, there are two effects:

- The first effect is that the goods are received; and
- The other effect is that cash is paid for the goods purchased.

As each transaction will have a double effect, two ledger accounts will be affected when a transaction is posted.

Example

Mary is a book shop owner who conducted the following transactions during the month of May:

1. Purchased books from Njema Plc.
2. Gave a cheque to Njema Plc.
3. Paid salary in cash to James
4. Sold books to Umoja college
5. Received cash from Umoja College

Required:

Identify the ledger accounts that would be impacted because of the above transactions.

Answer

1. Book purchases account and Njema Plc (supplier / vendor) account
2. Njema Plc supplier / vendor account and bank account
3. Salary account and cash account
4. Umoja college (customer) account and sales account
5. Cash account and Umoja college account

---

3. Summarising

Thousands of transactions could occur during a year and therefore users of financial accounts may not have the time to go through each one of these transactions. In certain cases, owners of a business also may wish to keep certain transactions confidential. Therefore transactions need to be summarised in a structured manner in order to understand an entity's financial position and performance at the end of a period.

The final products of financial reporting are the business **financial statements.** The three main financial statements that summarise all the transactions and events of a business during a specific period are:

(a) Statement of profit or loss (SOPL)
(b) Statement of financial position (SOFP)
(c) Statement of cash flows

These financial statements have been discussed in detail in later in this Study Text.

Conclusion

During the accounting process, accountants identify record and analyse the financial dealings of a company. At the end of each period, accountants use the information they have collected to prepare financial statements. Thus financial reporting is the process of **preparing and presenting the financial statements.**

1.2 Book-keeping

Definition

Book-keeping is a part of accounting and is concerned with maintenance of records or books of accounts. It covers recording and classification of transactions.

Alternatively, book-keeping can also be termed as record keeping. Book-keeping ensures that information within the organisation is organised and stored in a systematic manner, which can be later used to facilitate day to day operations and to prepare financial statements, tax returns, management reports, etc. Book-keeping can be referred to as a subset of accounting.

1.3 Accounting

We already discussed financial accounting in Paragraph 1.1 in detail. However, the word 'accounting' is broad and covers accounting in various fields such as cost accounting, financial accounting, management accounting, environmental accounting, human resource accounting, etc.

1.4 Differences between book-keeping and financial accounting

Basis of Distinction	Book-keeping	Financial Accounting
Scope	Book-keeping involves recording and classifying transactions	Accounting in addition to book-keeping involves analysing summarizing, interpreting and communicating financial transactions.
Stage	Book-keeping is the initial stage and constitutes the base for financial accounting.	The accounting process starts where book-
Objective	Its aim is to maintain systematic Records	It's aim is to ascertain the financial performance and financial position of the enterprise
Decision making	Managerial decisions cannot be taken with the help of these book-keeping records	Helps in management decision making

Test Yourself 1

Determine the correct sequence of the financial accounting process:

A Recording, analysing and summarising
B Analysing, summarising and recording
C Analysis, recording and summarising
D Balancing, recording and summarising

---

3. **Describe field of accounting.**
4. **Define and state the differences between Financial Accounting and Book-keeping.**

[Learning Outcomes c and d]

2.1 Field of accounting

For the purpose of Paper T01, we will broadly classify accounting under the following three major headings:

Financial Accounting
Cost Accounting
Management Accounting

The above three areas of accounting are discussed in detail below:

1. Financial Accounting

Accounting is the **process of recording, analysing and reporting (in the form of statement of profit or loss and statement of financial position).**

Financial accounting is concerned only with the financial state of affairs and financial results of operations. It is mainly concerned with the preparation of financial statements which primarily includes statement of profit or loss and the statement of financial position. These financial statements are used by various stakeholders such as trade payables, investors and financial institutions.

The statement of profit or loss is a statement of the business's financial performance and reflects all the items of income and expenses incurred by a business during a certain period. In a statement of profit or loss, the items of income and expenditure incurred by a business are matched against each other to arrive at the **profit / loss** generated by the business during that period.

The statement of financial position (SOFP) is a statement reflecting everything that the entity **owns** (its assets e.g. property, equipment, cash) and everything it **owes** (its liabilities to the owners and third parties e.g. suppliers / vendors, equity) as at a certain point in time.

2. Cost Accounting

Definition

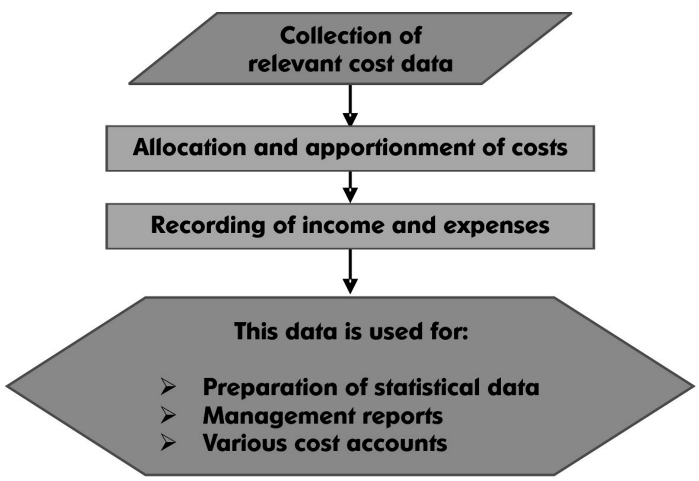
Cost accounting is "the establishment of budgets, standard costs (benchmark for comparison with actual) and actual costs of operations, processes, activities or products; and the analysis of variances, profitability or the social use of funds".

CIMA Official Terminology, 2005

Cost Accounting is the process of accounting for costs. It shows classification and analysis of cost on the basis of functions, process, products etc. It also deals with cost computation, cost saving, cost reduction etc. In cost accounting, cost per unit of output produced or services rendered is ascertained. It helps management in the control of cost of output or services rendered.

Cost accounting is the process of accounting or recording all attributable and allocable costs for a product or service, beginning with recording of income and expenditure relating to the product and ending with preparation of statistical data. Costing is essentially an activity of assigning the appropriate costs to a product and creating a data for future references as regards the cost relating to it.

Diagram 2: Cost accounting process



Its main objective is the creation of an underlying data for use in management accounting. This should include recording of:

- Cost of goods produced or services rendered
- Cost of combinations of activities grouped as a cost centre
- Accumulation of revenues

- Profitability at any level
- Optimum selling prices, ensuring all costs are covered
- Value of inventory
- Future costs
- Actual cost versus budgeted cost for budgetary control

Cost accounting systems can be found in all types of organisations, but are highly developed and extensively used in the manufacturing sector. This is because the industry is sensitive to costs, and the production costs need to be monitored and controlled effectively for the profit margins to be at the desired level. Cost accounting can be, and is generally, applied to all areas of the organisation. It is not department specific.

3. Management Accounting

It deals with the processing of data in financial accounting and cost accounting for managerial decision making. It also deals with the application of managerial economic concepts for decision making for the efficient running of the business, thus maximising profits.

In other words, it is accounting for the management. Management accounting is useful to the management to provided necessary information for decision making and creation of suitable policies within the organisation. The aim of management accounting is the efficient running of the business, and thus, maximising profits.

Where financial accounting focuses on external users, management accounting emphasises on the preparation and analysis of accounting information within the organisation.

The concept envisages the application of appropriate techniques and concepts, which would **aid management in the formulation of a strategy** for the achievement of objectives.

Data used for management accounting should serve its intended purpose. An appropriate concept or technique, even if borrowed from other branches of accounting or subjects such as mathematics or economics, can be used for management accounting purposes.

2.2 Difference between accounting and book-keeping

Basis of Distinction	Book-keeping	Accounting
Scope	Book-keeping involves recording and classifying transactions.	Accounting involves processing the book-keeping data for the purpose of preparing reports and statements under cost accounting, management accounting, financial accounting, etc.
Stage	Primary stage - book-keeping is the initial stage and constitutes the base for accounting.	Secondary stage - the accounting process starts where book-keeping ends. Using the book-keeping data, reports and various statements are generated.
Objective	To maintain systematic records.	To ascertain the financial condition, costing of certain product line, or to generate management reports, etc.
Decision making	Managerial decisions cannot be taken with the help of book-keeping records.	Helps in management decision making.
Sub - field	There is no sub-field of book-keeping.	It has several sub-fields like financial accounting, management accounting, etc.

Test Yourself 2

Management accounting, as a concept, makes use of:

A Both cost and financial accounting disciplines
B Neither cost nor financial accounting disciplines
C Cost accounting discipline only
D Financial accounting discipline only

5. **Define accounting concepts and accounting principles.**
6. **List the accounting concepts and explain applicability of each accounting concepts in business, covering the following:**
   - **i. Business entity**
   - **ii. Going concern**
   - **iii. Money measurement**
   - **iv. Accrual**
   - **v. Consistency**
   - **vi. Duality**
   - **vii. Matching Concept**
   - **viii. Historical Cost**
   - **ix. Cash basis**
   - **x. Accounting period**
   - **xi. Materiality**
   - **xii. Prudence / conservatism**

[Learning Outcomes e and f]

3.1 Accounting concepts and accounting principles

Accounting concepts

Definition

Accounting concepts are broad principles which form the basis of preparing financial statements.

While accounting standards differ from one jurisdiction to another, accounting concepts are universally accepted.

Accounting concepts are the **fundamental ideas and assumptions needed in accounting.** These are the fundamental rules that **must be followed** while preparing the financial statements. A clear disclosure must be made in the financial statements if these are not followed.

Accounting principles

Accounting principles are also referred to as qualitative characteristics.

Definition

Qualitative characteristics refer to the **attributes that financial statements should possess.** One has to **keep a balance between** all the **characteristics**. These characteristics make the financial statements more accurate and acceptable.

The accounting concepts and qualitative characteristics are given in the Framework for the preparation and presentation of financial statements and are issued by the IASB

When accounting **concepts and qualitative characteristics** are **adopted,** the information given in the **financial statements becomes** more **useful** and **understandable**.

Let us now discuss the accounting concepts and accounting principles in detail:

1. Business entity concept

For accounting purposes, business entity concept treats the business entity as having a separate existence from the owner. Therefore,

(a) The transactions between the owners and the business are also recorded. For example, when a person brings capital into the business or withdraws capital from the business, these are recorded.
(b) Amounts due from the business to the owners are shown as a liability from the business to the owners (i.e. the capital contributed by the owners).
(c) Personal assets and liabilities as well as income and expenses are not recognised in the business financial statements - the statement of financial position will only show business assets and liabilities; similarly, the statement of profit or loss will disclose only the incomes and expenses of the business.

(d) Personal payments or receipts, if routed through a business bank account, are recorded in the capital account of the owners.

(e) It may be noted that in the case of non-corporate entities, business entity concept is a fiction created by accounting practices; the insolvency laws may not treat the business entity as separate from the owners – business assets and personal assets will be combined to pay off business and personal liabilities in case of insolvency.

The business entity concept (i.e. treating the owners and the businesses as one) is applicable to all forms of businesses including sole traders and partnerships.

Example

Tom, a sole trader, purchases two properties at Tshs1 million each, using business funds. One of the properties is to be used for business while the other is to be used as Tom's residence. The transaction for the first property will be recorded as a purchase of a business asset. The property is shown in Tom's statement of financial position as an asset. The payment for the second property, which is used for residence, will be recorded as withdrawal of capital by Tom. Tom's capital will be reduced. No asset is recorded in the statement of financial position of Tom's business.

---

2. Going concern

The going concern concept assumes that an entity:

(i) will **continue** its operations **for at least the next 12 months**
(ii) does **not have any intention or need to close down its operations**
(iii) does **not have any intention or need to curtail materially, the scale of its operations**

Example

Due to an out-dated production method, the demand for the product is reduced and therefore the company has to reduce its production substantially. This affects going concern assumption.

The difference in accounting for an entity which is a going concern and which is not a going concern:

Going concern Financial statements	
	Valuation
Assets	Normal value
Liabilities	Normal value

Not a going concern Financial statements	
	Valuation
Assets	Disposal value
Liabilities	Settlement value

The value for an asset which has to be sold forcibly

The value of a liability which has to be settled immediately

Normal accounting bases include valuation on basis of fair value, historical cost, etc.

Example

Majuto runs a small dress-designing business in Kariakoo. He operates his business from a small shop. The cost of the shop is Tshs60 million. He also has to repay a bank loan of Tshs10 million. Majuto has an opportunity to move to Sinza and work for a top designer. Majuto needs to close down his business in Kariakoo. A customer has offered him Tshs35 million for the shop. The bank has agreed to accept Tshs9.5 million in full settlement of the loan.

Required:

State how Majuto will recognise the asset and liabilities related to his business in the financial statements.

Continued on the next page

Answer

Majuto's business is not a going concern.
Majuto has to sell the shop (no matter how low the realisable value is) and pay off the liability.
When the entity is not a going concern the assets are recognised at disposable value and liabilities at settlement value.
Disposable value: is the realisable value of an asset under a forced sale. Majuto is forced to sell the shop at Tshs35 million hence the disposable value is Tshs35 million.
Settlement value: is the value of a liability for immediate settlement. Majuto can settle the liability immediately by paying Tshs9.5 million hence its settlement value is Tshs9.5 million.

Below is a comparative statement of financial position for Majuto under the two conditions

(Amounts in Tshs'000)

	Going concern
Shop Premises	60,000
Total	**60,000**
Bank loan	10,000
Capital (balancing amount)	50,000
Total	**60,000**

	Not a going concern
Shop premises	35,000
Total	**35,000**
Bank loan	9,500
Capital (balancing amount)	25,500
Total	**35,000**

Capital decreased because of a decrease in the asset value. It increased partially by Tshs500,000 because of a decrease in the bank loan.

It is **usually assumed** that the **going concern** principle **is followed** when financial statements are prepared. However if it is not being followed then:

a disclosure should be made in the financial statements stating that the going concern principle has not been followed.
the basis on which the financial statements have been prepared should be given.
the reasons and details as to why the entity is not regarded as a going concern should be given.

Test Yourself 3

Under which of the following conditions is MAHINDI LLC deemed to be a going concern?

A The company deals in a chemical product. Environmental authorities have issued the company a notice to discontinue production. The company has taken the case to a court of law but the lawyer has recommended withdrawing the case because it is too weak.
B There was an intensive attack by enemies of the country. In this attack the company's plant was heavily damaged. This damage cannot be repaired in the near future.
C The company is facing heavy competition which may result in decline of revenue.

3. Money measurement

In accordance with the money measurement concept, only transactions and events that are capable of being measured in monetary terms are recognised in the financial statements. This is because the focus of accounting transactions is on quantitative information, rather than qualitative information.

Example

Examples of items that cannot be recorded in financial statements include:

Product quality or durability
Employee skill level
Efficiency in production process
Value of in-house brand
Sincerity, honesty and integrity of employees

The money measurement concept also requires that the records of the transactions must be kept not in physical units, but in monetary units.

Example

Baridi Ltd has constructed a factory on a piece of land measuring 10 acres, an office building which consists of 200 rooms, 10 elevators, 300 personal computers, etc. Under the money measurement concept, these assets will be recorded in money terms i.e. in Tshs.

---

4. Accruals

Exception – Cash flow information

The financial statements should be prepared on the basis of an accrual system of accounting. In the accruals system, items are recognised as assets, liabilities, incomes and expenses **on the date they satisfy the recognition criteria mentioned in their definitions.** The actual date of payment of cash is immaterial for the purpose of recognition.

The following examples will further explain the accruals concept.

Example

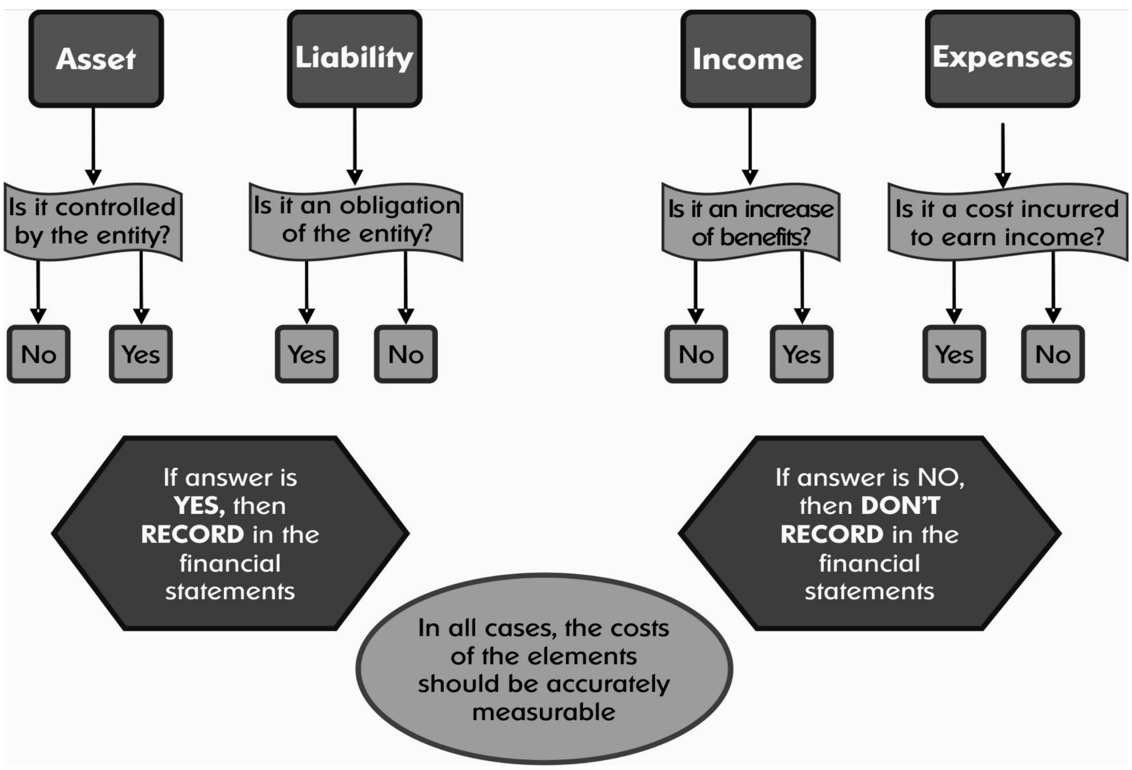
Lindi Inc purchased goods on 5 December 20X6 but paid the supplier on 8 February 20X7. Here, Lindi Inc became the owner of the goods on 5 December 20X6 even though the payment was made later. Hence the purchase transaction should be recorded on 5 December 20X6.

Example

Lindi Inc purchased goods on 5 December 20X6 but paid the supplier on 9 November 20X6. Here, Lindi Inc became the owner of the goods on 5 December even though the payment was made earlier (in advance). Hence the purchase transaction should be recorded on this date.

Under the accruals system, all the elements of the SOPL and the SOFP are recognised as follows:

Diagram 3: Recognising elements in the financial statements (Note that the timing of actual payment is immaterial)



5. Consistency

Definition

Consistency means the financial statements should be prepared in the same manner period after period.

IAS 1 Presentation of Financial Statements

According to this concept, the policy once adopted in one accounting period should be consistently followed in the subsequent accounting periods.

Example

Until 20X5, MAHINDI Plc followed the reducing balance method (RBM) for charging depreciation on assets. However, in 20X6, the company calculated depreciation according to the straight line method (SLM). Here, MAHINDI Plc has not followed the principle of consistency.

A new method of preparing the financial statements **can be used if**:

(a) The new method is **more appropriate**

(b) The new method is **prescribed by a standard or interpretation issued by the IASB**

Example

Nyekundu Co valued its inventory under the last in first out method (LIFO) until 20X4. But IAS 2: Inventories does not permit the LIFO method of inventory valuation and is applicable to the accounting periods in 20X5. Therefore the company has to follow a different method for valuing inventory from 20X5.

(c) there is a **change in the entity's operations** and a new method is needed

Example

MAHINDI Plc dealt with computer components until 20X7. Therefore it has classified its delivery vans as a non- current asset in the financial statements of 20X7.

In December 20X8, it stopped selling computers and started dealing in used vehicles. All vans are now available for sale. Therefore, all the delivery vans are required to be classified as a current asset in the financial statements of 20X8.

You will notice that during 20X7 delivery vans were classified as a non-current asset but in 20X8 the same vans are classified as current assets because of a change in the type of operations.

6. Duality

The duality concept states that all transactions have two effects. Duality means considering both the effects of a transaction.

Example

Smith bought a new car. This will have two effects:

Smith has received an asset (car)
Smith has paid for it

Accountants often say: 'every debit entry has a corresponding credit entry'. Journal entries are made to record transactions. Remember that each journal entry will contain items which are to be debited and items which are to be credited. The total of the debit items is always equal to the total of the credit items. A journal entry always has an explanation of the nature of the transaction. This is called the narration.

The journal entry to record the example given above is:

Dr		Car	XX	
	Cr	Cash		XX

Being a car acquired for cash– a non-current asset in the statement of financial position.

Debit is abbreviated as Dr, while credit is abbreviated as Cr

7. Historical cost

According to the Framework, under historical cost accounting, assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition.

Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.
Simply put this means that - **Historical cost accounting (HCA)** is where **accountants record transactions at historical cost** that is, the actual amounts of money, or money's worth, **received or paid** to complete the transaction.

Assets are recorded at

The amount of cash or cash equivalents paid. For example assets purchased on cash basis will be recorded at the amount of cash paid for purchase of the asset.

The fair value of the consideration given to acquire the assets, at the time of their acquisition.

Example

Affluent Co took over a branch of Dazzle Co by giving 3,000 ordinary shares of Brilliant Inc. The market value of the shares as on the date of sale is Tshs2,738 per share and the market value of the shares as at the end of the reporting period is Tshs2,950.
No. of shares

Market value on the date of sale

Affluent Company will reflect the machine at Tshs8,214,000 (3,000 x Tshs2,738)

Liabilities are recorded at

The amount of proceeds received in exchange for the obligation or

In some circumstances, the amounts of cash (or cash equivalents) expected to be paid to satisfy the liability in the normal course of business.

Example

If the amount of tax payable for an accounting period works out to be Tshs24 million, then a provision for tax payable will be recorded at Tshs24 million.

This is the amount of cash that will be required to satisfy the liability in the normal course of business.

---

8. Matching concept

In accordance with the matching concept, the revenue and the expenses incurred to earn the revenues must belong to the same accounting period. Under the matching concept, an organisation should ensure that only those expenses are charged to the statement of profit or loss to which the income (relating to those expenses) is earned.

Example

Jembe runs a transport business.

On 24 December 20X8, as his own trucks were unavailable, he hired a truck from Larry to deliver goods to his customer, Mason. He charged Tshs1 million for the goods sold to Mason and recorded it as revenue in the accounts for the year to 31 December 20X8.

However, until the year end i.e. 31 December 20X8, he did not receive an invoice nor did he pay Larry the agreed sum of Tshs80,000.

According to the matching concept, as Jembe has (in his accounts for the year to 31 December 20X8) recognised the revenue for the trip, he must also recognise the costs incurred for earning this revenue.

---

9. Cash basis

The cash basis of accounting is not permitted by IFRS / IAS. Only the cash flow statements are prepared using the measurement base of cash.

Smaller companies that haven't formally incorporated and most sole proprietors use cash-basis accounting because the system is easier for them to use on their own, meaning they don't have to hire a large accounting staff.

Under cash basis of accounting, expenses are recorded when expenses are actually paid and revenue is recorded when cash is actually received. The primary focus is on the amount of cash in the bank, and the secondary focus is on making sure all bills are paid. Little effort is made to match revenues to the time period in which they are earned, or to match expenses to the time period in which they are incurred.

The cash basis may be used, however, for small unincorporated entities, for example clubs and societies.

Example

Makini buys 100 tables for Tshs50,000 each in the month of April 2012. The purchase is made for cash. During
April 30, tables are sold for cash at Tshs70,000 each.

Using accrual based accounting, the results for January would be as follows:

	Tshs	Tshs
Revenue (30 × Tshs70,000)		2,100,000
Cost of sales		
Purchases (100 × Tshs50,000)	5,000,000	
Closing inventory (70 × Tshs50,000)	(3,500,000)	1,500,000
Profit		**600,000**

Using cash accounting, the results for January would be as follows:

	Tshs
Revenue (30 × Tshs70,000)	2,100,000
Cost of sales (100 × Tshs50,000)	(5,000,000)
Loss	**(2,900,000)**

You will notice from above that the cash basis of accounting shows an overall loss of Tshs2.9 million. Under accrual basis, the costs are matched with the revenue earned and the value of the closing inventories is carried forward as an asset under accrual based accounting.

---

10. Accounting period concept

In accordance with the accounting period concept, all the business transactions are recorded in the books of accounts on the assumption that profit / loss of transactions are to be ascertained for a specified period of time.

Applying this concept, all the financial statements are prepared for a specified period of time. For example, it may be for a quarter or for a six month period or on an annual basis. Although the going concern concept assumes that the business is run for an indefinite period, the accounting period concept states that the life of a business is divided into parts. These parts are known as accounting periods.

11. Materiality

Materiality means **relative importance**. Material items are **important items that the users of the financial statements must know**. The financial statements should show all the material items separately.

The concept of materiality relates to the time, efforts and the cost of accounting in relation to the usefulness of the data generated. Materiality requires that only those items which have a bearing on the determination of financial position and computation of profit and loss during the accounting period should be recorded and disclosed in the financial statements.

Example

Tausi Plc is a large manufacturing firm. The total of the company's receivables accounts for the year 20X8 is Tshs9.5 million. One of the company's stationery providers to whom Tshs1,000 was given as advance, closed his business. It was clear that the company would not be able to recover the advance.

Here, considering the company's scale of operations, Tshs1,000 is not a material amount. Hence, Tausi Plc need not adjust the total receivables amount immediately. The financial statements would still be fair.

Let's consider another example.

Example

Tausi Enterprises was penalised by the sales tax authorities for non-compliance with tax rules. The penalty amount was Tshs20,000. However, Tausi Enterprises included this amount of penalty under miscellaneous expenses which amounted to Tshs50,000 excluding the penalty. Hence miscellaneous expenses inclusive of penalty is Tshs70,000 (Tshs50,000 + Tshs20,000)

Here, penalty forms 28.5% of miscellaneous expenses. Hence it is a material item and must be disclosed separately.

Tausi Enterprises
SOPL

Materiality followed	
	Tshs
Sales	1,000,000
Cost of goods sold	(600,000)
Gross profit	**400,000**
Expenses	
Miscellaneous expenses	(50,000)
Penalty	**(20,000)**
Profit	**330,000**

Payment of a penalty is a material item hence should be deducted from Miscellaneous expenses and disclosed separately

Materiality not followed	
	Tshs
Sales	1,000,000
Cost of goods sold	(600,000)
Gross profit	**400,000**
Expenses	
Miscellaneous expenses	(70,000)
Profit	**330,000**

12. Prudence / conservatism

The concept of prudence implies that the **profit should not be over-stated but all anticipated losses should be recognised**. The implication of this is that all anticipated losses should be recognised and recorded immediately. But profits should be recognised and recorded in the books of account only when realised (this need not necessarily be in cash).

Example

Keira Co runs a bakery which is famous for delicious cakes. Shali bought a cake and ate it. She is now in a hospital suffering from food poisoning and all tests indicate that the cake from Keira Co is to blame.

Shali decides to take legal action against Keira Co and demands payment of her hospital bill from Keira Co. The lawyers have told Keira that it is virtually certain that Keira will lose the case. In this situation, it would make sense for Keira Co to put an additional legal expense in the financial statements, to cover the potential cost of losing the legal case.

Therefore, including the potential expense of the legal case in the financial statements is the application of the prudence concept.

Test Yourself 4

Recording of transactions in the books of accounts with a definite period is application of:

A Prudence concept
B Money measurement concept
C Going concern
D Accounting period concept

Test Yourself 5

Which of the following statements is/ are correct?

1. The money measurement concept is that only items capable of being measured in monetary terms can be recognised in financial statements.
2. Materiality means that only physical assets are recognised in the financial statements.

A Only 1
B Only 2
C Both 1 and 2
D None of the above

---

7. **Define accounting standards.**
8. **State the importance of accounting standards.**

[Learning Outcomes g and h]

Accounting standards refer to authoritative standards for financial reporting and specify how accounting transactions and events are to be recognized, measured, presented and disclosed in the financial statements. Tanzania adopted the International Financial Reporting Standards (IFRS) with effect from 1 July 2004 and therefore, every entity in the country, whether small or large, is required to prepare its financial statements in accordance with the IFRSs (except for public sector entities).

Definition

International Accounting Standards are a single set of high quality, understandable and enforceable global accounting standards.

IFRS are issued by a global body referred to as International Accounting Standards Board. The idea is that these same standards are used across the globe by companies, so financial statements can be prepared and compared on the same basis.

Importance of accounting standards

Accounting standards are needed for the following reasons

1. To prevent material manipulations or errors in financial statements

Many important economic decisions are regularly made on the basis of financial statements. However, financial information is open to manipulation or errors.

In order to avoid manipulation of figures in the financial accounts, there needs to be a consistent way of deciding which elements are recognised and measured, and how information is presented in the financial statements.

Example

An entity may revalue only those assets that have increased in value, so as to show a better picture. IAS 16 Property, plant and equipment allows an entity to revalue property, plant and equipment. However, it lays down a rule that an entire class of property, plant or equipment has to be revalued.

In absence of such guidance from the IAS the entity would have easily managed to manipulate the accounts. Thus in this case IAS 16 provides guidance that all the assets of that class should be revalued, irrespective of whether there is an increase or decrease in their value.

2. To ensure that items are treated in a consistent manner or an explanation is given as to why not

Accounting is not a subject where the results are always the same whoever does it. For example, in mathematics, 2 plus 2 must always equal 4; but in accounts, a figure for (say) profit or loss may vary, sometimes vastly, depending upon the subjective judgments of the person doing the calculations. It is important that explanations are given to help the user of financial statements make correct decisions.

Example

Santuri Co does not provide for investment property revaluations of Tshs600 million, based on an independent revaluation report, and does not disclose this fact. Santuri's profits are Tshs1,200 million. The user compares the financial statements with those of a similar company, Muziki Co that provides for revaluations of investment properties. Under IAS 40, all revaluation gains and losses are included in the profit for the year. Muziki's properties have increased substantially in value and therefore its profits have increased from Tshs1,200 million to Tshs1,800 million.

Santuri's profits for the year are lower than Muziki by Tshs600 million. The user concludes that Santuri Co is less profitable, therefore decides to invest in Muziki. This is an incorrect decision because the same accounting item has been treated differently by 2 companies. By having international accounting standards, items should be treated in a consistent manner, or, if there is a different treatment, an explanation should be given. So, under IAS, Santuri would need to state in its accounting policies that it does not revalue its investment properties.

3. To help in global harmonisation

This is a corollary of the purpose mentioned in the previous paragraph. Unless accounting activities are regulated across the globe, different entities in different countries will apply their own rules, which are unlikely to be harmonious.

The process of global harmonisation leads to global accounting standards. Global standards will help global trade and global economic growth as all users will be able to use the same standards to analyse the financial statements of any company, whether in the BUGURUNI, Posta, Kariakoo or Mwenge.

The process of global harmonisation of standards is not complete. There are countries like North America and India which use their own standards. However, now most of the national standard setters are harmonising their standards with the international standards.

Important

In Paper T01, students are advised to have an overview about IFRS. You will be studying the various IFRS's in detail in Paper T05.

Test Yourself 6

Who issue International Financial Reporting Standards?

A International Accounting Standards Board
B International Federation of Accountants
C National Board of Accountants and Auditors
D Certified Public Sector Accountants Board

Answers to Test Yourself

Answer to TY 1

The correct option is **A.**

Financial accounting process involves recording, analysing transactions into ledger accounts and summarising the transactions in the form of the financial statements.

Answer to TY 2

The correct option is **A**.

Management accounting is tailor made for management purposes. As such, it makes use of both cost and financial accounting records to extract appropriate and complete information. It can be anything about which management needs information and therefore information needs to be extracted from all the relevant areas.

Answer to TY 3

The correct option is **C**.

A **Not a going concern**: because there is a high probability of the company being unable to continue as its only product can no longer be manufactured.

B **Not a going concern:** because there is no scope of rehabilitation.

C **A going concern:** competition and a decline in revenue is a part and parcel of business.

Answer to TY 4

The correct option is **D.**

In accordance with the accounting period concept, all the business transactions are recorded in the books of accounts on the assumption that profit or loss on transactions will be ascertained for a specified period of time.

Answer to TY 5

The correct option is **A.**

Statement 2 is incorrect as materiality is a relative concept and does not deal with recognition of physical assets.

Answer to TY 6

The correct option is **A**.

IFRS are issued by a global body referred to as the International Accounting Standards Board.

Self-Examination Questions

Question 1

Identify the main differences between financial accounting and management accounting.

Question 2

MAHINDI Ltd purchased goods worth Tshs60,000. The transportation charges to deliver the material were Tshs5,000. The discount allowed by the supplier was Tshs2,000. Another supplier is willing to sell the same material for Tshs50,000.

Required:

What is the historical cost?

Question 3

Is it true that assets recorded at historical costs always show a value which is lower than the current value of the assets on the reporting date?

Question 4

Under the concept of going concern, the entity expects to exist for at least:

A The next 50 years
B The next 11 months and 20 days
C Next 5 years
D None of the above

Question 5

An accrual system of accounting prescribes:

A Recording the substance of the transaction and ignoring the form
B Recording all expenses when the payment is made
C Recording assets when they are controlled
D Overstating the expenses

Question 6

All material items should be:

A Presented in bold type in the financial statements
B Separately presented in the financial statements
C Clubbed together and presented in the financial statements
D Ignored

Question 7

Prudence is:

A Overstating the reserve for doubtful debts
B Understating the reserve for doubtful debts
C Fairly estimating the reserve for doubtful debts
D Ignoring the doubtful debts

Question 8

Consistency allows:

A Changing the method of preparing the financial statements when it is more appropriate
B Not changing the method of preparing the financial statements even when a new accounting standard prescribes so
C Not changing the method of preparing the financial statements when the entity changes its operations
D None of the above

Answers to Self-Examination Questions

Answer to SEQ 1

The main differences between financial accounting and management accounting are:

Financial accounting is mainly for external users (such as the shareholders) whereas management accounting is geared to respond to the decision making needs of the management.

Financial reporting needs to be done in compliance with specific rules and regulations (such as IFRS or other national GAAP) whereas management information can be tailored according to the specific needs of the business entity or according to the needs of the management.

Answer to SEQ 2

The historical cost is Tshs 63,000 (Tshs60,000 + Tshs5,000 – Tshs2,000). Historical costs are costs incurred at the time of purchase. The fact that MAHINDI Ltd could have bought the goods from another supplier at a lower price is irrelevant.

Answer to SEQ 3

Historical cost is the cost at which an asset is bought. It is incorrect to say that the historical cost will always be lower than the current value. This is especially true in today's world, where technology changes with every passing day. An asset which is exorbitantly expensive today could become extremely cheap with the passage of time through technological changes, for example, Pentium IV processors have lost their value because of the introduction of new Intel dual core processors. In this case, if the company owns these processors and has recorded the processors (assets) on historical cost basis, there is a possibility that the historical cost may reflect a higher value than the current cost of asset (market value will be lower due to technological changes).

Answer to SEQ 4

The correct option is **D**.

An entity should be expected to continue its operations for at least 12 months.

Answer to SEQ 5

The correct option is **C**.

Recording the substance of the transaction comes under the concept 'substance over form'. According to the accrual system of accounting, expenses should be recorded in the financial statements when there is a decrease in the economic benefits whereas assets should be recorded when economic benefits will flow to the entity.

Answer to SEQ 6

The correct option is **B**.

All material items should be separately presented in the financial statements. There is no need to put all material items in bold type.

Answer to SEQ 7

The correct option is **C**.

Prudence relates to fairly estimating the assets and liabilities. However, it is neither understating nor overstating the assets and liabilities.

Answer to SEQ 8

The correct option is **A**.

Consistency is preparing the financial statements in the same manner year after year. However the method can be changed if the new method is more appropriate or a new accounting standard prescribes it or it is necessary because of changes in the entity's operations.

ACCOUNTING INFORMATION

2

Get Through Intro

The end products of the financial reporting process are the financial statements that entities publish at the end of each financial year. These statements provide information that is useful to almost all of the organisation's stakeholders.

'Stakeholders' are all parties that have an interest in the entity (this includes groups such as shareholders / owners, investors, employees, customers, suppliers etc). These parties use the data presented in financial statements in order to make economic decisions regarding the organisation.

For example, if Stressfree Ltd approaches Townbank for a loan of Tshs400,000 then the bank has to decide whether Stressfree Ltd is capable of repaying both the loan and the interest on the loan in time. To ascertain the liquidity position of Stressfree Inc, Townbank will study the financial statements of Stressfree Ltd.

If at the same time Townbank is considering investing in the ordinary shares of Stressfree Ltd, it will study the financial statements of Stressfree Ltd once again. However this time it will check from a different point of view, whether the business of Stressfree Ltd is profitable and likely to grow and whether the value of its investment is likely to increase.

This shows that different users and stakeholders have different needs from the same set of financial statements. This Study Guide states the main stakeholders of an entity and discusses the type of information that each of these groups looks for in an organisation's financial statements.

As an accountant, you will be involved in both preparing and / or using the financial statements of various organisations. Hence you must have a solid understanding of how and why financial statements are prepared and the various types of information that can be extracted from them.

Learning Outcomes

a) Define accounting information
b) Explain the qualities of accounting information
c) Identify users of accounting information.
d) Described the accounting information needed by different users of financial statements covering the following:
   i. Investors
   ii. Employees
   iii. Lenders
   iv. Suppliers and other Creditors
   v. Customers
   vi. Government and its agencies
   vii. General public

1. Define accounting information.
2. Explain the qualities of accounting information
[Learning Outcomes a and b]

The words information and data are used interchangeably. This may lead to their confusion. However, they are not synonyms. Let us look into the definition of data and information.

Definition

Data is raw (unprocessed) information. It comprises of facts, events and transactions.

Definition

'Information' is the meaningful summarisation of data. Technically, information is data processed in a way that makes it purposeful.

Accounting data is the data contained in various business documents that support financial statements to produce financial results for the business. It may be in computer readable form or on paper. Accounting data is collected from sources such as the journal, ledger etc. After summarising it into the financial statements, accounting data becomes purposeful and can then be termed accounting information. The end result of the entire accounting process is the financial reports such as statement of profit or loss, statement of financial position, statement of cash flows, etc.

Diagram 1: Data and information

Example

Data is collected by a company selling water filters through a survey conducted on the usage of water filters in the area. This data will help them estimate the sales that they can have in the area. In this survey the data and information will constitute:

Data

- The number of people using water filters.
- The number of models of each brand used.
- The number of complaints for each brand.

Information

- A statement showing users and non-users of water filters and hence the quality of potable water supplied.
- A comparative statement depicting the most popular brand.
- An analysis highlighting the performance of each brand.

Information has meaning, while data does not. One person's information may be another's data depending on whether the data is relevant to the recipient.

Example

The information on the number of customers serviced by the company in the quarter is data for the manager as it does not help him plan the future profits required unless he also knows the sales price and profit margins earned. However, it is information for the person who accounts this data on a regular basis for reporting to the management.

Data is **unstructured**, **lacks context** and **may not be relevant** to the recipient. When data is correctly organised, filtered and presented with context it can become information because it then has "value" to the recipient.

Example

Sales invoices recorded in the accounting system do not make much sense, unless the sales invoices are totalled and the amount thus derived is used in financial statement preparation and analysis.

Distinction between data and information

Data	Information
Data is an **unprocessed** collection of facts, events and transactions	Information is a **processed** collection of facts, events and transactions.
Data is the **raw material** used for processing	Information is obtained after **processing** of data
Data is **unstructured**	Information is **structured**
Data lacks content and meaning	Information has **value** for the recipient
Decisions cannot be taken on the basis of data	Decisions are taken on the basis of information
The employee needs data to process and obtain information	The employee needs information to take decisions

Accounting information should exhibit the following qualities:

1. **Understandability:** it is easily understandable, and provides accounting information with clarity and in such a way that it is even easily understood by a common man who has reasonable knowledge of business and economic activities.

2. **Relevance:** accounting data provides relevant information to various users of business for taking appropriate decisions for the business.

3. **Consistency:** accounting data implies consistent treatment of similar items and application of accounting policies.

4. **Comparability:** it implies the ability for users to be able to compare similar companies in the same industry group and to make comparisons of performance over time.

5. **Reliability:** accounting data reflects the accounting information that is presented is truthful, accurate and complete.

Important

In addition to the above qualities, students are advised to refer to Study Guide 1 to understand the various qualitative characteristics prescribed by the IASB's Conceptual Framework. As discussed already, these qualitative characterises should be demonstrated by each financial statement to make it more meaningful and purposeful.

Test Yourself 1

Information is ________________.

A summarisation of data
B sorting of data
C interpretation of data
D all of the above

Test Yourself 2

Data is __________, __________context and may not be___________ to the recipient.

A unstructured, lacks, relevant
B structured, lacks, irrelevant
C structured, lacks, relevant
D unstructured, lacks, irrelevant

---

3. Identify the users of accounting information.
4. Described the accounting information needed by different users of financial statements covering the following:
i. Investors
ii. Employees
iii. Lenders
iv. Suppliers and other Creditors
v. Customers
vi. Government and its agencies
vii. General public

[Learning Outcomes c and d]

As mentioned earlier, there are several stakeholders who study / use an organisation's financial statements. The main groups of stakeholders and their information needs are described below.

1. Investors

The primary users of an organisation's financial statements are its owners / shareholders. This is because investors have provided the **capital** that makes it possible for an organisation to begin its operations. Naturally they want as much information and detail as possible in order to determine if their investment is not only safe but also growing.

As a general rule of thumb, if the owners are satisfied with the contents of an organisation's financial statements, then other groups also feel comfortable.

The information that investors are interested in include:

How their capital has been utilised

The number and type of assets the organisation owns

The level of debt the organisation has taken on

How profitable the operations of the organisation are and

Whether the financial condition and performance of the organisation is improving / deteriorating over time

Investors would also be interested in the above information as this information would help them decide if they could become the new owners / shareholders of the business. In addition, they will use the financial statements to assess whether the organisation represents a viable investment option (i.e. is the business likely to grow over the course of time and increase the value of their investment).

Example

Mark is an individual who has recently come into a large inheritance. He would like to use his new found wealth to invest in a suitable business. He identifies the telecom industry as one that is likely to see the most growth in the coming years.

Thereafter he looks at the financials statements of several companies that operate in this industry. He compares the financial condition and performances of these companies before deciding upon which particular organisation to invest his funds in.

---

2. Employees

Employees of an organisation are interested in the financial condition and performance of an organisation because that is the source of their salaries. In addition, organisations that are performing poorly or are in a weak financial position are unlikely to offer much scope for promotions, career development etc. Employees can figure out their career prospects from the financial statements.

3. Lenders e.g. banks or other financial institutions

Payables such as banks and other financial institutions typically provide the funding an organisation needs to carry on its operations and / or expand its business. As a result, they need to ascertain whether the organisation has the ability to repay its debts. As a result, they turn to the organisation's financial statements to determine the general trends followed by the organisation in terms of sales, profits, past scale of operations and cash flows. The specific information they seek from the organisation's financial statements include:

- How profitable the organisation has been
- Whether the company will continue to operate in the coming years, or is it likely that it will go out of business
- whether the operations of the organisation have generated sufficient cash flow to satisfy their debt repayments, going forward
- The value of the assets the organisation may have pledged as security / collateral

Example

Man-X is an organisation that has recently borrowed Tshs1 million from its bank to finance an expansion to its factory. To service this loan it will have to make payments of Tshs150,000 to the bank on an annual basis. For this, they have pledged their office premises as security to the bank, which is valued at Tshs2 million.

Before giving the loan, the bank will complete a detailed analysis of the liquidity position of Man-X. The financial statements of Man-X would be used for this analysis to assess the following:

- whether the organisation is generating sufficient cash to make the Tshs150,000 payment each year and
- whether the value of its security (the office premises) still stands at Tshs2 million.

---

4. Trade relations – customers and other creditors

Trade relations are the relations between the suppliers and customers of an organisation.

The trade payables, also referred to as creditors will use these statements to determine the financial condition and performance of the business in order to find out whether the organisation will be able to pay for the goods / services it orders from them.

Customers are typically less interested in the financial statements of an organisation they deal with. This is because normally their relationship with the organisation ends once the sale of goods / services has been made. However customers who have an on-going relationship with an organisation will be interested in the financial statements to determine if the organisation will continue to operate for the coming years.

Mono Computers manufactures personal computers which it sells to small and medium sized enterprises. It offers a one-year free service guarantee on the purchase of a computer. Customers would therefore be interested to study Mono's financial statements to help them determine whether or not the business would still be operating in twelve months' time (otherwise the one year guarantee becomes worthless).

---

5. Customers

Customers are interested in knowing to confirm whether business is likely to continue it operating in the near future. This is important if the customers are dependent upon the business for the goods and services.

6. Government and its agencies

Financial statements of organisations serve as a source of data for the government when it is compiling national economic statistics such as the country's GDP (Gross Domestic Product). This helps the government in taking different policy decisions.

Other government agencies such as the tax authorities use the financial statements to determine tax amounts. Income shown by the statement of profit or loss is used as the starting point for calculating taxable income. Revenue and purchase figures are used to determine VAT liability.

7. General public

The general public may be interested in the effects a company has on the economy, environment and the local community. This may include researchers, students and others who are interested in the financial statements for some valid reasons.

8. Management

Management will use the financial statements of the organisation as a kind of **"report card"** of their decisions / activities throughout the year. This is because the financial statements reflect how profitable (or unprofitable) these decisions or activities have been for the organisation.

Example

Fly Aircrafts is an organisation that manufactures airplanes. Since its inception the organisation has concentrated on the civilian market due to which sales and correspondingly profits have been stagnant over the past four years.

At the start of its current financial the year, the management of Fly Aircrafts made the strategic decision to move into the military market by making jet-fighters. The organisation's financial statements at the end of the year will help decide whether this decision was worthwhile or not by comparing with the previous year's financial statements.

---

9. Financial analysts, stock brokers, financial journalists

This group of users study the financial statements of organisations to determine their financial condition and performance. They also use these statements as a basis from which they make predictions regarding the future financial condition and performance of the organisation. Depending upon their predictions, they then advise their clients (investors) on whether to invest in a particular organisation or not.

Test Yourself 3

How do investors use financial statements to help them make decisions on whether or not to invest in a particular organisation?

2.1 Use of information by various users

There are several stakeholders who study / use an organisation's financial statements. We have already discussed in detail about the main groups of stakeholders and their information needs in the above paragraph. The summary of different users and their interest are summarised below.

Sr. No	Users	Use of information on the financial statements
1	**Owners and shareholders** i.e. the providers of capital for running the operations of the entity. Includes shareholders	To assess whether the entity has utilised the capital Efficiently. To ascertain the financial position of the entity i.e. information about the assets and liabilities of the company. To determine whether the financial condition and performance is improving / deteriorating over time. To determine the managements' efficiency in running the operations of the entity. To know the extent to which the available profits can be distributed to the shareholders. To assess the safety and growth of their investment. To assess the stewardship function of the management.
2	**Investors** i.e. the potential owners of the organisation	To assess the organisation as a profitable investment destination. To compare the financial statements of a number of companies from the same industry to make investment decisions.
3	**Employees**	Employees are interested in the company's financial position as their salaries are dependent on it. Employees use the financial statements to determine their future prospects for promotions, career development, etc.
4	**Providers of finance** to the company, which include: trade payables funding the operations of the company bank providing overdraft facility, long term finance, etc.	To know about the future profitability of the entity. To assess the entity's ability to generate sufficient cash flows to satisfy their debt repayments going forward. To determine the value of the assets that the company has pledged as security / collateral.
5	**Customers**	To know adequate availability of goods and services Without disruption. To determine business continuity in near future.
6	**Trade relations** i.e. Suppliers and Vendors Customers	Suppliers want to know the financial stability of the entity, i.e. the ability of the company to pay for the goods and services supplied. Customers want to be assured about the continuity of operations and regular supply of goods and services.
7	**Government and their agencies**	To know the allocation of resources to take different policy decisions. To collate the information of all entities and compile national economic statistics e.g. GDP
8	**General public**	To conduct research for their studies. To know the environmental impact
9	**Management of the company** who are appointed by the owners to supervise the day-to-day activities of the company	To analyse the information relating to current and future financial position of the entity To determine the efficiency of the management in taking timely decisions throughout the year To determine the effectiveness of management's control and planning
10	**Financial analysts and advisers** i.e. Stock Brokers Credit Agencies Journalists	To make predictions on the future financial conditions of the entity on the basis of the current financial statements To advise their clients (investors) on whether to invest in a particular organisation or not
11	**Tax Authorities**	To know the business profits To determine the amount of tax payable by the company, e.g. income tax or VAT liability from revenue and purchase figures

Answers to Test Yourself

Answer to TY 1

The correct option is **D.**

The information should have all the characteristics, so that it conveys the correct information without misleading the recipient and fulfilling the purpose of the intended use of the information.

Answer to TY 2

The correct option is **A.**

Data is **unstructured, lacks context** and may not be **relevant** to the recipient.

Answer to TY 3

Investors use financial information included in the financial statements to ascertain:

(a) Whether the business is profitable or not.

(b) Whether the cash and other resources entrusted to the entity are being properly utilised e.g. whether the entity is investing in profitable projects, continually searching for profitable expansion opportunities, servicing its debts etc.

(c) The levels of dividends that have been paid in the past. Some investors look for capital growth (share price increase), whilst others favour immediate income (high dividends).

Self-Examination Questions

Question 1

The owners of the business are interested in which of the following?

A Profitability of the business
B Assets of the business
C Total long term liabilities of the business
D All the above

Question 2

Which of the following are the users of financial statements?

(i) Owners
(ii) Management
(iii) Government
(iv) Suppliers

A (i) and (ii)
B (i), (ii) and (iii)
C (ii) and (iv)
D All the above

Question 3

Investors do not need to see the financial statements of an organisation.

A True
B False

Question 4

Providers of finance are keen to know the following:

(i) Profit earnings
(ii) Cash flow information
(iii) Repayment capacity of all debt

A (i) and (ii)
B (iii) only
C All the above
D None of the above

Question 5

___________ is raw facts and figures that are processed into ____________.

A Information and data
B Data and details
C Information and records
D Data and information

Question 6

Data is _______________.

A Unprocessed information
B Processed information
C Unused information
D Used information

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **D**.

Owners are interested in all aspects of the business including its profits, assets and liabilities.

Answer to SEQ 2

The correct option is **D**.

All the listed persons / entities are users of financial statements.

Answer to SEQ 3

The correct option is **D.**

When data is correctly organised, filtered and presented with context it can become information.

Answer to SEQ 4

The correct option is **A.**

Data are raw facts and hence unprocessed information.

Answer to SEQ 5

The correct option is **B**.

Investors use financial statements as a basis from which they make their decisions as to whether to invest in the company or not.

Answer to SEQ 6

The correct option is **C**.

Providers of finance are interested to know the level of cash and profits an organisation is generating and if these are adequate to service its debt requirements, going forward.

REGULATORY FRAMEWORK OF ACCOUNTING IN TANZANIA

3

Get Through Intro

The main objective of the accounting function is to produce comparable, consistent, accurate and easily understandable financial statements and reports. To help ensure this, every country has an accounting body that produces a set of standards and regulations. All financial statements must be produced in accordance with these. In Tanzania, the National Board of Auditors and Accountants is responsible for this.

However, these standards and regulations vary from country to country. Therefore, it is often difficult to compare the financial statements of organisations that operate in different countries. To solve this problem, the concept of a regulatory framework was introduced in the early 1970s. The main aim was to produce a universal set of accounting standards and regulations or the International Financial Reporting Standards that would transcend borders and be adopted internationally. Initially, many countries were unwilling to change to or adopt global accounting standards for a variety of reasons.

However, the growing forces of globalisation have resulted in more than a hundred countries today adopting the International Financial Reporting Standards (including Tanzania) when preparing financial statements.

Therefore, as an accounting technician, it is important that you understand the various regulations and regulatory bodies that govern the financial reporting process as well as how, where and why the International Financial Reporting Standards should be used. This Study Guide will cover the importance of regulatory framework and various bodies that produce them.

Learning Outcomes

a) Explain the history of accounting profession in Tanzania.
b) Describe requirement/ availability of accounting information for different forms of business organisation.
c) Describe the importance of regulation of financial reporting.
d) Identify the role of National Board of Accountants and Auditors (NBAA).
e) State the role of the International Federation of Accountants.
f) Explain the Professional Code of Conduct issued by NBAA.

1. Explain the history of accounting profession in Tanzania. [Learning Outcome a]

It is not surprising that evidence of record keeping for economic events has been found in the earliest civilizations. Many ancient civilisations such as the Mesopotamians were keeping records for various economic activities.

A dictionary meaning of the word "Accounting" is to give a satisfactory record of money. In the period of pre-industrial revolution, there were feudal societies that had wealthy landlords who owned vast properties and wealth. These properties were scattered at many places and they found it difficult to maintain control of activities being held on their properties. This need to control and look after the properties was addressed by appointing stewards at these distant locations who would look after the landlord's interests. As a result of this arrangement, there was a separation of ownership and control of resources. This is also true for modern day companies, wherein the management runs the business and acts as stewards for the owners of the business (i.e. shareholders).

Early references to the subject of accounting are found in the works of some ancient oriental writers.

The year 1494 witnessed the advent of the double entry book keeping system when a Franciscan monk and mathematics professor **Luca Pacioli**, published the first known text **'Summa de Arithmetica, Geometria, Proportione et Proportionalita'** to describe a comprehensive double-entry bookkeeping system. He authored several books and also contributed to the way companies ran and how transactions were recorded. In his short, fifty year life, he did so much for the business world that he never took credit for. It was Pacioli who was the first to describe the system of **debits and credits in journals and ledgers** that is still the basis of today's accounting systems. He is therefore even referred to by some as the father of accounting. This was the beginning of a systematic approach to double entry system.

Later, the industrial revolution spurred the need for more advanced cost accounting systems. Also to cater to mass production, there was felt a need for external capital providers (shareholders and bondholders) for which large corporations were set up. These corporations needed accountants to maintain the cost records and accounting records. The rising public status of accountants helped to transform accounting into a profession.

In Tanzania, it was a general opinion that there was a shortage of qualified accountants to manage and run businesses. In 1972, The National Board of Accountants and Auditors (NBAA) were set up to regulate and oversee the development of accounting in the country. NBAA was conferred all the statutory powers to regulate the accounting profession in Tanzania. The role of NBAA is explained later in this Study Guide.

Test Yourself 1

In Tanzania, the accounting profession is regulated by:

A International Accounting Standards Board
B International Federation of Accountants
C National Board of Accountants and Auditors
D Institute of Chartered Accountants of Tanzania

---

2. Describe requirement/ availability of accounting information for different forms of business organisation.
3. Describe the importance of regulation of financial reporting.
[Learning Outcomes b and c]

2.1 Importance of regulation in financial reporting

Financial statements are used by various users for a variety of purposes. In order that the financial statements give a true and fair view to the users, the published accounts should be subject to regulation. This will ensure that the financial statements are consistent and also more reliable.

There is no single law in which financial statements can be regulated. It is subject to a variety of economic, social and political factors applicable in the jurisdiction in which they are published. Therefore regulation with respect to financial reporting is country specific.

Financial reporting can be regulated with the help of:

- Local law
- National bodies such as NBAA
- Local and international accounting standards for example Tanzanian financial reporting standards and the international financial reporting standards
- Requirements of international body such as IASB, IFAAC, etc.

Regulation in financial reporting will play an important role:

1. To prevent material manipulations or errors

Many important economic decisions are regularly made on the basis of financial statements. However, financial information is open to many manipulations or errors.

To ensure that users are not misled into taking wrong decisions, some regulation of the manner in which elements are recognised and measured, as well as presentation of the information in the financial statements, is essential.

Example

Dee Co wants to obtain a working capital loan from a bank. Its Finance Director, Deacon, knows that the working capital borrowing amount (drawing power) depends on the value of net current assets, especially trade receivables, inventory and trade payables.

Deacon **inflates** the value of inventory artificially by increasing the unit rate of valuation. This has an overall effect of increasing inventory by $120,000 from $250,000 to $370,000. However, if he (and the auditor) follows the standard method of valuation permitted by IAS 2 Inventories, and abstains from unethical practices, manipulation of the rate would not be possible and inventories would be stated at $250,000.

---

2. To ensure that the financial communication is standardised

There may also be an intended or unintended miscommunication between the person who prepares the financial statements and the person who uses them. Accounting is said to be a language of business. However, unless both the giver and receiver of information understand the same meaning, the communication is not effective.

For example the companies adopting IFRS, have to follow the format given by IAS 1 Presentation of financial statements. This is to ensure consistency in financial reporting by various entities. Also this will help the users to understand the financial statements in a better manner.

3. To remove / reduce the element of subjectivity from accounting

Users of financial statements such as owners and investors need clear and comparable information to assess the financial condition and performance of different organisations. Regulation in financial reporting will ensure clear principles, rules or standards for all the enterprises.

4. To avoid financial crisis

Proper regulation of financial reports can help in avoiding financial crisis. Regulation helps in identifying risks and therefore triggers proper alarms to investors and their users of financial statements. For example if the going concern is challenged, entities are under an obligation to disclose the same to its shareholders.

2.2 Reporting requirement / availability of accounting information for different forms of business organisation

In Tanzania, companies are primarily subject to the requirements Companies Act 2002 and the requirements specified by National Board of Accountants and Auditors.

Tanzania migrated to IFRSs, IPSASs and ISAs with effect from 1st July, 2004 and therefore, every entity in the country, whether small or large, was required to prepare its financial statements in accordance with the International Financial Reporting Standards (IFRSs) or International Public Sector Accounting Standards (IPSASs) as the case may be.

Following the issuance of the IFRSs for SMEs by the International Accounting Standards Board (IASB) on 9 July, 2009, some entities in Tanzania are permitted to use the IFRSs for SMEs issued by IASB.

The National Board of Accountants and Auditors Tanzania issued a technical pronouncement on 15 October 2009 to clarify on the scope of financial reporting applicable to various enterprises.

S/No	Category of entities	Reporting requirement
1.	Publicly accountable entities or entities that represent public interest such as entities that take deposits or loans from the public; offer shares to the public; have essential public responsibility or privilege essential public service or entities that hold assets in a fiduciary capacity for a broad group of outsiders. Example of such entities: 1. Listed Companies, 2. Banks and Financial Institutions, 3. Insurance Companies, 4. Pension Funds 5. Utility Companies, 6. Government Agencies, 7. Mutual Funds, 8. Savings and credit cooperative organisation 9. Cooperative Societies, 10. Securities brokers/dealers,	These entities are required to report under full IFRS issued by the IASB. Also certain Tanzanian Financial Reporting Standards need to be complied.
2.	Public sector entities including ministries, regional governments, government departments, agencies and local government.	International Public Sector Accounting Standards (IPSAS's) and in some cases these entities are encouraged to report under full IFRS.
3.	**Category 1:** Entities that are not publicly accountable or representing public interest, **Category 2:** Entities including GBEs with less than 100 employees provided that they are not in categories 1 and 2 above, **Category 3:** Entities including GBEs with capital investment in non-current assets of less than Tshs800 million provided that they are not in categories 1 and 2 above.	These entities are required to report under IFRS for Small and medium enterprise issued by the IASB.

Test Yourself 2

In Tanzania, all the public sector entities are required to report under:

A Only IPSAS's
B Only Full IFRS's
C Only under Tanzanian Financial Reporting Standards
D Combination of full IFRS's and Tanzanian Financial Reporting Standards

4. **Identify the role of National Board of Accountants and Auditors (NBAA)**
5. **State the role of the International Federation of Accountants.**
6. **Explain the Professional Code of Conduct issued by NBAA.**

[Learning Outcomes d, e and f]

3.1 Role of NBAA

The National Board of Accountants and Auditors (NBAA) is a Tanzanian accountancy professional body established under the Auditors and Accountants (Registration) Act 1972. It is an accountancy regulatory professional body, operating under the Ministry of Finance (MoF).The Board started carrying out its activities from 15 January 1973.

Under the Auditors and Accountants (Registration) Act 1972, the main role of the National Board of Accountants and Auditors are as follows:

(i) Promote and provide opportunities and facilities for study and training in accountancy, auditing and allied subjects

(ii) Conduct exams and grant diploma

(iii) Sponsor, arrange and provide facilities for conferences, seminars, discussions and consultations on matters relating to accountancy and auditing

(iv) Arrange for the publication and general dissemination of materials produced in connection with the work and activities of the Board

(v) Maintain registers of accountants and auditors, and consider and decide upon applications for registrations

(vi) Regulate the activities and conduct of accountants and auditors

3.2 Role of IFAC

International Federation of Accountants (IFAC) is a global organisation comprising 155 members and associates (mostly national professional institutes) spread across 118 countries. Membership stands at more than 2.5 million accountants from public practice, industry and commerce, the public sector as well as educational backgrounds. IFAC is dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies.

IFAC's vision is that global accountancy profession be recognised as a valued leader in the development of strong and sustainable organisations, financial markets and economies.

IFAC's mission is to serve the public interest by: contributing to the development of high-quality standards and guidance; facilitating the adoption and implementation of high-quality standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms and to high-quality practices by professional accountants; promoting the value of professional accountants worldwide; and speaking out on public interest issues.

One of IFAC's main activities is publishing a uniform set of auditing standards to serve as a benchmark for professional accountants around the world when they are conducting their audits. IFAC heavily promotes these standards as it believes that their adoption will lead to a uniform quality of auditing across the globe.

IFAC supports the following independent standard-setting boards:

- International Auditing and Assurance Standards Board
- International Accounting Education Standards Board
- International Ethics Standards Board for Accountants
- International Public Sector Accounting Standards Board

As the global organization for the accountancy profession, IFAC performs the following roles:

(i) Contribution to the development of high-quality standards and guidance

(ii) Facilitating the adoption and implementation of high-quality standards and guidance

(iii) Contributing to the development of a strong accounting profession and accounting forms

(iv) Promoting the value of professional accountants world-wide

(v) Encouraging quality practice

(vi) Speaking out on public interest issues

3.3 Professional code of conduct issued by NBAA

Case Study

Francesca Darcy had been the internal auditor of a small department store, Wise Pocket, for the last six years. The owner of the store, Rob Collins had not found any fault with her work and both shared a very good professional rapport. On 15 June, 20X3, Rob received a notice from the tax authorities regarding a scrutiny assessment. In short, they, the tax authorities, wanted to take a closer look at Rob's financial records and, in particular, the personal cash inflow and outflow register he secretly kept under the cash register. Rob was eventually indicted on tax evasion charges. During the trial, it came to light that Francesca had been passing on information regarding Rob's finances to the taxation authorities which helped to support their case.

When Rob sued Francesca, one of the points Rob's attorney argued in court was that any client should feel that he was getting complete loyalty and confidentiality support from his accountant. The jury felt that the professional code of ethics for accountants fully supported this contention. However, the defence attorney contradicted this point stating that, as an accounting professional, the accountant has a moral, legal and ethical obligation to turn over information to the authorities when he (i.e. the accountant) feels that the concerned information violated any law or is in any way contradictory to public policy.

As an accounting professional, there may be several instances when one is caught between professional and moral issues. Accountants, among other duties, are conditioned to report a true and fair position of the client's business and perform their duties with honesty and integrity. However, until recently, accountants did not have any formal training in the ethical aspects of their profession nor was there any uniform, clear cut code of ethics governing the accounting profession. Since most accountants are conditioned to adopt a practical approach, they could find themselves lost should a question of ethics arise.

However, with the collapse of major companies like WorldCom, HealthSouth and the most infamous of them, Enron, which also led to the disintegration of its auditor, Arthur Andersen, the need for a uniform code of ethics in financial reporting by an auditor who in no way could be influenced by the company's management was voiced.

The accountancy profession in Tanzania is a member of the International Federation of Accountants (IFAC) The National Board of Accountants and Auditors has issued a Professional Code of Conduct for its members and professional accountants which are put forth as five fundamental principles that it expects its members to follow. These five principles are in line with the code of conduct issued by IFAC for the professional accountants.

These **FIVE** principles are explained below:

1. Integrity

A professional accountant shall be straightforward and honest in all professional and business relationships.

Those who work as accountants must have a high level of professional integrity. All members are expected to be straight forward and honest in their workings.

Accountants must, in order to project integrity, be independent. This means they must not allow their decisions, when declaring financial statements as true and fair, to be clouded by their other interests in the client. For this to be effective, they should not have any financial or management interest in the client they are currently auditing.

Example

An accountant is not expected to accept the external audit of a company if he is the director of the same company or his judgement is expected to be influenced by his interest in the company.

However, some accounting scholars debate this point as they believe that as the client pays the auditor for a service, their fee depends upon their relationship with the client. Also, apart from audit, auditors take up other assignments such as tax consultancy and due diligence for acquisitions. This is seen as inhibiting the auditor's independence as he could be persuaded to overlook an unfavourable accounting treatment in order to keep the revenue coming in.

2. Objectivity

Members of the profession should not allow conflicts of interest, personal bias or undue influences to impair their professional or business judgements.

Example

The internal auditor cannot rate the internal controls of a particular department as "weak" only because he does not get along with the head of that department.

---

3. Professional competence and care

This principle is extremely important because if accounting information is not presented properly, then it reflects badly on the accountant as well as the entire accounting profession. The accountant must ensure that:

- they have the necessary professional knowledge and skills to meet the requirements of their client and profession
- they work hard and with diligence while doing their job
- all their staff have the required training and supervision to fulfil their tasks efficiently

Example

An accountant who specialises in preparing and filing tax returns for individuals must ensure the following:

- He, as well as his staff, is kept informed of all the latest updates to tax law.
- He devotes sufficient time and attention to each tax return.

---

4. Confidentiality

An accountant is bound not to disclose information related to his client acquired in the course of business to any one apart from in the following two situations:

(a) There is a legal duty to disclose information.
(b) There is a professional obligation to do so.

This principle is enforced in order to restrain the accountant from using personal confidential information relating to his client for personal gain. These rules of confidentiality also apply when the accountant is no longer engaged by that particular client.

Example

During the course of her audit, Peggy Woo, Xansee's auditor, chances upon information regarding the launch of a new product that will cause Xansee's stock prices to soar. However, Peggy cannot pass on this information to a third party unless the announcement is made publicly. Passing on material, non-public information like this is referred to as trading on the basis of insider information. This kind of trading is illegal in many countries.

---

5. Professional behaviour

Members of the accounting profession should comply with all the laws applicable to their client's audit and should avoid any situation which would discredit the profession. Furthermore, members are required to behave with courtesy and consideration towards all those with whom they come in contact in a professional capacity.

Example

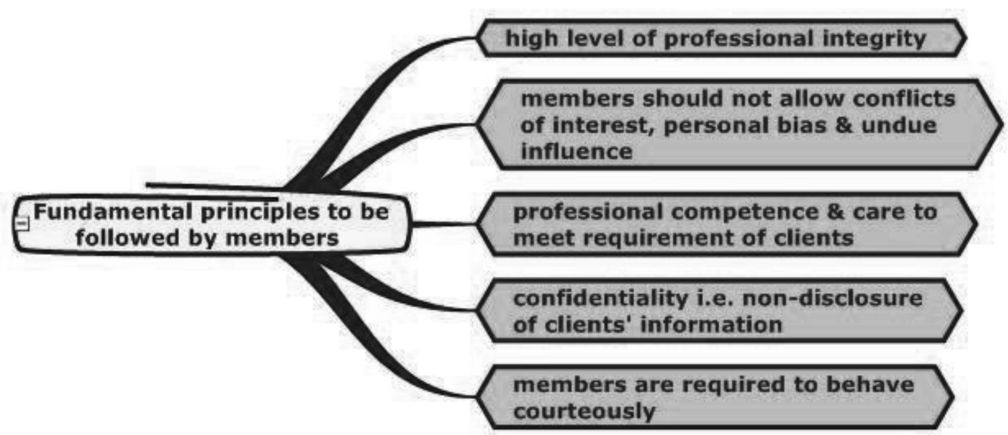
Nick Delfino is a partner in a mid-sized accounting firm. He has been approached by Tough Corp, a large manufacturer of tyres, to discuss whether he would consider taking on some audit assignments for the business. Nick has heard through unsubstantiated rumours that Tough Corp is unhappy with its current auditor. Nick is eager to take on Tough as a client but has had no experience of auditing manufacturing firms. During his discussions with Tough, Nick cannot:

claim to have any specialised expertise in auditing manufacturing organisations
slander or unduly criticise Tough's current auditors

Auditors assure the users of financial statements of the reliability of the accounting information presented. In other words, they state that the financial statements presented to the shareholders and other interested parties represent the true financial position of the organisation. Billions of dollars are put at stake based on the auditor's opinion.

As a result, in addition to maintaining the highest ethical standards mentioned above, an auditor is also, above all, expected to be independent, in fact and in appearance, i.e. be free from any interest in the client, both financial and otherwise when providing auditing services to a client. There is a very fine line between consenting to the client's accounting policies so that the client is not subjected to loss, and allowing the client to influence his opinion so that the client can get away with unscrupulous accounting policies which eventually defraud its investors.

SUMMARY



Test Yourself 3

Which principle of the Professional Code of Conduct issued by NBAA states "Members of the profession should not allow conflicts of interest, personal bias or undue influences to impair their professional or business judgements"

A Professional behaviour
B Integrity
C Confidentiality
D Objectivity

Test Yourself 4

Which of the following is not a fundamental principle set out in the Professional Code of Conduct issued by the NBAA?

A Materiality
B Confidentiality
C Objectivity
D Professional competence and due care

Answers to Test Yourself

Answer to TY 1

The correct option is **C.**

In Tanzania, the accounting profession is regulated by National Board of Accountants and Auditors.

Answer to TY 2

The correct option is **D.**

In Tanzania, all the public sector entities are required to report under combination of full IFRS's and Tanzanian Financial Reporting Standards.

Answer to TY 3

The correct option is **D.**

Answer to TY 4

The correct option is **A**.

Materiality is not a principle covered under the Professional Code of Conduct issued by the NBAA.

Self-Examination Questions

Question 1

How is the integrity of an accountant connected with his independence?

Question 2

Which principle of the code of conduct issued by NBAA is violated when a firm diversifies its operations into management consultancy and brokerage services and creates a conflict of interest situation?

Question 3

The National Board of Accountants and Auditors has issued a Professional Code of Conduct for its members. How many fundamental principles are covered under the Professional Code of Conduct?

A Four
B Five
C Seven
D Nine

Question 4

Who maintains the registers of certified public accountants in Tanzania?

A IFAC
B NBAA
C Ministry of finance
D IASB

Answers to Self Examination Questions

Answer to SEQ 1

Accountants should use their unbiased judgement in the performance of their duties. In order to ensure that their opinions are not influenced, they should maintain their independence and be free from any interest in the client.

Answer to SEQ 2

The principle of "**objectivity"** is violated. When accounting firms diversify their operations into other professional services, because of their already established contacts, they tend to start providing professional services other than audit to their audit clients. Most of the time, these services bring in more income than the audit function, and therefore in order to avoid losing the other professional services engagement, they overlook minor accounting policies that do not follow the law, accounting principles or ethical principles.

Answer to SEQ 3

The correct option is **B**.

The Professional Code of Conduct issued by NBAA suggests five principles.

Answer to SEQ 4

The correct option is **B**.

NBAA maintains the registers of certified public accountants in Tanzania.

ACCOUNTING EQUATION AND PRINCIPLE OF DOUBLE ENTRY

4

Get Through Intro

In this Study Guide, we will also introduce the most important element of accounting: **double-entry book-keeping**. It is very important that you understand this concept before moving on to future Study Guides, as this forms the basic building block of all subsequent Study Guides. If you master debits and credits it means you have understood the core mechanisms that make accounting work!

As a student of accounting and a future finance and accounting professional, you should be comfortable with the terms **debit** and **credit** and be able to recognise these two elements in each transaction. These two words are so important that the whole process of accounting and financial reporting rests on them.

Learning Outcomes

a) Define:
   i. Accounting Equation
   ii. Principle of Double Entry

b) Explain:
   i. Elements of Accounting Equation
   ii. Identify the effect of changes in elements of accounting equation
   iii. State the connection between accounting equation and the application of the double entry book-keeping
   iv. State the rules for debit entry and credit entry
   v. Make double entry records in a given set of transactions.

1. **Define:**
   i. **Accounting Equation**
   ii. **Principle of Double Entry**
2. **Explain:**
   i. Elements of Accounting Equation.
   ii. Identify the effect of changes in elements of accounting equation.
   iii. State the connection between accounting equation and the application of the double entry book-keeping.
   iv. State the rules for debit entry and credit entry.
   v. Make double entry records in a given set of transactions

[Learning Outcomes a and b]

1.1 Accounting equation

Definition

Accounting equation

The relationship between the assets, liabilities and owners' equity expressed in the form of an equation is called the accounting equation.

Principle of double entry

The principle of double entry states that there are always two aspects of a transaction. One is referred to as debit and other as credit.

1.2 Introduction to double entry book-keeping

Under the double entry system of book keeping all transactions have two effects. Further the principle of duality needs to be adhered. Duality means considering both the effects of the transaction.

Accountants often say: '**every debit entry has a corresponding credit entry'.** Journal entries are made to record transactions. Remember that each journal entry will contain items which are to be debited and items which are to be credited. The total of the debit items is always equal to the total of the credit items. A journal entry always has an explanation of the nature of the transaction. This explanation is called the narration of the journal entry.

In simple terms, a journal entry is an interpretation of a financial transaction showing the dual effect of each transaction (account to be debited and credited) along with an explanatory description of the transaction.

Tip

Do not confuse a journal entry and a journal. A journal entry is a way of recording a transaction in a debit/ credit form. A journal is a record of some special transactions.

Example

Adam purchased a car for Tshs2 million. Here, two transactions are involved:

1. Adam has received an asset (car)
2. Adam has paid cash.

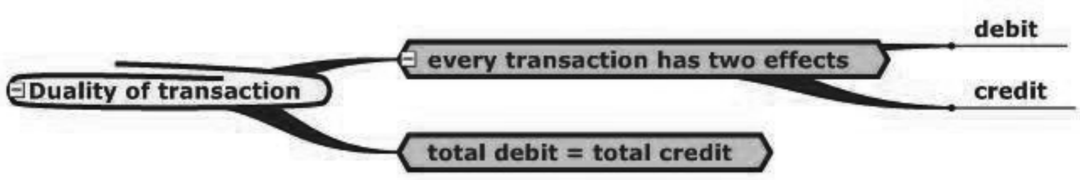
The journal entry to record a car purchased in cash is

Dr	Car	Tshs2 million	
Cr	Cash		Tshs2 million

Being a car acquired for cash

Debit is abbreviated as Dr, while credit is abbreviated as Cr. First let us understand the principle of double entry and then we will apply these principles in recording the various journal entries.

SUMMARY



Important

Remember that each journal entry will contain items which are to be debited and items which are to be credited. The total of the debit items is always equal to the total of the credit items.

1.3 Principles for double entry book keeping

In the journal entry given above why is the car debited and not cash? This is because all journal entries have to follow the principles of double-entry book-keeping.

Before we discuss these principles, allow us to boost your confidence! Most students are terrified as soon as they hear the words debit and credit. Believe us it is not that difficult! It is a logical mechanism that you need to assimilate and then you will be able to use it on 'autopilot'. To be able to learn this quickly and efficiently the rules for double entry book keeping are classified in terms of various elements of financial statements i.e. assets, liabilities, equity, income and expenses.

1. Assets

Assets represent what we own today. Whenever we purchase assets such as property, plant and equipment, motor vehicles etc, we debit the respective asset account. This is because our assets have increased.

Whenever we sell assets such as property, plant and equipment, motor vehicles etc, we credit the respective asset account. This is because our assets have decreased.

2. Liabilities

Liabilities represent our obligations today. Liabilities mean what we owe to third parties (e.g. banks or suppliers of goods or services) and also what we owe to the owners (capital).

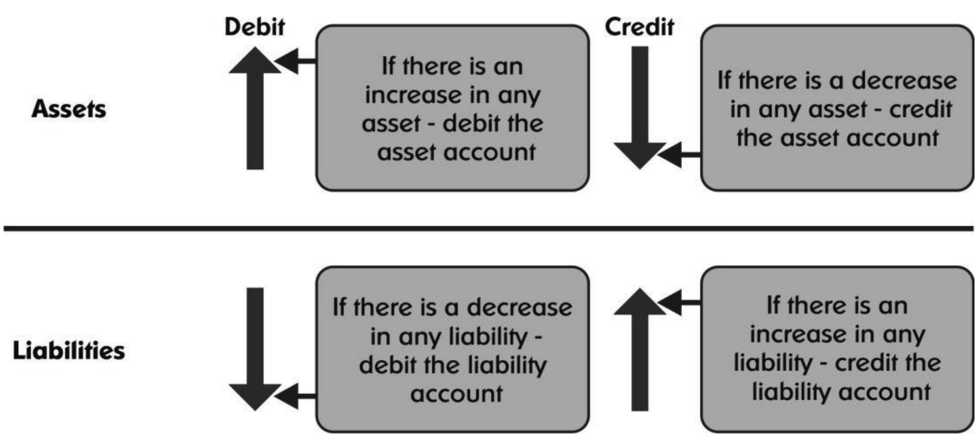
Whenever we incur a liability for example take a loan from a bank, we credit the respective liability account. This is because we have increased liabilities.

Whenever we repay a liability for example repay a loan, we debit the respective liability account since the liabilities have decreased.

3. Equity

Equity represents the residue after deducting the liabilities from the assets. The rules for double entry are same for equity and liabilities.

Diagram 1: Debit Credit rules for statement of financial position elements



Current assets are assets that are to be held for less than 1 year. Non-current assets will be used over a long period of time. Similarly, current liabilities are liabilities that will be settled within 1 year and non-current liabilities will be paid over a period longer than 1 year.

Example

Lead Way Co is setting up a small retail outlet with an initial capital of Tshs400 million and a loan of Tshs150 million to be invested as follows:

Land and building: Tshs300 million
Shelves, furniture, fixtures and fittings: Tshs60 million
Computers, till machine and other equipment: Tshs15 million
Delivery van: Tshs15 million

The delivery van was bought on credit from a second-hand car dealer, all the other items were paid for in cash.

Write the double-entry journal entries for the above transactions.

Specify whether the assets as well as liabilities are current or non-current in nature.

Answer

(Amounts in Tshs'000)

Dr	Land and buildings (non-current asset – SOFP)	Tshs300,000	
Cr	Cash (current asset – SOFP)		Tshs300,000

Being an asset - property, plant and equipment acquired in cash

Note that the business can now use this asset as a resource to perform its activity and make money.

Dr	Fixtures and fittings (non-current asset – SOFP)	Tshs60,000	
Cr	Cash (current asset – SOFP)		Tshs60,000

Being an asset - fixtures and fittings acquired in cash

Dr	Office equipment (non-current asset – SOFP)	Tshs15,000	
Cr	Cash (current asset – SOFP)		Tshs15,000

Being an asset - office equipment acquired in cash

Dr	Delivery van (non-current asset – SOFP)	Tshs15,000	
Cr	Payable to supplier of non-current assets (current liability – SOFP)		Tshs15,000

Being an asset - motor vehicles acquired on credit

Example

Continuing the previous example of Lead Way Co

Lead Way Co set up a small retail outlet with an initial capital of Tshs400 million contributed in cash by the owners, and a loan of Tshs150 million.

The entity acquired a van on credit from a second hand car dealer for Tshs15,million and thus, in addition to its liabilities to the owners and the bank, it is also liable to the second hand car dealer. Write the double-entry journals for these transactions.

(Amounts in Tshs'000)

Dr	Cash (current asset – SOFP)	Tshs400,000	
Cr	Capital (equity – SOFP)		Tshs400,000

Being capital contributed in cash by the owners

Continued on the next page

Note that the business now has a liability towards the owners to reimburse this cash.

Dr	Cash (current asset – SOFP)	Tshs150,000	
Cr	Loan (non-current liability – SOFP)		Tshs150,000
Being cash borrowed from the bank			

Note that the business now has a liability towards the bank.

Dr	Delivery van (non-current asset – SOFP)	Tshs15,000	
Cr	Payable to supplier of non-current assets (current liability – SOFP)		Tshs15,000
Being an asset - motor vehicles acquired on credit			

This has already been presented in the above example:

the asset – “delivery van” increases (it’s logical that an asset increases on debit)
the liability – “payables to the supplier” increases (it’s logical that a liability increases on credit)

Note: Capital or equity means a liability to the owners. Hence the rules of debit and credit related to liabilities are also applicable to capital.

Test Yourself 1

Present the journal entries (with narrative) for the following transactions:

(a) An entity repays part of a loan amounting to Tshs10 million
(b) An entity sells a non-current asset that it had in its books at Tshs12 million for the same amount in cash.
(c) An entity sells a piece of equipment that was recorded in the books at Tshs33 million for the same amount on credit.
(d) The acquirer of the equipment pays the amount due in cash.
(e) Cash that had initially been received from the owners of the business is used to buy a piece of land for Tshs140 million
(f) The entity pays the liability of Tshs25 million to the company that built their premises
(g) An entity acquires a piece of equipment with a value of Tshs10 million in exchange for a car.

4. Income

Income is an increase in economic benefits during the accounting period in the form of

(a) Direct inflows or
(b) Enhancements of assets or
(c) Decreases in liabilities

In other words, income increases simultaneously with increases in assets or decreases in liabilities.

Whenever we generate income e.g. sell goods we credit the respective income account.

Whenever income is reduced e.g. return of goods sold, we will debit the respective income account.

5. Expenses

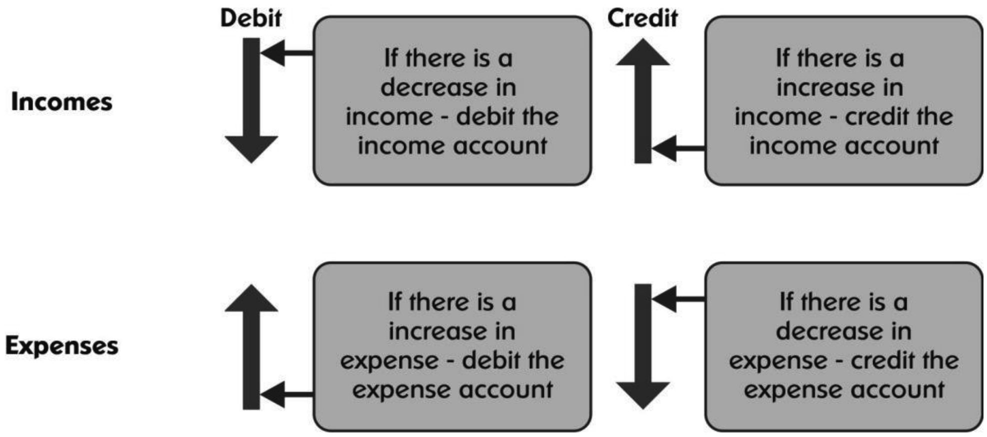
Expenses are decreases in economic benefits during the accounting period in the form of direct outflows or depletion of an asset or incurrence of a liability.

In other words, expenses increase simultaneously with increases in liabilities or decreases in assets. We can summarise this as follows:

Whenever we incur expenses for example purchase goods we debit the respective expense account.

Whenever expenses are reduced for example return of purchased goods we credit the respective expense account.

Diagram 2: Debit Credit rules for statement of profit or loss elements



Example

JJ Studious is a bookstore selling novels and travel books. During the month of December the following transactions took place:

1. Books with a total value of Tshs75 million were sold in cash to numerous individuals.

2. A multinational firm purchased books to offer to their employees as a Christmas bonus and agreed to pay Tshs15 million for the order in January.

3. JJ Studious agreed to rent a corner of the bookstore to another company which sells tea and cakes for an amount of Tshs2 million, payable monthly in cash. Rent for a month is received.

4. An amount of Tshs150 million was received from the bank as interest on the deposit made by JJ Studious

5. JJ Studious owed a large supplier of books an amount of Tshs25 million and settled this amount in cash, receiving a 2% discount for early settlement.

Write the journal entries for the above transactions, including narratives.

1.			
Dr	Cash (current asset – SOFP)	Tshs75,000	
Cr	Sales income (SOPL)		Tshs75,000
Being cash sales recorded			
2.			
Dr	Receivables (current asset – SOFP)	Tshs15,000	
Cr	Sales income (SOPL)		Tshs15,000
Being credit sales recorded (here we do not get direct inflows of cash but a promise of cash to come)			
3.			
Dr	Cash (current asset – SOFP)	Tshs2,000	
Cr	Rent income (SOPL)		Tshs2,000
Being rent (income) received in cash			
4.			
Dr	Cash (current asset – SOFP)	Tshs150,000	
Cr	Interest received (income – SOPL)		Tshs150,000
Being interest received from the bank			
5.			
Dr	Payables (current liability – SOFP)	Tshs25,000	
Cr	Cash (current asset – SOFP)		Tshs24,500
Cr	Discounts received (income – SOPL)		Tshs500
Being a liability to suppliers of goods, partly settled in cash and partly reduced by discounts received			

Example

Turbine Ltd began its retail activities during the year. In the first month of its activity it incurred the following expenses:

1. Turbine Ltd purchased inventories of Tshs25 million in cash.

2. Additional inventories were purchased on credit from a wholesaler for Tshs48 million.

3. The entity paid the following monthly expenses in cash:
   (a) Fuel: Tshs250,000
   (b) Wages and salaries: Tshs5 million
   (c) Interest of 10% per annum for the Tshs150 million loan.

4. The following expenses were incurred during the month, but Turbine Ltd will actually pay them in the next month:
   (a) Telephone: Tshs500,000
   (b) Utilities (electricity, gas, water): Tshs1 million

5. Turbine Ltd made a significant credit sale to a firm, granting them a 45 day credit period. The firm paid the total amount of Tshs10 million in advance, so Lead Way gave them 1% discount for early payment.

Write the journal entries for the above transactions, including narratives, and indicate whether the item is an SOFP (current or non-current) item or a statement of profit or loss item.

(Amounts in Tshs'000)

1.

Dr	Purchases expenses (SOPL)	Tshs25,000	
Cr	Cash (current asset – SOFP)		Tshs25,000

Being cash purchases recorded

2.

Dr	Purchases expenses (SOPL)	Tshs48,000	
Cr	Payables (current liability – SOFP)		Tshs48,000

Being credit purchases (i.e. no direct outflows of cash – hence you will not see cash debited - but we make a promise of paying cash to the supplier at a later date)

3.

Dr	Fuel expenses (SOPL)	Tshs250	
Cr	Cash (current asset – SOFP)		Tshs250
Dr	Wages and salaries expenses (SOPL)	Tshs5,000	
Cr	Cash (current asset – SOFP)		Tshs5,000
Dr	Interest expenses (Tshs150,000 x 10% / 12 months) (SOPL)	Tshs1,250	
Cr	Cash (current asset – SOFP)		Tshs1,250

Being business expenses settled in cash

4.

Dr	Telephone expenses (SOPL)	Tshs500	
Cr	Telephone expenses payable (current liability – SOFP)		Tshs500
Dr	Utilities expenses (SOPL)	Tshs1,000	
Cr	Utilities expenses payable (current liability – SOFP)		Tshs1,000

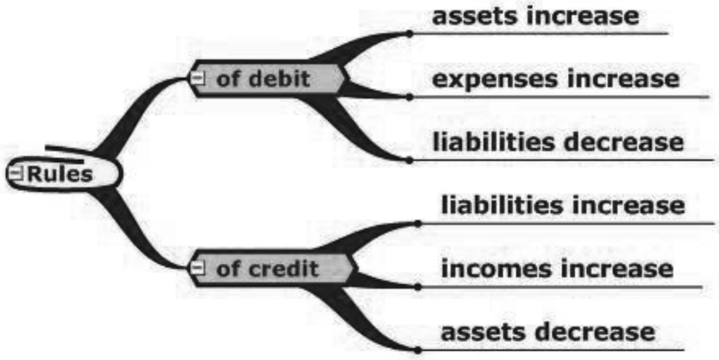
Being business expenses incurred during the month, to be settled in the future

5.

Dr	Cash (Current asset – SOFP)	Tshs9,900	
Dr	Discounts allowed (expenses – SOPL)	Tshs100	
Cr	Receivables (current asset – SOFP)		Tshs10,000

Being receivables collected less an amount allowed for early settlement

SUMMARY



Test Yourself 2

Which of the following is correct?

(a) Assets and expenses show debit balance
(b) Liabilities and capital show debit balance
(c) Assets and incomes show debit balance
(d) Liabilities and incomes show debit balance

1.4 Accounting equation and its impact on the elements of financial statements

As already discussed earlier, under the double-entry book-keeping system, all transactions are recorded by giving two accounting effects - **debit and credit.** Debit is traditionally shown as a positive figure and credit as a negative figure. When the entire accounting data has been recorded according to double entry system, the total of debit balances will equal always equal the total of credit balance. In other words, this relationship can be presented in form of an accounting equation which is as follows:

Assets = Capital + Liability

Let us try to understand the accounting equation and its impact on each element of financial statement with the help of an example.

Example

John has saved Tshs50,000. He is interested in starting a business selling glass under the name M/s Elite Traders. On 01/01/20X6 he introduced Tshs50,000 into the business. On the same day he bought glass worth Tshs15,000 and a shop for Tshs30,000. All the glass was sold during the same month for Tshs20,000.

These transactions can be shown at the end of the month as follows:

Table 1

Sr.	Transaction	Cash	Capital	Shop	Purchases account	Sales account	Debit	Credit
		Tshs	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs
1	John introduced capital	50,000	(50,000)				Cash (↑asset)	Capital (↑liability)
2	John purchased glasses	(15,000)			15,000		Purchases account (↑expenses)	Cash (↓asset)
3	John purchased shop	(30,000)		30,000			Shop (↑asset)	Cash (↓asset)
4	John sold glasses	20,000				(20,000)	Cash (↑asset)	Sales (↑income)
	Balance	**25,000**	**(50,000)**	**30,000**	**15,000**	**(20,000)**		

Continued on the next page

You can clearly see that:

Debits	**=**	**Credits**
(25,000 + 30,000+15,000)	=	(50,000 + 20,000) (figures in brackets)
Tshs70,000	**=**	**Tshs70,000**

The financial statements of M/s Elite Traders will be as follows:

Note: the steps related to recording the transactions and preparation of a trial balance, statement of profit or loss and statement of financial position are explained in greater detail later in this book. Here, a simple example is given to explain the accounting equation.

M/s Elite Traders	
SOPL	
	Tshs
Sales	20,000
Less: Purchases	(15,000)
Profit	**5,000**

M/s Elite Traders	
SOFP	
as at 1 January 20X6	
	Tshs
Assets	
Shop	30,000
Cash in hand	25,000
Total	**55,000**
Capital and liabilities	
Capital of John	50,000
Profit from business	5,000
Total	**55,000**

Capital is the liability of the business towards the owner for the amount contributed at set-up

Profit is a liability of the business to the owners

In accounting, **every transaction is debited in one account and credited in another account**. This means that for every amount that is debited the same amount is credited elsewhere. Therefore the total of all debit amounts and all credit amounts are equal.

Debits = Credits

The assets have a debit balance and liabilities have a credit balance. The **total debits** are always **equal** to **total credits** hence; in the **statement of financial position, total assets** are **equal** to **total liabilities (owed to outsiders and to owners).** Therefore, the two sides of the statement of financial position always balance.

The accounting equation is:

Assets = Capital + Liabilities
Dr = Cr

Profit is the net result of all incomes and expenses and is added to capital. Incomes / expenses are not considered individually in the accounting equation.

Applying this to M/s Elite Traders: Tshs30,000 + Tshs25,000 = Tshs50,000 + Tshs5,000
Tshs55,000 = Tshs55,000

The above formula can be presented in a number of ways:

Capital = total assets – liabilities
Liabilities = total assets – capital

All are mathematically the same. The most commonly used presentation is:

Assets = Capital + Liabilities

Continued on the next page

Continuing with the example of John

John required more funds. He took a cash loan of Tshs13,000 from Daniel. This loan will be recorded as follows:

Table 2

Transaction	Capital	Shop	Purchase account	Sales account	Cash	Loan from Daniel
	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs
Balance c/f from Table 1	(50,000)	30,000	15,000	(20,000)	25,000	-
Received loan from Daniel					13,000	(13,000)
Balance remaining	**(50,000)**	**30,000**	**15,000**	**(20,000)**	**38,000**	**(13,000)**

The basic equation still holds:

Debit	**=**	**Credit** (figures in brackets)
30,000 + 15,000 + 38,000	=	(50,000 + 20,000 + 13,000)
Tshs83,000	**=**	**Tshs83,000**

The financial statements of M/s Elite Traders will now be as follows:

M/s Elite Traders SOPL	
	Tshs
Sales	20,000
Less: Purchases	(15,000)
Profit	**5,000**

Totals assets = Total liabilities

(Because we follow the double-entry book-keeping system)

M/s Elite Traders SOFP as at 1 January 20X6		
	Tshs	Tshs
Assets		
Shop		30,000
Cash in hand		38,000
Total		**68,000**
Capital and liabilities		
Capital of John	50,000	
Profit	5,000	55,000
Loan form Daniel		13,000
Total		**68,000**

The accounting equation will be:

Capital + total liabilities	**=**	**total assets**
55,000 + 13,000	=	30,000 + 38,000
Tshs68,000	**=**	**Tshs68,000**

We can also reorganise this equation in order to derive the equity of the business as follows:

Assets - liabilities	**=**	**total equity (net assets)**
30,000 + 38,000 – 13,000	=	50,000 + 5,000
Tshs55,000	**=**	**Tshs55,000**

Assets – Liabilities = Net assets = Equity

The accounting equation aims to answer the following question: if we use the assets of the business in order to pay for the business liabilities, how much would be left to give to the shareholders?

Organising the accounting equation in this way recognises that the investors are the main users of the financial statements i.e. the principal group of stakeholders. Net assets represent the book value of the entity to the shareholders.

1.5 Impact of accounting equation on receivables, payables and drawings

1. Receivables and payables

When goods are sold or services rendered on credit, the receivables account is debited (it is an increase in an asset) and the sales account (income account) is credited. Similarly, when credit purchases are made, the purchase account is debited (it is an increase in expense) and payables (liability) are credited (being an increase in liability).

2. Drawings

Drawings are the amount of money taken out from the business by the owners. The capital or drawings account is debited (being a reduction in capital) and the cash account is credited (being a reduction in an asset).

3. Business equation

The business equation helps in calculating the amount of profits earned during a period, without preparing a statement of profit or loss! This is helpful, especially when you want to arrive at the profit figure, without going into details of how the profit was earned.

Profit = Increase in net assets + Drawings – Capital introduced.
(net assets means assets minus liabilities)

Example

Continuing the example of John

Let us add the following transactions to the above example:

credit purchases	Tshs14,000
credit sales (above quantity sold fully)	Tshs21,000
cash withdrawn from business	Tshs5,000

Transaction	Capital	Shop	Purchase account	Sales account	Cash	Loan from Daniel	Receivables	Payables
	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs
Balance remaining	(50,000)	30,000	15,000	(20,000)	38,000	(13,000)		
Credit purchases			14,000					(14,000)
Credit sales				(21,000)			21,000	
Cash withdrawn from business	5,000				(5,000)			
Revised balance	**(45,000)**	**30,000**	**29,000**	**(41,000)**	**33,000**	**(13,000)**	**21,000**	**(14,000)**

Now the revised assets are Tshs30,000 + Tshs33,000 + Tshs21,000 = Tshs84,000

Revised liabilities are Tshs13,000 + Tshs14,000 = Tshs27,000

Revised capital is Tshs45,000 + profit Tshs12,000 (i.e. Tshs41,000 – Tshs29,000) = Tshs57,000

The accounting equation is Assets = Capital + Liabilities
Therefore Tshs84,000 = Tshs57,000 + Tshs27,000

Here, profit was calculated by deducting the cost of sales from sales. However, it can also be calculated by using the business equation:

Profit = Increase in net assets + Drawings – Capital introduced.
= (Tshs84,000 - Tshs27,000)* + Tshs5,000 - Tshs50,000
= Tshs12,000

*Since it is a new business, the entire net assets amount to an increase in net assets, as the opening net assets were zero.

1.6 Accounting equation and double entry book keeping

As discussed above, an accountant must always ensure that the accounting equation is balanced at all times. To ensure this happens, the accountant should employ a double entry bookkeeping system. Thus each journal entry recorded should have two parts; either the journal entry should have an equal impact (increase or decrease) to both sides of the equation or it should have an equal and opposite impact to a single side. Let us understand this with the help of an example:

Example

Transaction	Asset	Liabilities	Equity
Business received cash of Tshs500,000 as commission revenue	Dr Cash Tshs500,000 ↑		Cr Commission Tshs500,000 ↑
Business paid Tshs300,000 wages in cash	Cr Cash Tshs300,000 ↓		Dr Wages Tshs300,000 ↓
Business paid creditors Tshs400,000 & received discount of Tshs20,000	Cr Cash Tshs400,000 ↓	Dr Trade payables Tshs420,000 ↓	Cr Discount Received Tshs20,000 ↑
Business received Tshs800,000 from debtors & allowed discount of Tshs80,000	Dr Cash Tshs800,000 ↑ Cr Debtors Tshs880,000 ↓		Dr Discount allowed Tshs80,000 ↑

Test Yourself 3

M/s Elite Traders received Tshs13,000 loan from Daniel. Which account will be credited?

A Income-loan
B Asset-loan
C Expense-loan
D Liability-loan

Test Yourself 4

Fill in the blanks with **debit** and **credit** for the above transactions in the books of M/s Elite Traders.

Julian invested Tshs50,000 cash in order to start the business. The accounting entries recorded by John were __________ cash Tshs50,000 and __________ capital account Tshs50,000. When Julian purchased goods costing Tshs15,000, the accounting entries were ___________ purchases (expense) account Tshs15,000 and ____________ cash Tshs15,000. On purchasing the shop for Tshs30,000 the accounting entries were ______________ shop (asset) account Tshs30,000 and _______________ cash Tshs30,000.

Test Yourself 5

Which of the following is correct?

	Assets	Liabilities	Capital
A	Tshs9,960	Tshs8,660	Tshs1,200
B	Tshs9,960	Tshs8,660	Tshs1,100
C	Tshs8,660	Tshs6,000	Tshs2,660
D	Tshs8,660	Tshs5,000	Tshs1,260

Test Yourself 6

A firm has the following assets and liabilities. Calculate the capital of the proprietor.

Premises used by the proprietor for business – Tshs100,000,000
Residential house of the proprietor-Tshs150,000,000
Receivables of the firm-Tshs20,000,000
Cash in the proprietor's house- Tshs50,000,000 (including Tshs20,000,000 of firm's cash)
Loan given by the bank toward working capital in the business- Tshs80,000,000
Loan given by the bank to purchase the residential house of the proprietor-Tshs100,000,000

Answers to Test Yourself

Answer to TY 1

(Amounts in Tshs'000)

(a)

Dr	Loan	Tshs10,000	
Cr	Cash (current asset – SOFP)		Tshs10,000

Being part of the principal of the loan repaid to the bank

The liability to the bank decreases (it's a debit) and cash also decreases (it's a credit).

(b)

Dr	Cash (current asset – SOFP)	Tshs12,000	
Cr	Non-current asset (SOFP)		Tshs12,000

Being non-current asset sold for cash

Cash increases (asset is debited) and the non-current asset is taken out of the books (by crediting it).

(c)

Dr	Amount receivable from the sale of a non-current asset (Current asset – SOFP	Tshs33,000	
Cr	Equipment (non-current asset – SOFP))		Tshs33,000

Being a sale of equipment on credit

Receivables increase (assets are debits) and the non-current asset is taken out of the books (by crediting it).

(d)

Dr	Cash (current asset – SOFP)	Tshs33,000	
Cr	Amount receivable from the sale of a non-current asset (SOFP)		Tshs33,000

Being cash received from the acquirer of the equipment

Cash increases (assets are debits) and receivables are taken out from the books (a decrease in an asset is a credit item).

(e)

Dr	Land (non-current asset – SOFP)	Tshs140,000	
Cr	Cash (current asset – SOFP)		Tshs140,000

Being cash paid to purchase land
An asset increases (assets are debits) and cash is paid (assets decrease hence credit).

(f)

Dr	Payable to supplier of non-current assets (current liability – SOFP)	Tshs25,000	
Cr	Cash (current asset – SOFP)		Tshs25,000

Being amount due to supplier of non-current assets settled in cash

(g)

Dr	Equipment (non-current asset – SOFP)	Tshs10,000	
Cr	Motor vehicles (non-current asset – SOFP)		Tshs10,000

Being acquisition of equipment (a non-current asset) in exchange for a car (another type of non-current asset)

Answer to TY 2

The correct option is **A.**

Students must remember these debit/credit rules:

	Debit effect	Credit effect
Assets have a **debit balance**	↑asset	↓asset
Liabilities have a **credit balance**	↓liability	↑liability
Expenses have a **debit balance**	↑expenses	↓expenses
Incomes have a **credit balance**	↓income	↑income

Answer to TY 3

The correct option is **D**.

M/s Elite Traders have a liability to pay back the Tshs13,000 loan in the future.

Answer to TY 4

Debit (an increase in cash-an asset)
Credit (an increase in capital – a liability of business to its owners)
Debit (An increase in purchases – an expense)
Credit (A decrease in cash – an asset)
Debit (An increase in shop – an asset)
Credit (A decrease in cash – an asset)

Answer to TY 5

The correct option is **C.**

The accounting equation is assets = capital + liabilities. Only (c) holds this equation.

Answer to TY 6

The capital of the proprietor is Tshs60,000,000.

We need to consider only the business assets and liabilities in the statement of financial position

	Tshs'000
Assets	
Premises	100,000
Residential house	-
Receivable	20,000
Cash- (consider the business cash no matter where it is located)	20,000
Total	**140,000**
Capital and Liabilities	
Capital (balancing figure)	**60,000**
Loan for business	80,000
Loan for personal asset	-
Total	**140,000**

Capital = Assets – Liabilities
= Tshs140,000,000 – Tshs80,000,000
= Tshs60,000,000

Self-Examination Questions

Question 1

Present the journal entries (with narrative) for the following transactions.

(i) An entity repays part of a loan amounting to Tshs10, 000,000.

(ii) An entity sells a non-current asset that it had in its books at Tshs12, 000,000 for the same amount in cash.

(iii) An entity sells a piece of equipment that was recorded in the books at Tshs33, 000,000 for the same amount on credit.

(iv) The acquirer of the equipment pays the amount due in cash.

(v) Cash that had initially been received from the owners of the business is used to buy a piece of land for Tshs140,000,000.

(vi) The entity pays the liability of Tshs25,000,000 to the company that built their premises.

(vii) An entity acquires a piece of equipment with the value of Tshs10,000,000 in exchange for a car.

Question 2

The following table shows a list of ten transactions of Baraka Co. Ltd.

Sr. No.	Transactions	Account to be debited	Account to be credited
1	Bought goods by cheque		
2	Deposited cash into bank		
3	Sold goods on credit to Hiyari Ltd		
4	Paid salary by cheque		
5	Withdrew cash for personal use		
6	Paid rent by cash to Alia		
7	Goods returned to creditor		
8	Goods returned by credit customer		
9	Started business by paying cheque into business		
10	Purchased furniture by paying cheque		

Required:

Indicate accounts to be debited and credited for each transaction.

(May 2012)

Question 3

What should the journal entry be if Miti Mirefu purchased goods for cash?

A Dr		Purchases	X	
	Cr	Sales		X
B Dr		Purchases	X	
	Cr	Cash		X
C Dr		Purchases	X	
	Cr	Supplier		X
D Dr		Cash	X	
	Cr	Purchases		X

Which of the following is the correct accounting equation?

A Capital + Total liabilities – Total assets
B Capital - Total liabilities + Total assets
C Capital = Total assets + Total liabilities
D Capital = Total assets – Total liabilities

Question 5

Which of the following is correct?

A Increase in asset – credit
B Decrease in asset - debit
C Increase in expense – credit
D Decrease in income – debit

Question 6

Which of the following is correct?

A Assets and expenses show debit balance.
B Liabilities and capital show debit balance.
C Assets and incomes show debit balance.
D Liabilities and incomes show debit balance.

Answers to Self Examination Questions

Answer to SEQ 1

(Amounts in Tshs'000)

(i)	Dr	Loan	Tshs10,000	
	Cr	Cash (current asset – SOFP)		Tshs10,000
		Being part of the principal of the loan repaid to the bank.		

The liability to the bank decreases (it's a debit) and cash also decreases (it's a credit).

(ii)	Dr	Cash (current asset – SOFP)	Tshs12,000	
	Cr	Non-current asset (SOFP)		Tshs12,000
		Being non-current asset sold for cash.		

Cash increases (asset is debited) and the non-current asset is taken out of the books (by crediting it).

(iii)	Dr	Amount receivable from the sale of a non-current asset (Current asset – SOFP)	Tshs33,000	
	Cr	Equipment (non-current asset – SOFP)		Tshs33,000
		Being a sale of equipment on credit		

Receivables increase (assets are debits) and the non-current asset is taken out of the books (by crediting it).

(iv)	Dr	Cash (current asset – SOFP)	Tshs33,000	
	Cr	Amount receivable from the sale of a non-current asset (SOFP)		Tshs33,000
		Being cash received from the acquirer of the equipment.		

Cash increases (assets are debits) and receivables are taken out from the books (a decrease in an asset is a credit item).

(v)	Dr	Land (non-current asset – SOFP)	Tshs140,000	
	Cr	Cash (current asset – SOFP)		Tshs140,000
		Being land (an asset that increases on debit) paid for in cash (cash decreases on credit as it is an asset).		

(vi) Dr		Payable to supplier of non-current assets (current liability – SOFP)	Tshs25,000	
	Cr	Cash (current asset – SOFP)		Tshs25,000

Being amount due to supplier of non-current assets settled in cash.

(vii) Dr		Equipment (non-current asset – SOFP)	Tshs10,000	
	Cr	Motor vehicles (non-current asset – SOFP)		Tshs10,000

Being acquisition of equipment (a non-current asset) in exchange for a car (another type of non-current asset)

Answer to SEQ 2

Sr. No.	Account to be debited	Account to be credited
1	Purchases	Bank
2	Bank	Cash
3	Debtor – Hiyari Ltd	Sales
4	Salary	Bank
5	Drawings	Bank/Cash
6	Rent	Cash
7	Creditor	Return outward
8	Return inward	Debtor
9	Bank	Capital
10	Furniture	Bank

Answer to SEQ 3

The correct option is **D**.

As we know, the business has to follow the business entity concept; capital (i.e. the funds brought by the owners of the business) is considered as a business liability. Also the business has to follow the double-entry accounting system; debits are always equal to credits.

The correct accounting equation is:

Capital (liability towards owners) + other liabilities = total assets controlled by the business.

Answer to SEQ 4

The correct option is **D**.

You must remember these debit / credit rules:

	Debit effect	Credit effect
Assets have a **debit balance**	↑Asset	↓Asset
Liabilities have a **credit balance**	↓Liability	↑Liability
Expenses have a **debit balance**	↑Expenses	↓Expenses
Incomes have a **credit balance**	↓Income	↑Income

Answer to SEQ 5

The correct option is **A**.

Refer debit / credit rules mentioned above.

Answer to SEQ 6

The correct option is **B**.

When making payments to a supplier, a remittance advice is sent along with the payment.

BUSINESS TRANSACTIONS AND SOURCE DOCUMENTS

5

Get Through Intro

You have probably heard of the terms **invoices, receipts and quotations**. These are the original source **documents** that all entities keep and on the basis of which, bookkeeping is performed.

This Study Guide will explain how to **identify accounting transactions** and how to **record these transactions** in the books of prime entry. This Study Guide will also **outline the business documents** used.

In the **previous Study Guides,** we discussed the most important elements of accounting: double entry book-keeping. It is very important that you understand this concept before moving on to study the subsequent Study Guides, as this forms the basic building block of all subsequent Study Guides. If you master debits and credits, it means you have understood the core mechanisms that make accounting work!

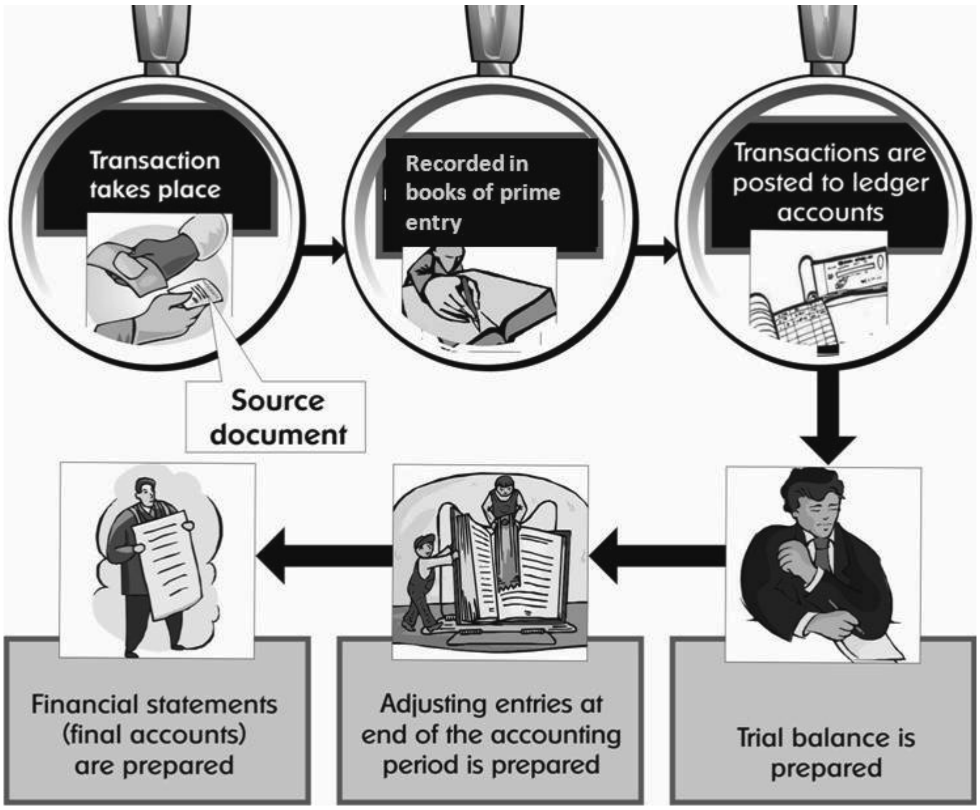
Learning Outcomes

a) Define business transactions
b) Identify types of business transactions
c) Mention and explain major source documents in business activities

1. Define business transactions.
2. Identify types of business transactions
[Learning Outcomes a and b]

The first step in the accounting cycle is the occurrence of a transaction. The documents generated when a transaction takes place form the source of recording a transaction. In this Study Guide we will discuss various types of business transaction (Learning Outcome 1) and also the source documentation (Learning Outcome 2) on the basis of which these transactions are recorded.

Diagram 1: The accounting cycle



Types of business transactions

The most common business transactions include sales, purchase, payments and receipts. These transactions are discussed in detail below:

1. Sales

Sale of goods refers to the **income generated by the entity from its main activities**. They may also be referred to as **turnover.** Sales are of two types:

(i) Cash sales: The payment for the sale is received immediately. The seller issues a cash invoice. The journal entry to record this transaction is:

Dr	Cash	X	
Cr	Sales		X

Being goods sold and cash received

(ii) Credit sales: The buyer promises to pay in the future, hence a receivable and payable relationship is created. The seller issues an invoice. The double-entry is:

Dr	Receivables	X	
Cr	Sales		X

Being goods sold on credit

Example

On 1 March 20X3, Sunrise Ltd sold goods worth Tshs2 million for cash to Brian.

The journal entry to record this transaction will be:

Dr	Cash	Tshs2 million	
Cr	Sales		Tshs2 million
	Being goods sold and cash received		

If the same goods are sold on credit, the journal entry will be:

Dr	Brian (Receivables)	Tshs2 million	
Cr	Sales		Tshs2 million
	Being goods sold on credit		

2. Purchases

Purchases are one of the most important activities for an entity. These are the opposite of sales – they refer to the main direct **expenses incurred in generating sales income**. Purchases are of two types.

(i) Cash purchases: The payment for the purchase is made immediately. The double-entry is:

Dr	Purchases	X	
Cr	Cash		X

Being purchases made and cash paid.

(ii) Credit purchases: The buyer does not pay immediately, but promises to pay in the future. The double-entry is:

Dr	Purchases	X	
Cr	Payables		X

Being purchases made on credit.

Example

Jack purchased goods worth Tshs5 million from Alistair in cash. The journal entry for this transaction will be:

Dr	Purchases	Tshs5 million	
Cr	Cash		Tshs5 million

Being purchases made and cash paid.

If the same goods are purchased on credit, the journal entry will be:

Dr	Purchases	Tshs5 million	
Cr	Alistair (Sundry Payables)		Tshs5 million

Being purchases made on credit.

Tip

Sales and purchases are opposite sides of the same transactions. One entity's sales are another entity's purchases.

3. Payments

Payments refer to the outflow of cash by the payer. Payments can be either:

1. Payment in cash OR
2. Payment by cheque, credit card, standing order or direct debit.

A payment can be towards:

(a) Cash purchases
(b) Payment to suppliers (payables)
(c) Purchases of non-current assets
(d) Drawings from the business (money taken for **personal** use by the proprietor)
(e) Expenses

(The above list is not exhaustive)

While making a payment you need to **obtain a receipt from the recipient** or obtain his acknowledgement on a payment voucher. This is your primary source of proof that payment has been made. A receipt must be obtained for all cash transactions.

Example

The following payments are made by Carl during the month of March 20X3:

(a) Payment by cheque for rent Tshs800,000
(b) Paid salaries to staff in cash Tshs650,000
(c) Withdrawn for personal use in cash Tshs225,000
(d) Paid for purchase of furniture by cheque Tshs936,000

The journal entries for all these transactions will be:

(a)	Dr		Rent	Tshs800,000	
		Cr	Bank		Tshs800,000
Being rent paid by cheque					
(b)	Dr		Salary	Tshs650,000	
		Cr	Cash		Tshs650,000
Being salaries paid by cash					
(c)	Dr		Drawings	Tshs225,000	
		Cr	Cash		Tshs225,000
Being cash withdrawn for personal use					
(d)	Dr		Furniture	Tshs936,000	
		Cr	Bank		Tshs936,000
Being furniture purchased and payment made by cheque					

---

4. Receipts

Receipts refer to the inflow of cash to the recipient. Receipts can be either:

1. Receipt in cash OR
2. Receipt by cheque, credit cards, direct credit and standing order

A receipt can be from:

(a) Cash sales
(b) Collection from customers (receivables)
(c) Sale proceeds from disposal of non-current assets
(d) Capital brought into the business by the owners
(e) Loan financing
(f) Other income received in cash

(The above list is not exhaustive)

While receiving money you need to **issue a receipt to the payer** or an acknowledgement of receipt.

Example

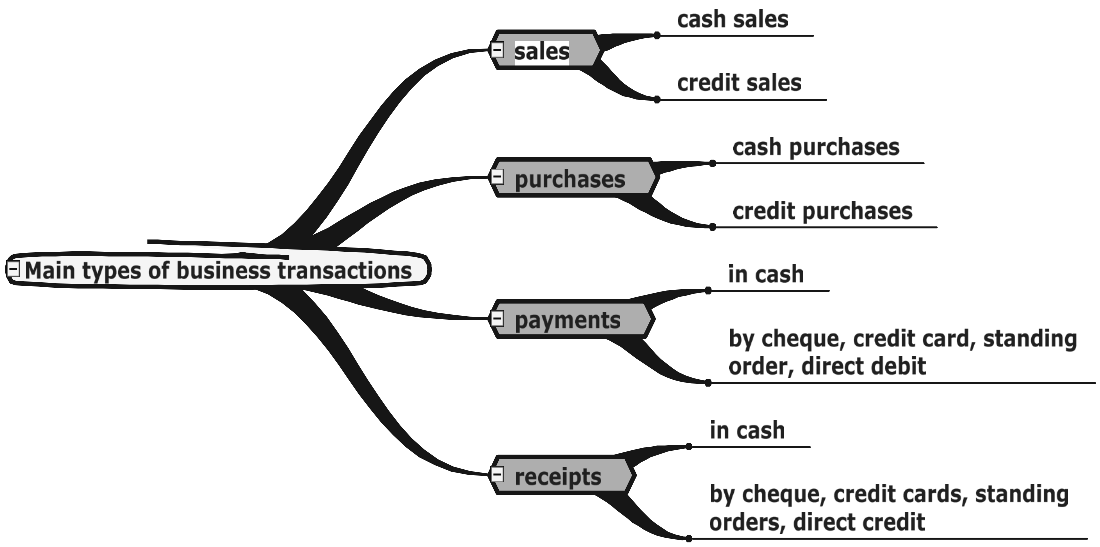
Record the following transactions in the books of Bill & Co:

(a) Paid in cheque towards capital Tshs1.5 million
(b) Sold goods to Jimmy for cash Tshs300,000
(c) Received cheque from Adam towards settlement of his account for credit sales Tshs425,000
(d) Cheque received from bank for loan taken of Tshs1,250,000
(e) Sold old furniture for cash Tshs100,000

The journal entries to record these transactions in the books of Bill & Co. will be:

(a)	Dr		Bank	Tshs1.5 million	
		Cr	Capital		Tshs1.5 million
Being amount received against capital					
(b)	Dr		Cash	Tshs300,000	
		Cr	Sales		Tshs300,000
Being goods sold and cash received					
(c)	Dr		Bank	Tshs300,000	
		Cr	Adams (Receivables)		Tshs300,000
Being cheque received from Adam					
(d)	Dr		Bank	Tshs1,250,000	
		Cr	Loan (liability)		Tshs1,250,000
Being cheque received from bank against loan taken					
(e)	Dr		Cash	Tshs100,000	
		Cr	Furniture		Tshs100,000
Being furniture sold for cash					

SUMMARY



Test Yourself 1

Applying the concepts discussed in above paragraphs, fill in the blanks with the words **debit** and **credit**.

While making a payment we __________the cash and when we make a payment by cheque we ___________ the cash at bank account because when an asset is decreased we ___________ the asset account. When we collect a cheque we ____________ the cash at bank account. When the proprietor withdraws cash from the business we __________ cash and _____________ drawing account. When we make cash expenditure on purchase of goods we ____________ purchases account and _________ cash. But when we make payment to suppliers for goods purchased on credit we _________ payable account and not the purchases account.

3. Mention and explain major source documents in business activities [Learning Outcome c]

3.1 Data sources

A data source is **evidence that proves the occurrence of a transaction or event.** In accounting, all transactions or events are recorded on the basis of a data source.

Example

John purchased a car. The evidence of this transaction is an invoice issued by the car dealer. An invoice contains the seller's name, description of goods, buyer's name, date of transaction and amount of transaction.

For the above transaction, the invoice issued by the car dealer is a data source.

The source documents of the various transactions of an entity can be categorised as:

Transaction	Source document
Purchases of goods	Supplier's invoice
Sales of goods	Entity's sales invoice
Returns of purchased goods	Debit note raised by the entity and credit note issued by the seller accepting the return
Returns of sold goods	Debit note raised by the customer and Credit note raised by the entity accepting the return
Provision of services	Entity's sales invoice
Purchases of assets	Supplier's invoice
Sales of assets	Entity's sales invoice
Cash receipts	Receipts issued by the entity for cash sales
Cash payments	Remittance advice accompanying the actual cash
Cheque payments	Remittance advice accompanying the actual cheque
Cheque receipts	Receipts issued by the entity
(The above list is not exhaustive)	

For each and every transaction of an entity, there has to be some kind of proof or data source. This is the first step in the accounting process i.e. **identifying transactions**.

The need for data sources in accounting

In accounting, all transactions are recorded on the basis of some data source, which gives evidence of the occurrence of transactions. Source documents are insisted on by auditors while reviewing the accounts. They must be retained by the company and properly filed for future reference.

3.2 Types of data sources

1. **Internal data source:** this is a data source which is **generated internally** by the entity.

Example

Tausi Enterprise sold goods. A sales invoice will be issued by Tausi Enterprise to its customers. This is a data source internally generated by Tausi Enterprise.

---

2. **External data source:** this is a data source which is **generated by another entity.**

Example

Tausi Enterprise purchased furniture from Krone Furniture. Krone Furniture will issue an invoice. This invoice is an external data source for Tausi Enterprise.

---

3. **Oral data source:** this data source is obtained through verbal communication, but it has to be confirmed in writing at a later date.

Example

The board of directors have proposed a dividend of 15% to its shareholders. The proposal at the meeting is an oral data source. However it has to be converted into minutes.

3.3 Different types of business documentation

1. Quotation

A quotation **contains terms and descriptions** about the seller's willingness to sell goods and on what terms. A quotation usually contains the following details:

(a) Description of goods
(b) Price including discounts and other benefits
(c) Delivery schedule
(d) Period of validity

Example

James Trading Corp is interested in buying computers from Computech Ltd. It has asked the marketing manager of Computech Ltd for a quotation. The manager has replied with a detailed description including the price of the computers, the payment schedule, the delivery schedule etc.

Pro-forma quotation

Computech Ltd 2nd Lane,23/4 Belgium Proforma Quotation		
Buyer's Name		**Q. NO.** 1065
James Trading Corp		**Date:** 24 Aug 20X3
Address		
Sr. No	**Details**	**Rate Tshs**
1	Computers	650,000 each
2		
3		
4		
Terms and Conditions 50% advance on confirmation of the order Final payment on delivery Delivery-First consignment will be sent within 15 days of confirming the order 2nd and final consignment will be sent 20 days after delivery of 1st consignment Freight, transport and insurance to be borne by the buyer Prices will include taxes as applicable **Authorised signatory** For Computech Ltd Marketing manager		

A quotation only gives the potential buyer a fair idea of the cost of purchasing a product / service. It cannot be used as documentation to indicate the sale transaction. The documentation to indicate a sale has been made is the sales invoice (covered later in this Learning Outcome).

2. Purchase order

When a company wants to purchase items, it sends a request to the supplier to supply the goods. The request sent by the buyer to the seller to supply goods to the buyer is known as a 'purchase order'. A purchase order **confirms the order and contains complete information** about it e.g.

(a) Name and address of the buyer

(b) Quantity and description of goods needed

(c) Price offered

(d) Delivery schedule

(e) Place of delivery

(f) Other terms and conditions

Example

James Trading is an electronics retailer. It intends to purchase five laptops from Computech Ltd. The purchase order that would have to be completed by James Mobile World is as follows:

Proforma purchase order

<table>
<tr><td colspan="5">James Trading Corp
Lexington, Kentucky
USA</td></tr>
<tr><td colspan="5">PURCHASE ORDER</td></tr>
<tr><td colspan="2">Seller's Name
Computech Ltd
2nd Lane,23/4 Belgium</td><td colspan="3">P.O. No. 1023
Date: 23 August 20X3</td></tr>
<tr><td>Sr. No</td><td>Details</td><td>Quantity</td><td>Rate Tshs</td><td>Amount Tshs</td></tr>
<tr><td>1</td><td>Laptop computers</td><td>5</td><td>650,000</td><td>3,250,000</td></tr>
<tr><td>2</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td>Total</td><td></td><td></td><td>3,250,000</td></tr>
<tr><td colspan="5">(Two Thousand dollars)</td></tr>
<tr><td colspan="3">TERMS AND CONDITIONS
50% Advance amount before delivery
Final payment on complete delivery
Freight and transport borne by supplier
Sales tax as applicable
Delivery within 20 days from issue of purchase order</td><td colspan="2">Authorised Signatory
For James Trading Corp

Chairman</td></tr>
</table>

3. Sales order

Sometimes when a buyer finds goods in the seller's premises, he books an order in the sales order book maintained by the seller.

Example

Computech will probably, have a number of customers placing orders on a daily basis. As company policy, Computech allows 15 working days for international orders. Based on the purchase orders received, Computech will enter each order into its Sales order book.

Proforma Sales order

Computech 2nd Lane, 23/4 Belgium						
Sales Order book						
Sr. No	**Date**	**Customer's name and address**	**Details**	**Qty**	**Rate Tshs**	**Other details**
1	31/10/20X3	James Trading Corp	Laptop computers	5	1.3 million each	Goods to be delivered by the end of next week
2	01/04/20X3	Mobile World	Office printers	2	0.4 million each	Advance paid
3	03/04/20X3	Coder Decoder	Automated offic assistant	1	5.65 million each	Tshs3.2 million paid as advance

4. Goods received note (GRN)

When the purchased goods are received, the receiver of the goods prepares a note for receipt of the goods. This note is called a 'goods received note' and it contains the following information:

(a) Information about the supplier
(b) Date of receipt of goods
(c) Quantity and description of goods

The GRN is generally prepared by the goods inwards department.

Example

When James Trading Corp receives computers; it prepares a goods received note. A goods received note will contain certain details e.g. supplier's name, date of receipt of computers, description and quantity of computers, the condition of computers (e.g. damaged) etc.

5. Goods despatched note (GDN)

When the sold goods leave the seller's place, the sender prepares a note for the despatch of the goods. This note is called a 'goods despatched note'. It contains the following information:

(a) Date of despatch of goods
(b) Buyer's name and address
(c) Quantity and description of goods

The GDN is generally prepared by the goods outwards department.

Example

When Computech Ltd sends computers it prepares a goods despatched note. A goods despatched note contains certain details e.g. customer's name, date of despatch of computers, quantity, description of computers etc.

6. Invoice

After supplying the goods, the seller sends an invoice to the buyer. An **invoice is the final proof that the goods have been sold** i.e. it conveys the ownership of the goods from the seller to the buyer.

An invoice contains the following information.

(a) Name of the seller
(b) Address of the seller
(c) Date of transaction
(d) Serial number of the invoice (invoices are pre-numbered documents, to ensure that they do not go missing)
(e) Description of the goods
(f) Name and address of the buyer
(g) Amount involved in the transaction
(h) Date due for payment

Example

Computech Ltd sold computers to James Trading Corp on 3 January 20X3. This was the first sales transaction of Computech Ltd for 20X3. A proforma invoice of the above transaction is given below:

Computech Ltd 2nd Lane, 23/4, Daresalam				
Invoice				
Buyer James Trading Corp Lexington, Kentucky USA		**Invoice number:** 01/03 **Date:** 3 January 20X3		
S. no	**Details**	**Quantity**	**Rate** **Tshs**	**Amount** **Tshs**
1	Computers	5	810,000	4,050,000
	Total	**5**		4,050,000
Amount in figures: Tshs four million fifty thousand only				
Authorised signatory		For Computech Ltd		

An entity can number the invoice in any manner but it should be unique and sequential

Invoices are raised (typed) by the seller on the seller's letter-headed stationery. **Within the business they will be termed 'sales invoice', consequently, when the same document is received by the customer / purchaser, it will be referred to as a 'purchase invoice'.**

7. Statement of account

A statement of account consists of the details of all the transactions between two parties that are outstanding on the statement date. In addition, the statement can also show payments received and the sales invoices they were allocated against.

Example

James Trading Corp asked Computech Ltd for a statement of account as at 31 December 20X3.

Computech Ltd will issue a statement in which it will give the following details:

Sale of goods with dates and description
Payments made by James Trading Corp
Any other adjustments for discounts, returns and eventual disputes or litigations etc.
The outstanding balance as at 31 December 20X3

A statement acts as a confirmation in accounting of all the transactions outstanding. For example James Trading Corp will compare his records to the statement issued by Computech Ltd, and ensure that it has received and processed all the invoices correctly. Computech Ltd will present the information as clearly and concisely as possible to allow the customer to easily see what is outstanding.

Pro-forma

Computech Ltd **2nd Lane,23/4 Dar es Salam** **Proforma Statement as at 31 December 20X3**					
Buyers Name James Trading Corp Address: 218, Pall Parade, London. For the period from 1/1/20X3 to 31/12/20X3			**Account number** X 20016		
Date	**Details**	**Allocated**	**Debit**	**Credit**	**Balance outstanding**
			Tshs'000	**Tshs'000**	**Tshs'000**
10/9/20X3	Sales-Inv-1023	A-1	1,500		1,500
06/09/20X3	Sales-Inv-1039	A-2	2,500		4,000
07/12/20X3	Receipt -1023	A-1		1,500	2,500
08/12/20X3	Sales-Inv-1098	A-2	1,000		3,500
10/2/20X3	Sales-Inv-1106	A-2	525		4,025
10/12/20X3	Sales returns	A-2		525	3,500
15/12/20X3	Sales-Inv-1122		1,250		4,750
31/12/20X3	Receipt	A-2		3,400	1,350
31/12/20X3	Discount	A-2		100	1,250
Balance outstanding at 31 December 20X3					**1,250**
For Computech Ltd Accounts Manager \ Authorised Signatory					

If the supplier prepares a statement in this format he can clearly identify which items have been paid for. This enables the customer to clearly identify which invoices are still outstanding. In this instance, the full outstanding balance of Tshs1.25 million relates to sales invoice "Sales-Inv-1122". Below is an alternative statement that Computech Ltd could have sent to its customers.

Proforma statement

Computech Ltd **2nd Lane,23/4 Dar-es Salam** **Statement as at 31 December 20X3**		
Buyers name James Trading Corp Address: 218, Pall Parade, London.		Account number X 20016
15/12/20X3	Sales-Inv-1122	1,250,000
Balance outstanding		1,250,000
Balance outstanding at 31 December 20X3		**Tshs1,250,000**
Authorised Signatory Accounts Manager		For Computech Ltd

8. Credit note

A credit note is a document used to adjust or rectify the discrepancies made in a sales invoice, and to account for the goods that are returned. A credit note is **raised by the seller when he has overcharged the customer**. It is generally printed in red to highlight the fact that it is a credit note and not an invoice. A credit note informs the party that its account has been credited due to the given reason.

Sometimes a credit note is referred to as a negative invoice.

Example

Computech Ltd sold 5 computers for Tshs0.8 million each to James Trading Corp. However one computer was damaged and not accepted by James Trading Corp. Now Computech Ltd will have to issue a credit note for the damaged computer.

Proforma credit note

CREDIT NOTE

Credit Note No.:

To Mr / M/s…………………………………………………..
You are hereby informed that we have credited your account with Tshs. ……………………….. only for the goods returned by you to us as under:

No. & /date of Invoice	Particulars	Quantity	Amounts Tshs

Amount in words ………………………………………………………………………………

Partner

9. Debit note

A debit note is a document used by the purchaser to adjust or rectify errors made in a sales invoice. A debit note informs the party that its account has been debited due to a certain reason mentioned in the debit note. .

Example

Computech Ltd sold 5 computers to James Trading Corp. However one computer was damaged and not accepted by James Trading Corp. Computech Ltd has not issued a credit note for the damaged computer. While making the payment James Trading Corp will raise a debit note for Tshs0.8 million on Computech Ltd and issue a cheque for Tshs3.2 million.

In reality, businesses rarely raise debit notes. It is more usual to contact the supplier and agree with him that a credit note should be issued. This is good practice, as the same party will raise both the invoice and the correction. This source document will then be processed by the customer, thereby creating the debit note entries in their accounts.

Pro-forma debit notes

DEBIT NOTE

Debit Note No.: Date:

To Mr / M/s…………………………………………………..
You are hereby informed that we have debited your account with Tshs. ……………………….. only for the goods returned by us to you as under:

No. & /date of Invoice	Particulars	Amount Tshs	Tshs

Amount in words ………………………………………………………………………………

E & O.E.

Partner

10. Remittance advice

A remittance advice accompanies a payment and contains the following information:

(a) Amount of payment
(b) Cheque number, name of the bank etc. if payment is made by cheque
(c) Details of payment:
    Invoice for which the payment is being made
    Date and amount of invoice

Example

James Trading Corp made a payment to Computech Ltd for the 5 computers received. It will send the following remittance advice with the cheque to ensure Computech Ltd is aware of which invoices are being paid.

Remittance advice

James Trading Corp	
Advice No.	**Advice Date:**
Paid to: Computech Ltd	**Cheque No.:** 12114
A/c Head: Computer Account	**Date:** 23/8/20X3
Invoice Number: 01/03	**Drawn on:** ABC Bank
	Tshs
Tshs four million fifty thousand only	4,050,000
Total	**4,050,000**
Prepared By: Approved Receiver's Signature	Revenue Stamp

11. Receipt

A receipt is a document **issued by the receiver of money to the payer** in acknowledgement of the payment.

A receipt would usually contain the following information:

(a) Date

(b) Amount received

(c) Signature of the receiver

(d) Name of the company

(e) Details of payment e.g. cheque number, invoice reference etc.

A receipt must always be obtained if a **cash payment** is made, as this will be your only proof of payment.

Example

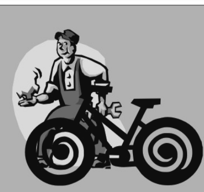
Computech Ltd will collect a cheque for Tshs4.05 million from James Trading Corp. The payment will be accompanied by a remittance advice issued by James Trading Corp. On collecting the cheque, Computech Ltd may issue a receipt to James Trading Corp for Tshs4.05 million.

Let us understand all the above documents with the help of the following conversation.

Shane

1. I want to buy this bicycle. Give me details of it in a quotation'.
3. All the terms in the quotation are acceptable to me'.
5. Shane gives a purchase order.
7. Shane receives the bicycle and prepares a goods received note.
9. Shane asks Harry to send a statement of account because he wants to pay his earlier dues along with this invoice.
11. Shane writes a cheque for the total balance outstanding and sends it to Harry along with a remittance advice.

Harry



2. Harry gives a quotation stating all his terms.
4. 'Give me a purchase order if you are satisfied'.
6. Harry dispatches the bicycle and prepares a goods dispatch note.
8. Along with the bicycle or a few days later Harry sends an invoice.
10. Harry sends a statement of account.
12. Harry receives the cheque and sends a receipt in acknowledgement of the cheque.

Test Yourself 2

Which of the following pairs do not show the transaction and its related source document on the basis of which the transaction is recorded in the books of accounts?

A Purchase of goods – supplier's invoice
B Goods returned – credit note issued by seller
C Sale of goods – entity's invoice
D Sale of asset – cheque received from the purchaser

Test Yourself 3

Fill in the blanks using the following words:

Remittance advice, goods despatched note, sales order, receipts, goods received note, statement, sales invoice, credit note, debit note, quotation, purchase order.

Roger recently opened a shop where he sells shirts. He also stocks shirts in his warehouse. In January Roger obtained the address of a shirt supplier from a business magazine. He found the rates and quality of the supplier reasonable and sent a ____________ to the supplier detailing the items that he wanted to buy, and the price. The supplier sent the goods, and few days later sent ____________ detailing the quantity, description and price of the goods he had delivered.

In February Roger visited Lantapoon's wholesale clothes outlet. He liked some T-shirts. He wrote a ____________ maintained at Lantapoon's outlet detailing what he wanted to buy, with quantities and the price. After 7 days he received a shipment of T-shirts from Lantapoon. The person in charge of Roger's warehouse prepared a ____________ on receipt of the shipment. Roger received the ____________ two days later and found that Lantapoon had over-charged him, so he made a ____________. Roger contacted Lantapoon and told them they had made an error. Lantapoon were very apologetic and immediately raised a ____________.

Answers to Test Yourself

Answer to TY 1

Credit (A decrease in cash – an asset)
Credit (A decrease in cash at bank – an asset)
Credit (A decrease in asset)
Debit (An increase in cash at bank – an asset)
Credit (A decrease in cash – an asset)
Debit (A decrease in capital – a liability. Drawings account is reported under the equity section in the SOFP)
Debit (An increase in purchases – an expense)
Credit (A decrease in cash – an asset)
Debit (A decrease in payables balance – a liability)

Answer to TY 2

The correct option is **D**.

Except for the sale of the asset, all the others are correct pairs of a transaction matched with its source documents. The source document for sale of the asset is an invoice issued by the entity to the purchaser, and not the cheque received from the purchaser.

Answer to TY 3

Purchase order, sales invoice, sales order, goods received note, sales invoice, debit note, credit note.

Self-Examination Questions

Question 1

A credit note is issued by the seller to:

A Raise invoices
B Adjust or rectify errors of overcharging made in the sales
C Adjust or rectify errors of overcharging made in the purchases
D Acknowledge receipt of cash

Question 2

Which of the following documents will accompany a payment made to a supplier?

A Statement
B Remittance advice
C Credit note
D Purchase invoice

Question 3

Goods are sent to a customer by the goods outward department. What document will be raised?

A Purchase invoice
B Goods despatch note
C Statement
D Remittance advice

Question 4

Which of the following documents is issued by a party receiving payment from its customer?

A Invoice
B Receipt
C Statement
D Credit note

Question 5

John returns to Monica goods that were purchased on credit.

Which of the following documents would be issued by John?

A Account statement
B Credit note
C Debit note
D Sales invoice

Question 6

You are given the following business transactions:

Example: Purchase goods on credit from Savimbi.

Source document	Primary book of account
Invoice	Purchase Journal

1. Bought office equipment on credit from Mr. Simbamwene
2. Sold goods and received cash
3. Sold goods on credit to Mrs. Chinsona
4. Goods returned by customer being damaged on transit
5. Cheque paid to supplier, returned by the bank for genuine reasons stated on the cheque

Required:

For each of the above transactions, state:

(i) One source accounting document
(ii) One book of original entry

(Adapted from May 2013)

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **B**.

When the seller sells goods on a credit basis, the accounting entry is:

Dr	XYZ (Receivable) account – SOFP	X	
Cr	Sales account – SOPL		X

However, when the seller wants to make corrections related to overcharging in the invoice (e.g. sales return, overstated price or quantity) then the seller issues a credit note. This entry will be:

Dr	Sales account – SOPL	X	
Cr	XYZ (Receivable) account – SOFP		X

Answer to SEQ 2

The correct option is **B**.

When making payments to a supplier, a remittance advice is sent along with the payment.

Answer to SEQ 3

The correct option is **B**.

All goods going out of an organisation are accompanied by a goods despatch note.

Answer to SEQ 4

The correct option is **B.**

A receipt is issued by the party receiving the money, either in cash or through cheque. This serves as an acknowledgement of receipt of money.

Answer to SEQ 5

The correct option is **C.**

As John is returning the goods purchased on credit, his liability is getting reduced. Therefore, John will debit Monica`s account by issuing a debit note. Alternatively Monica may issue John a credit note for the sales return.

Answer to SEQ 6

Sr. No	Transaction	Source document	Primary book(s)
1.	Bought office equipment on credit from Mr. Simbamwene	Invoice	Journal Proper General Journal Journal
2.	Sold goods and received cash	Cash sale/receipt	Cash Book
3.	Sold goods on credit to Mrs. Chinsona	Invoice	Sales day book
4.	Cheque paid to supplier, returned by the bank for genuine reason stated on the cheque	Customer's Debit Note Supplier's Credit Note	Returns Inwards daybook (Sales Returns day book)
5.	Cheque paid to supplier, returned by the bank for genuine reason stated on the cheque	Cheque Bank debit advice	Cash book

BOOKS OF ORIGINAL ENTRY AND LEDGER

6

Get Through Intro

Although the double entry system of bookkeeping has been in vogue for several centuries, it has now developed into a comprehensive, sophisticated accounting and financial reporting system. The principles, however, have remained the same. The recording of financial transactions begins with the journal. Transactions of repetitive nature are grouped and entered into specialised journals, known as the books of prime entry.

These entries are then posted to various ledger accounts, which are suitably classified and grouped. At the end of each period, these accounts are balanced to enable the extraction of the trial balance. This Study Guide takes you to the starting point of this process, i.e. the recording of the transactions in the books of prime entry.

Learning Outcomes

a) Identify types of books of account
b) Explain:
   i. Books of original entry
   ii. Ledger
   iii. Chart of Accounts
c) Identify books of original entry and their purposes.

1. Identify books of original entry and their purposes.

[Learning Outcome c]

1.1 Books of original entry

Definition

When an accounting transaction relating to a business is entered in the accounting records for the first time, these records are called **books of original entry or books of prime entry**.

Books of original entry are the books in which transactions are recorded for the first time. These are also called subsidiary books.

1.2 Purpose of books of original entry

The purpose of books of prime entry can be described through an example.

Example

There are 5,000 sales transactions every day in Lindi Inc. Jim, the accountant of Lindi Inc, has to write all the sales into a separate ledger account for each of the customers. There is a high chance that Jim may fail to record a transaction by misreading an entry or turning over two pages together in error.

Customer - Alistair	Tshs
Sales invoice - 2001	5,000

Customer - Brett	Tshs
Sales invoice - 2002	6,000
Sales invoice - 2005	10,000

Customer - Carl	Tshs
Sales invoice - 2003	8,000
Sales invoice - 2004	1,000

Customer - David	Tshs
Sales invoice - 2007	3,500
Sales invoice - 2009	2,500

Customer - Evan	Tshs
Sales invoice - 2006	2,000
Sales invoice - 2008	6,000

A better procedure would be:

- to maintain a sales day book
- to record all the sales transactions one after the other
- to, record (post) all transactions from the sales day book into each customer's account

The above procedure ensures that all sales transactions are recorded in the sales book.

Date	Invoice number	Customers	(Tshs)	Computers	Printers	Others (Tshs)
	Sale invoice - 2001	Customer-	5,000	5,000	-	-
	Sale invoice - 2002	Customer -	6,000	-	6,000	-
	Sale invoice - 2003	Customer -	8,000	8,000	-	-
	Sale invoice - 2004	Customer -	1,000	-	-	1,000
	Sale invoice - 2005	Customer -	10,000	10,000	-	-
	Sale invoice - 2006	Customer -	2,000	2,000	-	-
	Sale invoice - 2007	Customer -	3,500	-	3,500	-
	Sale invoice - 2008	Customer -	6,000	6,000	-	-
	Sale invoice - 2009	Customer -	2,500	-	-	2,500
		Total	**44,000**	**31,000**	**9,500**	**3,500**

By giving each transaction a sequential number within the sales day book you can clearly see if a transaction has been omitted. This gives you a master record to refer to if you think an error has occurred.

Thus, the general purpose of books of prime entry is given below.

(a) To exercise control over each business activity i.e. sales, purchases etc.(will be discussed in Study Guide 7)

(b) To reduce or minimise the chances of fraud and mistakes in business

(c) To locate errors in the trial balance

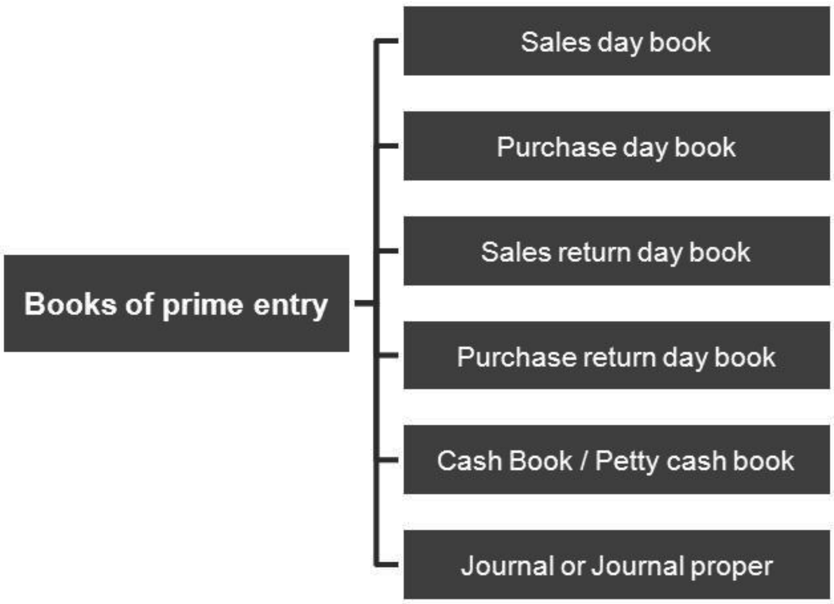
(d) To quickly retrieve desired information from the business

(e) To keep records of source documents to track payments from customers or amounts owed to suppliers

(f) To save same time by way of making summary posting into the sales account (discussed later)

Books of original entry include:

Diagram 1: Books of original entry



Let us discuss each of the above books of original entry in detail.

1. Sales day book or sales journal

Sales day book is used to record all **credit sales** made by the entity to its customers. Commonly, sales day books are also referred to as 'Sales Journal' or 'Sales Registers'.

It generally contains the following columns:

Date
Particulars
Ledger Folio
Customer invoice Number
Amount

Example

The following are details of credit sales for the month of January 20X3:

Date	Invoice	Transaction
10 Jan	INV- 2001	Sold Nails to Mark of Tshs5,000
15 Jan	INV- 2002	Sold Screws to Jane of Tshs6,000
25 Jan	INV- 2003	Sold bolts to Sammy of Tshs3,000

The above transactions will be recorded in the sales day book as follows:

Sales day book

Date	Invoice number	Folio No	Customer name	Total	Nails	Screws	Bolts
				Tshs	Tshs	Tshs	Tshs
10 Jan	INV- 2001	TR01	Mark	5,000	5,000	-	-
15 Jan	INV- 2002	TR25	Jane	6,000	-	6,000	-
25 Jan	INV- 2003	TR35	Sammy	8,000	5,000	-	3,000
			Total	**19,000**	**10,000**	**6,000**	**3,000**

Purpose of Sales Day book

The purpose of the sales day book is to record credit sales transactions for a period i.e. month or a year. It can be used as a reference for determining the amount owed from individual customers. Furthermore referring to the above example we can also get details of product-wise sales (i.e. nails, screws and bolts).

2. Purchase day book

Purchase day book is used to record all **credit purchases** made by the entity from its suppliers. Commonly, purchase day books are also referred to as 'Purchases Journal' or 'Purchase Registers'.

It generally contains the following columns:

Date
Particulars
Ledger Folio
Inward Invoice Number
Amount

This is a complete record of all credit purchases. A suggested format is as follows:

The purchases day book is totalled periodically and is debited to the purchases account in the ledger. The personal accounts are posted by crediting the individual accounts.

Example

The following are details of credit purchases for the month of February 20X3:

Date	Invoice	Transaction
3 Feb	10042	Purchased coal from BNG Inc. of Tshs2,000
17 Feb	A2001	Purchased steel from Christopher of Tshs8,000
25 Feb	200609	Purchased copper from Alexander of Tshs3,000

Continued on the next page

The above transactions will be recorded in the purchase day book as follows:

Purchase day book

Date	Purchase reference number	Folio No	Supplier's name	Supplier's invoice number	Total	Coal	Steel	Copper
					Tshs	Tshs	Tshs	Tshs
3 Feb	1	S05	BNG Inc	10042	2,000	2,000	-	-
17 Feb	2	S13	Christopher	A2001	8,000	-	8,000	-
25 Feb	3	S22	Alexander	200609	3,000	-	-	3,000
			Total		**13,000**	**2,000**	**8,000**	**3,000**

Purpose of Purchase Day book

The purpose of the purchase day book is to record credit purchase transactions for a period, i.e. a month or a year. It can be used as a reference for determining the amount owed to individual suppliers. Furthermore, as shown in the above example, we can also get details of product-wise purchases (i.e. coal, steel and copper).

3. Sales return day book or journal

Sales return day book is used to record all transactions relating to goods returned by customers. Commonly, purchase day books are also referred to as 'Sales Return Journal' or 'Sales Return Registers'.

Example

The following are details of sales return (return inwards) for the month of January 20X3:

Date	Credit Note No	Transaction
13 Jan	1850	Returned Nails to Mark of Tshs1,000
18 Jan	1851	Returned Screws to Jane of Tshs2,000

The above transactions will be recorded in the sales return day book as follows:

Sales return day book

Date	Credit note No	Folio No	Customers name	Total	Nails	Screws	Bolts
				Tshs	Tshs	Tshs	Tshs
13 Jan	1850	TR01	Mark	1,000	1,000	-	-
18 Jan	1851	TR25	Jane	2,000	-	2,000	-
			Total	**3,000**	**1,000**	**2,000**	**-**

The format of sales return day book is similar to sales day book, except the credit note number column in which the credit note number is recorded, instead of the invoice number. Credit notes have been discussed in detail in Study Guide 5 under source documents.

Purpose of Sales Day return book

The sales return book serves the purpose of issuing credit notes to customers who have returned the goods to the entity. Furthermore, as in the above example, it helps to identify the defective range of products i.e. nails and screws.

Tip

The words day book and journal are used interchangeably. Be careful, as the examiner may use either term.

4. Purchase returns day book or journal

Purchase return day book is used to record all transactions relating to the goods returned to suppliers. Commonly, purchase return day books are also referred to as 'Purchases Return Journal' or 'Purchase Return Registers'.

Example

The following are details of purchase return (return outwards) for the month of February 20X3:

Date	Debit Note No	Transaction
20 Feb	1002	Returned steel to Christopher of Tshs1,000 purchased earlier
28 Feb	1003	Returned copper to Jane of Tshs2,000 purchased earlier

The above transactions will be recorded in the purchase return day book as follows:

Purchase return day book

Date	Debit note No	Folio No	Supplier's name	Total	Coal	Steel	Copper
				Tshs	Tshs	Tshs	Tshs
20 Feb	1002	S13	Christopher	1,000	-	1,000	-
28 Feb	1003	S22	Alexander	2,000	-	-	2,000
			Total	**3,000**	**-**	**1,000**	**2,000**

The format of purchase return day book is similar to purchase day book, except the debit note number column in which the debit note number is recorded, instead of suppliers invoice number. Some entities add extra columns for management information, for example, quantity. Debit notes have been discussed in detail in Study Guide 5 under source documents.

Purpose of Purchase Day return book

The purchase return book serves the purpose of issuing debit notes to the suppliers to whom goods have been returned by the entity. Furthermore, as in the above example, it helps to identify the defective range of products returned i.e. steel and copper.

5. Cash book

The cash book is discussed in detail in Study Guide 8.

A cash book is a complete record of all cash and bank transactions.

Example

Cash book (with imaginary numbers)

Date	Receipts	Cash sales	Receivables	Total Tshs	Date	Payments	Cash purchases	Payables	Others	Total Tshs
Jan					**Jan**					
3	Cash sales	2,000		2,000	26	Cash purchases	2,500			2,500
5	Receivables - Tom		2,000	2,000	29	Salary payments			6,500	6,500
17	Dick		3,000	3,000	31	Balance c/f				1,000
21	Harry		3,000	3,000						
	Total	**2,000**	**8,000**	**10,000**		**Total**	**2,500**		**6,500**	**10,000**

Example

On 1 March 20X7, Mark Woods had a bank balance of Tshs1,000.

He entered into the following transactions during March 20X7.

1. Cash sale of Tshs60
2. Receipt from credit customer John Tshs780
3. Receipt from credit customer Ted Tshs300 less trade discount allowed Tshs30
4. Receipt from credit customer Rob Tshs250 less trade discount allowed Tshs20
5. Receipt of cheque from Mary Nelson Tshs1,500 against loan given
6. Receipt from second cash sale Tshs170
7. Receipt of cash for the sale of equipment Tshs400
8. Payment made to supplier Ian Tshs150
9. Payment made to supplier Peter Tshs250
10. Electricity bill paid Tshs500
11. Telephone bill paid Tshs250
12. Cash withdrawn from bank for petty cash Tshs200
13. New plant and machinery purchased for Tshs2,000 from Nick

Prepare a single column cash book.

Answer

Amounts in Tshs

Date	Receipts	Cash sales	Receivables	Others	Total	Date	Payments	Payables	Petty cash	Others	Total
01/03/20X7	Balance b/d				1,000		Purchase of machinery			2,000	2,000
	Cash sales	60			60		Payable - Ian	150			150
	Receivable John		780		780		Peter	250			250
	Ted		270		270		Electricity bill			500	500
	Rob		230		230		Telephone bill			250	250
	Loan – Mary Nelson			1,500	1,500		Petty cash		200		200
	Cash sales	170			170		Balance c/f				1,060
	Sale of non-current asset			400	400						
	Total	**230**	**1,280**	**1,900**	**4,410**		**Total**	**400**	**200**	**2,750**	**4,410**

6. Petty cash book

Every business has to make numerous small payments such as stationery, postage, taxi fares etc. If all these small transactions are recorded in the cash book then identifying important transactions from the cash book would be difficult. Therefore, a petty cash book is maintained to record the cash spent for day-to-day expenses.

The petty cash books are discussed in detail in Study Guide 8.

Date	Details	Amount spent	Balance
		Tshs	Tshs
01/04/20X6	Opening balance		500
03/04/20X6	Taxi fare	22.30	477.70
04/04/20X6	Stationery	12.60	465.10
06/04/20X6	Snacks for staff	36.50	428.60
06/04/20X6	Stationery	6.30	422.30
07/04/20X6	Fuel	65.90	356.40
08/04/20X6	Parking charges	3.50	352.90
09/04/20X6	Taxi fare	16.80	336.10
09/04/20X6	Drinks	6.20	329.90
11/04/20X6	Flowers and bouquets	15.50	314.4

Analytical columns are usually added to the petty cash book so as to help in a summary posting into the ledger. Refer to Study Guide 8.

Test Yourself 1

Which of these would not be recorded in the petty cash book?

A Purchase of a new company car
B Purchase of fuel for the car
C Car wash
D Puncture repairs

The purpose of the cash book and petty cash book has been explained in detail in Study Guide 8.

7. Journal

A general principle is that any transaction which cannot be recorded in the following books of original entry has to be recorded in a journal.

(a) Sales day book
(b) Purchases day book
(c) Sales returns day book
(d) Purchases returns day book
(e) Cash book
(f) Petty cash book

Journal provides date wise information of all the entries including the year-end adjustment entries. In the journal, transactions (journal entries) are recorded daily, as and when they take place. Therefore, one will not know at a glance, the combined effect of all the transactions, relating to a particular customer or supplier or item of income or expenditure. One would have to go through each page and every entry in the journal to collect all the information, and find out the effect of all the transactions with respect to a particular account. These difficulties make the role of the ledger important in the accounting process. Ledgers are covered in detail in Study Guide 7.

The following is an illustrative list of transactions that are usually recorded in a journal. This list is neither compulsory nor exhaustive. It all depends on the nature of activities that an organisation performs.

1. Entries for depreciation of non-current assets
2. Accrual entries e.g. to record expenses incurred but not yet paid
3. Rectification entries i.e. to correct the errors made in accounting
4. Transfer of profit / loss to capital or reserves
5. Purchases and sales of non-current assets on credit
6. Opening entries when we prepare a new set of books in the next accounting period
7. Entries for closing ledger accounts
8. Exchange entries e.g. exchange of assets

Note: Some of these entries are explained in detail in the later Study Guides, while some entries such as depreciation, exchange of assets, purchase and sale of assets, etc. will be covered in Paper T05.

Advantages of maintaining various day books include

Division of work: Work is divided so that the books of prime entry can be updated simultaneously by multiple persons

Facilitate postings: Provide information in a summarised form which can be directly used for posting.

Detection of errors and frauds: Since all the transactions are systematically and chronologically recorded, various frauds and errors can be located.

Better information: Provided summarised information such as credit sales, credit purchase, discounts allowed or discounts given through various journals maintained.

Example

Depreciation is a non-cash expense which cannot be recorded in the sales day book, the sales returns day book, the purchases day book, the purchases returns day book or the cash / bank book.

Hence it is recorded in the journal.

Example

Record the depreciation on machinery at 20% of cost. The cost is Tshs20,000.

Books of MAHINDI Ltd

Journal for the year to 31 December 20X6

31/12/20X6	Dr	Depreciation account	Tshs4,000	
	Cr	Accumulated depreciation account		Tshs4,000
		Being depreciation on the machinery charged at 20% on the cost of Tshs20,000		

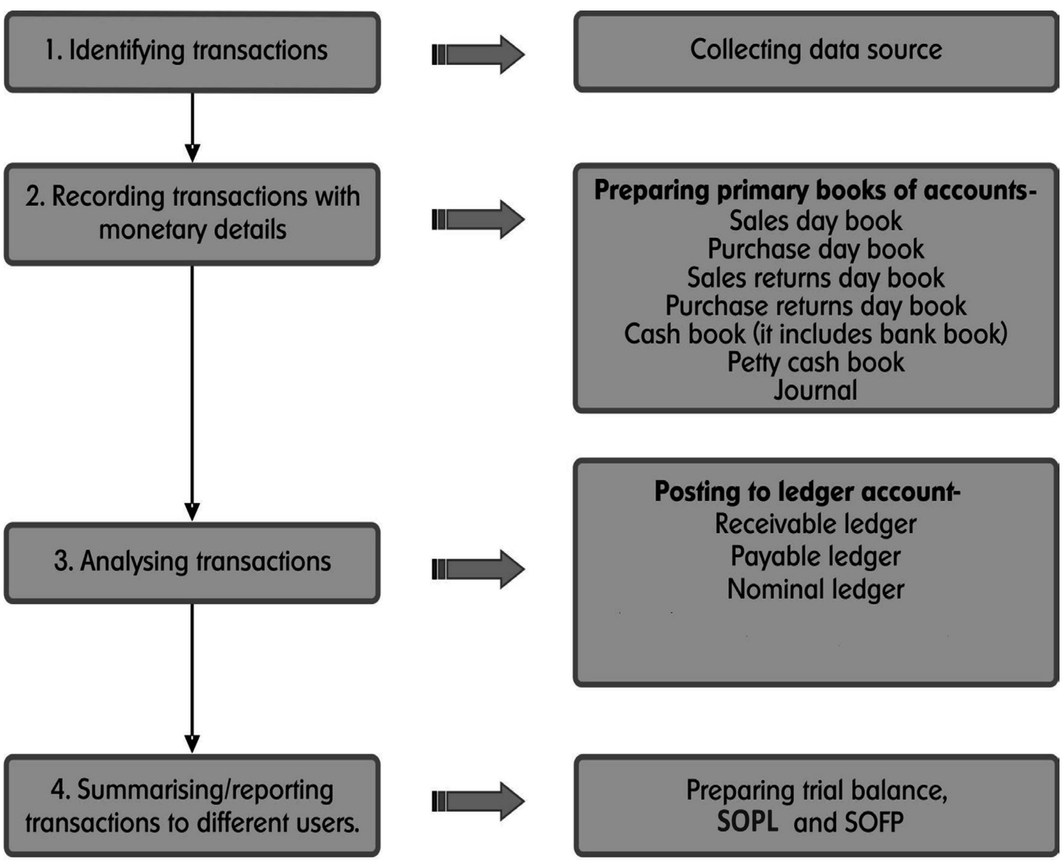
Tip

The day books maintained by an entity depend upon the type of the entity.

For example, a service provider need not maintain a sales day book as they are not selling products / inventories, instead they should maintain a service day book.

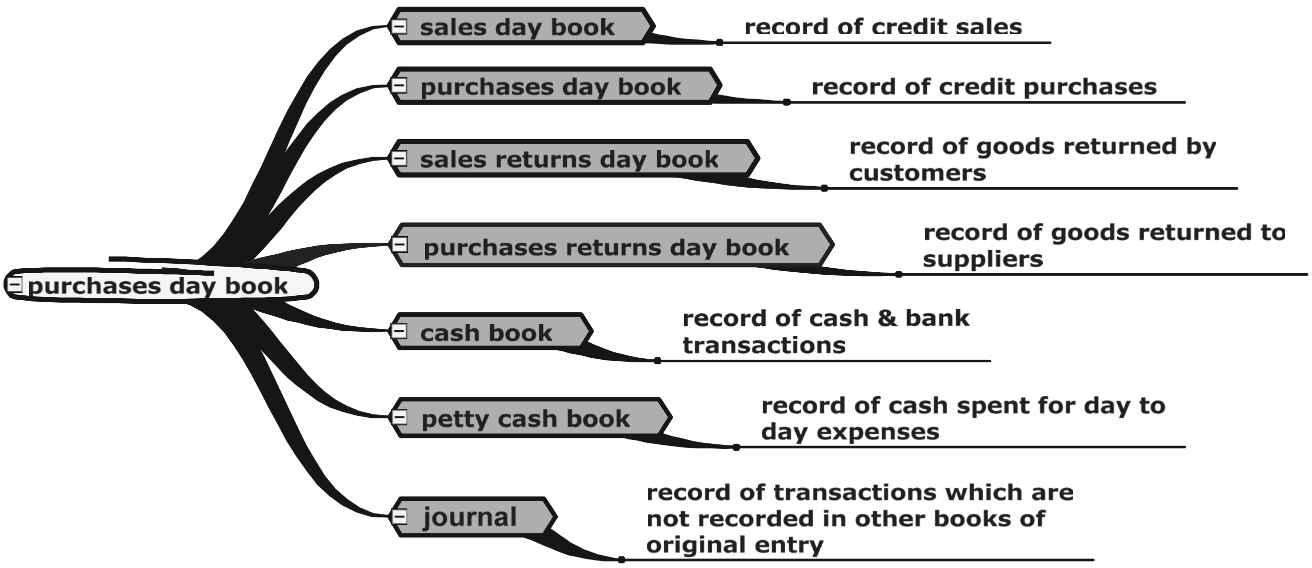
Let's now summarise the accounting process using the following flowchart

Diagram 2: Accounting process



You will remember that in the previous Study Guide we looked at step-1, collecting the data source. In this Study Guide we discussed above various books of prime entry and how transactions are recorded in each of the books. In the coming Study Guides we will discuss posting to the ledger accounts and preparing financial statements.

SUMMARY



Test Yourself 2

Fill in the blanks using one of these: sales day book, sales returns day book, purchase day book, purchase returns day book and cash book.

John is an antique dealer with a shop on Ye Olde High Street. He buys some antique furniture on credit. He will record the transaction in the ___________.

However, he notices that some items are damaged. Hence, he returns the furniture. He will record this transaction in his ___________.

John sells some antique pieces to Jenny on credit. He will record this transaction in his ____________.

John has a policy that customers can return the goods purchased by them within 10 days if they change their mind. He will record the goods returned transactions in his ___________.

John sells small items for cash on a daily basis. He will record these transactions in his___________.

1.3 Ledger posting

As seen elsewhere, under the double entry system, for each debit there has to be an equal credit. For a simple journal entry, there will be one debit and one credit.

Example

Buying a car involves both gaining an asset (ownership of the car) and a reduction for credit. The car will be debited and the supplier's account will be credited with the same amount of money (purchase price of the car).

The entry would be

Dr	Car account	X	
Cr	Supplier's account		X
Being car purchased			

Once the amounts are posted into these two ledger accounts (i.e. Car A/c and Supplier's A/c), the double entry or accounting equation remains intact since debits and credits have increased by an equal amount.

The end result of double entry book keeping is the general ledger or nominal ledger trial balance, which is used to prepare financial statements that tally, i.e. the total of debit balances is equal to the total of credit balances.

In order to tally the general ledger trial balance, the effect of double entry needs to be completed in the general ledger itself.

The books of prime entry are unlike the simple journal entry given above for the credit purchase of a car. For each entry, there would not be a debit and credit posting separately. Instead, a periodical, for example, monthly total is taken and posted into the general ledger.

1. Sales day book

With the periodical total of the sales book, the following entry would be made in the general ledger:

Example

Using the example of Sales Day Book discussed above, we can pass the following journal entry:

Dr	Receivables control account	Tshs19,000	
Cr	Sales		Tshs19,000

Being goods sold on credit during the month of _January 20X3 per sales day book

So far as individual parties are concerned, the debit effect of the above entry will be posted into their accounts in the receivables ledger. The receivables ledger will not contain the credit effect. However, its balances will be subject to a separate reconciliation with the receivables control account

2. Purchases day book

The double-entry is made with the periodical total of the purchase day book as follows:

Example

Using the example of Purchase Day Book discussed above, we can pass the following journal entry:

Dr	Purchases	Tshs13,000	
Cr	Payables control account		Tshs13,000

Being purchases made on credit during the month of February 20X3 per purchase day book

Individual party accounts will also be credited in the payables ledger with the respective amounts. The payables ledger will contain no debit posting. However, the payables ledger is subject to reconciliation with the payables control account

Tip

Sales and purchases are opposite sides of the same transaction. One entity's sales are another entity's purchases.

3. Cash book

As seen earlier, both debit and credit effects of most of the entries in the books of prime entry are posted to the nominal ledger so as to complete a double entry. However, the cash book is unique. It forms part of the double entry, so far as cash and bank columns are concerned. These columns themselves perform the function of cash and bank accounts. In other words, when we enter an amount to the receipts side of a cash book, a debit effect to the cash or bank account is given. We do not open a cash or bank account in the ledger to post the amounts. However, credit effect is given to the respective amounts.

Example

A rent of Tshs5,000 is received by cheque on 1 January 2011. Once it is written on the debit side in the bank column, the debit to bank is treated as given. What remains to be posted is only the credit effect. For this, in the rent income account, a credit posting of Tshs5,000 is done.

Similarly, when we enter an amount into the payments side of a cash book, a credit effect to cash or bank account is given. We do not open a cash or bank account in the ledger to post the amounts. The debit effect is given to the respective amounts.

Example

On 31 March 2011, an interest of Tshs2,000 is paid by cash and entered on the payment side of the cash book. The entry on the payment side is a credit effect. The debit effect is given by posting the amount to the debit of the interest expense account.

Test Yourself 3

Tomco sold goods worth Tshs10,000 to Jane. Examine the following:

(i) Jane's account in the nominal ledger will be debited with Tshs10,000
(ii) Jane's account in the receivables ledger will be debited with Tshs10,000
(iii) Sales account in the nominal ledger will be credited only with the total for the period
(iv) Sales account in the receivables ledger will be credited with Tshs10,000

Which of the following are correct?

A (i) and (ii)
B (ii) and (iii)
C (iii) and (iv)
D (i) and (iv)

---

2. Identify types of books of account.
3. Explain:
i. Books of original entry
ii. Ledger
iii. Chart of accounts

[Learning Outcomes a and b]

1. Books of original entry

This has already been explained in detail in Study Guide 7 of this Study Text.

2. Ledger

Definition

A ledger is the principal book in which the journal entries from various journals are posted in separate accounts.

Transactions in a ledger book are usually posted in the form of debits and credits. The process of recording journal entries into ledgers is called as posting. For example all the journal entries from the Purchase day book / journal are posted to the purchase ledger. The page number or folio number of the Ledger, where the posting has been made from the Journal is recorded in the L.F column of the Journal. Till such time, this column remains blank.

Debit entries are posted on the left side of each ledger account and credit entries are posted on the right side of each ledger account.

Pro-forma of ledger account with imaginary figures

Receivable Account

Dr **Cr**

Date		Tshs	Date		Tshs
1 Jan 2013	Balance b/d	3,000	22 Jan 2013	Cash	5,000
15 Jan 2013	Sales	12,000	31 Jan 2013	Balance c/d	10,000
		15,000			**15,000**

Difference between books of original entry (journal) and ledger

The following are few of the main difference between journal and ledger:

	Journal	Ledger
1	These are also referred to as books of original entry	These are referred to as books of secondary entry or final entry
2	Recorded on the basis of source documents.	Recorded on the basis of the books of original entry.
3	The journal is the book of chronological record i.e. entries are recorded date wise.	The ledger is the book for the analytical record i.e. entries are recorded ledger account- wise.
4	The process of recording in the journal is called journalising.	The process of recording in the ledger is called posting.

3. Chart of accounts

Definition

A chart of Accounts serves as an index to the various accounts maintained in the general and subsidiary ledgers.

A chart of account lists the account titles showing the location of accounts in general ledger. Basically the chart of accounts is divided into 5 main sections:

Income

Expenses

Assets

Liabilities

Capital / Equity

Various ledgers are categorised under these 5 heads and accordingly given a proper coding (unique reference number for identification). A sample proforma of chart of accounts of Baridi trading Co is given below:

Example

Ledger Folio No 1101 – 1200	Assets	Ledger Folio No 1201 – 1300	Liabilities
1101	Bank	1201	Bank overdraft
1102	Petty cash	1202	Bills payable
1103	Trade receivables	1203	Loan
1104	Plant and machinery	1204	Mortgage
1105	Furniture	1205	Accrued income
1106	Land	1206	Debentures issued
1107	Motor vehicles	1207	Advances from suppliers
1108	Inventories	1208	Dividends unpaid
1109	Prepaid insurance	1209	Accrued expenses
1110	Investments	12010	Tax payable

Ledger Folio No 1301 – 1400	Income	Ledger Folio No 1401 - 1500	Expenses
1301	Sales	1401	Purchases
1302	Sales return	1402	Purchase returns
1303	Discount received	1403	Discount allowed
1304	Interest income	1404	Salaries
1305	Royalty	1405	Electricity
1306	Income from sale of investments	1406	Telephone
1307	Commission	1407	Advertising
1308	Bonus	1408	Postage
		1409	Depreciation on plant
		1410	Depreciation on vehicles

Ledger Folio No 1501 – 1600	Equity		
1501	Capital		
1502	Accumulated profit		
1503	Drawings		
1504	General reserves		
1505	Revaluation reserves		

Baridi trading assigns a 4 digit account number to each account. For example Capital is assigned as 1501, Drawings as 1503, etc. These 4 digit number chosen have a special significance and therefore needs to be selected properly.

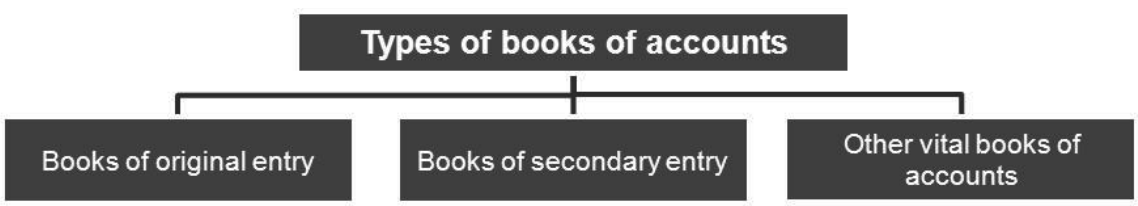
The first two numbers assigned shows the general ledger division in which account is located. For example Assets group is assigned “11”, Liabilities group is assigned “12”, Income is assigned “13”, etc.

The second two digits indicate the location of each account within the general ledger division.

---

4. Types of books of accounts

Books of accounts can be classified under three main categories:



Let us discuss the various types of books of accounts below:

1. Books of original entry

These include:

(a) Sales day journal - Discussed in Study Guide 7
(b) Purchase day journal - Discussed in Study Guide 7
(c) Sales return day journal - Discussed in Study Guide 7
(d) Purchase return day journal - Discussed in Study Guide 7
(e) Cash book / Petty cash book – Discussed in Study Guide 8
(f) Journal proper - Discussed in Study Guide 7

2. Books of secondary entry

Ledger books are the books of final entry which contains the various accounts to which the entries made in the books of original entry are transferred. For the sale of convenience, generally the ledger books are divided into:

Payable Ledger Book: This ledger contains all the accounts of suppliers.

Receivables Ledger Book: This ledger contains all the accounts of customers.

General Ledger Book: Also referred to as the nominal ledger. This book contains all the rest of the ledger accounts like the assets accounts, expenses account, total purchases account, total sales account, sales returns account, purchases returns account.

3. Other vital records

Some vital records are necessary and are useful in preparation of financial statements. These include:

Fixed asset register
Inventory register
Employee attendance register

Test Yourself 4

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

A Sales day book
B Journal proper
C Cash book
D Receivables ledger

Answers to Test Yourself

Answer to TY 1

The correct option is **A**.

Purchase of a new company car would not be recorded in the petty cash book.

Answer to TY 2

Purchases day book - purchases returns day book - sales day book - sales returns day book - cash book.

Answer to TY 3

The correct option is **B**.

When the seller does not receive the payment for the sales made immediately, it is a credit sale. The credit sale is recorded by passing the following entry:

Dr	Receivables	Tshs10,000	
Cr	Sales		Tshs10,000

Answer to TY 4

The correct option is **D.**

Receivables ledger is classified under books of secondary entry.

Self-Examination Questions

Question 1

Which of the following is not a primary book?

A Sales returns day book
B Purchases returns day book
C Journal
D General Ledger

Question 2

Which of the following is not a purpose of maintaining books of prime entry in business?

(i) To reduce the chances of fraud and errors
(ii) To exercise control over each business activity
(iii) To keep the records of sources of documents to track payment from customers or amounts owed to suppliers
(iv) To quickly retrieve desired information from the business

A Only (i)
B Only (i) and (ii)
C None of the above
D All of the above

Question 3

What is a book of prime entry?

A A ledger account where transactions are originally recorded
B A record in which transactions are originally recorded before being transferred to a ledger account
C A set of memorandum ledger accounts which are generated from source documents
D A subsidiary ledger which include details of transaction chronologically

Question 4

Which ONE of the following is not a book of prime entry?

A Receivables (sales) ledger
B Sales day book
C Petty cash book
D Journal proper

Question 5

The Journal is a book of prime entry which records transactions that are not routine or not recorded in any other book of prime entry.

Required:

List four (4) types of transactions which cannot be recorded in any book of prime entry except in the journal.

(Adapted from November 2011)

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **D**.

All the mentioned books except the general ledger are the books of prime entry. The general ledger is a secondary book where the records of all accounting transactions are maintained.

Answer to SEQ 2

The correct option is **C**.

Answer to SEQ 3

The correct option is **B.**

The transactions are first recorded in daybook (journals) and then transferred to the ledger accounts.

Answer to SEQ 4

The correct option is **A.**

Answer to SEQ 5

The following are the examples of transactions which cannot be recorded in any book of prime entry except the journal include:

(i) Year-end adjustments for:

- depreciation charges of whole period
- bad debt written off
- record of movement in allowance for debtors
- accruals and prepayments

(ii) Acquisition and disposals of non-current assets

(iii) Opening balances for all statement of financial position items

(iv) Correction of errors

RECORD AND POST ACCOUNTING TRANSACTIONS

7

Get Through Intro

Although the double entry system of bookkeeping has been in vogue for several centuries, it has now developed into a comprehensive, sophisticated accounting and financial reporting system. The principles, however, have remained the same. The recording of financial transactions begins with the journal. These entries are then posted to various ledger accounts, which are suitably classified and grouped. At the end of each period, these accounts are balanced to enable the extraction of the trial balance. A tallied trial balance, to a large extent (although not necessarily so), provides the confidence that the accounting process has been properly followed.

This Study Guide takes you through the process of posting entries from the various journal/daybook to the ledgers. Once you have understood the posting processes, you would be in a position to extract a trial balance and ultimately prepare the financial statements from the trial balance.

Learning Outcomes

a) Record day to day transactions in the books of prime entry
   i. Purchase Day Book / Purchase journal
   ii. Sales Day Book / Sales Journal
   iii. Return Outward (Purchases Return) Day Book / journal
   iv. Return Inwards (Sales Return) Day Book/ journal
   v. Cash payment journal
   vi. Cash receipt journal
   vii. Journal proper

b) Post journal entries to ledger accounts
   i. Sales ledger
   ii. Purchases Ledger
   iii. General ledger

1. Record day to day transactions in the books of prime entry i. Purchase Day Book
i. Purchase journal
iii. **Sales Day Book / Sales Journal**
iv. Return Outward (Purchases Return) Day Book / journal
v. **Return Inwards (Sales Return) Day Book/ journal**
vi. **Cash payment journal**
Vii Cash receipt journal
Viii Journal proper
2. Post journal entries to ledger accounts
i. Sales ledger
ii. Purchases Ledger
iii. General ledger
[Learning Outcomes a and b]

Sales and purchases are reported in the accounting period in which the merchandise is transferred in the name of the buyer from the seller. You need to know here that the accounting is performed after the merchandise has been transferred. Normally, this happens on delivery of goods and their acceptance by the purchaser or his agent. We have already discussed journal entries for sales in Study Guide A3.

1.1 Sales Day Book / Sales Journal

We learnt about the books of original entry in Study Guide 6. Sales day book is the book of original entry which is suitable where a large number of credit sales transactions are involved. A sales day book records only the **credit sales**. The cash sales are recorded in the cash book.

A sales day book meets the need of:

summarising all the transactions of credit sales in one place

making a **posting** of the total credits in the sales account, which would otherwise contain several entries.

For a service provider it may be called a **service daybook**.

Traditionally, the primary books were kept manually. All the discussions in this and subsequent Study Guides are based on the assumption that the books are maintained manually. However, in a computerised environment, the data is stored in the computer and can be used or analysed in any manner required. The daybook mentioned below may or may not be printed. However, the principles and the requirement for information remain the same whether the books are manual or computerised.

The sales book in its simplest form contains details of the sales made including:

- Customer's name and address
- Date of sale
- Amount of sales
- Invoice number
- Discount given

The analytical columns of the basic amount and transport serve the purpose of providing additional details to management about the business. Additional columns are sometimes added for the nature of the products sold, for example, computers and peripherals. Additional columns such as sales tax, octroi and other taxes can also be added. For simplicity sake, we will not be discussing taxes in this Study Guide. Let us understand the **preparation of the sales day book** with the help of the following example.

Example

Dimension Co is in the clothing industry. The following transactions sales took place during April, 20X7.

On 1 April 20X7, sold woollen clothes to Quartile Ltd as against invoice no. 6 of worth Tshs1,776,000 & transportation cost of Tshs100,000.

On 2 April 20X7 sold to Fertile Co, cotton clothes as against invoice no. 7 of worth Tshs3,640,000 and allowed a trade discount of Tshs20,000.

On 4 April 20X7 sold to Fertile Co woollen clothes as against invoice no. 8 of worth Tshs750,000 & transportation cost of Tshs120,000.

On 5 April 20X7 sold office furniture of Tshs2,000,000

On 5 April 20X7 sold cotton clothes for cash Tshs100,000

Sales day book
Dimension Co Ltd

Date	Customer name	Invoice number	Receivables ledger ref	Basic amount	Transport	Total	Cotton clothes	Woollen Cloth
20X7				**Tshs'000**	**Tshs'000**	**Tshs'000**	**Tshs'000**	**Tshs'000**
01/04	Quartile Ltd	6	128*	1,776	100	1,876		1,876
02/04	Fertile Co	7	88*	3,620		3,620	3,620	
04/04	Fertile Co	8	88*	750	120	870		870
	Total			**6,146**	**220**	**6,366**	**3,620**	**2,746**

Note:

* Receivables ledger reference is the page reference of the concerned customers account in the receivables ledger. In the given example, Quartile Ltd's ledger account is on page 128 in the receivable ledger.

A trade discount is deducted from the sales amount hence there is no need to record it separately. However, a cash discount is recorded separately on the collection of dues.

Other charges such as transportation charges can either be recorded separately or adjusted in the net sales amount.

Sale of office furniture is not included in the sales day book because it is not an ordinary sale.

Cash sales are not recorded in the sales book but recorded in the cash book.

Taxes included in sales are always recorded separately.

The sales day book is totalled periodically depending on the needs of the organisation e.g. weekly, monthly, quarterly etc.

One can include other columns as well, such as quantity, geographical classification, type of entity etc.

1. Recording / posting of sales transactions in receivable ledger and nominal ledger (general ledger)

A nominal ledger (or general ledger) is maintained for all SOFP and SOPL accounts e.g. incomes, expenses, (total) trade receivables, (total) trade payables. Personal accounts of individual parties are not maintained in the nominal ledger. Personal ledgers for receivables and payables are maintained separately from the nominal ledger. They are known as the receivables and payables ledgers..

Transactions of sales and purchases are entered in the **nominal ledger** in summary form, i.e. in totality. A periodical total of the sales book is taken, for example, for a month. The entry for credit sales is changed as follows:

Dr		Total accounts receivable (since it is an increase in an asset)	X	
	Cr	Sales (since it is an item of income)		X
Being total credit sales made during the period recorded				

Therefore the receivables and payables accounts are referred to as total receivables and total payables account in the nominal ledger (general ledger).

Example

The accounting entry in our example of Dimension Co is:

Dr		Total accounts receivable	Tshs6,366,000	
	Cr	Sales		Tshs6,366,000
Being total credit sales during the period recorded				

It may be appropriate to record sales of each product separately in separate ledger accounts. In this case, the sales book will have to provide columns for each type of sales.

Example

Refer to the sales day book above, and check the following entry.

Dr		Total accounts receivable	Tshs6,366,000	
	Cr	Sales – cotton clothes		Tshs3,620,000
	Cr	Sales – woollen clothes		Tshs2,746,000
Being total sales during the period recorded				

However, an organisation also needs to maintain records for each customer separately, so that it knows how much is receivable from each customer. A separate personal ledger known as a **receivables ledger or sales ledger** is maintained for this purpose, where accounts of individual customers are maintained.

The following **features of this ledger** need to be noted:

Since the main nominal ledger trial balance already contains a double entry, the personal ledger will contain only the additional details on **memorandum basis**. This applies equally to receivables and payables ledgers.

Entries in the personal accounts are matched invoice wise. Each collection or any other entry for example, discount, is matched with or linked to the related invoice.

There is a cross check between the total receivables account in the nominal ledger and the accounts in this ledger.

The total of the individual balances in the receivables ledger should match the balance of the total receivables account in the nominal ledger. The accounts in the nominal ledger are also called control accounts and will be discussed in Study Guide C2.

The following section shows how this is implemented:

2. Procedure for posting to receivables ledger

Copying transactions from the sales day book to each customer's account in the receivable ledger is known as posting to receivable ledger. It is done as follows:

(a) Open individual ledger accounts for each customer

(b) Write the details of sales on the debit side of the ledger account i.e. the left hand side

(c) Write the details of cash collection, sales return, discount allowed on the credit side of the ledger account i.e. on the right hand side

The amount posted to the ledger account will be the total amount which is receivable from the customer including all charges.
The folio number is the page reference of the sales day book.

Let us now prepare the personal accounts of the customers with the help of the sales book given above and the details of collection of cash to suppliers given in the following example.

Example

The transactions in the sales book of Dimension Company are posted in the personal accounts as shown in this example.

Let us assume the following cash collections on 30 April 20X7

Quartile Co   Tshs1,000,000 for invoice no. 6
Fertile Co   Tshs820,000 for invoice no. 8

These will appear on the credit side of the personal accounts since they are reductions in the assets.

Books of Dimension Co Ltd
Receivables ledger
Quartile Ltd Account

Balancing figure (1,876 - 1,000)

Dr **Cr**

Date		Folio	Tshs'000	Date		Folio	Tshs000
01/04/20X7	Sales – invoice 06		1,876	30/04/20X7	Cash Collections - invoice 6		1,000
				30/04/20X7	Balance c/f		876
	Total		**1,876**		**Total**		**1,876**
							Folio - 128

Fertile Co Account

Dr **Cr**

Date		Folio	Tshs000	Date		Folio	Tshs000
02/04/20X7	Sales - invoice 07		3,620	30/04/20X7	Cash Collections - invoice 8		820
04/04/20X7	Sales - invoice 08		870				
				30/4/20X7	Balance c/f		**3,670**
	Total		**4,490**		**Total**		**4,490**
							Folio - 88

Note that these ledgers help us in the following manner:

Invoice-wise break-up of the balance is as follows:

Quartile Ltd: Tshs876,000. This consists of invoice no 6.

Fertile Co: Tshs3,670,000 in total. This consists of invoice no. 7 full Tshs3,620,000 and invoice no. 8, a small balance of Tshs50,000.

Management or the accountant can now investigate the following

Why is invoice no. 7 still pending whereas the subsequent invoice no. 8 is already paid for?
Why is there a balance of Tshs50,000 against invoice no.8; is it towards a discount?
A cross-check between the total trade receivables account in the nominal ledger and the accounts in personal ledger. First, let us prepare the total receivables account:

Total Trade Receivables Account (in nominal ledger)

Dr **Cr**

Date		Folio	Tshs'000	Date		Folio	Tshs'000
30/04/20X7	Sales during the month according to the sales day book	1	6,366	30/04/20X7	Cash Collections		1,820
					Balance c/f		4,546
	Total		**6,366**		**Total**		**6,366**

Balances in the personal accounts are as follows: (See the accounts prepared earlier)

	Tshs'000
Quartile Ltd	876
Fertile Co	3,670
	4,546

The above total matches with the balance in the total account.

This proves the arithmetical accuracy of the personal ledgers.

To complete our understanding of postings for sales in the nominal ledger, let us also post the transactions to the sales account. Note that the sales account will include cash as well as credit sales transactions.

Sales Account (in nominal ledger)

Dr **Cr**

Date		Folio	Tshs'000	Date		Folio	Tshs'000
				05/04/20X7	Cash sales		100
				30/04/20X7	Sales during the month according to the sales day book		6,366
30/04/20X7	Balance c/f		6,466				
	Total		**6,466**		**Total**		**6,466**

1.2 Return Inwards (Sales Return) Day Book / Journal

A customer may return goods sold by the seller. Reasons for the return can include the following:

- Defective material
- Goods not according to specification
- Shortage in quantity
- Delayed delivery etc.
- Amount charged higher than that agreed

The goods returned by customers are recorded in sales return day book. (Also known as return inwards day book)

Example

Continuing with the above example of Dimension Co's Sales book seen earlier.

Suppose that some goods were returned by customers.

Quartile Co rejected goods worth Tshs114,000 which were received in a damaged condition.

Fertile Co returned all the goods to Dimension as they were not of the required quality.

The sales rejections are recorded as follows:

Sales return day book

Dr **Cr**

Date	Customer name and goods	Credit note number	Receivables ledger folio number	Total amount (Tshs'000)
01/05/20X7	Fertile Co all goods ref invoice 07	25	88	3,620
15/05/20X7	Quartile Co	26	128	114
	Total			**3,734**

Note:

Entities may or may not issue credit notes. However, it is useful to issue them.

The journal entry for recording sales returns in the nominal ledger is:

Dr	Sales returns	Tshs3,734,000	
Cr	Total Trade receivables		Tshs3,734,000

Being sales returns for the month of May 20X7

Postings of these will be made in the respective accounts in the nominal ledger.

Postings in the personal accounts will be made in the following manner

Sales Return account

Dr **Cr**

Date		Folio no	Tshs'000	Date		Folio no	Tshs'000
01/05/20X7	Fertile Co All goods		3,620	15/05/20X7			
15/05/20X7	Quartile Co Processor		114		By balance c/d		**3,734**
	Total		**3,734**		**Total**		**3,734**

Quartile Ltd Account

Dr **Cr**

Date	Details	Folio no	Tshs'000	Date	Details	Folio no	Tshs'000
01/04/20X7	Sales – invoice 06	1	1,876	30/4/20X7	Cash collections - invoice 06		1,000
				15/05/20X7	Sales returns CN 26		114
				31/05/20X7	Balance c/d		762
	Total		**1,876**		**Total**		**1,876**
							Folio - 28

Continued on the next page

Fertile Co Account

Dr **Cr**

Date		Folio no	Tshs'000	Date		Folio no	Tshs'000
02/04/20X7	Sales - invoice 07	1	3,620	30/04/20X7	Cash collections - invoice 8		820
04/04/20X7	Sales - invoice 08	1	870	01/05/20X7	Sales returns CN 25		3,620
				31/05/20X7	Balance c/f		50
	Total		**4,490**		**Total**		**4,490**
							Folio -88

Overview sales returns recording

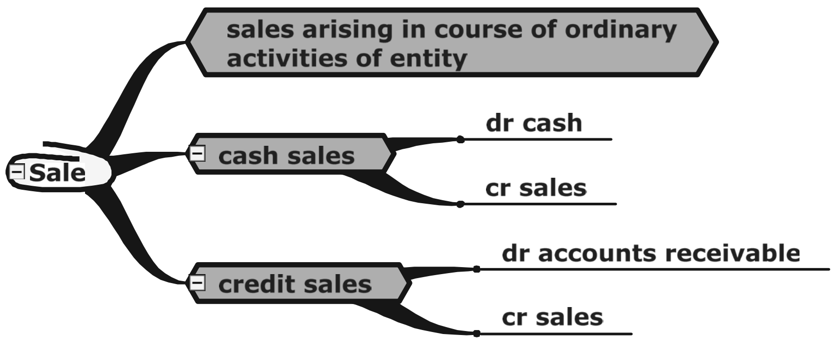
Record each sales return in the day book.

Post all invoices in the individual ledger account in the receivables ledger (credit side of the receivables ledger).

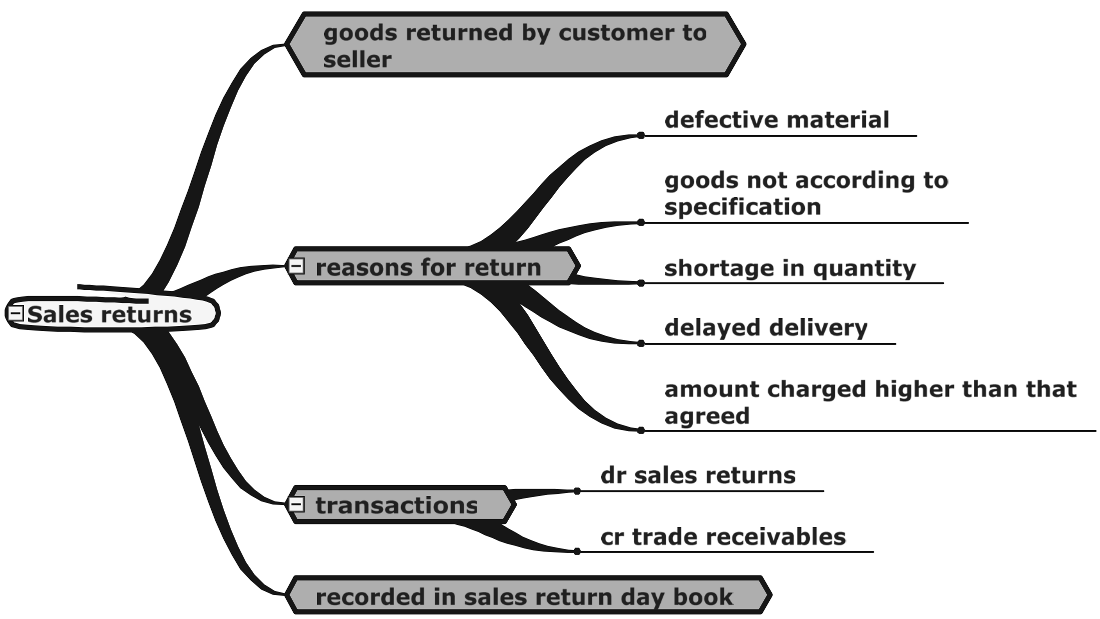
Take the periodical total of sales return

Post the periodic total of sales returns in sales return account in general ledger

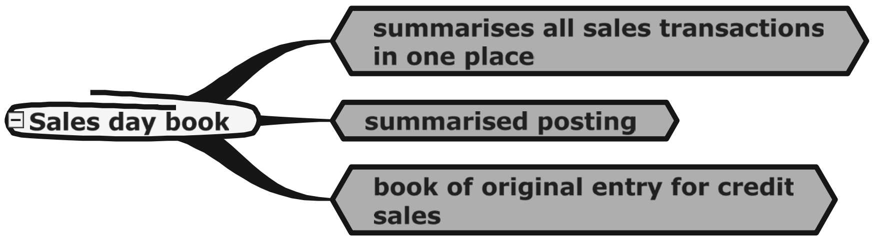
SUMMARY



SUMMARY



SUMMARY



Test Yourself 1

Shining Ltd trades in luxury goods. It has sold 1,000 units at Tshs100,000 to Bright Ltd Out of this 150 units are returned by Bright Ltd.

Required

Create a journal entry to record the sales and sales return.

1.3 Purchase day book / Purchase Journal

The purchase day book is the **book of original entry** which is suitable for a large number of credit purchase transactions. It is important to note that all the invoices for credit purchases are entered in to the purchase day book and the cash purchases are recorded in a cash book.

A purchase day book meets the need of

summarising all the transactions of credit purchases in one place

making a posting of the total debits in the purchase account, which would otherwise contain several entries.

The **preparation of a purchase day book** can be understood with the help of following example.

Example

Boleron Co Ltd deals in stationery items. The following are the transactions that took place during the month of April in the year 20X7.

Boleron Co Ltd purchased stationery from Terraco on 10/04/20X7 as against invoice no.105 amount Tshs3,000,000 for resale.

Purchased diesel from Samson on 11/04/20X7 as against invoice no.36 amount Tshs1,000,000

Purchased stationery items related to computer for resale from Terraco on 12/04/20X7 as against invoice no.120 amount Tshs5,000,000

Purchased from Boltron on 14/04/20X7 notebooks for resale as against invoice no.124 amount Tshs4,000,000

Boleron Company Ltd Purchase Day Book					
Date	**Supplier's name**	**Internal reference**	**Supplier's Invoice number**	**Purchase ledger ref**	**Purchases**
					Tshs'000
10/04/20X7	Terraco	1	105	17	3,000
12/04/20X7	Terraco	3	120	37	5,000
14/04/20X7	Boltron	4	124	42	4,000
	Total				**12,000**
					Folio no. 9

Note:

The purchase of diesel is not recorded in the purchase book as it is not an ordinary purchase.

The internal reference number is the reference number given by the entity to the supplier's invoice. Since the invoices are received from different parties, their invoice numbers are not in a serial order. For the convenience of filing and recording, companies frequently give their own reference number. Apart from these columns separate columns for types of purchases can also be incorporated.

Trade discount is deducted from the purchase amount hence there is no need to record it separately. However a cash discount is recorded separately at the time of payment. (We will learn about these two discounts later in the text).

Sales taxes included are always recorded separately. They will be covered in a subsequent section.

Other charges such as transportation charges can either be recorded separately as direct expenses or included in the net purchase amount. Usual practice is to record transport separately.

The purchase day book is totalled periodically depending on the need of the entity e.g. weekly, monthly, quarterly etc.

1. Recording / posting of purchase transactions in purchase ledger and nominal ledger

We have already discussed nominal ledger (or general ledger) and receivable ledger in Study Guide B2. We know that personal accounts of individual parties are not maintained in the nominal ledger. Personal ledgers for payables are maintained separately from the nominal ledger and they are known as **payables ledgers.**

Transactions of purchases are entered in the **nominal ledger** in summary form, i.e. in totality. A periodical total of the purchase book is taken, for example, for a month. The entry for credit purchases is changed as follows:

Dr	Purchases (since it is an item of expense)	X	
Cr	Total accounts payable (since it is an increase in liability)		X
Being total credit purchases made during the period recorded			

Example

The accounting entry in our example of Dimension Co is:

Dr	Purchases	Tshs12,000,000	
Cr	Total accounts payable		Tshs12,000,000
Being total credit sales during the period recorded			

However, an organisation also needs to maintain records for each supplier separately, so that it knows how much is payable from each supplier. A separate personal ledger known as a **payable ledger or purchase ledger** is maintained for this purpose, where accounts of individual suppliers are maintained.
Features of the personal ledger are covered in Study Guide B2.

The total of the individual balances in the payables ledger should match the balance of the total payables account in the nominal ledger.

The following section shows how this is implemented:

2. Procedure for posting to payables ledger

Recording in the payable ledger is known as posting to the payable ledger which is done as follows

1. open individual ledger account for each supplier
2. write the details of purchases on the credit side of the ledger account i.e. the right hand side
3. write the details of cash paid, purchase returns, discount received on the debit side of the ledger account i.e. the left hand side

    the amount posted to the ledger account will be the total amount which is payable to the supplier.

    the folio number is the page reference of the purchases day book.

Let us now prepare the personal accounts of the suppliers with the help of the purchase book given above.

Example

Continuing the previous example

The transactions in the purchase book of Boleron Company are posted in the personal accounts as shown here in this example.

Let us consider the following details of cash payments made to suppliers.

Terraco Tshs2,800,000 against invoice no.105 on 20 April 20X7
Boltron Tshs4,000,000 against invoice no.124 on 25 April 20X7

Balancing figure
(8,000 - 2,800)

Boleron Company Ltd
Payables ledger
Terraco account

Dr **Cr**

Date		**Folio No.**	**Tshs'000**	**Date**		**Folio No**	**Tshs'000**
20/04/20X7	Bank (against invoice no 105)		2,800	10/04/20X7	Purchase (invoice - 105)	9	3,000
30/04/20X7	Balance c/f		5,200	12/04/20X7	Purchase (invoice - 120)	9	5,000
	Total		**8,000**		**Total**		**8,000**
							Folio no. – 17

Samson account

Dr **Cr**

Date		**Folio No**	**Tshs'000**	**Date**		**Folio No.**	**Tshs'000**
30/04/20X7	Balance c/f		1,000	14/04/20X7	Diesel (invoice - 36)	9	1,000
	Total		**1,000**		**Total**		**1,000**
							Folio no. – 37

Boltron account

Dr **Cr**

Date		**Folio No.**	**Tshs'000**	**Date**		**Folio No**	**Tshs'000**
25/04/20X7	Bank (against invoice no 124)		4,000	14/04/20X7	Purchase (invoice - 124)	9	4,000
	Total		**4,000**		**Total**		**4,000**
							Folio no. - 37

Note that these ledgers help us in the following manner

Invoice-wise break-up of the balance is as follows:

Terraco Ltd: Tshs5,200,000 in total. This consists of invoice no. 105, Tshs200,000 (Tshs3,000,000 - Tshs2,800,000) and invoice no. 120, Tshs5,000,000.

Samson Tshs1,000,000 against invoice no. 36

Boltron - Nil

Management or the accountant can now investigate the following:

Why is there a balance of Tshs200,000 against invoice no.105; is it towards a discount?
A cross-check between the total receivables account in the nominal ledger and the accounts in this ledger.

Continued on the next page

First, prepare the total payables account:

Total trade payables account (in nominal ledger)

Dr Cr

Date		Folio	Tshs'000	Date		Folio	Tshs'000
30/04/20X7	Cash payments April 20X7		6,800	30/04/20X7	Purchases during the month per purchase book		12,000
30/04/20X7	Balance c/f		6,200	30/04/20X7	Diesel purchase		1000
	Total		13,000		Total		13,000

Balances in the personal accounts are as follows: (See the accounts prepared earlier)

	Tshs'000
Terraco Ltd	5,200
Samson	1,000
Boltron	Nil
Total	**6,200**

The above total matches with the balance in the total trade payables account. This proves the arithmetical accuracy of the personal ledgers.

The following account completes the posting of purchases in the nominal ledger.

Transferred to SOPL at the end of the year

Purchase account (in nominal ledger)

Dr Cr

Date		Folio No	Tshs'000	Date		Folio No	Tshs'000
30/04/20X7	Purchases for the month per purchase book		12,000	30/04/20X7	Balance c/f		12,000
	Total		12,000		Total		12,000

Cost of diesel account (in nominal ledger)

Dr Cr

Date		Folio No	Tshs'000	Date		Folio No	Tshs'000
30/04/20X7	Samsons (trade payables)		1,000	30/04/20X7	Balance c/f		1,000
	Total		**1,000**		**Total**		**1,000**

Transferred to SOPL at the end of the year

Note: Usually an analysis of the purchase book leads to separate ledger accounts.

1.4 Return Outward (Purchases Return) Day Book / journal

Purchase returns i.e. goods returned to suppliers are recorded in a purchase returns day book / journal.

Refer to the example of Boleron Co's purchase day book seen earlier. Suppose that some goods were returned to suppliers. The purchase returns are recorded in the manner shown below.

Purchase Returns Day Book

Dr Cr

Date	Supplier name and goods	Debit note number	Receivables ledger folio number	Total amount (Tshs'000)
17/05/20X7	Terraco	25		1,000
			Total	**1,000**

The journal entry for recording purchase returns in the nominal ledger is:

Dr	Total Trade Payables	Tshs1,000,000	
Cr	Purchase Returns		Tshs1,000,000

Being purchase returns for the month of May 20X7

These transactions will be posted in the personal accounts as follows:

Boleron Company Ltd
Purchase Return account

Dr **Cr**

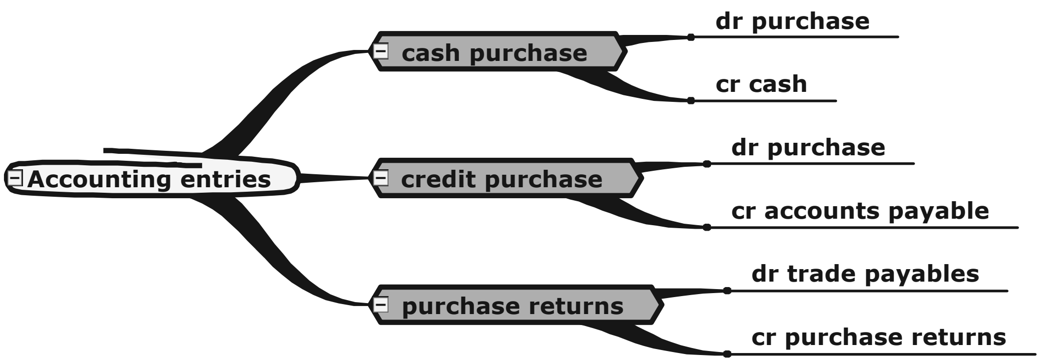
Date		Folio No	Tshs'000	Date		Folio No	Tshs'000
				17/05/20X7	Terraco		1,000
30/05/20X7	Balance c/f		1,000				
	Total		**1,000**		**Total**		**1,000**

Payables ledger
Terraco account

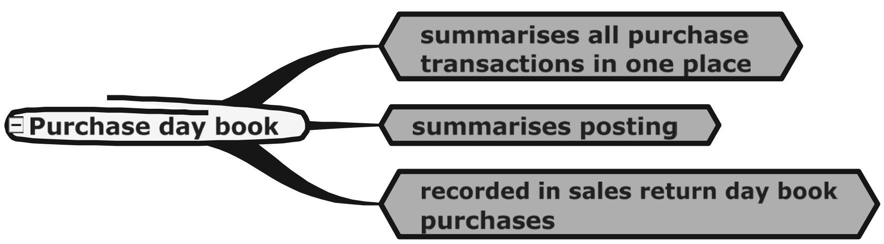
Dr **Cr**

Date		Folio No.	Tshs'000	Date		Folio No.	Tshs'000
20/04/20X7	Bank (against invoice no.105)		2,800	10/04/20X7	Purchase (invoice – 105)	9	3,000
17/05/20X7	Purchase return – DN 25		1,000				
31/05/20X7	Balance c/f		4,200	12/04/20X7	Purchase (invoice - 120)	9	5,000
	Total		**8,000**		**Total**		**8,000**
							Folio no. – 17

SUMMARY



SUMMARY



Test Yourself 2

Fill in the blanks

(a) Cash purchases are recorded in _________________.
(b) In _________________, payables are analysed according to the period of time for which the suppliers remain unpaid.
(c) A ______________ is received when the payment due is made in time to the supplier

---

1.5 Cash payments and cash receipt journal

Cash receipt journal and cash payment journal represent the debit and credit side of a cash account respectively. Therefore nowadays instead of maintaining two separate journals for receipts and payments, these two aspects are recorded directly in the cash account. This is also referred to as the cash book of the entity.

This may either be maintained on a manual basis or in an electronic format. The two parts of the cash book are as follows:

The cash receipt part (debit side of cash book) records all cash receipts such as accounts receivables and cash sales.

The cash payment part (credit side of cash book) records all cash payments such as accounts payables, cash purchases, operating expenses, etc.

Entries in the cash book are then posted into the general ledger (nominal ledger). For example, entries related to cash sales and cash purchases are posted to sales accounts and purchase accounts respectively.

Important

The cash receipts journal and cash payments journal can be replaced by a single cash book, which is simply a combination journal showing all receipts and all payments together.

Refer to the Proforma of a cash book below.

Cash Book with analytical columns

Dr **Cr**

Date	**Particulars**	**Sales**	**Discount**	**Others**	**Total**	**Date**	**Particulars**	**Purchases**	**Discount**	**Others**	**Total**
Jan		**Tshs**	**Tshs**	**Tshs**	**Tshs**	**Jan**		**Tshs**	**Tshs**	**Tshs**	**Tshs**
1	To bal b/d	-	-	-	30,000	5	By Rivera		200	6,000	6,000
11	To Roger		400	19,600	19,600	6	Purchases	10,000	-	-	10,000
12	To Sales	8,000	-	-	8,000	12	By Smith		100	5,900	5,900
						21	By Wages			1,000	1,000
						31	By bal c/d				34,700
		8,000	**400**	**19,600**	**57,600**			**10,000**	**300**	**12,900**	**57,600**

Cash Receipts **Cash Payments**

The totals of the analytical columns (sales, discounts) are then posted in the general ledger (nominal ledger).

Preparation of cash books and posting entries to general ledger is discussed in detail in Study Guide 8.

1.6 Journal Proper

Journal proper is also referred to as the "**General Journal**". The journal proper shows all journals for anything not recorded in any of the journals discussed above. In other words, journal proper is used to record entries that are not related to cash or credit.

The following is an illustrative list of transactions that are usually recorded in a journal. This list is neither compulsory nor exhaustive. It all depends on the nature of activities that an organisation performs.

(i) Entries for depreciation of non-current assets

(ii) Accrual entries e.g. to record expenses incurred but not yet paid

(iii) Rectification entries i.e. to correct the errors made in accounting

(iv) Transfer of profit / loss to capital

(v) Purchases and sales of non-current assets on credit

(vi) Opening entries when we prepare a new set of books in the next accounting period

(vii) Entries for closing ledger account

(viii) Exchange entries e.g. exchange of assets

Example

Depreciation is a non-cash expense which cannot be recorded in the sales day book or in the sales returns day book, the purchases day book, the purchases returns day book or the cash / bank book.

Hence it is recorded in the journal.

MAHINDI Ltd purchased machinery at a cost worth Tshs20,000. Record the depreciation on machinery at 20% of cost.

Books of
MAHINDI Ltd
Journal for the year to 31 December 20X6

Date			**Tshs**	**Tshs**
31/12/20X6	Dr	Depreciation A/c	4,000	
	Cr	Accumulated depreciation A/c		4,000
		Being depreciation on the machinery charged at 20% on the cost of Tshs20,000		

Test Yourself 3

State which books of accounts the following transactions would be entered into.

(a) A payment is made to Robin (a supplier) by your business of Tshs500,000.

(b) The administration department urgently requires Tshs50,000 to buy some stationery.

(c) An invoice is sent by your business to Mark (a customer) for Tshs700,000.

(d) An invoice is received from Robin for Tshs200,000.

(e) Mack, a customer, returns goods worth Tshs350,000.

(f) Your business pays Mark Tshs300,000.

(g) Goods worth Tshs612,000 are returned to J Waugh.

(h) Tshs400,000 is paid by Mack to your business.

Answers to Test Yourself

Answer to TY 1

In the books of Shining Ltd:

		Tshs'000	Tshs'000
Dr	Bright Ltd A/c	100,000	
Cr	Sales A/c		100,000
Being goods sold to Bright Ltd			
Dr	Sales return A/c	15,000	
Cr	Bright Ltd A/c		15,000
Being goods returned by Bright Ltd			

Answer to TY 2

(a) Cash book
(b) Aged payable analysis
(c) Cash discount

Answer to TY 3

(a) Cash book
(b) Petty cash book
(c) Sales day book
(d) Purchases day book
(e) Sales returns day book
(f) Cash book
(g) Purchases returns day book
(h) Cash book

Self-Examination Questions

Question 1

All transactions in the sales day book are posted to individual customers' ledger accounts in the ________.

A Sales ledger
B Receivable ledgers
C General ledger
D Sales day book

Question 2

Write journal entries in the books of Ketty for the following transactions.

(i) Sold goods for cash amounting to Tshs1,000 to Sherly at a 10% cash discount.
(ii) Sold goods worth Tshs2,000 to Chang on credit and allowed a trade discount of Tshs200.
(iii) Goods of Tshs500, (net of trade discount) returned by Chang.

Question 3

Simon purchased goods from Paula. Paula sends a credit note to Simon. Paula will record this entry in

A Sales returns
B Purchase returns
C Sales
D Purchases

Question 4

State true or false:

(i) All credit purchases of goods are recorded in a purchase day book
(ii) Trade discount is accounted in the books of accounts
(iii) Discount received is disclosed in statement of profit or loss as an expense
(iv) Purchase returns are also known as return inwards

Question 5

Write journal entries in the books of Macy for the following transactions.

(i) Goods of Tshs10,000 purchased from Rosary traders at a 10% trade discount and also received a cash discount of Tshs500 for the immediate payment.
(ii) Goods for Tshs7,500 purchased from Bonny and paid cheque of Tshs3,000.
(iii) Goods of Tshs1,000 purchased from Bonny were not correct according to the order and therefore were returned to him.

Question 6

The purchase day book records:

A Total purchases
B Cash purchases
C Credit purchases
D All of the above

Question 7

(a) You are given the following financial transactions which occurred for the month of May 2016

(i) May 1st, brought a motor vehicle on credit from Motors Ltd for TZS.6,790,000

(ii) May 3rd, A debt of TZS.34,000 owing from N Smart was written off as a bad debt.

(iii) May 8th, furniture bought by us for TZS.490,000 was returned to the supplier Wood Offices, as it was unsuitable. Full allowance will be given to us.

(iv) May 12th, we are owed TZS.150,000 by W Hayes. He is declared bankrupt and we received TZS.39,000 in full settlement of the debt.

(v) May 14th, we take TZS.45,000 goods out of the business stock without paying for them.

(vi) May 28th, sometime ago we paid an insurance bill thinking that it was all in respect of the business. We now discover that TZS.76,000 of the amount paid was an insurance of our private house.

(vii) May 28th, Bought machinery TZS.980,000 on credit from Xerox Machines Ltd.

REQUIRED:

Prepare the journal entries necessary to record the financial transactions for the month of May 2016.

Note: narrations are required.

(b) (i) Define drawings

(ii) Outline four (4) circumstances under which the capital of a business

may change.

(iii) The following information was extracted from the books of LIMA Ltd. for the year ended 31st December 2015:

Initial capital as at 1st January 2015 – TZS.200,000,000

Made a net loss of TZS.50,000,000

The proprietor invested into the business from her personal savings TZS.600,000,000

The proprietor withdraw in cash for her personal use TZS.250,000,000.

REQUIRED:

Using the final capital formula, determine the final capital as at 31st December 2015.

Question 8

(a) Briefly explain five (5) characteristics of journal

(b) What are the five advantages of journal?

(c) Your are given the following information of NOWE Co.
April 1, 2017 Returned by Avni four pieces of Philips radio costing TZS.150,000 each.

April 9 Returned by Zeccon Electronics three pieces of VCP costing TZS.900,000 each.

April 29 Returned by PLV Co. two pieces of Two-in-one radio cassette costing TZS.200,000 each.

REQUIRED:

Write-up a Sales Returns Book of NOWE Co. Ltd and post them into ledger:

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **B.**

Receivable ledger

Answer to SEQ 2

In the books of Ketty

(i)	Dr		Cash	Tshs900	
	Dr		Discount allowed	Tshs100	
		Cr	Sales		Tshs1,000
	Being goods sold for cash				
(ii)	Dr		Chang	Tshs1,800	
		Cr	Sales		Tshs1,800
	Being goods sold on credit				
(iii)	Dr		Sales return	Tshs500	
		Cr	Chang		Tshs500
	Being goods returned by Chang				

Answer to SEQ 3

The correct option is **A.**

A credit note is a document raised by seller to adjust or rectify the discrepancies made in a sales invoice and to account for goods that are returned. Paula is a seller and will record the entry in sales returns.

Answer to SEQ 4

(i) True

(ii) False, Trade discount is not recorded in the books of accounts and the purchase price is recorded after deducting the discount.

(iii) False, the discount received is recorded as an income on the credit side of statement of profit or loss.

(iv) False, purchase returns are also known as return outwards.

Answer to SEQ 5

In the books of Macy

(i)	Dr		Purchases	Tshs9,000	
		Cr	Discount received		Tshs500
		Cr	Cash		Tshs8,500
(ii)	Dr		Purchases	Tshs7,500	
		Cr	Bank		Tshs3,000
		Cr	Bonny		Tshs2,500
(iii)	Dr		Bonny	Tshs1,000	
		Cr	Purchase returns		Tshs1,000

Answer to SEQ 6

The correct option is **C.**
The purchase day book records credit purchases and does not record cash purchases.

Answer to SEQ 7

General Journal

	Date	Detail	Debit ‘000	Credit ‘000
(i)	1st May	Motor Vehicle	6,790	
		Motor Ltd.		6,790
		Motor vehicle bought on credit From Motor Ltd.		
(ii)	3rd May	Bad debts	34	
		N Smart-Debtors		34
		The Amount due from N Smart Written off as bad		
(iii)	8th May	Wood offices	490	
		Furniture		490
		Office furniture returned to Wood office		
(iv)	12th May	Bad debts	111	
		W. Hayes		111
		Amount owed now written off as bad debt		
		OR		
		Cash received	39	
		Bad debts	111	
		W. Hayes		150
		Being bad debts written off		
(v)	14th May	Drawing for goods	45	
		Purchase		45
		Goods taken from the business for personal use		
(vi)	8th May	Drawings	76	
		Insurance Expenses		76
		Insurance relating to private house now transferred to drawings		

(vii)	28th May	Machinery	980	
		Xerox Machines		980
		Machinery bought from Xerox Machine Ltd.		

(b)

(i) Drawings – money or other assets taken from the business by the owner for personal use.

(ii) 4 circumstances under which the capital of a business may change:

- Additional investment
- Drawings from the business
- Profit making
- Loss making

(iii) Final Capital = Initial Capital + Investment + Profit – Loss – Drawing
Therefore = Sh.200m + Sh.600m – Shs.50m – 250m

= Sh. 500m

Answer to SEQ 8

(a) Features/characteristic of a journal (any five)

(i) Journal is the first successful step of the double entry system. A transaction is recorded first of all in the journal. So, journal is called **the book of original entry.**

(ii) a transaction is recorded on the same day it takes place.

(iii) Transactions are recorded chronologically. So, journal is called **chronological book.**

(iv) For each transaction the names of the two concerned accounts indicating which is debited and which is credited, are clearly written into consecutive lines. This makes ledger – posting easy. That is why journal is called **"assistant to ledger" or subsidiary book".**

(v) Narration is written below each entry.

(vi) The amount is written in the last two columns – debit amount in debit column and credit amount in credit column.

(a) Advantages of a Journal

(i) Journal is the first successful step of the double entry system. A transaction is recorded first of all in the journal. So, journal is called the book of original entry.

(ii) Since the transactions are kept recorded in journal chronologically with narration, it can be easily ascertained when and why at transaction has taken place.

(iii) For each and every transaction of the two concerned accounts will be debited and which account credited, are clearly written in journal. So, there is no possibility of committing any mistake in writing the ledger.

(iv) Since all the details of transactions are recorded in journal, it is not necessary to repeat them in ledger. As a result, ledger is kept tidy and brief.

(v) Journal shows the complete story of a transaction in one entry.

MOWE CO. LTD
Sales Returns Book

Date	Particulars	Credit Note No.	LF	TZS.	Remarks
April 1	Avni 4 pcs of Philis radio @ 150,000 each			600,000	
April 9	Zeccon Electonics 3 pcs of VCP @ 900,000 each			2,700,000	
April	PVL Co 2 pcs of Two-in-one @ 200,000 each			400,000	
				3,700,000	

General Ledger
Sales Returns Account

Dr. Cr.

Date	Particulars	TZS	Date	Particulars	TZS
April 30	To Sundry Debtors A/C	3,700,000			

Sundry Debtors Account

Dr. Cr.

Date	Particulars	TZS	Date	Particulars	TZS
	D		April 30	By Sales Returns A/c	3,700,000

e debtors’ Ledger
Avni Account

Dr. Cr.

Date	Particulars	TZS	Date	Particulars	TZS
			April 1	By Sales Returns A/c	600,000

Zeccon Account

Dr. Cr.

Date	Particulars	TZS	Date	Particulars	TZS
			April 9	By Sales Returns A/c	2,700,000

PLV CO. Account

Dr. Cr.

Date	Particulars	TZS	Date	Particulars	TZS
			April 29	By Sales Returns A/c	400,000

CASH BOOKS AND PETTY CASH

8

Get Through Intro

Cash is the most liquid resource that an entity has. Cash includes cash and cash equivalents both in hand as well in the bank. There are several transactions every day that cause a continuous flow of cash between the entity and outsiders, and also within the entity itself. Cash, being so liquid, is also the biggest moral hazard! It is easier to commit a fraud or an error in cash transactions, as compared to any other kind of transactions.

Cash is the lifeline of a business. It affects almost all the departments and business segments. Proper records of cash transactions are important not only for accounting purposes, but also to help the financial manager in efficiently managing the business' cash and cash equivalents.

It is obvious that cash transactions affect the performance and the financial statements of an entity. Therefore, it is essential to know the correct principles and procedures for recording cash transactions. The procedures laid down have to be those which will present a fair view in the financial statements and also protect the assets of the company.

Among cash transactions, petty cash transactions involve the maximum handling of hard cash. The possibilities for fraud are the highest in this case. Efficient systems and procedures have to be made in order to control this risk. An example of such a system which minimises risk is the imprest system.

In this Study Guide we will discuss the recording of cash transactions in the cash book and the petty cash book. As an accountant, this is definitely a task that you will have to do at some point, so be prepared!

Learning Outcomes

a) Define and explain
   i. Cash Book
   ii. Two column cash book
   iii. Three column cash book
   iv. Petty cash book
b) Explain the format of a cash book and petty cash book
c) Record and post cash receipts and cash payments in the:
   i. Cash book
   ii. Petty cash book
d) Calculate
   i. Cash discount
   ii. Trade discount
e) Record Cash receipts and payment through bank
   i. Two columnar cash book
   ii. Three columnar cash books

1. Define and explain
- **i. Cash Book**
- **ii. Two column cash book**
- **iii. Three column cash book**
- **iv. Petty cash book**

2. Explain the format of a cash book and petty cash book

3. Record and post cash receipts and cash payments in the:
- **i. Cash book**
- **ii. Petty cash book**

4. Calculate
- **i. Cash discount**
- **ii. Trade discount**

5. Record Cash receipts and payment through bank
- **i. Two columnar cash book**
- **ii. Three columnar cash books**

[Learning outcomes a, b, c, d and e]

Cash is a lifeline for a business. It affects almost all the departments and business segments. Proper records of cash transactions are important not only for accounting purposes, but also to help the financial manager in efficiently managing the cash. It is obvious that cash transactions affect the performance and the financial statements of an entity. Therefore, it is essential to know the correct principles and procedures for recording cash transactions. The procedures laid down have to be those which will present a fair view in the financial statements and also protect the assets of the company.

Now we will discuss the recording of cash transactions in the cash book.

1.1 Cash Book

The cash book is a book of prime entry of a special kind as it is also a part of the ledger system. Cash or bank columns serve the purpose of cash or bank accounts, often in a ledger account. There is no need to post the transactions again in cash or bank accounts. These columns are balanced just like a ledger account and the closing balances are taken into a trial balance**.**

The main **features of the cash book** are as follows:

- **Only cash transactions** are recorded in the cash book.
- Transactions are recorded in the cash book in a **chronological order**.
- The **receipts side** of the cash book is used to record entries which **debit cash** or **bank** account for example: received cash from one of the customers.
- The **payments side** is used to record entries which **credit cash**. For example: paid salary by cash.

Once the transaction is entered in the cash book we have to give effect to the respective ledger account For example: when salary is paid by cash the entry would

Dr Salary account x — Post in respective ledger account
Cr Cash account x — Recorded on the payment side of the cashbook

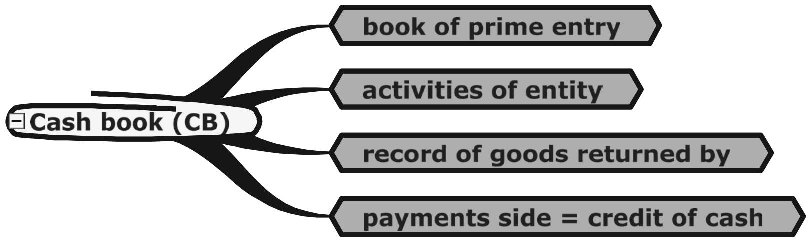
The steps to record transactions in the cash book are as follows:

The receipts side of the cash book is used to record entries which debit the cash account or the bank account; for example, received cash a receivable.

The payments side is used to record entries which credit either the cash account or the bank account; for example, paid salary by cash.

However, once the transaction is entered in the cash book, the second effect to the respective ledger account is also given. For example, respective receivable account in case of.

SUMMARY



1.2 Types of cash book

1. Single column for cash as well as bank transactions

If there is only one column for cash and bank transactions, the balance brought down and carried forward will consist of cash-in-hand as well as bank balances (especially, if there is any cash that is not yet deposited into the bank). If all the cash collections are deposited in the bank, the balance will consist of only the bank balance.

A proforma of a single column cash book with imaginary figures is given below:

Summary of transactions:

	Tshs
Cash in hand	1,000
Received from Ron	200
Paid Rent	100
Sold goods for cash	200
Paid to Sam	500
Purchased furniture	500
Paid Salaries	100
Rent due not yet paid	100
Amount deposited in bank	200

Receipts	Tshs	Payments	Tshs
Balance b/f	1,000	Rent account	100
Ron account	200	Sam account	500
Sales account	200	Furniture account	500
Bank account	200	Salaries account	100
		Balance c/f	400
	1,600		**1,600**

This is a cash book, therefore only the deposited cash is recorded.

Note: rent due, but not yet paid, is not shown in the cash book.

A similar account would be set up for bank account.

Example

Enter the following transactions in a simple cash book.

2006	Particulars	Tshs'000
Jan 1	Cash in hand	24,000
Jan 4	Received from Harry	6,000
Jan 7	Paid Rent	6,000
Jan 8	Goods sold	14,000
Jan 10	Paid Simone	4,000

Single Column Cash Book

Dr Receipts			Cr Payments		
Date	**Particulars**	**Tshs'000**	**Date**	**Particulars**	**Tshs'000**
Jan 1	To balance b/d	24,000	Jan 7	By Rent	6,000
Jan 4	To Harry	6,000	Jan 10	By Simone	4,000
Jan 8	To Sales	14,000	Jan 31	By balance c/d	34,000
		44,000			**44,000**

2. The two column cash book: different columns for cash and bank transactions

(a) Cash and bank transactions are recorded in the respective cash and bank columns. The steps to record transactions in the cash book have been explained earlier.

(b) Transactions between cash and bank are recorded as **contra transactions** in the cash book with cash and bank columns.

Cash deposited	Cash withdrawn
Cash deposited into the bank is recorded as a payment in the cash column, and as a receipt in the bank column.	Cash withdrawn from the bank is recorded as a payment in the bank column and as a receipt in the cash column.
Dr Bank account X Cr Cash account X	Dr Cash account X Cr Bank account X

These contra transactions do not have to be posted into any ledger accounts since both debit (receipt) and credit (payments) effects have already been given in the cash and bank columns of the cash book, which itself is also a ledger account.

A proforma of a two column cash book with imaginary figures is given below:

	Tshs
Annie commences business with cash	20,000
Paid into current account	19,000
Received cheque from Diana on account	600
Paid Diana & Co's cheque into bank on the other day	600
Paid to Ron & Co by cheque	330
Received cash from cash sales	100
Paid sundry expenses in cash	50

The day the cheque is received it is recorded in the cash book.

Contra entry for a cheque paid into the bank is recorded as it is made on another day

Cash book					
Receipts	**Cash Tshs'000**	**Bank Tshs'000**	**Payments**	**Cash Tshs'000**	**Bank Tshs'000**
Capital account	20,000		Bank account (contra)	19,000	
Cash account (contra)		19,000	Bank account (contra)	600	
Diana & Co	600		Ron & Co		**330**
Cash account (contra)		600	Sundry expenses account	50	
Cash sales	100				
			Balance c/d	1,050	19,270
	20,700	**19,600**		**20,700**	**19,600**
Balance b/d	1,050	19,270			

Example

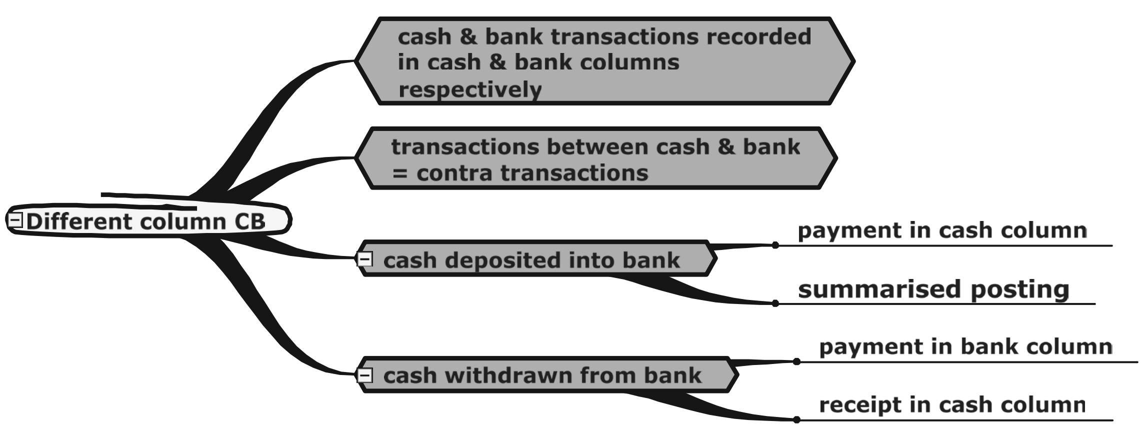
The following transactions relate to Gems Trading. Enter the following transactions in a two column cash book.

		Tshs'000
1-Jan	Cash in hand	30,000
5-Jan	Paid to Rivera (Net of discount of Tshs200)	6,000
6-Jan	Purchased goods	8,000
11-Jan	Received from Roger (discount allowed Tshs400)	19,600
12-Jan	Sale of goods	8,000
12-Jan	Paid to Smith	5,900
12-Jan	Discount received from Smith	100
21-Jan	Paid wages	1,000
25-Jan	Paid to Nick in full settlement of his account which shows a Credit Balance of Tshs8,000	7,800

Double Column Cash Book

Date	Particulars	Discount	Cash	Date	Particulars	Discount	Cash
		Tshs'000	Tshs'000			Tshs'000	Tshs'000
1-Jan	To Balance b/d	-	30,000	5-Jan	By Rivera	200	6,000
11-Jan	To Roger	400	19,600	6-Jan	Purchases	-	8,000
12-Jan	To Sales	-	8,000	12-Jan	By Smith	100	5,900
				21-Jan	By Wages		1,000
				25-Jan	By Nick	200	7,800
				31-Jan	By balance c/d		28,900
		400	**57,600**			**500**	**57,600**

SUMMARY



3. Three column or Analytical columns

Certain additional analytical columns are drawn on either side of a cash book according to the accounting and reporting needs of each entity. These columns are totalled and not balanced. The totals are used for the purpose of summary postings into ledger accounts e.g. discount allowed, accounts receivable, cash sales, sales tax on cash sales etc.

If analytical columns are maintained, instead of individual entries, only the totals are recorded to the respective ledger accounts. For example, if columns are maintained for accounts receivable and cash sales, the totals of these columns will be recorded in the accounts receivable and cash sales ledger account. Individual transactions of accounts receivable are posted in the personal ledgers, which are not part of the double entry system.

Tip

It can be seen that only the bank and cash columns are balanced in order to give a balance to be incorporated into the trial balance. These accounts serve the purpose of being ledger accounts. Other analytical columns do not function as ledger accounts. They simply give totals which can be posted to the individual ledger accounts.

This kind of cash book has been explained with the help of the following example.

Analytical cash book with discount in a multi-columnar cash book

The accounting effects of discounts are given by using periodic totals of the specified columns of the cash book.

Example

Record the following transactions in the cash book:

Deposited in bank Tshs5,000
Paid to trade payable through cheque Tshs2,000, Discount received Tshs200
Cash received deposited in bank Tshs1,000
Cheque received from Trade receivable Tshs2,000, Discount allowed Tshs200
Received from trade receivables Tshs7,000, Discount allowed Tshs700
Cash withdrawn from bank Tshs2,000

Cash book

Receipts	Cash	Bank	Discount allowed	Payments	Cash	Bank	Discount received
	Tshs	Tshs	Tshs		Tshs	Tshs	Tshs
Balance b/f				Bank account (contra)	5,000		
Cash account (contra)		5,000		Trade payable		2,000	200
Cash account (contra)		1,000		Bank account (contra)	1,000		
Trade receivable		2,000	200	Cash account		2,000	
Trade receivable	7,000		700				
Bank account (contra)	2,000			Balance c/f	3,000	4,000	
	9,000	**8,000**	**900**		**9,000**	**8,000**	**200**
Balance b/f	3,000	4,000					

These columns need not be balanced. They are only to be totalled. They should be posted to the respective ledger accounts.

Journal entry to record Discount allowed

Dr Discount allowed	Tshs900	
Cr Trade receivable (Total)		Tshs900

Journal entry to record Discount received

Dr Trade payables	Tshs200	
Cr Discount received		Tshs200

Tip

Discount allowed, being an expense is always debited.
Discount received, being an income is always credited.

Another example of an analytical cash book is given below.

Example

Record the following transactions in the cash book of Montek Traders:

05 October 20X6	Cash purchases Tshs2,000. The invoice value was Tshs2,300; however the seller allowed a trade discount
06 October 20X6	Cash sales of Tshs3,000. Sales tax charged on this was Tshs300
07 October 20X6	A customer paid Tshs6,000 against the outstanding of Tshs6,200. A discount of Tshs200 was allowed to the customer for early payment.
31 October 20X6	Paid Tshs4,000 to a supplier instead of Tshs4,350 A discount of Tshs350 was allowed to the customer for early payment.

Answer

Montek Traders

Cash book (extract – only receipts related data)

Dr **Receipts**

Date	Receipts	Amount	Receivables	Discount allowed	Cash sales	Sales tax on cash sales
		Tshs	Tshs	Tshs	Tshs	Tshs
06/10/20X6	Sales	3,000			3,000	300
	Sales tax	300				
07/10/20X6	Receivable	6,000	6,000	200		
	Total	**9,300**	**6,000**	**200**	**3,000**	**300**

This amount is not added to the cash book total, but recorded here so discounts can be posted to the nominal ledger

Posting to general ledger

The accounting entries will be:

Dr	Cash	Tshs9,300	
Cr	Receivables		Tshs6,000
Cr	Sales		Tshs3,000
Cr	Sales tax payable		Tshs300

Being the cash receipts for October

Dr	Discounts expense	Tshs200	
Cr	Receivables		Tshs200

Being the discount given for early payment.

Note:

Trade discount (TD) is not recorded in cash book. That’s why the trade discount of Tshs300 (Tshs2,300 - Tshs2,000) is not recorded in cash book.

Continued on the next page

Montek Traders

Cash book (extract – payments related data only)

Payments

Dr **Cr**

Date	Payment	Amount	Payables	Cash Purchases	Discount received
		Tshs	Tshs	Tshs	Tshs
05/10/20X6	Purchases*	2,000	-	2,000	-
31/10/20X6	Payable	4,000	4,000		350
	Total	**6,000**	**4,000**	**2,000**	**350**

* Trade discount is not recorded.

Posting to general ledger

Dr	Purchases	Tshs2,000	
Dr	Payables	Tshs4,000	
Cr	Cash		Tshs6,000

Being cash payments for October

Dr	Payables	Tshs350	
Cr	Discounts received		Tshs350

Being discount received for early payment

Example

The following are certain transactions from 11 August, 20X7

Receipt of Tshs500 from Bela – receivable
Payment to Sheena Tshs850 - payable
Payment to Rony Tshs1300 - payable
Payment of telephone bill Tshs350
Cash sales Tshs5000
Sale of old computer Tshs2000
Electricity bill payment Tshs250
Purchase of new laptop Tshs3125

You are required to record these transactions in the cash book.

Cash book receipt

Date	Narration	Total Amount	Accounts receivable Amount	Cash sales Amount	Other Amount
		Tshs	Tshs	Tshs	Tshs
11/08/20X7	Accounts receivable - Bela	500	500		
	Sales	5,000		5,000	
	Computer	2,000			2,000
	Total	**7,500**	**500**	**5,000**	**2,000**

Expenses that are occasionally incurred are entered in the Other's column

Cash book payment

Date	Narration	Total Amount	Accounts payable Amount	Cash purchases Amount	Other Amount
		Tshs	Tshs	Tshs	Tshs
11/08/20X7	Accounts payable - Sheena	850	850		
	Accounts payable - Rony	1,300	1,300		
	Telephone	350			350
	Electricity	250			250
	Laptop	3,125			3,125
	Total	**5,875**	**2,150**	**0**	**3,725**

1.3 Recording into ledger accounts

1. Receipts

As stated above, cash or bank columns on the receipts side of the cash book perform the function of the debit side of a cash or bank account. Therefore, only the credit side of the journal entry needs to be recorded in the ledger.

Example

Receipts for cash sales were Tshs5,000. If we were to make a journal entry, we would write:

Dr	Cash	5,000	
Cr	Sales		5,000

Being cash sales recorded.

We would then record these amounts to the debit side of the cash account and the credit side of the cash sales account. However, when this entry is written on the receipts side of the cash book, it means that we have already debited the cash account. Only the credit side of the journal entry has to be recorded in the ledger.

Tip

The general rule is that for each receipt in the cashbook, only the credit side has to be recorded in the respective account.

2. Payments

Cash or bank columns on the payments side of the cash book perform the function of the credit side of a cash or bank account. Therefore, only the debit side of the journal entry needs to be recorded in the ledger.

Example

Payment for telephone expenses is Tshs800. If we were to make a journal entry, we would write:

Dr	Telephone expenses	Tshs800	
Cr	Cash		Tshs800

Being telephone expenses paid.

We would then record these amounts to the debit of the telephone expenses account and the credit of the cash account. However, when this entry is written on the payments side of the cash book, it means that we have already credited the cash account. Only the debit side of the journal entry has to be recorded in the telephone expenses account.

Tip

The general rule is that for each payment in the cash book, only the debit side has to be recorded in the respective account.

If analytical columns are maintained, instead of individual entries, only the totals are recorded to the respective ledger accounts. For example, if columns are maintained for **accounts receivable** and cash sales, totals of these columns will be recorded in the accounts receivable and cash sales ledger account. Similarly if columns are maintained for **accounts payable** and cash purchase, totals of these columns will be recorded in the accounts payables and cash purchase. Individual transactions of accounts receivable and account payables are posted in the personal ledgers, which are not part of the double entry system.

Example

Following is the extract of the cash book of Tellyte Ltd for the year 20X7.

Cash book receipt

Date	Narration	Total Amount	Accounts receivable	Cash sales	Other Amount
		Tshs	Tshs	Tshs	Tshs
01/02/20X7	Accounts receivable - Bela	500	500		
12/06/20X7	Sales	5,000		5,000	
01/07/20X7	Sale of scrap	2,000			2,000
	Total	**7,500**	**500**	**5,000**	**2,000**

Cash book payment

Date	Narration	Total Amount	Accounts payable	Other Amount
		Tshs	Tshs	Tshs
01/03/20X7	Accounts payable - Sheena	2,150	2,150	
15/04/20X7	Electricity expense	350		350
15/08/20X7	Stationery (purchase of stationery)	5,000		5,000
	Total	**7,500**	**2,150**	**5,350**

The transactions recorded above are to be shown in the r**eceivable ledger account, payable ledger account and general ledger account** as follows.

Books of Tellyte Ltd
Bela (account receivable) account

Dr **Cr**

Date		Tshs	Date		Tshs
			01/02/20X7	Cash received	500

Books of Tellyte Ltd
Sheena (account payable) account

Dr **Cr**

Date		Tshs	Date		Tshs
01/03/20X7	Cash paid	2,150			

Sales account

Dr **Cr**

Date		Tshs	Date		Tshs
			12/06/20X7	Cash	5,000

Other income account

Dr **Cr**

Date		Tshs	Date		Tshs
			01/07/20X7	Cash (sale of scrap)	2,000

Continued on the next page

Electricity expense account

Dr **Cr**

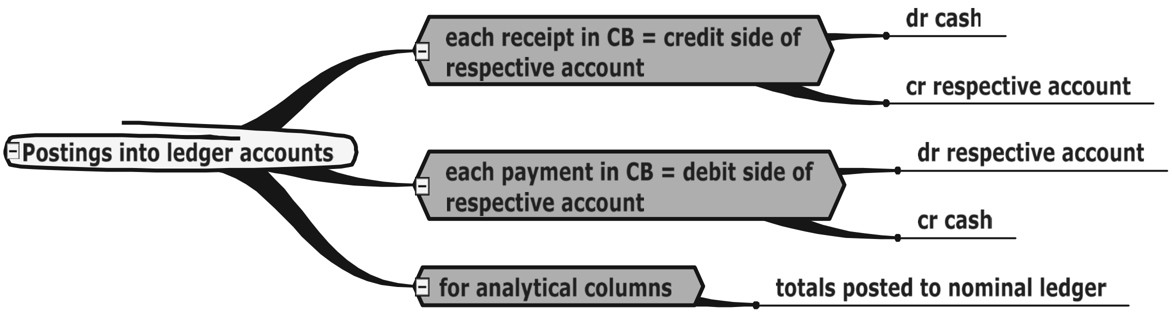
Date		Tshs	Date		Tshs
15/04/20X7	Cash	350			

Stationery account

Dr **Cr**

Date		Tshs	Date		Tshs
15/08/20X7	Cash (purchase of stationery)	5,000			

SUMMARY



Test Yourself 1

Jack deposited Tshs4,000 in the bank on 1 January 2008. He issued a cheque to Jill for Tshs3,000 on 1 February 2008. Record the entries in the books of Jack.

Required:

Draft the journal entries for these transactions.

Test Yourself 2

Nasser's cash book currently shows a debit balance of Tshs5,000 in the cash column. Nasser, being a doctor is very confused as he has no knowledge of accounting. As his accountant how would you explain this?

(a) This is an error: there should be a credit balance of Tshs5,000 in the bank column.
(b) This is an error: such large amounts are not to be posted in the cash column, but in the bank column.
(c) Nasser's cash box contains Tshs5,000 at this very point of time.
(d) Nasser has to pay someone Tshs5,000.

1.4 Petty cash books

Petty cash transactions

There could be certain transactions such as payments for postage, local transport or food and refreshments for the staff that may not be paid for by cheque. These payments have to be made for in cash due to their small amounts or the lack of systems at the receiver's side to process the amounts.

As indicated by the literal meaning of the word 'petty' i.e. insignificant or small, petty cash transactions mean small cash transactions. Petty cash refers to the cash that is held by the entity for small payments of cash.

Need for separate records for petty cash transactions

Even though an individual transaction is of a petty amount, there are several of these transactions in an accounting period. A further analysis of these transactions into different account headings is needed for the purpose of accounting. Hence, it makes sense to keep a separate analytical petty cash book. It is not feasible to add these columns to the main cashbook as it would become unmanageable.

Administratively, the task of handling petty cash is entrusted to a separate person. Since the person is responsible for giving an account of the petty cash handled by him, it is desirable that the person maintains a separate petty cash book. This will enable him to control the physical cash as well as perform and maintain analysis.

If proper records are not kept for petty cash transactions, the cash balance may be abused or stolen.

Test Yourself 3

Dhillon, a new accountant, is confused as to which of the following transactions would be entered into the petty cash books and which of the following transactions would be entered into the double columnar cash books of the entity. As an accounting senior, please help him classify which of the following transactions fit into the appropriate cash book:

	Tshs
Cash paid to supplier	4,000
Cash paid for refreshments for office staff	50
Cash received from customer	2,500
Postage charges	15
Accountant's salary	2,000

1. Methods of maintaining petty cash transaction

Primarily two methods are used to record petty cash transaction, which include:

Imprest system
Non-imprest system

(a) Imprest system

The petty cash is usually maintained on the basis of the imprest system. An imprest system means a system where initially the petty cashier is given a fixed amount of cash and subsequently the amount of expenses is reimbursed.

How does the imprest system of petty cash work?

The petty cashier has to make all petty cash payments from the cash given to him. This amount of cash given to the cashier is called the **"float".** At the end of a pre-determined period or on the balance reaching a critical minimum, the amount of expenses are reimbursed or topped up so as to restore the balance to the imprest amount. The 'float' is decided in such a manner that it will cover average petty cash expenses during a given period, for example, a week.

This system provides better security as it minimises the amount of cash in the hands of the cashier.

Example

On 1 July 20X7, a petty cashier was given cash of Tshs500, being an imprest or a float. During the month of July 20X7, he spent Tshs350 on various accounts. On 31 July, a cheque for Tshs350 drawn on the company's bank account was handed over to him. He withdrew cash from the bank and put it into the cash box. The balance in his cash box was restored to Tshs500.

Cash is spent against petty cash vouchers. Once the amount is reimbursed to the petty cashier, he hands over the vouchers to the main cashier, in return for the reimbursement of the related vouchers. At any point of time, the cash in hand plus the total of vouchers not yet reimbursed must be equal to the imprest or float amount.

Continued on the next page

In the example stated above, the situation before reimbursement is:

	Tshs
Cash in hand of petty cashier	150
Total of vouchers not reimbursed	350
Must be equal to the float or imprest	**500**

Example

Imprest system

Note: Remember to practice this example thoroughly in order to get the feel of how transactions are posted into the petty cash book.

Post the following entries and also prepare a petty cash ledger account.

		Tshs
01 January 20X7	Receipt of cash	200
02 January 20X7	Postage	20
09 January 20X7	Transport	10
13 January 20X7	Transport	12
18 January 20X7	Postage	9
23 January 20X7	Postage	16
30 January 20X7	Transport	11
01 February 20X7	Cash receipt	78

Petty cash book

Receipts Amount	Date		Total Amount	Postage Amount	Transport Amount
Tshs			Tshs	Tshs	Tshs
200	01/01/20X7	Cash			
	02/01/20X7	Postage	20	20	
	09/01/20X7	Transport	10		10
	13/01/20X7	Transport	12		12
	18/01/20X7	Postage	9	9	
	23/01/20X7	postage	16	16	
	30/01/20X7	Transport	11		11
200			**78**	**45**	**33**
78	01/02/20X7	Cash			

These totals are used for entries in the ledger account

Postings to ledger accounts will be as follows:

Dr	Postage account	Tshs45	
Dr	Transport account	Tshs33	
Cr	Petty cash		Tshs78

Being petty cash expenses posted to respective accounts.

Petty cash account

Dr **Cr**

Date		Tshs	Date		Tshs
01/01/20X7	Cash	200	31/01/20X7	Payments	78
			31/01/20X7	Balance c/d	122
		200			**200**
01/02/20X7	Balance b/d	122			
01/02/20X7	Cash	78			
		200			

(b) Non-imprest system

A non-imprest system is a petty cash system which does not follow the imprest system. There is therefore **no** amount **fixed** as **float**. The amount which is reimbursed and the timing of reimbursement are decided by people operating the system. The petty cashier may or may not have the same closing balance of petty cash as opening balance.

2. Analysing petty cash transactions

The petty cash book contains small transactions of various types. Accounting for these requires an analysis of the transactions according to different account heads. Usually an analytical petty cash book contains several columns. Each column takes care of an expense which is often repeated. Expenses encountered occasionally are entered in the 'Others' column of the petty cash book. A further analysis of the 'Others' column is needed at the end of the period so as to record the transactions in the relevant ledger account. The total of each specific column is recorded in the ledger account it represents. Please see the example that follows.

Whether or not an imprest method is followed, there will be no difference in the analytical part of the petty cash book. The only difference will be on the receipts side of the petty cash book. Under an imprest system, there will be receipts for reimbursement of expenses at fixed intervals. When the amount is reimbursed the petty cash balance will be restored to the amount predetermined as float.

3. Recording from the petty cash book

At the end of the period, a journal entry for payments is made. For the purpose of making this journal entry, the totals of the various columns are used. The amounts are recorded in the respective ledger accounts with the help of this entry.

Alternatively, amounts may be recorded in the respective ledger accounts directly from the total column. The respective account is debited and the petty cash account is credited.

When reimbursement is received, the petty cash account is debited and the cash account is credited.

Test Yourself 4

Anna is looking after the petty cash system of Choice Ltd. At the beginning of January, she was given Tshs250 for petty cash. Out of this amount she spent Tshs153 during the month. It is the policy of Choice Ltd that the petty cash balance should be maintained at Tshs250. What amount should be reimbursed to her so that her petty cash balance can be restored to Tshs250?

A Tshs153
B Tshs250
C Tshs97
D None of the above

Answers to Test Yourself

Answer 1

1. The entries in the books of Jack on:

1 January 2008

Dr	Bank account	4,000	
Cr	Cash account		4,000
Being cheque deposited into bank			

1 February 2008

Dr	Jill account	3,000	
Cr	Bank account		3,000
Being cheque issued to Jill			

Answer 2

The correct option is **C**.

Cash being an asset would mean that the account would carry a debit balance. Hence a debit balance of Tshs5,000 means that Nasser currently owns Tshs5,000, or that his cash box contains Tshs5,000.

Answer 3

Petty cash transactions are small cash transactions.

The transactions which go to the petty cash book are paid by cash. Refreshments and postage charges are all recorded in the petty cash book while the payments to suppliers, receipts from customers and the accountant's salary are not petty cash transactions.

Answer 4

The correct option is **A.**

The opening balance of the petty cash is Tshs250, out of this Tshs153 is spent. Therefore the closing balance is Tshs97. In order to restore the balance, the additional amount required is Tshs153 (i.e. minimum requirement Tshs250 – actual closing balance Tshs97).

Self-Examination Questions

Question 1

Tim, owns a diner on the interstate freeway. As he gets diners around the clock he deposits cash every evening at five, just before the bank closes for business. Last night, he deposited Tshs3,120. How would Tim record this transaction in his cash book?

A Debit Bank; Credit Cash
B Debit Bank; Credit Bank
C Debit Cash; Credit Bank
D Debit Cash; Credit Cash

Question 2

Which one of the following is incorrect?

A The petty cash book can be maintained on impress as well as non-imprest systems.
B Maintaining the petty cash book enables the petty cashier to control the physical cash.
C A petty cash book is maintained so as to separate the task of making small payments.
D Petty cash transactions are significantly big transactions which require a separate book.

Question 3

From the following information, post the entries in the petty cash book using the non-imprest method:

	Tshs
01 January 20X7 receipt of cash	100
02 January 20X7 postage	30
09 January 20X7 transport	15
10 January 20X7 cash receipt	50
13 January 20X7 transport	32
18 January 20X7 cash receipt	75
19 January 20X7 postage	22
23 January 20X7 postage	16
28 January 20X7 cash receipt	30
30 January 20X7 transport	11

Also show how the above transactions would reflect in the petty cash account.

Question 4

While deciding on the petty cash float, which of the following should be considered?

A It should be enough to cover average expenditure during the period.
B It should be as low as possible.
C Reimbursement / availability of cash to cover costs in emergencies.
D All of the above.

Question 5

Reimbursement of a fixed amount is a feature of the imprest system. Is this statement true or false?

Question 6

Prepare a two column cash book from the following transactions:

	Tshs
Business commenced with cash	45,000
Goods purchased from John and paid by cheque	5,000
Goods sold for cash	2,000
Cheque received from Dolly & Co	8,000
Cash received deposited into bank	8,000
Salaries paid through cheque	500
Sales to CC& Co and amount received through cheque which is deposited in bank on the same day	1,500
Cash with drawn form bank	2,000
Sundry expenses paid in cash	200

Question 7

Furaha Co. Ltd operates its petty cash account on the imprest system. It is maintained at a figure of Tshs,800,000 on a monthly basis. During the month ending 31 July 2011, the following petty cash transactions took place:

Date	Petty Cash inflows and outflows during the month	Tshs.
July 01	Cash received from cashier	1,800,000
July 02	Boat fare – 4 trips for 3 officers. Ticket price is Tshs.10,000 per trip	120,000
July 02	Counter books	50,000
July 03	Drawing pins	60,000
July 07	Photocopy paper	150,000
July 09	Trade journals	80,000
July 12	Bus fare	45,000
July 14	Correction fluid	20,000
July 17	Typewriter ribbons	29,000
July 18	Paper clips	10,000
July 19	Photocopier repairs	250,000
July 22	Newspaper	70,000
July 22	Parcel postage	68,000
July 25	Marker pens	95,000
July 26	Train fare – 2 trips 1 officer, Tshs.20,000 per trip	40,000
July 27	Display decorations	86,000
July 28	Cello tape	34,000
July 30	Typewriter repair	42,000
July 30	Taxi fares	64,000
August 01	Cash received to restore imprest	?

Required:

(a) Open and post the company's analysed petty cash book for the period of July 2011, with analysis columns for expenditure on travelling, stationery, postage, miscellaneous and repairs.

(b) Open the ledger accounts to complete the double entry for the analysis columns: travelling, stationery, postage, miscellaneous and repairs in the general ledger.

(Adapted from November 2011)

Question 8

Briefly differentiate trade discount from cash discount

Question 9

(a) (i) Define an 'accounting cycle'.

(ii) List the steps in accounting cycle.

(b) Jessica starts a new business. Before she actually starts to sell anything, she has bought display equipment of TZS.3,000,000 rented a shop for TZS.5,000,000 per annum and an inventory of goods of TZS.4,000,000. She has paid in full for the display equipment and shop rental, she still owes TZS.2,300,000 for the inventory of goods. Her mother has lent her TZS.1,500,000. After these events the business bank account has TZS.1,500,000 and there is TZS.250,000 cash in hand.

REQUIRED:

Compute the capital of Jessica.

(c) Dunia Manoti is a sole proprietor who started his business six months ago. The following are his transactions for the month of July 2015.

2015			**TZS**
July	1	Cash in hand	600,000
		Cash at bank	9,670,000
July	2	Received cash from Samuel	1,900,000
		Allowed him discount	100,000
July	4	Paid Jazar by cheque	800,000
		Discount received	30,000
July	6	Purchased Goods and paid by cheque	2,100,000
July	8	Deposited with bank	2,100,000
July	10	Sold goods to Anita on credit	1,100,000
July	12	Sold goods & received payment by cheque	900,000
July	15	Received a cheque from Anita in full settlement of his account	1,050,000
July	17	Withdrawn from bank for office use	900,000
July	19	Purchased goods from K & Co.	3,000,000
July	19	Paid K & Co. by cheque	2,900,000
		Discount received	100,000
July	20	Paid telephone charges	100,000
July	23	Paid Kimwaki by cheque	684,000
		Discount received	16,000
July	24	Cash sales	1,900,000
July	26	Received cheque from Antony and sent to the bank	480,000
		Discount allowed	20,000
July	27	Purchased a new machinery for office use by cheque	4,000,000
July	28	Bank intimated that Antony's cheque has been dishonored	480,000
July	31	Deposited with bank	600,000
	31	Bank charges as shown in the pass book	26,000

REQUIRED:

Prepare a three columnar Cash Book for the month of July.

Answers to Self-Examination Questions

Answer 1

The correct option is **A.**

This transaction would lead to an increase in the bank balance. Hence a debit to the bank account is required. On the other hand, this transaction would also lead to a decrease in the balance of cash present with Tim. Hence, a credit to the cash column is required.

Answer 2

The correct option is **D.**

Petty cash transactions are insignificant, small transactions. However, there are several such transactions which occur in a day. Therefore in order to have a record of such small transactions, a petty cash book is maintained.

Answer 3

Petty cash book

Receipts	Date	Particulars	Total	Postage	Transport
Tshs			Tshs	Tshs	Tshs
100	01/01/20X7	Cash			
	02/01/20X7	Postage	30	30	
	09/01/20X7	Transport	15		15
50	10/01/20X7	Cash			
	13/01/20X7	Transport	32		32
75	18/01/20X7	Cash			
	19/01/20X7	Postage	22	22	
	23/01/20X7	Postage	16	16	
30	28/01/20X7	Cash			
	30/01/20X7	Transport	11		11
255			**126**	**68**	**58**

Petty cash account

Date		Amount	Date		Amount
		Tshs			Tshs
01/01/20X7	Cash	100	31/01/20X7	Payments	126
10/01/20X7	Cash	50			
18/01/20X7	Cash	75			
28/01/20X7	Cash	30	31/01/20X7	Balance c/d	129
		255			**255**
01/02/20X7	Balance b/d	129			

Answer 4

The correct option is **D.**

This is because the petty cash float should be as low as possible while covering the expenditure made in the period. Another consideration is that, in the case of emergency cash should be made available at the earliest.

Answer 5

False, under the imprest system, cash is reimbursed to the extent of the amount paid during the period, so as to maintain the float. A fixed amount is not reimbursed every time.

Answer 6

Cash book					
	Cash	**Bank**		**Cash**	**Bank**
Receipts	**Tshs**	**Tshs**	**Payments**	**Tshs**	**Tshs**
Capital account	45,000		Purchases		5,000
Sales	2,000		Bank account (contra)	8,000	
Dolly & Co	8,000		Salaries		500
Cash account (contra)		8,000	Cash account (contra)		2,000
Sales		1,500	Sundry expenses	200	
Bank account (contra)	2,000				
			Balance c/d	48,800	2,000
	57,000	**9,500**		**57,000**	**9,500**
Balance b/d	48,800	2,000			

Answer 7

(a) Petty Cash Book

Receipts	Date	Details	Total	Traveling	Stationery	Postage	Misc.	Repairs
Tshs			**Tshs**	**Tshs**	**Tshs**	**Tshs**	**Tshs**	**Tshs**
1,800,000	1 July	Bal b/d						
	2 July	Boat Fare	120,000	120,000				
	2 July	Counter Book	50,000		50,000			
	3 July	Draw Pins	60,000		60,000			
	7 July	Photo Paper	150,000		150,000			
	9 July	Trade Journal	80,000				80,000	
	12 July	Bus Fare	45,000	45,000				
	14 July	Corr. Fluid	20,000		20,000			
	17 July	T.W. Ribbons	29,000					29,000
	18 July	Paper clips	10,000		10,000			
	20 July	Photo repair	250,000					250,000
	22 July	Newspaper	70,000				70,000	
	22 July	P. Postage	68,000			68,000		
	25 July	Marker Pens	95,000		95,000			
	26 July	Train fare	40,000	40,000				
	27 July	Display Decoration	86,000				86,000	
	28 July	Cello tape	34,000		34,000			
	30 July	Typewriter repair	42,000					42,000
	30 July	Tax fare	64,000	64,000				
			1,313,000	**269,000**	**419,000**	**68,000**	**236,000**	**321,000**
		Balance c/d	487,000	**GL**	**GL**	**GL**	**GL**	**GL**
1,313,000	1 Aug	Cash receipt						
		Bal c/d	**1,800,000**					

(b) Ledgers

Cash Book extract

Date		Amount	Date		Amount
		Tshs			Tshs
			01/07/20X1	Petty Cash	1,800,000
			01/08/20X1	Petty Cash	1,313,000
					3,113,000

Travelling Expenses A/c

Date		Amount	Date		Amount
		Tshs			Tshs
02/07/20X1	Petty cash A/c	120,000			
12/07/20X1	Petty cash A/c	45,000			
26/07/20X1	Petty cash A/c	40,000			
30/07/20X1	Petty cash A/c	64,000			
				Balance c/d	269,000
		269,000			**269,000**

Stationery Expenses A/c

Date		Amount	Date		Amount
		Tshs			Tshs
02/07/20X1	Petty cash A/c	50,000			
03/07/20X1	Petty cash A/c	60,000			
07/07/20X1	Petty cash A/c	150,000			
14/07/20X1	Petty cash A/c	20,000			
18/07/20X1	Petty cash A/c	10,000			
25/07/20X1	Petty cash A/c	95,000			
28/07/20X1	Petty cash A/c	34,000			
				Balance c/d	419,000
		419,000			**419,000**

Postage Expenses A/c

Date		Amount	Date		Amount
		Tshs			Tshs
22/07/20X1	Petty cash A/c	68,000			
				Balance c/d	68,000
		68,000			**68,000**

Miscellaneous Expenses A/c

Date		Amount	Date		Amount
		Tshs			Tshs
09/07/20X1	Petty cash A/c	80,000			
22/07/20X1	Petty cash A/c	70,000			
27/07/20X1	Petty cash A/c	86,000			
				Balance c/d	236,000
		236,000			**236,000**

Repairs Expenses A/c

Date		Amount	Date		Amount
		Tshs			Tshs
17/07/20X1	Petty cash A/c	29,000			
20/07/20X1	Petty cash A/c	250,000			
30/07/20X1	Petty cash A/c	42,000			
				Balance c/d	321,000
		321,000			**321,000**

Answer 8

TRADE DISCOUNT AND CASH DISCOUNT

TRADE DISCOUNT	CASH DISCOUNT
This is a reduction in the price of goods.	Deduction from the invoice price
encouraging customers to buy in bulk	encouraging customers to pay their accounts early
is not recorded in the books of account	Cash discount is recorded in the books of accounts as discount received or discount allowed

Answer 9

(a)

(i) Accounting cycle is a step-by-step process of recording, classification and summarization of economic transactions of a business.

(ii) The steps in accounting circle are as follows:

- Analyses of the source of documents
- Recording in the Journal chronologically
- Post entries to the accounts in the general ledger
- Prepare a trial balance (unadjusted)
- Adjusting Journal entries record & Post
- Prepare a Trial balance (Adjusted)
- Prepare financial statements
- Closing Journal entries record & posted.

(b)

Assets		=	Liabilities		+	Capital
Display equipment	3,000,000		Trade payables	2,300,000		
Prepaid Rent	5,000,000		Loan	1,500,000		
Inventory	4,000,000					
Cash at bank	1,500,000					
Cash in hand	250,000					
TOTAL	13,750,000		TOTAL	3,800,000		9,950,000

(c)

DR	**THREE COLUMNAR CASH BOOK 0**										CR
Date	**Particulars**	**LF**	**D. Allowed**	**Cash**	**Bank**	**Date**	**Particulars**	**L.F**	**D. Received**	**Cash**	**Bank**
2015			TZS	TZS	TZS	2015			TZS	TZS	TZS
July			“000”	”000”	“000”	July			“000”	“000”	“000”
1	Balance b/d			600	9,670	4	Jazar		30		800
2	Samuel		100	1,900		6	Purchases				2,100
8	Cash	C			2,100	8	Bank	C		2,100	
12	Sales				900	17	Cash	C			900
15	Anita		50		1,050	19	Purchases		100		2,900
17	Bank	C		900		20	Telephone charges			100	
24	Sales			1,900		23	Kimwaki		16		684
26	Antony		20		480	27	Machinery				4,000
31	Cash	C			600	28	Antony		20		480
						31	Bank	C		600	
						31	Bank charges				26
						31	Balance c/d			2,500	2,910
			170	**5,300**	**14,800**				**166**	**5,300**	**14,800**
1-Aug	Balance b/d			2,500	2,900						

9 BANK RECONCILIATIONS

Get Through Intro

Every person has a bank account. The entries of deposits and withdrawals are the key components of bank transactions. All the transactions relating to the bank have to be monitored properly because this helps in identifying any differences between the cash book and bank statement. It also helps make sure that nobody has been stealing money directly from your bank account!

Generally, there should be no difference between the balances shown on the bank statement and in the cash book, because all the entries should appear in both. It may happen that on a particular date some entries are recorded in the cash book but are not shown on the bank statement. Entities usually have a policy of entering cheques received from any party immediately in the cash book.

In Tanzania, it may take 7 - 21 days for local and country cheques to be cleared respectively if they are issued from a different bank. Therefore these cheques will be reflected in the bank statement only when they are cleared. The time lag between deposit of cheques and clearance of cheques is the most common reason for the differences between the cash book and the bank statement.

It is therefore necessary to prepare a bank reconciliation statement to discover the differences between the bank statement and the cashbook. This will help to keep a check on the accounts maintained by the entities and the transactions recorded by the bank.

Most organisations prepare monthly bank reconciliations to maintain proper records. So, when you become a consultant and have to prepare a bank reconciliation statement, you should be in a position to prepare it accurately.

Learning Outcomes

a) Define and explain bank reconciliation
b) State and explain causes of disagreement between bank statement and cash book balances.
c) List items commonly appearing in the bank statements and not in cash book.
d) Prepare an updated cash book.
e) Prepare statement of bank reconciliation.
f) State the importance of preparing periodic bank reconciliation statements.

1. Define and explain bank reconciliation.
2. State the importance of preparing periodic bank reconciliation statements.
[Learning Outcomes a and f]

Definition

A bank reconciliation statement is a statement that **compares the cash book and the bank statement.** It provides the differences between the two.

1.1 Purpose of bank reconciliation

Bank reconciliation is prepared by almost all the entities as it helps in reconciliation of balance per bank statements and with the accounting records. It is prepared for the following reasons:

1. **To check the accuracy of accounts:** a bank reconciliation is prepared to assess whether the transactions entered by the entity in the cash book have actually happened and are reflected in the bank account.

Example

The cash book of Sam showed a balance of Tshs20 million, whereas the balance per the bank statement was Tshs15 million. Sam wondered why there was a difference in the cash book and bank statement.

When he prepared the bank reconciliation statement, he found that he had recorded a receipt of Tshs5 million from one of his customers but this transaction was not reflected in the bank account.

So, by preparing the reconciliation statement, he located the missing link and was also ensured about the accuracy of accounts.

---

2. **To find mistakes:** a bank reconciliation helps in discovering any errors in entry, i.e. whether the amounts or the nature of the entry is correct. The amount means the exact figure of the entry, and, by nature of the transaction, we mean whether the transaction has been recorded correctly as a receipt or issue.

Example

The bank statement of Jack showed a cheque received from Suzy of Tshs10 million. The cash book had recorded this cheque for Tshs1 million. This is a mistake made while recording the transaction in the cash book. This mistake was discovered when Jack prepared a bank reconciliation statement.

---

3. **To find out timing differences, if any:** the entry is recorded in the cash book by the entity's personnel, whereas, in the bank statement, the entry is made by the bank's personnel. So, there is a possibility that there may be a difference in timing between these two. A bank reconciliation discloses this timing difference, if any.

Example

On 1 January 20X3, Michael received a cheque from Mack for Tshs20 million. This cheque was entered by the bank on his bank statement after three days. So, there is a difference in cash book balance and bank statement, as the cheque was recorded in the cash book as soon as it was received from Mack. However, it was not reflected in the bank statement as it had to be cleared by the bank. This timing difference is recognised on the bank reconciliation statement.

---

4. **To maintain up-to-date records for management and for the audit:** management need to be sure that all transactions have been recorded and recorded correctly. This helps them make decisions on how to run the business. Also, when an audit is conducted, the audit staff looks through the cash book and bank statements. There may be differences between the two. So, if the entity prepares bank reconciliation, it provides the reasons for these differences at a glance. As a result, it helps in obtaining quick records for audit.

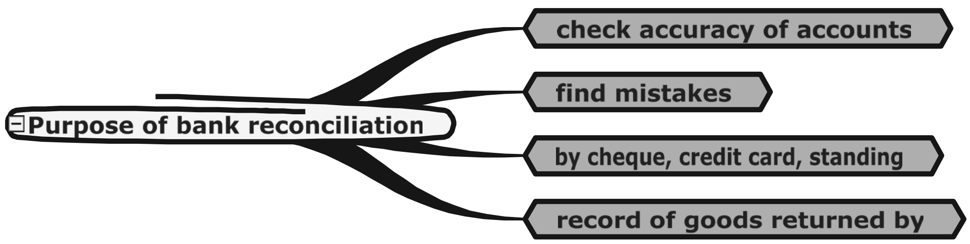
Example

Sun Inc closes its books on 31 December every year. Sam is the auditor of the company. He asked for the cash book and bank statement of the company for verification. Sam found different balances in the two records.

He wanted to be sure that the correct bank balance was being disclosed in the final accounts. So, he asked for a bank reconciliation statement. The bank reconciliation statement stated the reasons for the difference between the two and hence he was able to confirm the correct balance.

Therefore, from the above discussion, it is clear that the preparation of a bank reconciliation statement is essential for any entity.

SUMMARY



1.2 Importance of preparing a periodic bank reconciliation statements

A periodic bank reconciliation statement is required due to the following reasons:

(i) It ensures the accuracy of the balances shown by the cash book and bank statement.
(ii) It provides an arithmetical check on the accuracy of entries made in both the books.
(iii) It indicates any undue delay in the collection and clearance of some cheques.
(iv) It helps to detect and rectify any error committed in both the books.
(v) It helps to update the cash book by with entries not yet recorded.

Test Yourself 1

A bank reconciliation statement is:

(i) prepared by the bank and sent to its account holders
(ii) a statement sent by a bank to those customers who do not maintain a minimum balance
(iii) not a part of the double entry system
(iv) prepared by the entity to find discrepancies

A Only (i)
B (ii) and (iii)
C (iii) and (iv)
D (ii) and (iv)

---

3. State and explain causes of disagreement between bank statement and cash book balances.
4. List items commonly appearing in the bank statements and not in cash book.
[Learning Outcomes b and c]

An entity has to maintain its records properly so that the business can run efficiently and that management can look at the accounts, to see how the business is performing. We prepare a bank reconciliation statement to determine the differences between the cash book and the bank statement.

First, however, we should understand what a cash book and a bank statement are.

2.1 Cash book and bank book

Cash book: The transactions relating to money going in or out of the bank account are entered by the entity's personnel in the cash book. So these records are maintained within the entity.

A **proforma cash book** is given below:

Receipts	Cash Tshs	Bank Tshs	Payments	Cash Tshs	Bank Tshs
Balance b/f					
Bank		X	Accounts payable - Lawson		X
Cash	X		Petty cash	X	
			Employee Remuneration	X	
Accounts receivable - Jesson		X			
Accounts receivable - Masson		X			
Cash withdrawn - contra	X		Cash withdrawn - contra		X
			Balance c/f		
			Bank		X
			Cash	X	
	X	**X**		**X**	**X**

However, for this Learning Outcome we will show only the bank column in the cash book. This is because a cash book actually reflects what is happening in the bank account. Petty cash book shows actual cash transactions.

Cash Book
(showing only bank transactions)

Date	Receipts	Tshs	Date	Payments	Tshs
	Balance b/d	X		Bank charges	X
	Cheques received	X		Standing orders	X
	Bank interest			Direct debits	X
				Dishonoured cheque	X
				Cheques issued	X
	Total	**X**		**Total**	X

Notes:

1. Cheques received also include **outstanding lodgements** which are cheques received from the customers but not yet shown by the bank.

2. Cheques issued also include **unpresented cheques** which are cheques issued to creditors for payment but not yet cashed by them.

Bank statement: here, the transactions are entered by the bank's personnel. So, these records are maintained outside the entity.

A proforma bank **statement is as follows:**

Bank Statement

Date	Particulars	Withdrawals	Deposits	Balance
1/12/20X3	Balance b/d			X
5/12/20X3	Cheque issued	X		
7/12/20X3	Bank charges	X		
10/12/20X3	Bank interest		X	
15/12/20X3	Cheque deposited		X	
31/12/20X3	Balance c/d			X

Now, let us see why there is a difference between the cash book and the bank statement.

2.2 Reason for differences between cash book and bank books

The main reasons for differences between the cash book and the bank statement are discussed below:

1. **Cheques received but not deposited in the bank:** when a cheque is received by the entity, it immediately enters this receipt in the cash book, whereas the bank makes the entry for this receipt only when the cheque has been processed by the bank and the funds transferred from the customer's account to the entity's account. This is also known as an outstanding lodgement. So, this is a **timing difference** which appears in the bank reconciliation.

2. **Cheques issued:** when a cheque is issued by the entity for payment, the entry for this payment is immediately made by the entity in the cash book, but, the bank will make the entry only when the cheque has been processed by the bank and the funds transferred from the entity's account to the supplier's account. So, there will be a **difference in these two until the time the payment is transferred by the bank**.

3. **Bank charges:** banks charge a certain amount of money simply for keeping a customer's account or providing any other services, e.g. loans or overdrafts. These charges are recorded by the bank. Normally they appear directly on the bank statement.

   Generally, an entity becomes aware of the bank charges only when they appear on the bank statement. Consequently, they are not recorded in the cash book until after the bank statement is received.

Example

Suzy had issued a cheque of Tshs20 million on Sam. The cheque was dishonoured due to insufficient balance in her account. For dishonour of cheque, the bank charged Tshs0.2 million.

Suzy had no information about these bank charges until she got the bank statement. So there was no entry in the cash book. This resulted in a difference of Tshs0.2 million between the balance in the bank statement and in the cash book.

---

4. **Bank interest:** when an entity has an account with a bank, the bank pays a certain percentage of interest on any positive balance in the account. Interest is shown directly on the bank statement, and the entity does not have information about this interest until it receives the bank statement. As a result, the entry for bank interest received is not made in the cash book until after the bank statement is received.

Example

Sam had an account with Excel bank. Every quarter the bank paid some interest on his positive balance. In December 20X3, the bank credited his account with an amount of Tshs1 million as interest. Sam had no information about this interest until he received the bank statement. So, no entry was made in cash book for interest paid by the bank. This will result in a difference of Tshs1 million between the cash book and bank statement.

---

5. **Cheques dishonoured:** cheques are dishonoured by the bank when the party which has issued the cheque has insufficient funds in its bank account. An entity often does not know whether a cheque it has deposited has been dishonoured by the bank until it receives the bank statement. So there will be no entry for the same, in the cash book until the entity receives the bank statement.

Example

Michael deposited a cheque received from one of his customers of Tshs50 million. The cheque was dishonoured by the bank because there was insufficient balance in the customer's account. This fact was not known to Michael.

This resulted in a difference between the cash book and bank statement. Michael had shown this deposit but there was no corresponding entry in the bank book.

---

6. **Errors:** there may be differences between the cash book and bank statement because of errors committed either by the entity's personnel or the bank's personnel. Errors may be of calculation, or may be made while recording a transaction.

Example

Diana received a cheque from Suzan of Tshs20 million. She recorded the cheque received from Suzan with an amount of Tshs2 million. She has made a mistake while recording the transaction into her cash book.

When she received a bank statement from the bank, she found that entry in bank statement was for Tshs20 million. She realised her mistake, which had resulted in the difference between the cash book and bank statement.

Example

A cheque of Tshs10 million has been deposited into Arby Co's bank account. However, the accountant erroneously made an entry of Tshs1 million. This is an error made in the cash book and as a result, the cash and bank balances will not reconcile.

---

7. **Standing order:** the account holder of the bank instructs the bank to pay money regularly from his account for example to pay the electricity bills or phone bills etc. The bank makes the entry for this payment immediately but it will be recorded in the books of the entity only after the bank statement is received.

Example

Jack instructs his bank to pay the rent of the office building of Tshs10 million on the fifth of every month.

---

8. **Direct debit:** the account holder gives permission to the creditor to claim money directly from his account. Here, the **amounts may vary** each month.

Example

Jack tells the electricity department to collect the bill amount directly from the bank, every month. Here, the bank will pay Jack's electricity bill directly to the department. So, this is a direct debit made by bank in Jack's account.

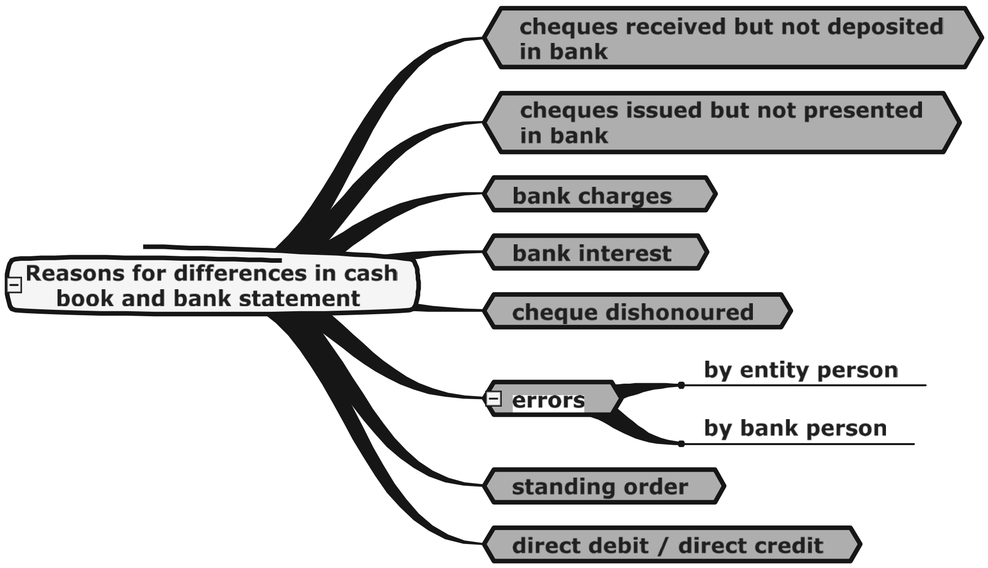
---

9. **Direct credit:** the customers may make payments directly into the account holder's bank. The information regarding the credited amount will be known only on receipt of the bank statement.

Example

Jenny, a customer of Jack, paid his dues directly into his bank account. The bank will credit Jack's account with the amount paid by Jenny. Jack will get information regarding this transaction through a bank statement provided after a certain period of time.

SUMMARY



2.3 Items appearing in bank statements and not in cash books

The following items listed in bank statements need to be updated in the cash book after a bank statement is received:

- Direct debits
- Direct credits
- Bank charges
- Standing order
- Interest charges by banks

These items are already discussed in detail in paragraph 2.2.

Test Yourself 2

A cheque was issued by Matrix Ltd to Jack (creditor), but it has not yet appeared on the bank statement. This cheque is known as ________.

A A dishonoured cheque
B A standing order
C An outstanding cheque
D A credit transfer

Test Yourself 3

Which of the following does not cause a difference between the cash book and the bank statement?

A Interest on bank overdraft debited in the bank account
B Cheques issued and presented for payment
C Cheques received and entered in the cash book, but not yet paid into the bank for collection
D A certain amount directly deposited by a customer into the bank

---

5. Prepare an updated cash book.

[Learning Outcome d]

One of the many reasons due to which the bank statements and the cash book show different balances on the same day is that there could be errors or omissions in the recording of transactions in the cash book. Error means a **mistake committed** while recording a transaction.

Example

Diana received a cheque from Juliet of Tshs25 million on 2 January 20X3. While recording this transaction in the cash book, she wrote the amount as Tshs52 million.

This error (called a **transposition error** as the numbers have been transposed from 25 to 52) leads to a difference of Tshs27 million (Tshs52 million - Tshs25 million) between the two balances.

On the other hand, omission means **not recording** a transaction which has to be recorded.

Example

Continuing the previous example of Diana,

If Diana forgets to record the cheque received from Juliet of Tshs25 million in the cash book then she has made an error of omission.

In this case the difference between the two balances is Tshs25 million (Tshs25 million - Tshs0)

All errors and omissions in the cash book are first rectified to determine the correct balance per the cash book. We then prepare a bank reconciliation statement.

Let us understand how we can determine the correct cash book balance with the following example:

Example

On 30 June 20X3, Superb Inc discovered a difference between the cash book and the bank statement. The accountant of the company was unable to explain the difference. The details of the balances are as follows:

On 30 June 20X3, the balance in the cash book was Tshs900,000 (debit) and in the bank statement was Tshs1,000,000 (credit).

After verification, it was found that the difference was because of the following transactions:

(a) The cash book was understated by Tshs50,000.
(b) Cheques deposited but not credited by the bank amounted to Tshs300,000.
(c) Cheques issued but not presented amounted to Tshs450,000.
(d) Cheques issued of Tshs50,000 wrongly recorded on receipt side of cash book.
(e) The cash book did not include Tshs125,000 towards interest earned by Superb, although it appeared in the bank statement.
(f) The cash book did not include Tshs12,000 towards bank charges incurred by Superb, although it appeared in the bank statement.

a) and d) are errors in the cash book. Furthermore, items mentioned under e) and f) are omissions in the cash book. We will first correct the errors and incorporate the omissions.

Cash Book

Date	Receipts	Tshs'000	Date	Payments	Tshs'000
				Cheque wrongly recorded on	100
	Balance b/d Bank	900		receipt side (Tshs50,000 x 2)* - d	
	interest - e Under	125		Bank charges – f	12
	casting - a	50		Balance c/d	963
	Total	**1075**		**Total**	**1075**

Continued on the next page

The revised balance of the cash book is Tshs963,000.

Items (b) and (c) are not errors. They are items which will appear in the bank reconciliation statement.

*The amount has been deducted twice: first for the reversal of the previous wrong entry on the receipt side, and later for the correct recording of the entry for cheque issued.

The only error in the cash book is that it **is understated by Tshs50,000** and **issued cheque is debited instead of credited**. Hence, we will first correct this error.

It is explained in the next Learning Outcome.

Test Yourself 4

On 30 July 20X3, Reliable Inc discovered a difference between the cash book and the bank statement. The balance in the cash book was Tshs1,800,000 (debit) and in the bank statement it was Tshs1,900,000 (credit).

After verification, it was found that the difference was because of the following transactions:
(a) The cash book was overstated by Tshs200,000.
(b) Cheques issued, but not presented, amounted to Tshs900,000.
(c) Cheques to the value of Tshs600,000 were deposited, but were not credited by the bank.

Required:

Find out the correct cash book balance.

Test Yourself 5

The cash balance of Kelia Plc was Tshs700,000 (debit). The bank statement showed a credit balance of Tshs1,600,000 on 31 March 20X3. The difference was caused due to the following transactions:

(i) Cheques of Tshs500,000 were issued, but not presented to the bank for payment.
(ii) A cheque was received amounting to Tshs200,000, but was recorded as Tshs20,000.
(iii) Payment of Tshs250,000 from a customer was directly received by the bank.
(iv) The cash book was overstated by Tshs30,000.

What will be the revised balance in the cash book after taking the above transactions into consideration?

A Tshs750,000
B Tshs850,000
C Tshs550,000
D Tshs690,000

---

6. Prepare statement of bank reconciliation.

[Learning Outcome f]

We have seen the reasons for the difference between balances in the cash book and the bank statement. We have also seen the purpose and importance of bank reconciliations. Let us now understand how to prepare a bank reconciliation statement.

4.1 Procedure for preparing a bank reconciliation statement

Before learning how to prepare a bank reconciliation statement, let us recap some terms explained in earlier learning outcomes:

Bank statement / pass book: this is the statement a banker gives to the account holder. The banker maintains records of all the transactions of the account holder. These transactions are recorded in the bank statement.

Cash book: this is the record of bank transactions maintained by the entity in its books of accounts.

Direct debit: the account holder gives permission to the creditor to claim money directly from his account. Here, the **amounts may vary** at different occasions.

Direct credit: the customers may deposit their dues directly into the account holder's bank. The information regarding the credited amount will be known to the customer only on receipt of the bank statement.

Diagram 1: Steps in bank reconciliation

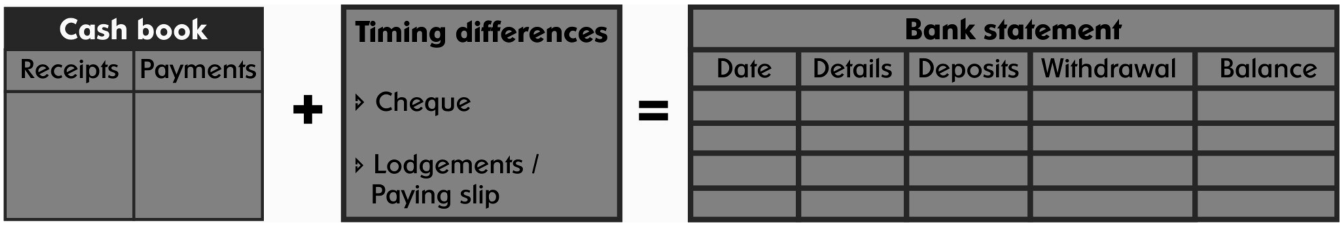
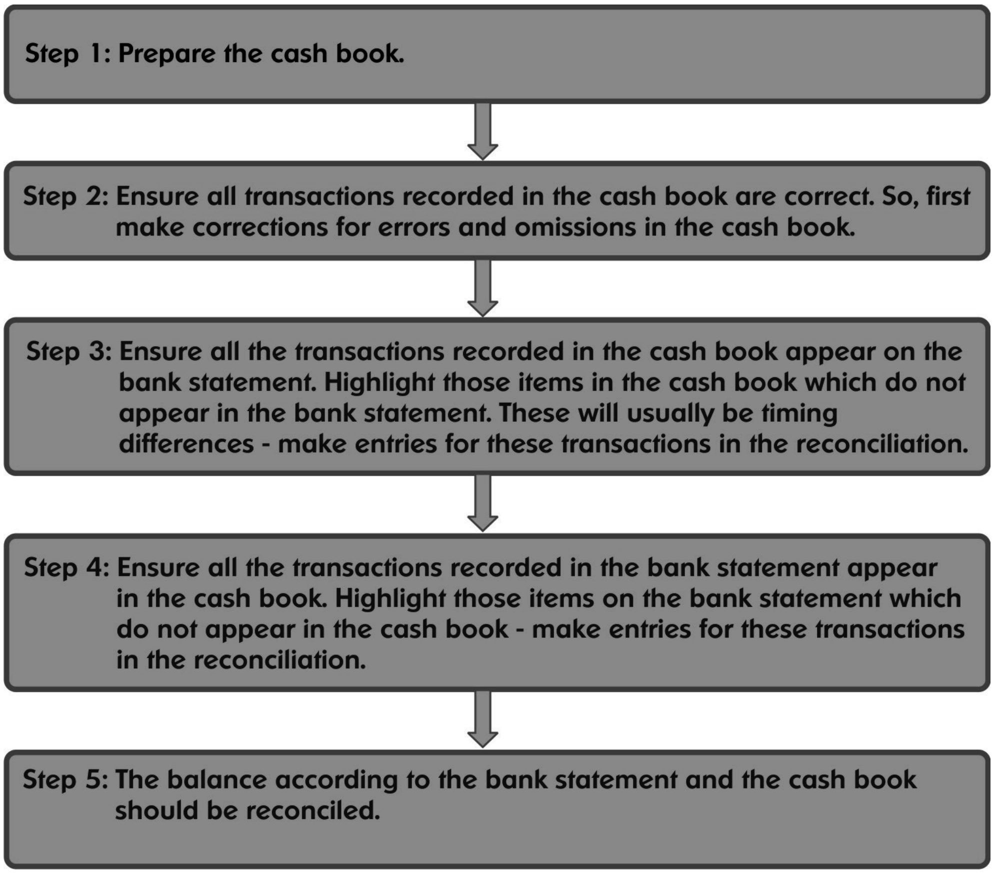


Diagram 2: Steps in bank reconciliation



Note: bank balances can be either favourable or unfavourable in the cash book and the bank statement

The **cash book** shows a debit balance when the receipt (debit) side of the cash book exceeds the payment (credit) side of cash book. This balance is also known as a **favourable balance.**

Similarly, when the payment side of cash book exceeds the receipt side of cash book, the balance is known as an **unfavourable balance**. This balance is also called an **overdraft balance** in the cash book.

The **bank statement** has a credit balance or a **favourable balance** when the credit side of the bank statement is higher than the debit side.

In the same manner when the debit side of bank statement is greater than the credit side of the bank statement, it shows a debit balance or an **unfavourable balance.** This balance is also known as an **overdraft balance.**

Before preparing the bank reconciliation statement, let us see the proforma of the same in two different ways.

1. When we move from the cash book balance to the bank statement balance.
2. When we move from the bank statement balance to the cash book balance.

Proforma of the bank reconciliation statement when we move from the cash book balance to the bank statement balance

Bank Reconciliation Statement

	Tshs
Balance per cash book	**X**
Add:	
Cheque issued but not presented	X
Bank interest	X
Direct credit by customers	X
	X
Less:	
Standing order / direct debit	(X)
Cheques deposited in bank but not credited	(X)
Bank charges	(X)
Cheque dishonoured	(X)
Balance per bank statement	**X**

Tip

If the pass book balance is taken as the starting point, the process needs to be reversed. Add those items which are deducted from cash book balance and deduct those which are added to the cash book.

Proforma of bank reconciliation statement when we move from the bank statement balance to the cash book balance

Bank Reconciliation Statement

	Tshs
Balance per bank statement	**X**
Add:	
Cheques deposited in bank but not credited	X
Bank charges	X
Standing order / direct debit	X
Cheque dishonoured	X
	X
Less:	
Cheque issued but not presented	(X)
Bank interest	(X)
Direct credit	(X)
Balance per cash book	**X**

Let us understand the preparation of a bank reconciliation statement with the help of an example.

Example

Superb Ltd maintains a cash book. The balance in the cash book on 31/03/20X3 was Tshs20 million, but the bank statement of the company showed a balance of Tshs25.98 million. On close scrutiny of the cash book and bank statement, it was found that the difference was due to the following transactions:

(a) A cheque issued on 28/03/20X3 of Tshs12 million was debited by bank on 04/04/20X3.
(b) Cheques deposited in bank but not credited by bank until 31/03/20X3.
  (i) Cheque received from High tech Ltd of Tshs2 million.
  (ii) Cheque received from Smart Ltd of Tshs11 million.
(c) The bank has collected a payment directly from Talented Ltd of Tshs8 million, but the entry was not recorded in the cash book for it.
(d) Bank charges of Tshs0.5 million on 28/03/20X3 were not recorded in the cash book.
(e) Standing order of Tshs1 million was given to the bank for payment of Telephone bill. This was not recorded in the cash book.
(f) Cheque issued to Phalna Ltd of Tshs0.5 million was dishonoured. Bank has charged noting charges of Tshs20,000 for the same.

Here, we prepare the bank reconciliation statement by starting with the balance according to the cash book.

Bank Reconciliation Statement – Cash book to Bank statement

	Tshs'000	**Tshs'000**
Balance according to cash book		**20,000**
Less: Bank charges	(500)	
Less: Noting charges charged by bank	(20)	(520)
Add: Cheque issued to Phalna dishonoured		500
Corrected cash balance		**19,980**
Add: Cheque issued but not debited by bank	12,000	
Add: Direct credit by Talented Ltd	8,000	20,000
		39,980
Less: Cheques deposited in bank but not credited		
- received from High Tech ltd	(2,000)	
- received from Smart Ltd	(11,000)	
Less: Standing order for telephone bill	(1,000)	(14,000)
Balance according to bank statement		**25,980**

Now using the same data, we will prepare a bank reconciliation statement taking the balance according to the bank statement and reconciling it with the balance according to the cash book.

Bank Reconciliation Statement – Bank statement to Cash book

We need to first correct the cash book (as we have done it above) and then prepare the bank reconciliation as follows:

	Tshs'000	Tshs'000
Balance according to bank statement		25,980
Add: Cheques deposited in bank but not credited by bank		
received from High Tech Ltd	2,000	
received from Smart Ltd	11,000	
Add: Standing order for telephone bill	1,000	14,000
		39,980
Less: Cheque issued but not debited by bank	(12,000)	
Less: Standing order: Talented Ltd	(8,000)	(20,000)
Balance according to cash book		**19,980**

4.2 Dealing with overdraft balances

Sometimes, the trader or the company may have overdraft balance with the bank. This situation occurs when the debit side of a bank statement is higher than the credit side of the bank statement, i.e. when a business withdraws amount more than the available balance from their bank account. This amount is referred to as an **overdraft balance** in the bank pass book. In the cash book, it is shown as a credit balance.

To summarise

In the cash book – credit balance

In the bank statement (pass book) – debit balance

These are also referred to as unfavourable balances.

While dealing with overdraft balances, we need to reverse the procedure discussed above for favourable balances. The following table will help you understand the preparation of bank reconciliation with unfavourable balance.

S.No	Items	If you start with	
		Cash Book Credit Balance	Pass Book debit Balance
1.	Cheques issued but not presented to bank	Subtract	Add
2.	Cheques deposited in bank not entered in cash book	Subtract	Add
3.	Wrong credit in cash book	Subtract	Add
4.	Wrong credit in pass book	Subtract	Add
5.	Standing order	Add	Subtract
6.	Cheques deposited but not credited	Add	Subtract
7.	Wrong debit in cash book	Add	Subtract
8.	Wrong debit in pass book	Add	Subtract

Let us understand how to carry out bank reconciliations through an example with an overdraft balance.

Example

On 31 December 20X3, Big Inc has an overdraft balance in its bank statement of Tshs8.5 million but the cash book showed an overdraft balance of Tshs7 million.

The difference between the two was because of the following reasons:

(a) Interest on overdraft for 6 months ending was Tshs0.2 million, not entered in the cash book.
(b) Bank charges of Tshs0.3 million debited in the bank statement, but no effect given in the cash book.
(c) Cheque deposited but not cleared until 31/12/20X3 was Tshs3 million.
(d) Cheque issued but not presented of Tshs2 million.

Here, the important point to be noted is that both the balances are overdraft balances. So, the transactions which increase the balance in the bank will have to be deducted from the overdraft balance. This is because the cheque deposited into the bank account will reduce the overdraft. Also, transactions which reduce the bank balance will be added to the overdraft balance.

A bank reconciliation statement is prepared as follows:

	Tshs'000
Overdraft balance per cash book	**7,000**
Add:	
Interest on overdraft	200
Bank charges	300
Cheque deposited but not cleared	3,000
	10,500
Less:	
Cheque issued but not presented	(2,000)
Balance per bank statement (overdraft)	**8,500**

Alternatively, bank reconciliation statement can be prepared using the debit and credit columns.

	Tshs'000	Tshs'000
	Debit	Credit
Overdraft balance per cash book		**7,000**
Interest on overdraft		200
Bank charges		300
Cheque deposited but not cleared		3,000
Cheque issued but not presented	2,000	
Total	**2,000**	**10,500**
Balance per bank statement (overdraft)	**8,500**	

Since the final balance in the bank statements lies on the debit column, we can infer that the bank statement shows an overdraft of Tshs8,500,000

Test Yourself 6

Ricky's cash book shows a credit balance of Tshs8.7 million for the month of January. The balance of the bank statement does not match with that of the cash book, due to the following reasons.

(i) Interest on an overdraft of Tshs0.5 million had been debited by the bank but not recorded in the cash book.
(ii) Cheques of Tshs5 million issued during the month, but were not presented in the bank until 31 January 20X3. Cheques of Tshs3.5 million were deposited but not cleared.
(iii) Interest on investments of Tshs1 million was directly collected by the bank.
(iv) The bank had wrongly debited Tshs0.8 million.

The balance per the bank statement is:

A Tshs7.5 million (debit)
B Tshs9,5 million (debit)
C Tshs5.9 million (credit)
D Tshs7.5 million (credit)

4.3 Bank balance to be reported in final accounts

Final accounts record all the assets and liabilities of an entity. The bank balance is one of the entity's current assets. The amount to be disclosed in the statement of financial position should be accurate because the financial statements are used by customers and other stakeholders for financial decision-making.

In Paragraph 4.1 and 4.2 above, we have seen that the balance per the cash book, after making all necessary adjustments, will be reported in the statement of financial position.

The balance in the cash book before all the adjustments have been made, cannot be reported in the final accounts because there is a possibility that some transactions e.g. bank charges or bank interest have not been recorded or errors have been made while recording other entries. So, in order to report an accurate bank balance, the cash book balance should only be reported after all adjustments have been made.

Example

High tech Inc has a bank account with Excel bank. Michael is the M.D. of the company. He found differences between the cash book and the bank statement. He has provided us with the bank reconciliation statement of the company.

Explain which balance will form part of the final accounts.

High tech Inc - Bank Reconciliation Statement

	Tshs'000
Balance per bank statement	60,000
Add: cheque from customer Jay Co deposited but not credited	50,000
	110,000
Less: cheque issued to supplier Zara Co but not presented	(35,000)
Balance per cash book	**75,000**

The balance in the cash book arrived at after all adjustments have been made is recorded in the statement of financial position.

Here, the balance per the cash book after all necessary adjustments is Tshs75 million. So, the bank balance to be reported in the final accounts is Tshs75 million. This is because the adjusted cash balance will reflect all the transactions up until the year end. If the bank balance was reported as Tshs60 million in the financial statements, then the receivables would be overstated. Similarly, if the payment of Tshs35 million to Zara Co is not taken into account, the payables would be overstated.

Report the bank balance in the final accounts

If the corrected bank balance has a debit balance then, it will be reported in the statement of financial position as a current asset. If it has a credit balance, then it should be reported as a current liability.

SOFP		
		Tshs
Assets		
Non-Current assets		X
Current assets		
Bank	**X**	X
Total		**X**
Capital and liability		
Bank	**X**	X
Total		**X**

Debit bank balance will appear here

Credit bank balance will appear here

Test Yourself 7

The following is the bank reconciliation statement of Superb Inc. What bank balance will be reported in the final accounts?

Bank Reconciliation Statement

	Tshs'000
Overdraft per cash book	(3,000)
Add: Cheque issued but not presented	35,000
	32,000
Less: Cheque deposited but not credited	(25,000)
Balance per bank statement	**7,000**

A Tshs7 million
B (Tshs3 million)
C Tshs32 million
D None of the above

Answers to Test Yourself

Answer to TY 1

The correct option is **C**.

The bank reconciliation statement is prepared by an entity to find discrepancies in the cash book and the bank statement. It is a statement and not an account and hence is not a part of the double entry system.

Answer to TY 2

The correct option is **C**.

It is a cheque issued to Jack for payment but not yet cashed by him.

Answer to TY 3

The correct option is **B**.

Cheques issued but not presented for payment will cause the difference between the balances of the cash book and the bank statement.

Answer to TY 4

The only error in the cash book is that it is overstated by Tshs200,000.
The correction in the cash book has been made below:

Cash Book

Date	Receipts	Tshs'000	Date	Payments	Tshs'000
	Balance b/d	1,800		Overstated figure (a)	200
				Balance c/f	1,600
	Total	**1,800**		**Total**	**1,800**

The revised balance of the cash book is Tshs1,600,000.
Items b) and c) are not errors. They are items which will appear in the bank reconciliation statement.

Answer to TY 5

The correct option is **B**.

(ii) and (iv) are the errors in the cash book.

The correction in the cash book is made as follows:

Cash Book

Dr **Cr**

Date	Receipts	Tshs'000	Date	Payments	Tshs'000
	Balance b/d	700		Overstated	30
	Cheque entered with a wrong amount (Tshs200,000 - Tshs20,000)	180		Balance c/d	850
	Total	**880**		**Total**	**880**

The revised balance of the cash book is Tshs850,000. Items (i) and (iii) are not errors. They are items which will appear in the bank reconciliation statement.

Answer to TY 6

The correct option is **A**.

	Tshs'000	Tshs'000
	Dr	**Cr**
Overdraft balance per cash book		**8,700**
Interest on overdraft not entered in the cash book		500
Cheques deposited but not cleared		3,500
Wrong debit by bank		800
Cheque issued but not presented	5,000	
Interest on investment directly collected by bank	1,000	
Total	**6,000**	**13,500**
Overdraft balance per bank statement (debit balance)	**7,500**	

Answer to TY 7

The correct option is **B**.

Tshs3 million **credit** will be reported in the current liabilities.

Self Examination Questions

Question 1

A bank reconciliation statement means:

A A statement sent by a bank to those customers who do not maintain a minimum balance
B A statement sent by an entity to its customers
C A statement giving the difference between the bank balance according to the bank statement and the cash book
D None of the above

Question 2

A bank reconciliation statement is:

A Prepared by an entity and sent to its customers
B A part of a double entry system
C Not a part of a double entry system
D Prepared by a bank and sent to its account holders

Question 3

Which of the following will not result in the difference between the balance per cash book and the balance per bank statement?

A Cheque deposited not yet cleared
B Cheque issued but not presented
C Bank charges
D None of the above

Question 4

Which of the following is a timing difference that reduces the balance according to the cash book in the case of bank reconciliation?

A Cheques deposited but not cleared
B Cheques issued but not presented
C Bank charges
D Bank interest

Question 5

The following is a bank reconciliation statement prepared by Sun Inc:

	Tshs'000
Overdraft per bank statement	40,000
Add: deposits not credited	45,000
	85,000
Less: outstanding cheques	(6,000)
Overdraft per cash book	**79,000**

Assuming the bank statement balance of Tshs40 million to be correct, what should the correct cash book balance be?

Question 6

The bank reconciliation of Star Inc is given as follows:

	Tshs'000
Overdraft per bank statement	60,000
Add: deposits not credited	90,000
	150,000
Less: Cheques issued but not presented	(40,000)
Overdraft per cash book	**10,000**

What would be the correct cash book balance, assuming Tshs60 million to be the correct bank statement balance?

A Tshs40 million overdrawn
B Tshs10 million overdrawn
C Tshs90 million overdrawn
D Tshs10 million cash at bank

Question 7

Mack prepares the cash book for his business. The balance per cash book is Tshs10 million. From the following details, find out what is the balance per bank statement.

	Tshs'000
Standing order	1,000
cheques deposited in bank not yet credited	2,000
Bank charges	500
cheque issued not yet presented	3,000

A Tshs11.5 million
B Tshs9.5 million
C Tshs7.5 million
D Tshs7.5 million overdrawn

Question 8

The accountant of Venus Ltd, has prepared the following bank reconciliation statement:

	Tshs'000
Overdraft per bank statement	90,000
Add: Deposits not credited	95,000
	185,000
Less: Outstanding cheques	(2,000)
Overdraft per cash book	**183,000**

Required:

From the bank reconciliation statement given below, what is the cash book balance?

Question 9

The bank column in the cash book of Daima, and bank statement for the month of February 2012 are as follows:

Cash Book

	Tshs		Tshs
Feb.1 Balance b/d	105,750	Feb. 2 H. Lonna	13,500
3 K. Jommo	24,650	8 J. Lule	38,925
13 W. Tutu	46,375	12 S. Tadei	33,075
23 K. Kabanda	46,800	24 B. Goba	61,650
26 L. Bernard	42,900	28 Balance c/d	119,325
	266,475		**266,475**

Bank Statement

	Debit	Credit	Balance
	Tshs	Tshs	Tshs
Feb. 1 Balance b/d			105,750
4 Cheque		24,650	130,400
4 H. Lonna	13,500		116,900
10 J. Lule	38,925		77,975
14 S. Tadei	33,075		44,900
15 Cheque		46,375	91,275
25 K. Kabanda		46,800	138,075
27 S. Lamma: standing order	71,300		66,775
27 P. Furaha: credit transfer		21,600	88,375
28 Bank charges	13,375		75,000

Required:

Prepare:

(a) Adjusted cash book

(b) Bank reconciliation statement for the month ended 29th February 2012.

(May 2012)

Question 10

a) Briefly explain four (4) reasons for a cheque to be dishonoured by a bank.

b) Juma Makambo's Cash Book at 30th November 2015 showed an overdrawn position of TZS.3,630,000 although his bank statement showed only TZS.2,118,000 overdrawn.

Detailed examination of the two records revealed the following:

1. The debit side of the cash book had been under-casted by TZS.300,000.
2. A cheque for TZS.1,560,000 in favour of Zamtu Ltd., had been omitted by the bank from its statement, the cheque have been debited to another customer's account.
3. A cheque for TZS.182,000 drawn in payment of the telephone account had been entered in the cash book as TZS.128,000 but was shown correctly on the bank statement.
4. A cheque for TZS.210,000 from A. Moses having been paid into the bank was dishonoured and shown as such on the bank statement although no entry relating to the dishonour had been made in the cash book.
5. The bank had debited a cheque for TZS.126,000 to Juma's account in error; it should have been debited to Rashid Hussein account.
6. A dividend of TZS.90,000 on Juma's holding of ordinary shares has been paid direct to his bank account and no entry made in the cash book.
7. Cheques totaling TZS.1,260,000 drawn on 30th November had not been presented for payment.
8. A lodgement of TZS.1,080,000 on 30th November had not been credited by the bank.
9. Interest amounting to TZS.228,000 had been debited by the bank but not entered in the cash book.

REQUIRED:

(i) Make any necessary entries in the cash book.

(ii) Prepare a statement reconciling Juma Makambo's corrected cash book with his bank statement at 30th November 2015.

Question 11

a) An entity has to maintain its records properly so that the business can run efficiently and that management can look at the accounts to see how the business is performing. Bank reconciliation statements are prepared to determine the differences between the cash book and the bank statement.

REQUIRED:

Explain four main purposes of preparing a bank reconciliation statement.

b) You are working as accounting trainee employed by Masumbuko Ltd. One of your duties is to prepare bank reconciliation, the bank statement sent to you on monthly basis by the local branch of the CBD bank plc. On 30th June 2015 the cash book balance showed an overdraft of TZS.60,000,000 whilst the bank statement showed that on the same date Masumbuko Ltd has TZS.620,000,000 in credit with the bank.

Checking through both the cash book and the bank statement you discover the following:

(i) A cheque for TZS.126,000,000 payable to Malingumu has been entered twice into the cash book.

(ii) Bank charge TZS.50,000,000 debited to the bank statement do not appear in the cash book.

(iii) A dividend for TZS.240,000,000 received by the bank on 28th June 2015 has not entered in the cash book.

(iv) Cheques issued totaling TZS.620,000,000 and entered into cash book have not been presented to the bank for payment

(v) A direct debt for TZS.42,000,000 paid correctly by the bank on 26th June 2015 does not appear in the cash book.

(vi) Receipts from various customers amounting to TZS.187,000,000 have been entered into cash book but do not appear on the bank statement.

(vii) A cheque for TZS.87,000,000 issued to Makusaro shown incorrectly on the bank statement as TZS.78,000,000.

(viii) A customer cheque has been returned unpaid by his bank and the amount of TZS.36,000,000/= shows as adjustment on the bank statement. No entry has been made for this item in cash book.

REQUIRED:

(i) Bring the cash balance up to date as at 30th June 2015.

(ii) Draw a bank reconciliation statement as at June 2015.

Answers to Self-Examination Questions

Answer to SEQ 1

The correct option is **C**.

A bank reconciliation statement is a statement giving the difference between the bank balance according to the bank statement and the cash book.

Answer to SEQ 2

The correct option is **C**.

A bank reconciliation statement is not a part of a double entry system.

Answer to SEQ 3

The correct option is **D**.

It is because all the three result in a difference between the two records.

Answer to SEQ 4

The correct option is **A**.

Cheques deposited but not cleared.

Answer to SEQ 5

The bank reconciliation statement is prepared as follows:

	Tshs'000	**Tshs'000**
	Dr	**Cr**
Overdraft per bank statement	40,000	
Deposits not credited		45,000
Add: Cheques issued but not presented	6,000	
Total	**46,000**	**45,000**
Cash book (favourable balance)		**1,000**

Answer to SEQ 6

The correct option is **D.**

The cash book balance is calculated as follows:

	Tshs'000	**Tshs'000**
	Dr	**Cr**
Overdraft per bank statement	60,000	
Deposits not credited		90,000
Outstanding cheques	40,000	
Total	**100,000**	**90,000**
Cash book (favourable balance)		**10,000**

Answer to SEQ 7

The correct option is **B.**

	Tshs'000
Balance per cash book	**10,000**
Add: cheque issued but not presented	3,000
	13,000
Less:	
Cheques deposited in bank but not credited	(2,000)
Bank charges	(500)
Standing order	(1,000)
Balance per bank statement (favourable balance)	**9,500**

Alternatively using the debit credit columns

	Tshs'000	Tshs'000
	Dr	Cr
Balance per cash book	**10,000**	
Cheque issued but not presented	3,000	
Cheques deposited in bank but not credited		2,000
Bank charges		500
Standing order		1,000
Totals	**13,000**	**3,500**
Balance per bank statement (favourable balance_		**9,500**

Answer to SEQ 8

Bank reconciliation statement of Venus Ltd

	Tshs'000
Overdraft per bank statement	(90,000)
Add: Deposits not credited	95,000
	5,000
Less: Outstanding cheques	(2,000)
Cash book balance	**3,000**

Answer to SEQ 9

Adjusted Cash Book

	Tshs		Tshs
Balanced b/d	119,325	Standing order - S. Lamma	71,300
Credit transfer – direct credit from P. Furaha	21,600	Bank charges	13,375
		Balance c/d	56,250
	140,925		**140,925**

Bank reconciliation statement as at 28 February 2012

	Tshs
Balance per adjusted cash book	56,250
Add: Cheques issued but not presented by B.Goba	61,650
	117,900
Less: Cheques deposited but not credited – L. Bernard	(42,900)
	75,000

Working

Before preparing the bank reconciliation statement, the cash book is compared with bank statements. Refer to the workings below to understand how the cash book and bank statements are reconciled. The un-reconciled items are either a part of adjusted cash book or the bank reconciliation statement.

Cash Book

	Tshs	Ref		Tshs	Ref
Feb.1 Balance b/d	105,750		Feb. 2 H. Lonna	13,500	D
3 K. Jommo	24,650	A	8 J. Lule	38,925	E
13 W. Tutu	46,375	B	12 S. Tadei	33,075	F
23 K. Kabanda	46,800	C	24 B. Goba	61,650	
26 L. Bernard	42,900		28 Balance c/d	119,325	
	266,475			**266,475**	

Bank Statement

	Debit	Credit	Ref
	Tshs	**Tshs**	
Feb. 1 Balance b/d			
4 Cheque		24,650	A
4 H. Lonna	13,500		D
10 J. Lule	38,925		E
14 S. Tadei	33,075		F
15 Cheque		46,375	B
25 K. Kabanda		46,800	C
27 S. Lamma: standing order	71,300		
27 P. Furaha: credit transfer		21,600	
28 Bank charges	13,375		

Answer to SEQ 10

(a)

(i) The amount in figures is different from amount in words e.g. in words it is written one hundred thousand shillings but in figures it is written shs. 150,000.

(ii) The business deposits the cheque with the bank after the expiration period of the cheque. Cheques usually have a certain period of time by which they must be deposited e.g. 6 months, after this period, these cheques are considered as “stale” cheques if they are not yet deposited. So, the bank may dishonor these cheques.

(iii) The customer’s bank account has insufficient funds to pay for the cheque. For instance the customer has a balance of shs. 2 million on his bank account and he wrote a cheque of shs. 4 million to the business while she has not been allowed an overdraft to pay for that cheque. This cheque will be dishonored by the bank.

(iv) The signature in the cheque differs from that officially recognized by the bank.

(v) Postdated cheque.

(vi) Owner instructed the bank not to honour any cheque.

(b)

Dr.		**Cash Book**	**Cr**
2015	Shs.000	2015	Shs. 000
Suspense-undercast	300	Balance b/d	3630
Dividend received	90	Telephone-undercast	54
Balance c/d	3732	Moses-dishonoured cheque	210
		Interest	228
	4122		**4122**

Bank Reconciliation Statement as at 30th November 2015

	Shs.000	Shs. 000
Balance as per bank statement		(2,118)
Add: Error by the bank	126	
Uncredited deposit	1,080	1,206
		(912)
Less: Cheque omitted – Zito Limited	1,560	
Unpresented Cheque	1,260	2,820
Balance per adjusted/corrected cash book		**(3,732)**

OR

	Shs.000	Shs. 000
Balance as per adjusted cash book		(3,732)
Add: Cheque omitted – Zito Limited	1,560	
Unpresented Cheque	1,260	2,820
		(912)
Less: Error by the bank	126	
Uncredited deposit	1,080	1,206
Balance per bank statement		**(2,118)**

Answer to SEQ 11

(i) To check the accuracy of accounts: bank reconciliation is prepared to assess whether the transactions entered by the entity in the cash book have actually happened and are reflected in the bank account.

(ii) To find mistakes: bank reconciliation helps in discovering any errors in entry, i.e. whether the amounts or the nature of the entry is correct. The amount means the exact figure of the entry, and by nature of the transaction, we mean whether the transaction has been recorded correctly as a receipt or issue.

(iii) To find out timing differences, if any: the entry is recorded in the cash book by the entity's personnel, whereas, in the bank statement, the entry is made by the bank's personnel. So, there is a possibility that there may be a difference in timing between these two. Bank reconciliation discloses this timing difference, if any.

(iv) To maintain up-to-date records for management and for the audit: management need to be sure that all transactions have been recorded and recorded correctly. This helps them make decisions on how to run the business. Also, when an audit is conducted, the audit staff looks through the cash book and bank statements. There may be differences between the two. So, if the entity prepares bank reconciliation, it provides the reasons for these differences at a glance. As a result, it helps in obtaining quick records for audit.

(b)(i) ADJUSTED CASH BOOK

		TZS			TZS
30 June 2015	Malingumu	126,000,000.00	30 June 2015	Balance b/d	60,000,000.00
	Devidend	240,000,000.00		Bank charges	50,000,000.00
				Direct debit	42,000,000.00
				Unpaid cheque	36,000,000.00
				Balance c/d	178,000,000.00
		366,000,000.00 ===========			366,000,000.00 ===========

MASUMBUKO LIMITED

BANK RECONCILIATION STATEMENT AS AT 30 JUNE 2015

Balance per cash book (from part (a)		178,000,000.00
Add: Un-presented cheque	620,000,000.00	
Bank error (Makusaro)	9,000,000.00	629,000,000.00
		807,000,000.00
Less: Un-cleared lodgements		187,000,000.00
Balance per bank statement		620,000,000.00

PREPARATION OF TRIAL BALANCE

10

Get Through Intro

'Every debit entry has a corresponding credit entry.' – is the main principle of the double-entry system of accounting. Hence if there are no errors, then the total debit balances and total credit balances of all the ledger accounts of a company should be equal.

Before preparing its financial statements, a company should check the arithmetical accuracy of its accounting records. A list of all the ledger accounts and their respective balances as at a specified point is called a trial balance.

A **trial balance** ensures the arithmetical accuracy of the accounting records. If the trial balance does not balance (i.e. debit totals are not equal to credit totals) then it means that there is definitely an error in the accounts. These errors need to be determined and rectified before the company can prepare its financial statements.

However, if the totals of both sides of the trial balance equal each other, it does not automatically mean that there are no errors. This is because there could be compensating errors – you will learn more about this in the Study Guide.

Preparation of financial statements is the main object of the entire accounting exercise. The importance of the trial balance stems from the fact that financial statements cannot be prepared without a trial balance. In this Study Guide, you will learn about the **trial balance**, its **preparation and uses**.

Learning Outcomes

a) Define and explain the trial balance
b) Calculate account balances for different ledger accounts.
c) Identify debit and credit balances
d) Extract a trial balance at a particular date from a given set of ledger accounts.

1. Define and explain the trial balance

[Learning Outcome a]

1. Trial balance

Definition

A trial balance is the **summary of all the ledger account balances** at a particular point in time.

Under the double entry system of accounting, every debit has a corresponding credit and vice-versa. This means that the **total of the debit** balances of all accounts in the ledger **must equal** the **total of all credit** balances.

The trial balance is simply a list of all the ledger accounts and their respective balances as at a specified point of time e.g. as at 31 December 20X3.

Pro forma of trial balance

Trial balance as at __________

	Debit Tshs	**Credit Tshs**
Cash	X	
Inventory	X	
Payables		X
Share capital		X
Retained earnings		X
Other accounts etc.		X
Total	**X**	**X**

Though it has debit and credit columns, the trial balance is a statement, not a ledger account. It is prepared periodically, usually at the end of every reporting period. Note that, the trial balance is not a part of the financial statements.

2. Purpose of a trial balance

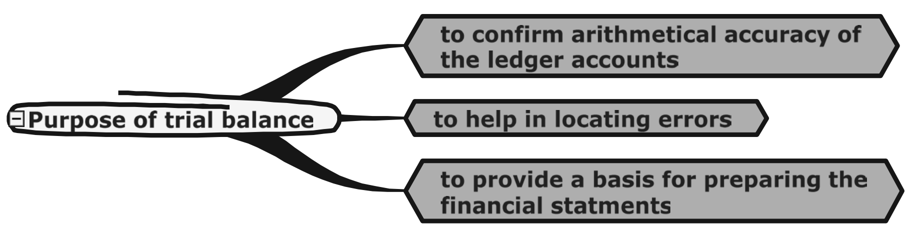
After preparing all required ledgers, a **trial balance** is **prepared,** to **list out at one place,** the **balances** of all the ledger accounts. This helps the accountant to **check** the **arithmetic accuracy of accounting.**

When preparing a trial balance, the debit and credit balances for each ledger account are totalled. If the totals of the debit column and the credit column of the trial balance do not balance, we know at once that there is some error in the ledger balance.

The fact that the trial balance agrees is a preliminary assurance that there are no mathematical / arithmetic errors in the preparation of the accounts.

Checking for mathematical / arithmetical accuracy is the primary purpose of the trial balance. However, because a trial balance presents the ledger account balances in a readily available format it is often used to prepare the financial statements.

SUMMARY



Tip

A trial balance is prepared in order to:

(a) confirm the arithmetical accuracy of the ledger accounts
(b) help in locating errors
(c) provide a basis for preparing the financial statements

3. Relationship of the trial balance with the accounting cycle

The entire accounting exercise is summarised below:

(a) Transactions are identified and recorded in day books (journal, sales book, purchase book, cash book, etc.).

(b) Transactions are recorded from day books to ledger accounts.

(c) A trial balance is prepared from the ledger accounts. It is a list of the balances of all ledger accounts where total debits = total credits.

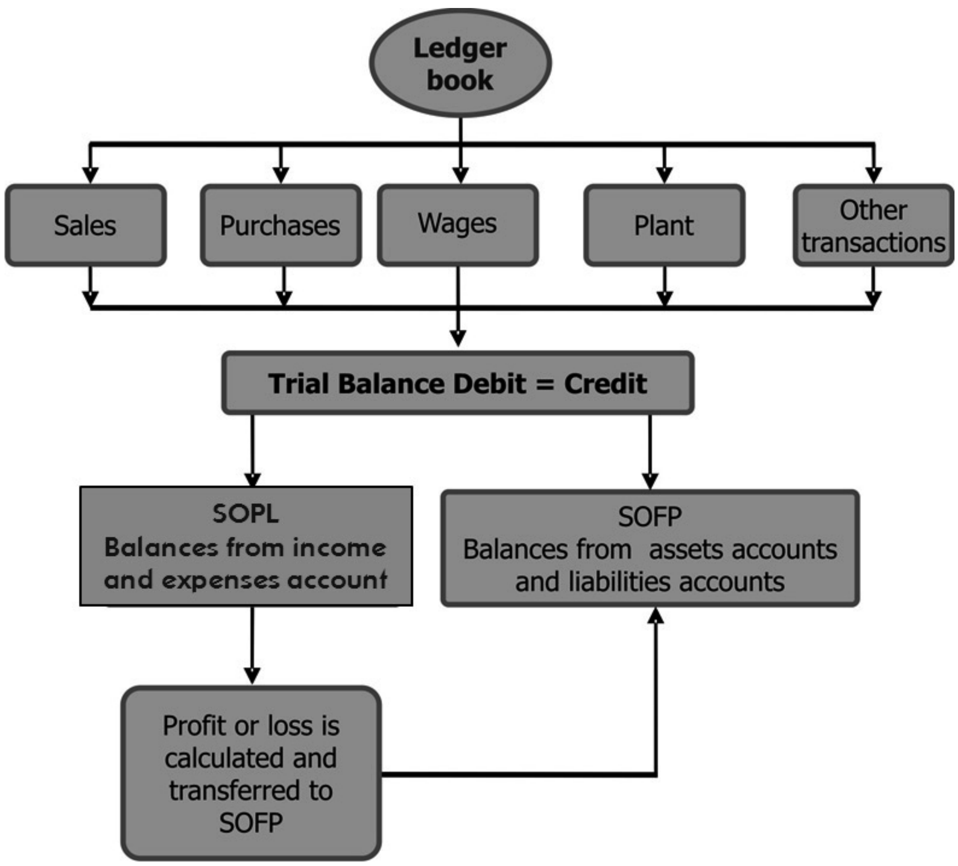
(d) A trial balance contains:
- ledger balances that affect the statement of profit or loss: balance of expense accounts and income accounts
- ledger balances that affect the statement of financial position: balance of asset accounts and liability accounts

(e) Balances that affect the statement of profit or loss are recorded in it and profit earned or loss incurred during the period is determined.

(f) Balances that affect the statement of financial position along with the profit or loss determined by the statement of profit or loss are recorded in it.

(g) The asset and liability side of the statement of financial position is totalled. The total of the assets side should be equal to the total of the liabilities side.

Diagram 1: Relationship of trial balance and financial statements



This accounting exercise will be discussed in detail as we progress through Study Guides 5 and 6.

Test Yourself 1

Fill in the blanks.

(a) The trial balance only ensures ____________ accuracy.
(b) The total of all debit balances must be ____________ to the total of all credit balances.
(c) A trial balance is ______________, not a ______________.

Important

Suspense accounts will be discussed in detail in Learning Outcome 5 of this Study Guide.

2. Calculate account balances for different ledger accounts. Identify debit and credit balances.

[Learning Outcomes b and c]

2.1 Steps involved in the preparation of a trial balance

1. Balance all the ledger accounts in the general ledger.
2. Calculate the totals of the balances in the accounts payable and accounts receivable ledger accounts. (A single consolidated figure will be taken for total receivables/payables in the trial balance - not all individual ledger accounts).
3. Prepare a trial balance.
   Write the names of all accounts one after the other.
   All credit balances are written in the credit column of the trial balance – against the name of the respective accounts.
   All debit balances are written in the debit column of the trial balance – against the name of the respective accounts.
   Total both the columns.
   The **two totals** should be **equal.**

Example

Given below are the ledger accounts of MAHINDI Ltd as at 31 December 20X3. Capital Tshs23 million

Books of MAHINDI Limited - Nominal ledger

Dr **Wages payable account** **Cr**

Date		Tshs'000	Date		Tshs'000
			01/01/20X3	Balance b/d	850
30/11/20X3	Cash payment	500	30/11/20X3	Wages-November	665
			31/12/20X3	Wages-December	1,200
31/12/20X3	Balance c/d	**2,215**			
	Total	**2,715**		**Total**	**2,715**

Dr **Machinery account** **Cr**

Date		Tshs'000	Date		Tshs'000
01/01/20X3	Balance b/d	5,000			
12/05/20X3	Cash - new machinery	23,308	12/05/20X3	Cash-sale of machinery	15,000
			05/09/20X3	Cash-sale of machinery	12,100
			31/12/20X3	Balance c/d	**1,208**
	Total	**28,308**		**Total**	**28,308**

Continued on the next page

Sales account

Dr Date		Tshs'000	Date		Cr Tshs'000
			02/05/20X3	AAL account	10,000
			02/05/20X3	SAIL account	16,000
31/12/20X3	Balance c/d	**31,200**	25/05/20X3	Cash	5,200
	Total	**31,200**		**Total**	**31,200**

Purchases- Coal account

Dr Date		Tshs'000	Date		Cr Tshs'000
31/01/20X3	Accounts payable	20,950			
23/04/20X3	Cash	5,050	31/12/20X3	Balance c/d	**26,000**
	Total	**26,000**		**Total**	**26,000**

Motor car account

Dr Date		Tshs'000	Date		Cr Tshs'000
01/01/20X3	Balance b/d	10,000			
			10/06/20X3	Cash- sale of asset	1,000
			31/12/20X3	Balance c/d	**9,000**
	Total	**10,000**		**Total**	**10,000**

Receivables Ledger

AAL Inc account

Dr Date		Tshs'000	Date		Cr Tshs'000
02/05/20X3	Credit sales	10,000			
			05/10/20X3	Cash received	5,000
			31/12/20X3	Balance c/d	**5,000**
	Total	**10,000**		**Total**	**10,000**

SAIL Ltd account

Dr Date		Tshs'000	Date		Cr Tshs'000
02/05/20X3	Credit sales	16,000			
			05/10/20X3	Cash received	1,000
			31/12/20X3	Balance c/d	**15,000**
	Total	**16,000**		**Total**	**16,000**

Wages account

Dr Date		Tshs'000	Date		Cr Tshs'000
30/11/20X3	Wages payable	665	31/12/20X3	Balance c/d	**1,865**
31/12/20X3	Wages payable	1,200			
	Total	**1,865**		**Total**	**1,865**

Payables Ledger

RAIM Plc account

Dr Date		Tshs'000	Date		Cr Tshs'000
			31/01/20X3	Credit purchases	20,950
31/12/20X3	Balance c/d	**20,950**			
	Total	**20,950**		**Total**	**20,950**

Continued on the next page

Dr **Cash account** Cr

Date		Tshs'000	Date		Tshs'000
01/01/20X3	Balance b/d	8,850	30/11/20X3	Wages account	500
10/06/20X3	Motorcar account	1,000	12/05/20X3	Machinery account	23,308
12/05/20X3	Machinery account	15,000	23/04/20X3	Purchase account	5,050
05/09/20X3	Machinery account	12,100			
25/05/20X3	Sales account	5,200			
05/10/20X3	AAL Inc account	5,000			
05/10/20X3	SAIL Ltd account	1,000			
			31/12/20X3	Balance c/d	19,292
	Total	**48,150**		**Total**	**48,150**

Total of receivables ledger: Tshs5 million + Tshs15 million = Tshs20 million
We will now see how to prepare a trial balance from these ledger accounts.

MAHINDI Ltd
Trial balance as at 31 December 20X3

All debit balances written in this column

All credit balances written in this column

	Debit	Credit
	Tshs'000	Tshs'000
Wages payable		2,215
Machinery	1,208	
Sales-credit		31,200
Purchases-coal	26,000	
Motor car	9,000	
Wages payable	1,865	
Cash	19,292	
Accounts payable		20,950
Capital		23,000
Accounts receivable	20,000	
Totals	**77,365**	**77,365**

The example we used above had only a few accounts that needed to be closed. In the real world, a trial balance will be far more extensive.

Test Yourself 2

The ledger balances of BBG Inc as on 31 December 20X3 are as follows. Prepare a trial balance.

Ledger Accounts	Tshs'000	Ledger Accounts	Tshs'000
Sales	1,000,000	Plant & machinery	600,000
Purchases	700,000	Intangible assets	200,000
Salaries	25,000	Inventory (opening)	100,000
Power and fuel	40,000	Cash	18,000
Auditor's fees	10,000	Share capital	500,000
Bad debts	2,000	Retained earnings	200,000
Depreciation	35,000		
Miscellaneous income	20,000		
Rent received	60,000		
Dividends	50,000		

Test Yourself 3

Prepare a trial balance for Banana Computers from the following information as at 31 December 20X3.

Books of prime entry

Cash book

Dr **Cr**

	Tshs'000		Tshs'000
Share capital	12,000	Salaries	2,000
Matthew-receivables	4,000	ABCL Plc.-payables	3,000

Banana Computers - Nominal ledger

Share capital account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
				Cash	12,000

Sales account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
				John	6,000
				Matthew	4,000

Purchases account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
	Montessori Ltd	3,000			
	ABCL Plc.	3,000			

Salaries and wages account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
	Cash	2,000			

Banana Computers
Receivables ledger

John account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
	Sales	6,000			

Matthew account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
	Sales	4,000		Cash	4,000

3. Extract a trial balance at a particular date from a given set of ledger accounts [Learning Outcome d]

3.1 Preparing extracts of an opening trial balance

There are two types of accounts:

1. **Accounts that are transferred to the statement of profit or loss** and closed at the year end. These are the incomes and expenses accounts.

2. **Accounts that are taken to the statement of financial position** and carried over to the next accounting year. These are the assets and liabilities accounts.

Example

Consider the trial balance of Banana Computers given above.
(Accounts are classified according to the nature)

Trial balance as at 31 December 20X2

	Debit Tshs'000	Credit Tshs'000	Nature of item	Disclosed in
Sales		10,000	Income	SOPL
Purchases	6,000		Expense	SOPL
Salaries and wages	2,000		Expense	SOPL
Cash	11,000		Asset	SOFP
Receivables	6,000		Asset	SOFP
Payables		3,000	Liability	SOFP
Share capital		12,000	Liability	SOFP
Total	**25,000**	**25,000**		

Example

Prepare an opening trial balance as at 1 January 20X3 from the above trial balance.

Answer

Step 1: Close all accounts and identify if they should be transferred to the statement of profit or loss or carried over to next year. (We have already done it above).

Step 2: Transfer all expenses and income to the statement of profit or loss.

Statement of profit or loss

	Tshs'000
Sales	10,000
Purchases	(6,000)
Salaries and wages	(2,000)
Profit	**2,000**

Note: The above **profit** of Tshs2 million is **payable to the owners** and **hence is a liability** on the opening statement of financial position.

Step 3: Carry over all assets and liabilities to the next year. **Don't forget to include profit or loss** incurred during the previous year.

Continued on the next page

Trial balance as at 1 January 20X3

	Debit Tshs'000	Credit Tshs'000
Cash	11,000	
Receivables	6,000	
Payables		3,000
Share capital		12,000
Profit retained		2,000
Total	**17,000**	**17,000**

This is profit brought forward from the last year

Total debit = Total credit

Tip

To prepare an opening trial balance, the closing statement of financial position of the previous period is taken as a base. E.g. the balances in a statement of financial position as at 31/12/20X2 constitute the opening trial balance for 01/01/20X3.

3.2 Accounting entries after preparation of a trial balance

You are now aware that a trial balance is a list of all ledger account balances. However, there are some accounting entries which are made directly in the financial statements, and so do not appear in a trial balance.

The following are examples of such entries:

1. Closing inventory
2. Provisions etc.

Tip

The entries which appear in the trial balance have only one effect in the preparation of financial statements while the entries which do not appear in the trial balance have two effects in the financial statements, i.e. debit and credit.

In the following example we will explain how to record these items.

Example

Given below is the trial balance of Enterprise Co.

Enterprise Co - Trial balance as at 31 December 20X3

	Debit	Credit
	Tshs'000	Tshs'000
Sales		12,500
Purchases	5,000	
Salaries	2,000	
Plant & machinery	6,000	
Inventory (opening)	1,500	
Cash	5,000	
Equity capital		5,000
Accumulated depreciation		2,000
Totals	**19,500**	**19,500**

Closing inventory on 31 December 20X3 was Tshs2 million.

Continued on the next page

From the given trial balance the statement of profit or loss and statement of financial position will be prepared as follows:

Enterprise Co - Statement of profit or loss for the year to 31 December 20X3

Closing inventory is reduced to find cost of sales in the statement of profit or loss

	Debit	Credit
	Tshs'000	**Tshs'000**
Sales		12,500
Opening inventory	1,500	
Add: Purchases	5,000	
Less: Closing inventory	**(2,000)**	(4,500)
Gross profit		**8,000**
Salaries expenses		(2,000)
Profit		**6,000**

Enterprise Co - Statement of financial position as at 31 December 20X3

	Tshs'000	Tshs'000
Assets		
Plant and machinery	6,000	
Accumulated depreciation	(2,000)	4,000
Cash		5,000
Closing inventory		**2,000**
Total		**11,000**
Capital and liability		
Equity shares	5,000	
Retained earnings	6,000	11,000
Total		**11,000**

Closing inventory is recorded as a current asset in the SOFP

Entries which don't appear in the trial balance always have two effects in the financial statements, debit and credit

---

3.3 Limitations of a trial balance

The fact that the trial balance balances is a preliminary assurance that the accounts are free from any mathematical / arithmetic errors. However it is not conclusive proof of the absence of errors. It only shows arithmetical accuracy i.e. every debit has been provided a corresponding credit.

Therefore, even if the totals of the debit column and the credit column agree, certain errors may remain unnoticed. Such errors are:

1. **Errors of omission**: these are errors caused by failure to record a transaction.

2. **Errors of commission:** these are errors caused due to incorrect recording of a transaction in the day book, from day books to ledger, inaccurate totalling/ balancing etc.

3. **Errors of principle**: these include the types of errors which result from the violation of fundamental principles of accountancy e.g. capital expenditure treated as revenue expenditure and vice-versa.

4. **Compensating errors:** when two or more errors are committed in such a way that the net effect of these errors on the debit and credit of accounts is nil.

Tip

Note: All these errors are discussed at length in the Learning Outcome 4 of this Study Guide.

Similarly, if items were incorrectly analysed in the ledger account or posted to the incorrect account, the trial balance will not identify this. Therefore, even when a trial balance agrees, there is always a chance for hidden errors which can be revealed only after a thorough scrutiny of the accounts.

Tip

A trial balance is not a financial statement. It does not reflect the financial position of a company.

A trial balance does not explain the financial position and performance of the entity. To enable us to understand and interpret the financial data, other financial statements e.g. the statement of profit or loss and the statement of financial position are prepared using the trial balance as their source of information.

Conclusion: A trial balance is an important document and it is important that it is fully understood by the student. A comprehensive example of how a trial balance is prepared is given below.

Example

Preparation of financial statements from source documents

The school holidays have started. It occurred to John that, during the holidays, children need toys to play with. He set up a business in the name of Creative Traders and started selling toys. The following transactions took place in January 20X3:

1. **On 1 January 20X3** he invested cash of Tshs50 million in the business.

2. John opened a bank account and deposited Tshs5 million on **02/01/20X3**. The bank allotted him the account number C/A-6630

3. He approached two suppliers from whom he bought the following toys on credit:
(a) Toys Company- Invoice number 88 dated **02/01/20X3** for Tshs15 million.
(b) Fun Inc.- Invoice number 66 dated **05/01/20X3** for Tshs25 million. Fun Inc. gave a trade discount of Tshs1 million.
(c) Toys Company- Invoice number 145 dated **31/01/20X3** for Tshs16 million.

4. **On 03/01/20X3** he found some defects in the material which was purchased on 02/01/20X3 from Toys Company and returned the defected goods. The value of these goods was Tshs5 million.

5. He also made cash purchases from Fun Inc. on **05/01/20X3** worth Tshs20 million. He incurred transportation charges of Tshs2.5 million in cash.

6. He appointed a worker, to manage his business, whom he pays Tshs2 million in cash at the **end of every month**.

7. The worker takes care of the inventory and marketing. He has found two buyers for his products. The two buyers are Enjoy Ltd and Getway Traders. The sales to these customers were:
   (a) Enjoy Ltd- Invoice No-1 dated **06/01/20X3** Tshs15 million.
   (b) Getway Traders- Invoice No-2 dated **15/01/20X3** Tshs30 million.
   (c) Enjoy Ltd- Invoice No-3 dated **31/01/20X3** Tshs16 million.

8. **On 15/01/20X3** John issued a cheque for Tshs22 million to Fun Inc. The amount payable was Tshs24 million but he took a cash discount on this payment.

9. **On 23/01/20X3** Getway Traders returned some goods worth Tshs8 million.

10. John made cash sales worth Tshs30 million on **10/01/20X3**. However he incurred expenditure on transportation of Tshs8 million. He paid by cheque.

11. John received cheques from the customers as follows:
    (a) Enjoy Ltd Tshs15 million on **06/01/20X3**.
    (b) Getway Traders Tshs22 million on **20/01/20X3**.

12. John paid Tshs10 million in cash to Toys Company on **05/01/20X3** for credit purchases made.

13. **On 31/01/20X3** John withdrew Tshs10 million from the business for personal expenses.

Continued on the next page

John has been following the principles of double entry, but is concerned that he may make a mistake. He asks you, as an accountant, how he can ensure mathematical accuracy. You suggest and he prepares a trial balance.

Check the entries that have been made in the books of prime entry, check how they are recorded in the ledger, find the closing balance of each account and prepare a trial balance as at 31 January 20X3.

Tip

To do this you will first need to prepare the books of prime entry. In this case these are the sales day book, sales returns day book, purchases day book, purchases returns day book and cash book. Next, record the entries in the ledgers, find the closing balance of each account and prepare the trial balance.

Answer

Step 1: Preparing books of prime entry

Purchases day book for January 20X3

Date		Tshs'000
02/01/20X3	Toys Company	15,000
05/01/20X3	Fun Inc	24,000
31/01/20X3	Toys Company	16,000
	Total	**55,000**

Trade discounts are not recorded.

Purchases returns day book for January 20X3

Date		Tshs'000
03/01/20X3	Toys Company	5,000
	Total	**5,000**

Sales day book for January 20X3

Date		Tshs'000
06/01/20X3	Enjoy Ltd	15,000
15/01/20X3	Getway Traders	30,000
31/01/20X3	Enjoy Ltd	16,000
	Total	**61,000**

Sales returns day book for January 20X3

Date		Tshs'000
23/01/20X3	Getway Traders	8,000
	Total	**8,000**

Continued on the next page

Cash book for January 20X3

Date	Receipts	Cash Tshs'000	Bank C/A Tshs'000	Date	Payment	Cash Tshs'000	Bank C/A Tshs'000
01/0120X3	Capital	50,000		02/01/20X3	Bank - contra	5,000	
02/01/20X3	Cash- contra		5,000	05/01/20X3	Purchases	20,000	
06/01/20X3	Enjoy Ltd		15,000	05/01/20X3	Toys Company	10,000	
10/01/20X3	Sales- cash	30,000		05/01/20X3	Carriage inward	2,500	
20/01/20X3	Getway traders		22,000	10/01/20X3	Carriage outward		8,000
				5/01/20X3	Fun Inc		22,000
				31/01/20X3	Salary	2,000	
				31/01/20X3	Drawings	10,000	
				31/12/20X3	Balance c/d	30,500	12,000
		80,000	**42,000**			**80,000**	**42,000**

Step 2: Preparing receivables, payables and nominal ledger

Receivables ledger

Dr **Enjoy Ltd account** **Cr**

Date		Tshs'000	Date		Tshs'000
06/01/20X3	Sales	15,000	06/01/20X3	Bank	15,000
31/01/20X3	Sales	16,000			
			31/01/20X3	Balance c/d	16,000
	Total	**31,000**		**Total**	**31,000**

Dr **Getway traders account** **Cr**

Date		Tshs'000	Date		Tshs'000
15/01/20X3	Sales	30,000	23/01/20X3	Sales returns	8,000
			20/01/20X3	Bank	22,000
			31/01/20X3	Balance c/d	
	Total	**30,000**		**Total**	**30,000**

Payables ledger

Dr **Toys Company account** **Cr**

Date		Tshs'000	Date		Tshs'000
3/01/20X3	Purchases returns	5,000	02/01/20X3	Purchases	15,000
5/01/20X3	Cash	10,000			
			31/01/20X3	Purchases	16,000
1/01/20X3	Balance c/d	16,000			
	Total	**31,000**		**Total**	**31,000**

Dr **Fun Inc account** **Cr**

Date		Tshs'000	Date		Tshs'000
15/01/20X3	Bank	22,000	05/01/20X3	Purchases	24,000
	Discount received	2,000			
	Total	**24,000**		**Total**	**24,000**

Continued on the next page

Dr **Capital - John account** Cr

Date		Tshs'000	Date		Tshs'000
			01/01/20X3	Cash	50,000
31/01/20X3	Balance c/d	50,000			
	Total	**50,000**		**Total**	**50,000**

Dr **Sales account** Cr

Date		Tshs'000	Date		Tshs'000
			10/01/20X3	Cash	30,000
			31/01/20X3	Credit	61,000
31/01/20X3	Balance c/d	91,000			
	Total	**91,000**		**Total**	**91,000**

Dr **Purchases account** Cr

Date		Tshs'000	Date		Tshs'000
05/01/20X3	Cash	20,000			
31/01/20X3	Credit	55,000			
			31/01/20X3	Balance c/d	75,000
	Total	**75,000**		**Total**	**75,000**

Dr **Carriage inward account** Cr

Date		Tshs'000	Date		Tshs'000
05/01/20X3	Cash	2,500			
			31/01/20X3	Balance c/d	2,500
	Total	**2,500**		**Total**	**2,500**

Dr **Carriage outward account** Cr

Date		Tshs'000	Date		Tshs'000
10/01/20X3	Bank	8,000			
			31/01/20X3	Balance c/d	8,000
	Total	**8,000**		**Total**	**8,000**

Dr **Discount received account** Cr

Date		Tshs'000	Date		Tshs'000
			15/01/20X3	Fun Inc	2,000
31/01/20X3	Balance c/d	2,000			
	Total	**2,000**		**Total**	**2,000**

Dr **Salary account** Cr

Date		Tshs'000	Date		Tshs'000
31/01/20X3	Cash	2,000			
			31/01/20X3	Balance c/d	2,000
	Total	**2,000**		**Total**	**2,000**

Dr **Drawings account** Cr

Date		Tshs'000	Date		Tshs'000
31/01/20X3	Cash	10,000			
			31/01/20X3	Balance c/d	10,000
	Total	**10,000**		**Total**	**10,000**

Dr **Sales returns account** Cr

Date		Tshs'000	Date		Tshs'000
31/01/20X3	Credit	8,000			
			31/01/20X3	Balance c/d	8,000
	Total	**8,000**		**Total**	**8,000**

Continued on the next page

Dr **Purchases returns account** **Cr**

Date		Tshs'000	Date		Tshs'000
			01/01/20X3	Credit	5,000
31/01/20X3	Balance c/d	5,000			
	Total	**5,000**		**Total**	**5,000**

Step 3: Extracting trial balance from all ledger account balances

Trial balance as at 31 January 20X3

	Debit Tshs'000	Credit Tshs'000	From trial balance c/d to
Purchases	75,000		SOPL
Carriage inward	2,500		SOPL
Carriage outward	8,000		SOPL
Salary	2,000		SOPL
Drawings	10,000		SOFP
Sales returns	8,000		SOPL
Receivables	16,000		SOFP
Cash in hand	30,500		SOFP
Bank balance	12,000		SOFP
Capital		50,000	SOFP
Sales		91,000	SOPL
Discount received		2,000	SOPL
Purchases returns		5,000	SOPL
Payables		16,000	SOFP
Total	**164,000**	**164,000**	

Step 4: Preparing statement of financial position and statement of profit or loss

This final step will be studied in detail in Study Guides 6 and 7. We have included the answer at this stage so you can see the full process from start to finish.

Creative Traders – Statement of profit or loss for January 20X3

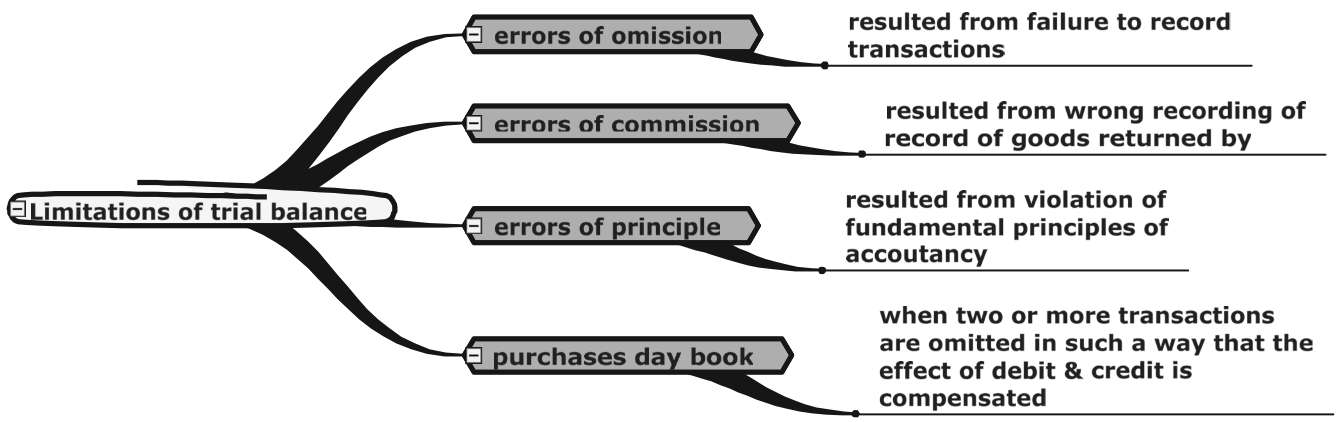
	Tshs'000	Tshs'000
Sales	91,000	
Less: Returns	(8,000)	83,000
Cost of goods sold		
Purchases	75,000	
Less: Returns	(5,000)	
	70,000	
Carriage inward	2,500	(72,500)
Gross profit		**10,500**
Add: Discount received		2,000
		12,500
Indirect expenses		
Carriage outward	8,000	
Salary	2,000	(10,000)
Profit		**2,500**

Continued on the next page

Creative Traders - SOFP as at 31 January 20X3

	Tshs'000	Tshs'000
Assets		
Cash in hand	30,500	
Bank balance	12,000	42,500
Receivable		16,000
Total		**58,500**
Capital and liabilities		
Capital	50,000	
Add: profit	2,500	
	52,500	
Less: drawings	(10,000)	42,500
Payables		16,000
Total		**58,500**

SUMMARY



Test Yourself 4

A credit sale transaction of Tshs3 million was wrongly recorded as Tshs13 million. This is an:

A Error of omission
B Error of commission
C Error of principle
D Compensating error

Test Yourself 5

"Treating a revenue expense as capital expenditure" is an example of:

A A compensating error
B An error of principle
C An error of omission
D An error of commission

Answers to Test Yourself

Answer to TY 1

(a) Arithmetical
(b) Equal
(c) Statement, ledger account

Answer to TY 2

Trial balance as at 31 December 20X3

	Debit Tshs'000	Credit Tshs'000
Sales		1,000,000
Purchases	700,000	
Salaries	25,000	
Power and fuel	40,000	
Auditor's fees	10,000	
Bad debts	2,000	
Depreciation	35,000	
Miscellaneous income		20,000
Rent received		60,000
Dividends	50,000	
Plant & machinery	600,000	
Intangible assets	200,000	
Inventory (opening)	100,000	
Cash	18,000	
Share capital		500,000
Retained earnings		200,000
Totals	**1,780,000**	**1,780,000**

Answer to TY 3

After balancing, the ledger accounts of Banana Computers will appear as follows:

Banana Computers

Books of prime entry

Cash book

Dr **Cr**

	Tshs'000		Tshs'000
Share capital	12,000	Salaries	2,000
Matthew-receivables	4,000	ABCL Plc-payables	3,000
		Balance c/d	**11,000**
	16,000		**16,000**

Nominal ledger

Share capital account

Dr Date		Tshs'000	Date		Cr Tshs'000
				Cash	12,000
	Balance c/d	**12,000**			
	Total	**12,000**		**Total**	**12,000**

Sales account

Dr Date		Tshs'000	Date		Cr Tshs'000
				John	6,000
				Matthew	4,000
	Balance c/d	**10,000**			
	Total	**10,000**		**Total**	**10,000**

Purchases account

Dr Date		Tshs'000	Date		Cr Tshs'000
	Montessori Ltd	3,000			
	ABCL Plc	3,000		Balance c/d	**6,000**
	Total	**6,000**		**Total**	**6,000**

Salaries and wages account

Dr Date		Tshs'000	Date		Cr Tshs'000
	Cash	2,000			
				Balance c/d	**2,000**
	Total	**2,000**		**Total**	**2,000**

Banana Computers
Receivables ledger

John account

Dr Date		Tshs'000	Date		Cr Tshs'000
	Sales	6,000			
				Balance c/d	**6,000**
	Total	**6,000**		**Total**	**6,000**

Mathew account

Dr Date		Tshs'000	Date		Cr Tshs'000
	Sales	4,000		Cash	4,000
	Total	**4,000**		**Total**	**4,000**

Answer to TY 15

Payables Ledger

Dr **Montessori Ltd account** **Cr**

Date		Tshs'000	Date		Tshs'000
				Purchases	3,000
	Balance c/d	**3,000**			
	Total	**3,000**		**Total**	**3,000**

Dr **ABCL Plc account** **Cr**

Date		Tshs'000	Date		Tshs'000
	Cash	3,000		Purchases	3,000
	Total	**3,000**		**Total**	**3,000**

Tip

Remember – start preparing the trial balance only when all entries are recorded in the ledger and all ledger accounts have been closed.

Trial balance as at 31 December 20X3

	Debit Tshs'000	Credit Tshs'000
Sales		10,000
Purchases	6,000	
Salaries and wages	2,000	
Cash	11,000	
Receivables	6,000	
Payables		3,000
Share capital		12,000
Total	**25,000**	**25,000**

Answer to TY 4

The correct option is **B**.

Commission: as the numerical error has been committed by the accountant. It has neither been omitted nor is it an error of accounting principle.

Answer to TY 5

The correct option is **B**.

Errors of principle: because this error is a violation of the generally accepted principles of accountancy.

Self-Examination Questions

Question 1

A company's machinery account for the year to December 20X3 was as follows:

Dr **Machinery account** **Cr**

Date		Tshs'000	Date		Tshs'000
	Balance b/d	50,000			
	Additions	20,000		Disposals	10,000
				Balance c/d	60,000
	Total	**70,000**		**Total**	**70,000**

What amount will be included in the trial balance as at 31 December 20X3?

A Tshs50 million Dr
B Tshs50 million Cr
C Tshs60 million Cr
D Tshs60 million Dr

Question 2

(Based on previous SEQ) What amount will be included in the opening trial balance of 20X4?

A Tshs50 million
B Tshs70 million
C Tshs40 million
D Tshs60 million

Question 3

Which of the following is not transferred to the opening trial balance?

A Cash
B Share capital
C Maintenance
D Receivables

Question 4

Which of the following is transferred to the opening trial balance?

A Accumulated depreciation
B Salary costs
C Depreciation in the year
D Rent received

Question 5

Accessories Ltd has the following trial balance as at 31 December 20X3

Trial balance as at 31 December 20X3

	Debit	**Credit**
	Tshs'000	**Tshs'000**
Sales		5,000
Purchases	3,000	
Salaries and wages	500	
Cash	3,000	
Receivables	3,500	
Payables		1,000
Share capital		4,000
Total	**10,000**	**10,000**

Prepare the opening trial balance as at 1 January 20X4.

Question 6

Receivables outstanding at the beginning of the year were Tshs10 million. During the year the following transactions occurred:

Credit sales Tshs700 million
Cash sales Tshs100 million
Prompt payment discounts given Tshs3 million
Payment Tshs600 million

What is the closing balance of receivables in the closing trial balance?

A Tshs107 million
B Tshs207 million
C Tshs210 million
D Tshs710 million

Question 7

The trial balance of Enterprise Co is as follows:

Enterprise Co - Trial balance as at 31 December 20X3

	Debit	**Credit**
	Tshs'000	**Tshs'000**
Sales		50,000
Purchases	30,000	
Power and fuel	2,000	
Auditor's fees	500	
Miscellaneous income		6,000
Plant & machinery	50,000	
Cash	15,000	
Equity capital		35,000
Revaluation surplus		9,000
Retained earnings		3,000
Depreciation	3,500	
Accumulated depreciation		7,000
Prepaid expenses	6,000	
Accrued income	3,000	
Sales tax		1,000
Discount allowed	1900	
Profit on sale of asset		900
Totals	**111,900**	**111,900**

Make a Tshs2.2 million provision for claims.

Required:

Calculate the profit or loss earned by Enterprise Co.
Prepare an opening trial balance as at 01/01/20X4.

Question 8

Prepare the correct ledger accounts for BBG Inc, after rectifying the following errors:

BBG Inc omitted to record a cash collection from Tony of Tshs5 million.

BBG Inc purchased machinery but recorded it as machinery expenses of Tshs6 million.

BBG Inc sold goods for Tshs0.2 million to customer A, but omitted to record it. It also collected the cash for this sale but omitted to record it.

BBG Inc paid wages of Tshs0.9 million but recorded Tshs0.7 million in the cash book. Tshs0.7 million was posted to the wages account.

BBG Inc received Tshs1 million from a customer but recorded it as Tshs1.5 million in the cash book.

Question 9

Calculate the correct closing balance in the following control account

Dr **Receivables ledger control account** **Cr**

Date		Tshs'000	Date		Tshs'000
	Balance b/d	25,000			
	Credit-sales	50,000		Cash received	55,000
				Sales returns	5,000
				Interest on overdue balance	6,000
				Bad debts	1,000
				Allowance for bad debts	800
				Balance c/d	7,200
	Total	**75,000**		**Total**	**75,000**

A Tshs8 million
B Tshs13.2 million
C Tshs15 million
D Tshs20 million

Question 10

Calculate the correct closing balance of the following account:

Dr **Receivables ledger control account** **Cr**

Date		Tshs'000	Date		Tshs'000
	Balance b/d	25,000			
	Credit-sales	50,000		Cash received	60,000
	Interest on overdue balance	6,000		Allowance for bad debts	800
	Contras against payables	6,000			
				Balance c/d	26,200
	Total	**87,000**		**Total**	**87,000**

A Tshs15 million
B Tshs27 million
C Tshs20.2 million
D Tshs14.2 million

Question 11

Calculate the correct closing balance of the following account:

Dr **Payables ledger control account** **Cr**

Date		Tshs'000	Date		Tshs'000
	Opening balance	25,000			
	Credit-purchases	50,000		Cash paid	60,000
	Interest on overdue balance	6,000		Discount	800
	Contras against receivables	6,000			
	Cash purchases	6,000			
	Purchases returns	6,000			
				Balance c/d	38,200
	Total	**99,000**		**Total**	**99,000**

A Tshs38.2 million
B Tshs28.2 million
C Tshs8.2 million
D Tshs14.2 million

Question 12

In December 2005, the following errors were discovered in the books of Mtakuja Ltd.

(i) Sales of Tshs.250,000 to J Cheusi had been debited in error to J. Cheupe's account.
(ii) The sale of a motor vehicle at book value had been credited in error to sales account Tshs.360,000.
(iii) Machinery purchased for Tshs.150,000 had been debited to the purchase account.
(iv) A payment of Tshs.56,000 for Postage had been posted to that account as Tshs.65,000.
(v) Depreciation of Tshs.500,000 on motor vehicle had been credited to machinery account.

Required:

Show the journal entries necessary to correct the above errors.

(Adapted May 2012)

Question 13
As at 31st March 2015, a business of S. Manyisi, has the following nominal ledger balances:

	TZS.'000'
Bank loan	12,000
Cash at bank	11,700
Capital	13,000
Rent	1,880
Trade payables	11,200
Purchases	12,400
Sales	34,600
Other payables	1,620
Trade receivables	12,000
Bank loan interest	1,400
Other expenses	11,020
Non-current assets	22,020

During the year ended 31st March 2016, the business made the following transactions:

1. Bought materials for TZS.1,000,000 half for cash and half on credit.
2. Made sales of TZS.1,040,000 which TZS.800,000 was on credit.
3. Paid wages to shop assistants of TZS.260,000 in cash.

REQUIRED:

(i) Draw up a trial balance showing the balances as at the end of 31st March 2015.
(ii) Draw up a trial balance showing the balances as at the end of 31st March 2016.

Question 14
The trial balance of KAMUSI Used Auto Company, on March 31, 2015 is as follows:

.	**Debit TZS "000"**	**Credit TZS "000"**
Cash	10,000	
Accounts receivable	20,000	
Automobile inventory	100,000	
Accounts payable		3,000
Notes payable		70,000
Kamusi, owner's equity		57,000
Total	130,000	130,000

This business is a sole proprietorship, thus the equity account used here is KAMUSI, Owner's Equity. In practise, it is often called Capital account.

KAMUSI rented operating space and equipment on a month-to-month basis. During April, the business had the following summarized transactions:

(i) Invested additional TZS.20,000,000 cash in the business.
(ii) Collected TZS.10,000,000 on accounts receivable.
(iii) Paid TZS.2,000,000 on accounts payable.
(iv) Sold autos for TZS.120,000,000 cash.

(v) Cost of autos sold was TZS.70,000,000.
(vi) Replenished inventory for TZS.60,000,000 cash.
(vii) Paid rent expense in cash, TZS.14,000,000.
(viii) Paid utilities in cash, TZS.1,000,000.
(ix) Paid selling expense in cash, TZS.30,000,000.
(x) Paid interest expense in cash, TZS.1,000,000.

REQUIRED:

(a) Journalize transactions (i) to (x) above with narratives.
(b) Open ledger accounts (T-accounts) for the accounts in the trial balance and from the following: Sales, cost of goods sold, rent expense, utilities expense, selling expense, and interest expense. Enter the March 31 balance, April's transactions in the appropriate accounts and provide closing entries.
(c) Prepare a Statement of Profit or Loss for April. Ignore income taxes.
(d) Prepare the Trial Balance as of April 30, 2015.

Question15

John's Trial balance as at 31st December, 2015 was as follows:

PARTICULARS	**DEBIT 'TZS**	**CREDIT 'TZS**
Capital		17,239,690
Creditors		2,500,000
Sales		28,500,000
Commission received		2,400,000
Returns outwards		4,350,500
Bank		1,300,000
10% Bank loan		4,500,000
Motor van	12,500,000	
Fixtures and fittings	3,700,000	
Stock at 1st January 2015	1,550,000	
Debtors	2,450,000	
Cash	580,000	
Drawings	250,000	
Purchases	18,000,000	
Salaries	5,400,000	
Commission paid	3,500,000	
Rent	2,400,000	
Office expenses	2,140,000	
Carriage inwards	3,213,500	
Carriage outwards	2,345,890	
Returns inwards	2,760,800	
Total	**60,790,190**	**60,790,190**

Stock as at 31st December 2015 was valued at TZS.2,400,000

REQUIRED:

(a) Prepare John's income statement for the year ended 31st December 2015.
(b) Prepare John's statement of financial position as at 31st December 2015.

Question 16

Jovina Mwalukasa, who is a sole proprietor, operates three (3) retail shop in Mbeya City. The following is the trial balance for her business as at 31st December 2016:

	Debit TZS.	Credit TZS.
Sales		54,500,000
Purchases	25,400,500	
Return inwards	560,000	
Return outwards		450,000
Carriage inwards	1,250,000	
Carriage outwards	1,550,500	
Electricity	1,650,000	
Insurance premium	170,000	
Salaries	5,400,000	
Cleaning	250,000	
Salesman commission	2,450,000	
Security expenses	600,000	
Furniture repairs	150,000	
Motor van repairs	560,000	
Office rent	7,200,000	
Stationeries	220,000	
Discount allowed	4,500,000	
Discount received		1,200,000
Interest on loans	4,500,000	
Communication expenses	450,000	
Motor van	25,000,000	
Furniture	5,500,000	
Fixtures and fittings	3,500,000	
Debtors	3,750,000	
Creditors		6,500,000
Bank overdraft		5,400,000
Long term bank loan		12,000,000
Cash	560,000	
Capital		20,721,000
Drawings	1,200,000	
Stock at 1st December 2016	4,400,000	
Total	100,771,000	100,771,000

Additional information

Stock valued at TZS.5,550,000 remained unsold at the end of the financial year 2016.

REQUIRED:

(a) Prepare the Statement of Profit or Loss and other comprehensive income for the year ended, 31st December 2016.

(b) Prepare the Statement of Financial Position as at 31st December 2016.

Question 17

George's trial balance as at 30th September 2014 is as shown below:

	Dr.	Cr.
	Tshs '000'	Tshs '000'
Capital at 1st October 2013		60,434
Inventory at 1st October 2013	25,120	
Receivables	25,760	
Payables and accruals		13,122
Bank	7,508	
Cash	2,000	
Sales		181,120
Returns inward	750	
Purchases	145,348	
Carriage inwards	1,948	
Wages	9,368	
Rent	6,400	
Postage expenses	764	
Travel and accommodation	1,498	
Telephone	1,706	
General expenses	1,506	
Drawings	25,000	
	254,676	254,676

Additional information:

- The value of George's inventory as at 30th September 2014 was Tshs.23,750,000.
- George has discovered the following errors in the postings:
  - (i) An invoice for carriage inwards was posted to the returns inwards account. The invoice was for Tshs.528,000.
  - (ii) A credit invoice for Tshs.1,120,000 was posted as Tshs.1,300,000.
  - (iii) A cash purchase of Tshs.100,000 was not recorded.

REQUIRED:

(a) Pass rectification journal entries to correct the errors

(b) Prepare a rectified trial balance after correcting the errors.

(c) Based on the corrected trial balance, calculate:

- (i) The gross profit and the net profit for the year ended 30th September 2014.
- (ii) The capital balance as at 30th September 2014.

Question 18

On 31st March 2015, while balancing the books of account of Anusha they did not agree. The difference in Trial Balance amounting to TZS.783,000 was debited to Suspense Account. Later, the following errors were noticed:

- (i) Total of Purchases Day Book for March, 2015 has been undercast by TZS.300,000 .
- (ii) TZS.220,000 paid for repairing the machinery has been debited to Machinery Account.
- (iii) The Sales Day Book has been overcast by TZS.150,000.
- (iv) A sale of TZS.1,200,000 to Mr. Kapur has been passed through the Purchases Day Book.
- (v) Cash TZS.117,000 received from Sharad though entered in the Cash Book has not been posted to Sharad Account.
- (vi) Goods returned by Mr. Akash, TZS.225,000 have been entered in the Returns Outward Book. However, Mr. Akash Account is correctly posted.

REQUIRED:

Prepare the journal entries for rectification of errors and prepare the suspense Account.

Answers to Self-Examination Questions

Answer to SEQ 1

The correct option is **D**.

A trial balance consists of the closing balances in the ledger accounts. The closing balance in the machinery account is Tshs60 million Dr.

Answer to SEQ 2

The correct option is **D**.

Some figures from a closing trial balance of a year are taken to the opening trial balance of the next year. Therefore, the closing balance in the machinery account of Tshs60 million debit in 20X3 will be the opening balance of 20X4.

Answer to SEQ 3

The correct option is **C**.

The income and expenditure balances of a year are not transferred to the opening trial balance of the next year. Maintenance is an expense and is included in the statement of profit or loss.

Answer to SEQ 4

The correct option is **A**.

The asset and liability balances of a year are transferred to the opening trial balance of the next year. Accumulated depreciation is a type of reserve (liability) and is therefore transferred to the opening trial balance. Salary costs and depreciation provided for the year are expenditures, while rent received is an income.

Answer to SEQ 5

Accessories Ltd

Statement of profit or loss

	Tshs'000
Sales	5,000
Less: Purchases	(3,000)
Gross Profit	**2,000**
Less: Salaries and wages	(500)
Profit	**1,500**

Trial balance as at 1 January 20X4

	Tshs'000	Tshs'000
Cash	3,000	
Receivables	3,500	
Payables		1,000
Share capital		4,000
Profits retained		1,500
Total	**6,500**	**6,500**

Answer to SEQ 6

The correct option is **A**.

Receivables account			
	Tshs'000		**Tshs'000**
Balance b/d	10,000		
Credit sales	700,000	Discounts	3,000
		Payment received	600,000
		Balance c/d	107,000
	710,000		**710,000**

Answer to SEQ 7

Enterprise Co – Statement of profit or loss for the period to 31 December 20X3

	Tshs'000	Tshs'000
Sales		50,000
Purchases		(30,000)
Gross profit		**20,000**
Profit on sale of asset		900
Miscellaneous income		6,000
		26,900
Expenses Power		
and fuel Auditors	2,000	
fees Depreciation	500	
Discount allowed	3,500	
Provision for claims	1,900	
Profit	2,200	(10,100)
		16,800

Enterprise Co – Statement of financial position as at 31 December 20X3

	Tshs'000	Tshs'000
Assets		
Non-current assets Plant		
& machinery Accumulated	50,000	
depreciation **Current**	(7,000)	43,000
assets		
Cash	15,000	
Prepaid expenses	6,000	
Accrued income	3,000	24,000
Total Assets		**67,000**
Capital and liabilities		
Share capital		35,000
Revaluation surplus		9,000
Retained earnings	3,000	
Add: profit for the year	16,800	19,800
Total equity		**63,800**
Liabilities		
Provision for claims		2,200
Sales tax		1,000
Total liabilities		**3,200**
Total equity and liabilities		**67,000**

Enterprise Co - Trial balance as at 01 January 20X4

	Debit	Credit
	Tshs'000	**Tshs'000**
Plant & machinery	50,000	
Accumulated depreciation		7,000
Cash	15000	
Prepaid expenses	6000	
Accrued income	3000	
Equity capital		35,000
Revaluation surplus		9,000
Retained earnings		19,800
Provision for claims		2,200
Sales tax		1,000
Total	**74,000**	**74,000**

Answer to SEQ 8

Correction entry

Dr	Cash	Tshs5 million	
Cr	Tony's account		Tshs5 million

Being cash received which was omitted earlier now recorded.

Tony's account (before correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Sales	5,000		
		Balance c/f	5,000
Total	**5,000**	**Total**	**5,000**

Tony's account (after correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Sales	5,000	Cash	5,000
Total	**5,000**	**Total**	**5,000**

Correction entry

Dr Machinery account Tshs6 million
Cr Machinery expense a/c Tshs6 million

BBG Inc has incorrectly debited the machinery expense account; hence to rectify this mistake it must credit the machinery expense account.

Machinery expense account (before correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Cash	6,000		
		Balance c/f	6,000
Total	**6,000**	**Total**	**6,000**

Machinery expense account (after correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Cash	6,000	Machinery a/c	6,000
		Balance c/f	0
Total	**6,000**	**Total**	**6,000**

Machinery account (before correction)

Dr			Cr
	Tshs'000		**Tshs'000**
	0	Balance c/f	
Total	**0**	**Total**	**0**

Machinery account (after correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Machinery expense a/c	6,000		
		Balance c/f	6,000
Total	**6,000**	**Total**	**6,000**

As entries have been omitted, we have to rectify the mistake by recording the entries.

Correction entry

Dr Customer-A account Tshs0.2 million
Cr Sales account Tshs0.2 million
Being sales to customer A recorded

Dr Cash Tshs0.2 million
Cr Customer-A account Tshs0.2 million
Being cash collected from customer-A

Customer-A account (before correction)

Dr			Cr
	Tshs'000		**Tshs'000**
	0	Balance c/f	0
Total	**0**	**Total**	**0**

Customer-A account (after correction)

Dr			Cr
	Tshs'000		**Tshs'000**
Sales	200	Cash	200
		Balance c/f	0
Total	**200**	**Total**	**200**

Correction entry

Dr Wages account Tshs0.2 million
Cr Cash Tshs0.2 million
Being shortfall of Tshs0.2 million (0.9 million – 0.7 million) rectified in wages account
.

Wages account (before correction)

Dr	Tshs'000		Tshs'000 Cr
Cash	700		
		Balance c/f	700
Total	**700**	**Total**	**700**

Wages account (after correction)

Dr	Tshs'000		Tshs'000 Cr
Cash	700		
Cash	200	Balance c/f	900
Total	**900**	**Total**	**900**

Correction entry

Dr Customer account Tshs0.5 million
Cr Cash Tshs0.5 million
Being excess Tshs0.5 million recorded in the cash journal, now rectified

Customer account (before correction)

Dr	Tshs'000		Tshs'000 Cr
Sales	5,000	Cash	1,500
		Balance c/f	3,500
Total	**5,000**	**Total**	**5,000**

Customer account (after correction)

Dr	Tshs'000		Tshs'000 Cr
Sales	5,000	Cash	1,500
Cash	500	Balance c/f	4,000
Total	**5,500**	**Total**	**5,500**

Answer to SEQ 9

The correct option is **D**.

Receivables ledger control Account

Dr Cr

Date		Tshs'000	Date		Tshs'000
	Opening balance	25,000			
	Credit-sales	50,000		Cash received	55,000
	Interest on overdue balance	6,000		Sales returns	5,000
				Bad debts	1,000
				Balance c/d	20,000
	Total	**81,000**		**Total**	**81,000**

Allowance for bad debts is not credited to the receivables account.

Answer to SEQ 10

The correct option is **A**.

Receivables ledger control account

Dr Cr

Date		Tshs'000	Date		Tshs'000
	Balance b/d	25,000			
	Credit-sales	50,000		Cash received	60,000
	Interest on overdue balance	6,000			-
				Contras against payables	6,000
				Balance c/d	15,000
	Total	**81,000**		**Total**	**81,000**

Answer to SEQ 11

The correct option is **C**.

Payables ledger control account

Dr **Cr**

Date		Tshs'000	Date		Tshs'000
	Cash paid	60,000		Balance b/d	25,000
	Discount	800		Credit-purchases	50,000
	Contras against receivables	6,000			
	Purchases returns	6,000		Interest on overdue balance	6,000
	Balance c/d	8,200			
	Total	**81,000**		**Total**	**81,000**

Answer to SEQ 12

Journal entries to correct the errors are:-

			Dr	Cr
(i)	Dr	J. Cheusi A/c	2,50,000	
	Cr	J. Cheupe A/c		2,50,000
	(Being sales debited to Cheupe A/c now rectified)			
(ii)	Dr	Sales A/c	3,60,000	
	Cr	Motor vehicle A/c		3,60,000
	(Being sales of motor vehicle credited to Sales A/c now rectified)			
(iii)	Dr	Machinery A/c	1,50,000	
	Cr	Purchases A/c		1,50,000
	(Being purchase of machinery debited to Purchase A/c now rectified)			
(iv)	Dr	Suspense A/c	9,000	
	Cr	Postage A/c		3,40,000
	(Being postage expenses of Tshs56,000 incorrectly posted as Tshs65,000 now rectified)			
(v)	Dr	Machinery A/c	5,00,000	
	Cr	Motor vehicle A/c		5,00,000
	(Being depreciation of motor vehicle credited to machinery A/c now rectified)			

Answer to SEQ 13

(i) **TRIAL BALANCE AS AT 31.03.2015**

	DR TZS."000"	**CR TZS."000"**
Bank Loan		12,000
Cash at bank	11,700	
Capital		13,000
Rent	1,880	
Trade Payables		11,200
Purchases	12,400	
Sales		34,600
Other Payables		1,620
Trade Receivables	12,000	
Bank Loan Interest	1,400	
Other expenses	11,020	
Non-Current assets	22,020	
	72,420	**72,420**

(ii) **TRIAL BALANCE AS AT 31.03.2016**

	DR TZS."000"	CR TZS."000"
Bank Loan		12,000
Cash at bank	11,180	
Capital		13,000
Rent	1,880	
Trade Payables		11,700
Purchases	13,400	
Sales		35,640
Other Payables		1,620
Trade Receivables	12,800	
Bank Loan Interest	1,400	
Other expenses	11,280	
Non-Current assets	22,020	
	73,960	73,960

Answer to SEQ 14

(a) **Journal Entries**

		Tshs.	**Tshs.**
i.	Dr. Cash Account	20,000	
	Cr. Kamusi's Equity Account (capital)		20,000
	Being additional capital invested in the business		
ii.	Dr. Cash Account	10,000	
	Cr. Account Receivables		10,000
	Being cash collected on account receivables		
iii.	Dr. Account Payable	2,000	
	Cr. Cash Account		2,000
	Being cash paid on account payables		
iv.	Dr. Cash Account	120,000	
	Cr. Sales Account		120,000
	Being cash sales of autos		
v.	Dr. Cost of goods sold	70,000	
	Cr. Auto Inventory account		70,000
	Being cost of autos sold		

vi.	Dr. Auto Inventory account	60,000	
	Cr. Cash Account		60,000
	Being cash paid for replenishing inventory		
vii.	Dr. Rent Expense Account	14,000	
	Cr. Cash Account		14,000
	Being cash paid for rent expense		
viii.	Dr. Utilities Account	1,000	
	Cr. Cash Account		1,000
	Being cash paid for utilities expense		
ix.	Dr. Selling expense Account	30,000	
	Cr. Cash Account		30,000
	Being cash paid for selling expenses		
x.	Dr. Interest Expense Account	1,000	
	Cr. Cash Account		1,000
	Being interest expense paid in cash		

(b) Ledger Accounts

Cash A\C TSHS "000"

Balance b/d	10,000	Account payable	2,000
Kamusi's Equity (capital a/c)	20,000	Inventory	60,000
Account receivables	10,000	Rent	14,000
Sales a/c	120,000	Utilities	1,000
		Selling expenses	30,000
		Interest expense	1,000
		Balance c/d	**52,000**
	160,000		**160,000**

Account Receivables

Balance b/d	20,000	Cash a/c	10,000
		Balance c/d	**10,000**
	20,000		**20,000**

Inventory Account

Balance b/d	100,000	Cost of goods	70,000
Cash	60,000	**Balance c/d**	**90,000**
	160,000		**160,000**

Accounts Payable

Cash	2,000	Balance b/d	3,000
Balance c/d	1,000		
	3,000		**3,000**

Note Payable

		Balance b/d	70,000
Balance c/d	70,000		
	70,000		**70,000**

KAMUSI's Owners Equity (Capital Account)

		Balance b/d	57,000
Balance c/d	77,000	Cash a/c	20,000
	77,000		**77,000**

Sales Account

		Cash	120,000
Statement of P/L	120,000		
	120,000		**120,000**

Cost of goods Sold Account

Inventory a/c	70,000	Statement of P/L	70,000
	70,000		70,000

Rent Expenses Account

Cash a/c	14,000	Statement of P/L	14,000
	14,000		**14,000**

Utilities Account

Cash a/c	1,000	Statement of P/L	1,000
	1,000		**1,000**

Selling Expenses Account

Cash a/c	30,000	Statement of P/L	30,000
	30,000		**30,000**

Interest Expense Account

Cash a/c	1,000	Statement of P/L	1,000
	1,000		**1,000**

(c) **KAMUSI Used Auto Company**

Statement of Profit or Loss for the period to 30 April 2015

	Tshs.	Tshs.
Sales		120,000
Cost of goods sold		(70,000)
Gross Profit		**50,000**
Expenses		
Rent	14,000	
Utilities	1,000	
Selling expense	30,000	
Interest expense	1,000	(46,000)
Profit		**4,000**

(d) **KAMUSI USED Auto Company**

Trial Balance as at 30th April 2015

	Debit Tshs.	**Credit Tshs.**
Cash	52,000	
Account Receivables	10,000	
Inventory	90,000	
Accounts Payable		1,000
Notes payable		70,000
Kiki owners'equity (capital account)		77,000
Profit		4,000
	152,000	**152,000**

Answer to SEQ 15

(a) **John's**

Income Statement for the year ended 31st December 2015

	Tshs.		Tshs.		Tshs.	
Sales					28,500,000	
Return Inwards					(2,760,800)	
Net Sales					25,739,200	
Opening stock	1,550,000					
Purchases	18,000,000					
Carriage Inwards	3,213,500					
Cost of goods available for sale			22,763,500			
Return Outwards	(4,350,500)					
Closing stock	(2,400,000)		(6,750,500)			
Cost of goods sold					(16,013,000)	
Gross profit					**9,726,000**	
Other Income:						
Commission received					2,400,000	
Total					**12,126,000**	
Operating Expenses:						
Salaries					5,400,000	
Commission paid					3,500,000	
Rent					2,400,000	
Office expenses					2,140,000	
Carriage Outwards					2,345,890	
Net Loss					**(3,659,690)**	

(b)

John's

Statement of Financial Position as at 31st December 2015

Non-Current Assets	**TSHS.**		**TSHS.**	
Motor van			12,500,000	
Fixtures and fittings			3,700,000	
Total			**16,200,000**	
Current Assets				
Stock			2,400,000	
Debtors			2,450,000	
Cash			580,000	
Total			**5,430,000**	
Total Assets			**21,630,000**	
Capital and Liabilities				
Capital as at 1st January 2012	17,239,690			
Net Loss for the year	(3,659,690)			
Drawings	(250,000)			
Total			**13,330,000**	
Long Term Liabilities				
10% Bank loan			4,500,000	
Current Liabilities				
Creditors			2,500,000	
Bank overdraft			1,300,000	
Total			3,800,000	
Total Capital and Liabilities			**21,630,000**	

Answer to SEQ 16

a) JANETH MWALUKASA

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31ST DECEMBER 2012

	TZS.	TZS.
Net sales (w1)		53,940,000
Cost of sales (w2)		(25,050,500)
Gross profit		28,889,500
Other Incomes		
Discount received		1,200,000
		30,089,500
Operating expenses		
Carriage outwards	1,550,500	
Electricity	1,650,000	
Insurance premium	170,000	
Salaries	5,400,000	
Cleaning	250,000	
Salesman commission	2,450,000	
Security expenses	600,000	
Furniture repairs	150,000	
Motor van repairs	560,000	
Office rent	7,200,000	
Stationeries	220,000	
Discount allowed	4,500,000	
Interest on loans	4,500,000	
Communication expenses	450,000	
Total expenses		29,650,500
Net profit		439,000

Working 1
Net sales = sales – return inwards
Net sales = 54,500,000 – 560,000 = 53,940,000

Working 2

Cost of sales	
Opening stock	4,400,000
Add: Purchases	25,400,500
Carriage inwards	1,250,000
Less: Returns outwards	450,000
Cost of goods available for sale	30,600,500
Less: Closing stock	(5,550,000)
Cost of sales	25,050,000

(b)

JANETH MWALUKASA

STATEMENT OF FINANCIAL POSITION AS AT 31ST DECEMBER 2016

	TZS.	TZS.
Non-Current Assets		
Motor van	25,000,000	
Furniture	5,500,000	
Fixture and fittings	3,500,000	
Total		34,000,000
Current Assets		
Stock	5,550,000	
Debtors	3,750,000	
Cash	560,000	
Total		9,860,000
Total Assets		43,860,000
Capital and Liabilities		
Capital (W3)		19,960,000
Long Term Liabilities		
Bank loan		12,000,000
Current Liabilities		
Creditors	6,500,000	
Bank overdraft	5,400,000	
Total		11,900,000
Total capital and liabilities		43,860,000

Working 3

Capital at the beginning	20,721,000
Add: Net profit	439,000
Less: Drawings	(1,200,000)
Capital at the end	19,960,000

Answer to SEQ 17

(a) The following corrections must be made, with the resulting balances as shown:

		Tshs.	**Tshs.**
(i)	Dr carriage inwards a/c	528,000	
	CR Returns inwards a/c		528,000

Being invoice for carriage inwards posted to the returns inwards now rectified.

(ii)	Dr Sales a/c	180,000	
	CR Receivables A/c		180,000
(iii)	Dr Purchases A/c	100,000	
	CR Cash A/c		100,000

Being cash purchase omitted earlier now recorded.

(b) Rectified Trial Balance

	Tshs. '000' Dr	Tshs. '000' Cr
Capital at 1st October 2013		60,434
Inventory at 1st October 2013	25,120	
Receivables	25,580	
Payables and Accruals		13,122
Bank	7,508	
Cash	1,900	
Sales		180,940
Returns Inwards	222	
Purchases	145,448	
Carriage Inwards	2,476	
Wages	9,368	
Rent	6,400	
Postage expenses	764	
Travel and accommodation	1,498	
Telephone	1,706	
General expenses	1,506	
Drawings	25,000	
	254,496	254,496

(c) (i) Calculation of Gross profit and Net profit for the year ended 30th September 2014

	Tshs. '000'	**Tshs. '000'**
Sales	180,940	
Less: Return Inwards	(222)	180,718
Opening Inventory	25,120	
Purchases	145,448	
Carriage Inwards	2,476	
	173,044	
Less: closing Inventory	(23,750)	
Cost of Sales		149,294
Gross profit		**31,424** ======
Telephones	1,706	
Wages	9,368	
Rent	6,400	
Postage expenses	764	
Travel and Accommodation	1,498	
General expenses	1,506	
Total expenses		21,242
Net Profit		10,182

(ii) Calculation of Capital Balance as at 30th September 2014

	Tshs. '000'
Opening capital	60,434
Profit	10,182
Less: Drawings	(25,000)
Closing Balance	45,616

Answer to SEQ 18
(a)

Journal **Dr** **Cr**

Date	Particulars	Tshs.	Tshs.
2015 March 31 (i)	Purchase a/c To Suspense a/c (Being the Purchases Day Book was undercast by TZS 300,000 now rectified)	300,000	 300,000
(ii)	Repairs a/c To Machinery a/c (Being repairing to machinery wrong debited to Machinery Account now rectified)	220,000	 220,000
(iii)	Sales a/c To Suspense a/c (Being Sales Day Book was overcast by TZS 150,000, now rectified)	150,000	 150,000
(iv)	Mr Kapur a/c To Sales a/c To Purchase a/c (Being a sales of TZS 1,200,000 to Mr Kapur wrongly passed through Purchases Day Book, now rectified)	2,400,000	 1,200,000 1,200,000
(v)	Suspense a/c To Sharad a/c (Being cash received from Sharad not posted to his account now rectified)	117,000	 117,000
(vi)	Return Inward a/c Return Outward a/c To Suspense a/c (Being good returned by Mr Akash wrongly passed through the Return Outward Book, now rectified)	225,000 225,000	 450,000

Suspense Account

Dr. **Cr**

Date	**Particulars**	**Tshs.**	**Date**	**Particulars**	**Tshs.**
2015 March 31	Balance Sharad a/c	783,000 117,000 ------------ 900,000	2015 March 31	Purchases a/c By Sales a/c By Returns Inward a/c By Returns Outwards a/c	300,000 150,000 225,000 225,000 ----------- 900,000

PREPARATION OF FINANCIAL STATEMENTS

11

Get Through Intro

Cooking food well is only half the job: The food will not be relished unless it is served in a proper manner! Similarly, doing day-to-day accounting well is only half the job. It will not serve its purpose unless the results are presented in a proper format, with the required content.

The process of accounting ends with the preparation of the financial statements. In this Study Guide, we will learn these concepts and also the method of preparing the statement of financial position. The importance of this Study Guide stems from the fact that the entire accounting exercise is undertaken in order to prepare financial statements.

The financial statements of an entity consist of a number of reports / statements – one such statement is the statement of financial position. The statement of financial position is a statement which reflects the financial position of an entity as at a particular date. The statement of financial position (along with its companions) - the statement of profit or loss and the statement of changes in equity, function like a thermometer – they depict whether the company is ailing or flourishing.

The three primary statements are not sufficient to report the financial performance and position of an entity. Financial statements have to contain some essential further information if they are to be helpful to investors and other users in taking decisions. For example, notes to accounts contain additional information about non-current assets, contingent assets and contingent liabilities.

This Study Guide will help you understand the last and the most crucial step in the accounting process i.e. preparation of financial statements.

Learning Outcomes

a) Define financial statements.
b) State objectives and qualities of good financial statements.
c) State and explain element of financial statements as per the framework for preparation and presentation of financial statements.
d) Mention and explain sets of financial statements as per IAS 1.
e) Prepare statement of income as per guidance of IAS 1.
f) Prepare statement of financial position as per guidance of IAS 1.

1. Define financial statements.
State the objective and qualities of good financial statements.
[Learning Outcomes a and b]

1.1 What are financial statements?

Definition

Financial statements are the accounting reports which are compiled in conformity with the provisions of GAAP (Generally Accepted Accounting Principles) to meet the common needs of wide range of users.

They provide information about the financial strength, performance and changes in financial position of an enterprise.

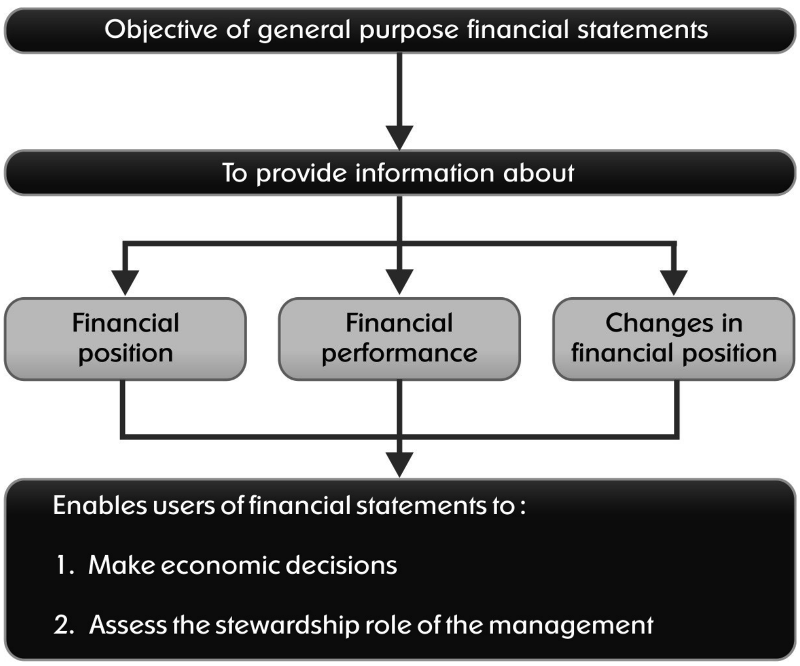
1.2 Objectives of financial statements

Financial reporting is aimed at responding mainly to the needs of external users of financial statements such as shareholders, banks, payables etc. in assisting them to assess:

- the financial position of the entity as at a certain moment, (what the company owns and owes)
- its financial performance during a period (how much profit the company has made) and
- the changes in the financial position from one period to the next. (how the company has performed this year compared to the last year)

The following diagram explains the objectives of financial statements.

Diagram 1: Objectives of financial statements



1.3 The need for the financial statements

Financial statements are important as they enable shareholders, banks, trade payables, etc. who are the external users of financial statements to assess the financial status of the company.

Tip

Financial statements only deal with past events and generally do not contain non-financial data.

The various users of financial statements and their needs have already been discussed in detail in Study Guide 2.

1.4 Qualities of good financial statements

During the preparation of financial statements, a proper balance should be ensured between the qualitative characteristic discussed in Study Guide 1.

Test Yourself 1

Sun Inc has recorded the value of a property at Tshs10 million until last year. This year the company revalued the property and recorded it at Tshs15 million. Another effect of the increase in value was given by adding Tshs5 million to the reserves account. This adjustment was not disclosed anywhere in the financial statements.

Required:

Do the statements satisfy the understandability criterion?

Test Yourself 2

Mack owns a courier service. The business has four delivery vans to make deliveries in the entire city. The total cost of all the delivery vans is Tshs80 million. Mack has recently decided to start a business of delivering newspapers. For this purpose, last month, Mack purchased seven street bikes. The total cost of the bikes amounted to Tshs2.1 million.

Required:

Should Mack disclose the cost of the bikes in the financial statements?

Test Yourself 3

Does the general public use the financial statements of an entity? If so, state their interest?

---

2. Mention and explain sets of financial statements as per IAS 1.

[Learning Outcome d]

Financial statements have the following components:

1. Statement of profit and loss and other comprehensive income
2. Statement of financial position
3. Statement of changes in equity
4. Statement of cash flows
5. Notes to the financial statements

We will discuss all these financial components and the preparation of financial statements of companies in accordance with prescribed formats and relevant accounting standards in this Learning Outcome. The formats of financial statements are provided in **IAS 1 "Preparation and presentation of financial accounts"**.

In most jurisdictions the structure and content of financial statements are determined by the local law. However companies adopting IFRS have to prepare financial statements in accordance with the requirements of IAS1. **IAS1 gives the following guidance and format for preparation of financial statements.**

2.1 Statement of profit or loss and other comprehensive income (income statement)

This is a statement for a period, typically one year. Revenue, expenses and profits for the period for which it is prepared are to be included in the statement of profit or loss and other comprehensive income (also referred to as an income statement). It is like a video recording of all the transactions that occur in the period!

Example

A statement of profit or loss and other comprehensive income for the year to 31 December 20X3 covers the period between 1 January 20X3 and 31 December 20X3. Incomes and expenses occurring during this period are included in the statement of profit or loss and other comprehensive income.

---

1. Information to be presented on the face of the statement of profit or loss

The information in the financial statements may be provided for on the face of the statement or in the notes to the financial statements. Certain information, being important for the users of the statements, is required to be presented on the face of the financial statements.

IAS 1, Presentation of Financial Statements, requires particular information to be presented on the face of the statement of profit or loss and other comprehensive income.

As a minimum, the face of the statement of profit or loss and other comprehensive income shall include line items that present the following amounts for the period:

(a) revenue;
(b) finance costs;
(c) tax expense;
(d) profit or loss.

Additional line items, headings and subtotals shall be presented in the statement of profit or loss and other comprehensive income and the separate statement of profit or loss (if presented), when such presentation is relevant to an understanding of the entity's financial performance.

There are other disclosure requirements according to IAS 1 regarding share of the profit or loss of associates and joint ventures and profit or loss of discontinued operations. However, these do not form a part of your syllabus.

Unlike the statement of financial position, IAS 1 does not specify many line items to be disclosed on the face of the statement of profit or loss and other comprehensive income. The probable reason is that reporting entities deal in a wide variety of businesses, and one set of line items may not be applicable to all.

2. Purpose of the Statement of profit or loss and other comprehensive income

To show whether an entity has made a **profit** or **loss** in an accounting period.
To describe how the profit or loss arose e.g. it differentiates costs between **operating costs and cost of sales.**
statement of profit or loss and other comprehensive income analysis gives much more information than a company's earnings.
It provides important information about management's efficiency in controlling expenses, amount of income, and taxes paid.
Investors can use it to calculate financial ratios that will ultimately give the rate of return.
To compare a company's profits with that of its competitors by examining various profit margins e.g. the operating profit margin, gross profit margin and net profit margin.

3. Content

(a) The IASB has introduced the concept of comprehensive income (which replaces the earlier statement of profit or loss). All non-owner changes in equity are to be presented in a separate Statement of profit or loss and other comprehensive income.

(b) The Statement of profit or loss is divided into two parts:

Statement of profit or loss

It includes total income earned during the year less expenses and excludes the components of other comprehensive income.

Other comprehensive income

It includes the total of income less expenses such as gains on revaluation of property that are not recognised in the statement of profit or loss. Other IFRS / IAS do not permit such items to be presented in the statement of profit or loss. All owner changes in equity are included in other comprehensive income.

Therefore total comprehensive income =

Profit for the year (after tax) + Other comprehensive income relating to the year

(c) IAS 1 gives **a choice regarding presentation of expenses** in the statement of profit or loss based on:

The nature of expenses, for example, it contains details of expenses incurred for staff, raw materials, etc.
The function of expenses, for example, cost of sales, administrative cost, etc.

4. Proforma of statement of profit or loss and other comprehensive income

The proforma given below is prepared based on the function of expense method. This is the most commonly used method of presentation of income and expenses.

XYZ Group - Statement of profit or loss and other comprehensive income for the year ended 31 December 20X3

	20X3 Tshs'000	20X2 Tshs'000
Revenue	X	X
Cost of sales	(X)	(X)
Gross profit	X	X
Other income	X	X
Distribution costs	(X)	(X)
Administrative expenses	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Profit before tax	**X**	**X**
Income tax expense	(X)	(X)
Profit for the year	**X**	**X**
Other comprehensive income:		
Gains on property revaluation	X	X
Other comprehensive income for the year, net of tax	**(X)**	**X**
Total comprehensive income for the year	**X**	**X**

Important

In the examination, whenever 'Statement of profit or loss and other comprehensive income' is referred to, it always relates to the single statement format which is presented above.

2.2 Statement of financial position (SOFP)

A **statement of financial position** is a statement of assets, liabilities and capital of a business at a given moment.

It discloses the state of affairs of the entity at that moment. Usually a statement of financial position is prepared at the end of the accounting year. The elements of a statement of financial position are:

Assets include what the entity **owns** or what it **has to receive** in the future.

Liabilities indicate the **amounts due** from the entity to outsiders.

Capital represents the **amount that was invested** by the owners into the business and the amount of

Profit retained in the business (i.e. to the extent it is not withdrawn by the owners).

Any transaction or event has an effect on these three categories.

A statement of financial position is based on the accounting equation. This equation can be presented in a manner where the total of capital and liabilities is equal to the total of assets or where

Capital = Assets - Liabilities

The only difference between the statement of financial position and the accounting equation is that a statement of financial position is in a detailed format. It contains the assets and liabilities of the entity, grouped in a suitable manner.

The Companies Acts or similar legislations of different countries lay down the format of statement of financial position and the companies have to adhere to that format. Other entities do not have a format fixed by law.

1. Content

(a) IAS1 prescribes certain minimum disclosure requirements in the statement of financial position. These disclosures are discussed in the proforma of statement of financial position below.

(b) If required by other standards, further classification of the main headings is permitted in the statement of financial position or in the notes to accounts, in order to comply with the requirements of other IAS/IFRS.

For example, IAS 16 Property, plant and equipment requires that the heading “Non-current assets” should be further sub classified into sub-headings such as freehold buildings, plant and machinery, office equipment, etc.

(c) **Distinction between current and non-current**

An entity has to differentiate between current and non-current assets and liabilities while making disclosures in the Statement of financial position.

IAS 1 sets out following four criteria to identify a current asset or liability:

whether the entity expects to use or sell the asset in its normal operating cycle e.g. inventory,

whether the entity holds the asset primarily for trading rather than long-term usage within the business e.g. gold ornaments for a jeweller,

whether the entity expects to realise the asset within twelve months after the reporting period or,

whether the entity has access to the cash or cash equivalent within twelve months after the reporting period e.g. debtors who are offered a credit period of 30 days.

If either of the above four criteria are not satisfied the asset or liability is termed as non-current.

Example

Asterix Ltd supplies bamboo to a furniture manufacturer. The operating cycle of producing bamboo is clearly defined and bamboo is obtained within five to six years after planting the crop.

The cost of the bamboo inventories should be classified as a current asset if they are realised within the normal operating cycle. If Asterix Ltd is not able to liquidate its inventories (after the completion of the operating cycle) in cash or cash equivalent within 12 months after the end of the reporting period it should be classified as a non-current asset in order to assist users of financial statements to assess its liquidity and solvency.

---

2. Purpose of statement of financial position

(a) The worth of the business can be ascertained.

(b) The lenders use statement of financial position to make a decision regarding provision of finance.

(c) It helps as information to take major decisions such as expansion.

(d) The risk bearing capacity of the entity can be known.

(e) The comparison of statement of financial position helps to know where the business was and where it is now.

(f) Liquidity position of the entity can be calculated by analysing the ratios.

3. Proforma of Statement of financial position

XYZ Group – Statement of financial position at 31 December 20X3		
	20X3	**20X2**
	Tshs'000	**Tshs'000**
Assets		
Non-current assets		
Property, plant and equipment	X	X
Goodwill	X	X
Other intangible assets	X	X
	X	X
Current assets		
Inventories	X	X
Trade receivables	X	X
Other current assets	X	X
Cash and cash equivalents	X	X
	X	X
Total assets	**X**	**X**
Equity and liabilities		
Equity attributable to owners of the parent		
Share capital	X	X
Retained earnings	X	X
Other components of equity	X	X
Total equity	X	X
Non-current liabilities		
Long-term borrowings	X	X
Long-term provisions	X	X
Total non-current liabilities	X	X
Current liabilities		
Trade and other payables	X	X
Short-term borrowings	X	X
Current tax payable	X	X
Total current liabilities	X	X
Total equity and liabilities	**X**	**X**

2.3 Statement of changes in equity

It summarises all the transactions the organisation has had with its owners / shareholders. It is designed to show whether the owners / shareholders have:

maintained their original investment in the organisation and / or
if this capital has been added to or reduced over a particular period

In addition it shows the level of profit earned by the organisation that has been:

reinvested into the business and
paid out to the owners / shareholders in the form of dividends.

1. Content

The Statement of changes in equity presents all changes regarding all the components of equity such as share capital, share premium, etc. A Statement of changes in equity includes the following:

(a) the effect of change in accounting policy or of corrections in errors regarding each component of equity.

(b) reconciliation between the carrying amount at the beginning and at the end of the period for each component of equity. This reconciliation should take into account the following:
profit or loss earned during the period
other comprehensive income during the period
transactions with owners in the capacity of owners. For example, issue of shares or distribution of dividends

IAS 1 requires an entity to present dividends recognised as distributions to owners during the period and related amounts per share in the Statement of changes in equity or in the notes.

2. Proforma of Statement of changes in equity

XYZ Group – Statement of changes in equity for the year ended 31 December 20X3

	Share capital	Share Premium	Retained earnings	Revaluation surplus	Total
Balance at 01/01/20X2	X	X	X	X	X
Changes in accounting policy	X		X		X
Restated balance	**X**	**X**	**X**	**X**	**X**
Changes in equity for the year 20X2					
Dividends					
Total Comprehensive income for the year					
Balance at 31/12/20X2	**X**	**X**	**X**	**X**	**X**
Changes in equity for the year 20X3					
Issue of share capital	X	X			X
Dividends			(X)		(X)
Total Comprehensive income for the year			X	X	X
Transfer to retained earnings					
Balance at 31/12/20X3	**X**	**X**	**X**	**X**	**X**

Example

Following is the information for Delta Co:

The issued share capital is Tshs50 million as at 1 April 20X1. The company issued 20,000 equity shares on 1 October 20X1 at Tshs1,500 each. The face value of equity shares is Tshs1,000 per share.

The retained earnings as at 1 April 20X1 are Tshs30 million. The profit for the year ended 31 March 20X3 is Tshs34.81 million. The dividend paid on ordinary shares on 1 June 20X2 is Tshs7 million.

Delta revalued its property A to Tshs20 million in June 20X2 the cost of which is Tshs13.2 million. The opening balance of share premium account at 1 April 20X1 is Tshs40 million.

Delta Co – Statement of changes in equity for the year ended 31 March 20X3

	Share capital	Share premium	Revaluation reserve	Retained earnings	Total
	Tshs'000	Tshs'000	Tshs'000	Tshs'000	Tshs'000
Balance at 01/04/20X1	50,000	40,000	-	30,000	120,000
Changes in accounting policy	-	-	-	-	
Restated balance	**50,000**	**40,000**	**-**	**30,000**	**120,000**
Changes in equity for 20X1					
Shares issued on 01/10/20X1	20,000				20,000
Share premium		10,000			10,000
Balance at 31/03/20X2	**70,000**	**50,000**	**-**	**30,000**	**150,000**
Total comprehensive income			6,800	34,810	41,610
Dividends paid				(7,000)	(7,000)
Balance at 31/03/20X3	**70,000**	**50,000**	**6,800**	**57,810**	**184,610**

2.4 Statement of cash flows (IAS 7)

The statement of cash flows provides details on the inflows and outflows of cash that have occurred over a particular period of time (usually one year). Its main purpose is to identify for the user:

the activities which have generated cash for the organisation (e.g. sales)
the activities which have depleted or used cash up in the organisation (e.g. buying machinery) and
The activities which have provided finance to the organisation

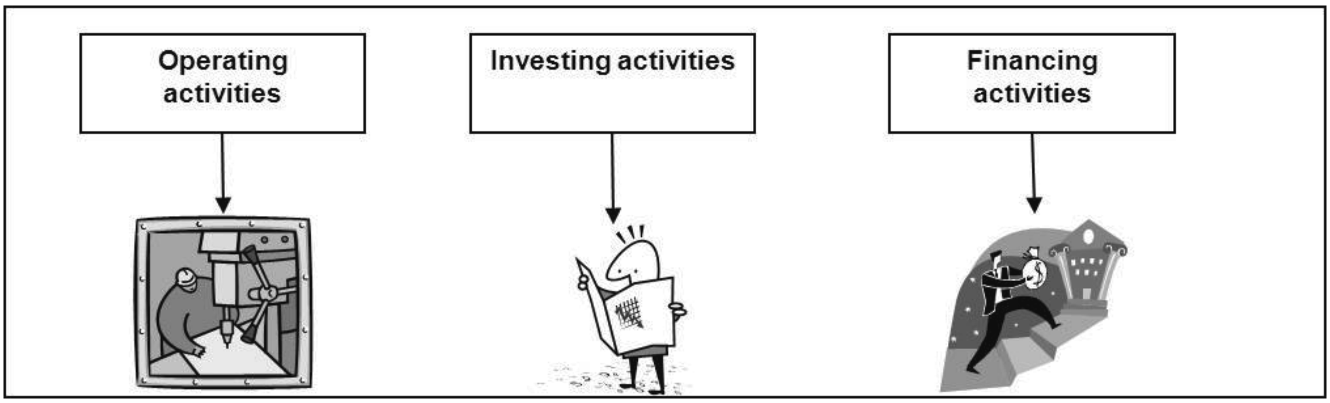
Cash flow means a flow of cash and cash equivalents. When the opening and closing balance is calculated for the Statement of Cash Flows, a total of cash and cash equivalents are considered.

The movements between any two components of cash and cash equivalents are not treated as cash flows and therefore not reported in a statement of cash flows. They represent the internal changes to the group of cash and cash equivalents.

In a cash flow statements the effect of any transactions can be classified under any one of the following categories:

(a) Operating activities
(b) Investing activities
(c) Financing activities

Diagram 2: Nature of activities in cash flow statements



We will not be discussing statement of cash flow in detail as it is not covered under Paper T01.

2.5 Notes to financial statements

1. Notes **are the supplementary schedule and other information** provided along with the financial statements in order to help the users of financial statements to **understand the financial statements**. Notes form an integral part of financial statements.

2. The purpose of having **notes to the financial statements** is to allow the organisation to disclose any relevant additional information to the reader, not covered in any of the other statements. For instance, an explanation of the type of accounting policies the organisation has used is usually found in this statement.

3. Notes to financial statements may include the following information:

   significant accounting policies and explanatory notes
   risk and uncertainties affecting the organisation,
   resources and obligations not recognised in the financial statements (such as mineral reserves),
   information about geographical and business segments,
   information regarding certain events which occur after the end of reporting period,
   information on the key assumptions made by the management concerning the company's future, etc.

4. Notes can be in the form of a narrative, disclosures, disaggregation of information presented elsewhere in the financial statements or any additional information which has not been presented elsewhere in the financial statements.

5. No format for disclosure through notes has been prescribed under IFRS. However, notes must be presented systematically (for example, in order of items presented in the financial statements) along with proper cross reference to items in the financial statements.

The following example illustrates the disclosures which are made in the notes to accounts.

Example

Zentel Ltd – Extract of notes to financial statements for the year ended 31 December 2011.

1. Property, Plant and Equipment:

Property plant and equipment are initially recorded at cost Direct costs are capitalized until the assets are ready for use. The assets are carried at cost, less accumulated depreciation and impairments, if any. Property, plant and equipment are depreciated on a straight line basis over their estimated useful lives.

The Management estimates the useful lives for the assets as follows:

Buildings	20 years
Plant and machinery	10 years
Furniture and fixtures	13 years
Vehicles	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

The carrying amounts and the movements in the balances are as follows:

Schedule of property , plant and equipment

Tshs million

Cost or valuation	Buildings	Plant and machinery	Furniture and fixtures	Vehicles	Total
Balance at 1 January 2011	**1,500**	**1,700**	**150**	**300**	**3,650**
Additions		500			500
Disposals				(50)	(50)
Balance at 31 December 2011 (a)	**1,500**	**2,200**	**150**	**250**	**4,100**
Depreciation					-
Balance at 1 January 2011	150	510	23	60	743
Depreciation for the year	75	220	11	50	356
Removals				(10)	(10)
Balance at 31 December 2011 (b)	**225**	**730**	**34**	**100**	**1,089**
Net carrying value (a) -(b)	**1,275**	**1,470**	**116**	**150**	**3,011**

2. Provisions and contingencies

A provision is recognized in the Statement of Financial Position when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are recognized at present value by discounting the expected future cash flows.

3. Inventory

Inventory is valued at the lower of acquisition or production cost and net realizable value. The cost is generally determined on the basis of a first-in, first-out method. Production costs comprise direct material and labour and applicable manufacturing overheads, including depreciation charges. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses

At the reporting date, inventories costing Tshs1 million had a net realizable value of Tshs0.8 million. These inventories are written down to the net realizable value and the difference of Tshs0.2 million is charged to the cost of sales for the year 2011.

2.6 Purpose of Disclosure Notes

(a) Provide clarification

The information contained within the disclosure notes not only supplements financial statement information, but also clarifies line-items that are a part of the financial statements. Disclosure notes provide information about how the amounts reported in the financial statements were determined.

Example

Harbour Ltd has impaired a major non-current asset. Notes to financial statements could serve to corroborate the reason for the impairment by providing specific information relative to how the asset became impaired.

(b) Accounting policy followed

Disclosure notes are also used to explain the accounting policies used and valuation model used to prepare the financial statements.

Example

Non-current assets - whether the cost model or the revaluation model
Method of valuing inventory - whether FIFO or Weighted Average Cost

(c) Qualitative and descriptive information

Unlike the purely numerical financial statements, information in disclosure notes can be provided in descriptive and qualitative terms. For example the disclosure notes may include details of transactions with directors, related party transactions, details of the ultimate controlling party, detail of any contingent liabilities, details of any going concern issues and events after the reporting date.

2.7 Other requirements of IAS1

1. Identification

(a) The financial statements should be identified **clearly and distinguished** from other information in the same published document.
(b) Each component of the financial statement **should be identified**.

Example

The title (e.g. 'Statement of profit or loss and other comprehensive income', 'Statement of financial position' should be clearly given at the top of the page).

2. Comparative information

Unless the standard permits or requires otherwise, comparative information with respect to the previous period should be disclosed for all numerical information in the financial statements. Furthermore, comparative information should be included in the narrative and descriptive information when it is relevant for understanding the financial statements of the current period.

3. Timeliness

If there is undue delay in the reporting of information it may lose its relevance. Therefore management should ensure that timely and reliable information is made available.

A proper balance between reliability and timeliness needs to be maintained. This is because if reporting is delayed, even though the information may be highly reliable it may be of little or no use to the users.

Certain regulatory authorities may require that the reporting of financial statements be done within 6 months from the end of the reporting period. This is to ensure that the users of financial statements are provided with timely information.

4. The following information is to be displayed prominently and repeated when necessary

(a) **Name** of the reporting entity or any other means of identification (e.g. logo), and any changes therein from the end of the preceding period
(b) Whether the statements cover an **individual entity or a group of entities**
(c) The **end date of the reporting period** or period covered by financial statements
(d) **Presentation currency** (e.g. Tshs, Euro, US$)
(e) **Level of rounding off used in presenting amounts (e.g. to the nearest thousand)**

Example

When the report is in a physical, printed form, the above information can be included as titles on each page.

5. The period to be covered

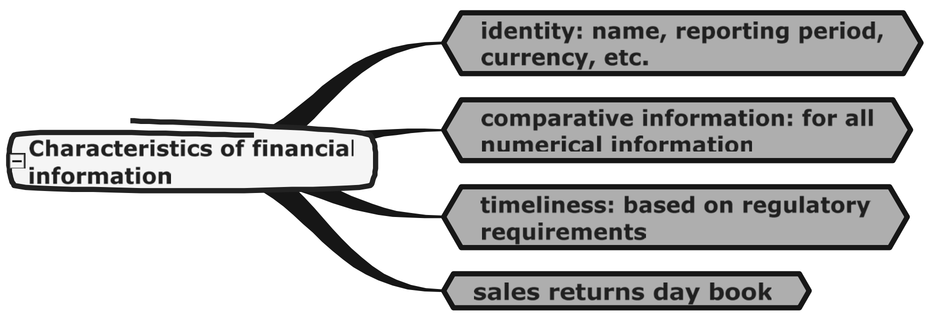
The financial statements are to be presented **at least annually**. If the reporting date is changed, and the financial statements are presented for a period longer or shorter than one year, they should disclose:

a) **the period covered**
b) the **reasons for using a longer or shorter period**
c) the fact that **the prior-period amounts** for the Statement of profit or loss, Statement of changes in equity and cash flow statements are **not entirely comparable** as they relate to periods with varying durations.

Example

Wanjiru Co normally presents its financial statements as on 31 December each year. The last set of statements was prepared for the year ended 31 December 20X2. Local laws were amended in 20X3 to require all entities to follow a uniform accounting year ending on 31 March. Wanjiru will prepare its next financial statements for the period from 1 January 20X3 to 31 March 20X4, and will disclose in the financial statements the fact that the reporting period is of 15 months.

SUMMARY



2.8 Relationship between the main financial statement components

The relationship between the statement of financial position and the statement of profit or loss and other comprehensive income is very significant.

Profit for the year as shown by the statement of profit or loss and other comprehensive income is added to the capital of the owner in the case of a sole trading firm or a partnership firm. In the case of a company, the amount of profit is added (loss deducted from) to the statement of financial position as '**Retained Earnings'**. The components of other comprehensive income are taken to the suitable account under the 'Equity' group. The equity group of accounts consists of the accounts representing capital and other reserves belonging to the owners (shareholders).

Example

According to the statement of profit or loss, profit for the year is Tshs1,400,000, other comprehensive income is Tshs120,000 (net revaluation gain) and therefore, the total comprehensive income is Tshs1,520,000.

Tshs1,400,000 representing profits will be added to the retained earnings. The revaluation gain is added to the revaluation surplus in the statement of financial position.

The accounting equation is:

Assets = Liabilities + Owners' capital i.e. Owners' capital = Assets - Liabilties

Example

The existing Capital of Troy Co is Tshs60 million, represented by assets worth Tshs100 million less liabilities worth Tshs40 million.

To put it in an equation form,
Capital = Assets – Liabilities
i.e. Tshs60 million = Tshs100 million - Tshs40 million
i.e. Tshs60 million = Tshs60 million

Profits earned by Troy Co for the year to 31 December 20X3 are Tshs25 million.

This profit is added to capital in the statement of financial position. Revised capital is Tshs85 million (Tshs60 million + Tshs25 million). The statement of financial position shows that trade receivables have increased by Tshs35 million and loans have increased by Tshs10 million.

The revised equation is:

Capital = Assets – Liabilities

i.e. Tshs60 million + Tshs25 million = (Tshs100 million + Tshs35 million) - (Tshs40 million + Tshs10 million)
i.e. Tshs85 million = Tshs135 million - Tshs50 million
i.e. Tshs85 million = Tshs85 million

The loss made during a period determined by the statement of profit or loss is deducted from the owners' capital.

When the owners' capital decreases, the net assets of the business are decreased by an amount equal to the loss. This is how the accounting equation is maintained.

Example

To continue the example of Troy, if there was a loss of Tshs20 million during the year, there would then be a reduction in the capital by this amount. The net assets will also decrease by an amount equal to the loss. Assuming there is an increase in the liabilities, the new equation would be:

Capital = Assets – Liabilities

i.e. Tshs60 million - Tshs20 million = Tshs100 million – (Tshs40 million + Tshs20 million)
i.e. Tshs40 million = Tshs40 million

---

1. Business expenses are disclosed in the statement of profit or loss whereas personal expenses paid are treated as drawings, and reduced from the capital in the statement of financial position. For example rent of Tshs20 million paid for the business premises, is charged as a business expense. However, rent worth Tshs6 million paid for the residence of the owner is a drawing and reduced from the capital.

2. Accrued expenses that are not paid at the end of the reporting date are added to the relevant expenses in the statement of profit or loss and recorded as a liability in the statement of financial position. For example if there is a rent of Tshs500,000 accrued but not paid, it is added to rent expense and shown as a current liability.

3. Accrued income that is not received by the reporting date is added to the relevant income in the statement of profit or loss, and as an asset in the statement of financial position. For example if there is an interest of Tshs200,000 accrued but not received, it is added to the other income in the statement of profit or loss and shown as a current asset in the statement of financial position.

4. An expense paid but not yet recognised in the statement of profit or loss (because it has not accrued) is reduced from the concerned expense in the statement of profit or loss and recognised as an asset in the statement of financial position.

Example

Insurance of Tshs1 million is paid for the year commencing 1 April 20X3. The reporting date is 31 December 20X3. At this date, 9 months have passed since the insurance was paid. The correct insurance expense to recognise is Tshs750,000 (Tshs1,000,000 x 9/12). The insurance for 3 months is paid but not yet used. It is reduced from the insurance expense in the statement of profit or loss and shown as an asset in the statement of financial position as a pre-paid expense.

---

5. Income received but not yet recognised in the statement of profit or loss (because it was received in advance) is deducted from the income in the statement of profit or loss and recognised as a liability in the statement of financial position. (deferred income). For example if the commission received includes an amount of Tshs600,000 received in advance. It is deducted from commission income and shown as a liability in the statement of financial position.

Test Yourself 4

Babati Ltd has the following items in its trial balance for the year ended 30 September 20X3.

Gain on valuation of available for sale financial assets
Interest expense
Exchange differences on translating foreign operations
Administrative expenses
Gains on property revaluation
Revenue
Actuarial losses on defined benefit pension plans
Cost of sales
Distribution costs
Share of profit of associates
Income tax expense

Required:

Where should each of these items be shown in the other comprehensive income according to Revised IAS 1?

Test Yourself 5

Kijani Kibichi Ltd had taken an 8% loan from a bank which was to be repaid within a period of 8 months from the date of obtaining the loan. Kijani Kibichi was facing a credit crunch and therefore did not repay its debt on the due date. The bank provided Kijani Kibichi with an option to repay the loan after 2 years, provided the company paid an interest of 10% p.a.

Under which heading of the Statement of financial position the loan should be presented according to IAS 1?

A Current liabilities
B Current assets
C Non-current liabilities
D Non-current assets

Test Yourself 6

Maridadi Ltd gives the following information relating to balances on 1 January 20X3.

	Tshs'000
Balances as at 01/01/20X3	
Share capital	3,000
Revaluation reserve	400
Property revaluation account	700
Accumulated profits	5,400
During the period 01/01/20X3 and 31/12/20X3	
Surplus on revaluation of property, plant and equipment	1,500
Profit earned	7,000
Dividends distributed	4,400
Issue of ordinary shares for cash	2,000

All investments were sold and the revaluation surplus was transferred to accumulated profits.

Required:

Prepare an extract of statement of changes in equity for the year to 31 December 20X3.

Test Yourself 7

How will you treat an expense paid but not yet recognised in the statement of profit or loss?

A Recognise it as an asset
B Recognise it as a liability
C It's not related to the business, hence no adjustment is required.
D It's not related to the current year, therefore no adjustment is required.

3. State and explain element of financial statements as per the framework for preparation and presentation of financial statements.

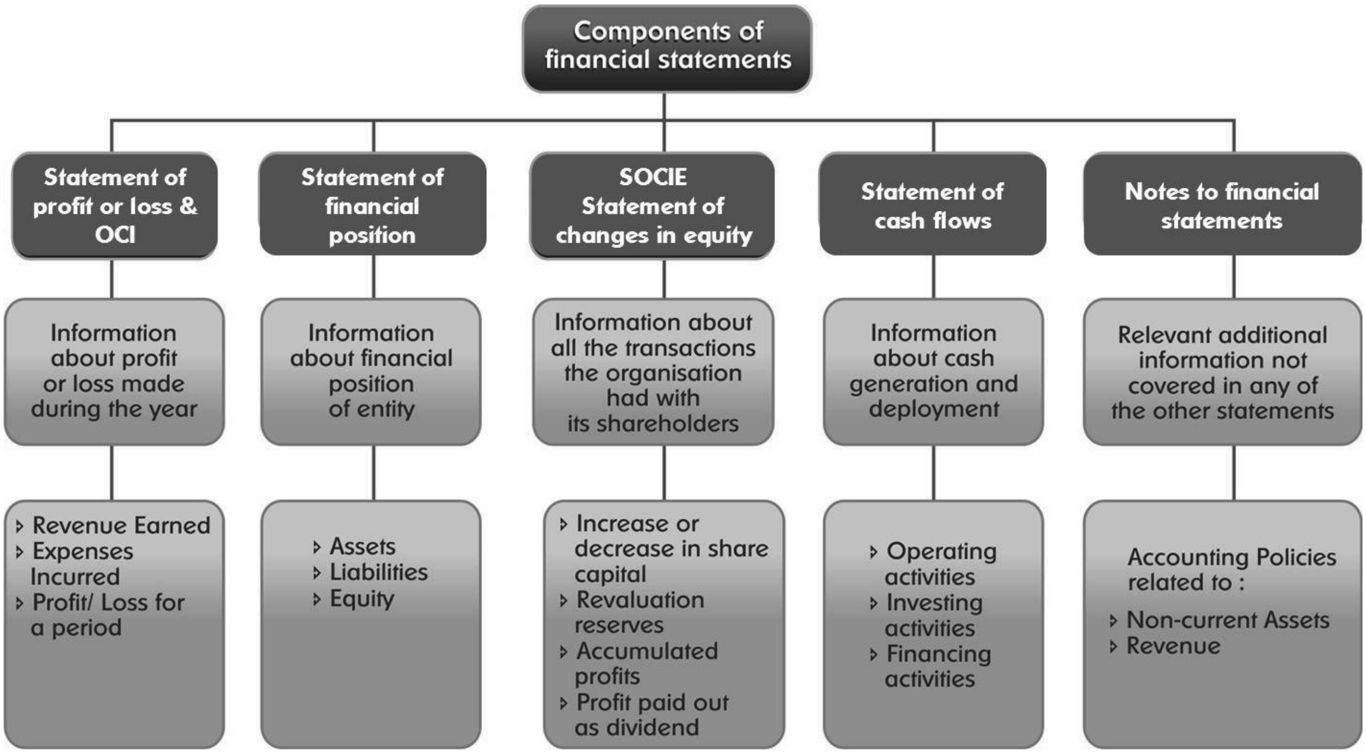
[Learning Outcome c]

3.1 Elements of financial statements

Financial statements are the end result of the financial accounting process. Financial accounting process consists of recording the transactions through journal entries, posting the entries in appropriate ledger accounts, casting of accounts and preparing the trial balance.

An organisation's financial statements consist of four summary reports accompanied by notes to these statements as set out in **IAS 1 Presentation of financial statements**. Each statement provides separate but complementary information about the financial condition and performance of the organisation. Hence, to get a complete financial picture of the organisation, all five statements need to be prepared.
The following diagram briefly describes these statements

Diagram 3: Purpose and elements of financial statements



1. Elements of the statement of financial position (SOFP)

The following are the elements of a statement of financial position.

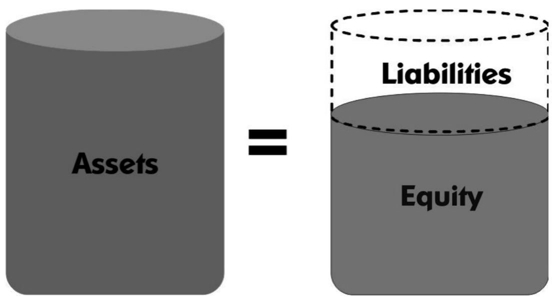
(a) Assets

(b) Liabilities

(c) Equity

It is also important to note that for every statement of financial position, the formula mentioned below holds good:

Diagram 4: Composition of a statement of financial position



(a) Assets

Definition

An asset is a **resource controlled** by the entity as a result of **past events** and from which future **economic benefits** are expected to flow to the entity.

Framework para 49

Therefore, the term asset means the total possessions of a business, such as machinery, buildings, furniture, vehicles, cash, amount receivable from others etc.

(b) Liabilities

Definition

A liability is a **present obligation** of the entity arising from **past events**, which when paid is likely to cause an **outflow** from the entity of resources.

Framework para 49

Therefore, the term liability represents the total amounts payable by the business to others such as bank loans, trade payables, and expenses payable.

(c) Equity

Definition

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

Framework para 49

Tip

The terms capital and equity can be used interchangeably.

Capital = Total assets – Total liabilities

Equity includes reserves and contribution from owners. Reserves are the accumulated profits of the company.

(i) Contribution from owners

Contribution from owners denotes capital. Capital is the amount invested by the owners, into the business. In the case of sole proprietorship, the entire amount of capital is brought into the business, by the sole proprietor alone. In the case of partnership firms, the partners contribute towards the capital. In the case of limited liability companies, the shareholders contribute towards the capital of the entity. These entities issue shares to the shareholders.

(ii) Distribution to owners

Amounts distributed to owners are generally in the form of dividend paid by companies. Dividend may be defined as distribution of profits of company among the owners (shareholders in the case of companies) of the company. It is calculated as a percentage of profits on the nominal value of the shares held by the shareholders.

In the case of partnership firms, the profit is distributed among the partners in the ratio which is pre-determined in the partnership deed.

2. Elements of the Statement of profit or loss and other comprehensive income

The elements of a statement of profit or loss and other comprehensive income include income and expenses.

(a) Income

Definition

Income is increases in economic benefits during the accounting period in the form of:

direct inflows, or
enhancements of assets, or
decrease of liabilities

that results in increase in equity, other than those relating to contributions from equity participants.

Framework para 70

Forms of Income

Revenue: represents earnings through the ordinary activities of the business, for example, sales, fees, interest, dividends, royalties and rent.

Gains: represent other items of income that may not arise in the ordinary course of business, for example, gains on disposal of property.

(b) Expense

Definition

Expenses are cost incurred to earn income. Expenses are defined as decrease in economic benefits during the accounting period in the form of:

- direct outflow ,or
- depletion of an asset, or
- incurrence of a liability

that result in decreases in equity, other than those relating to distributions to equity participants.

Framework para 70

Examples of expenses are purchases of goods, discounts allowed to customers for early payment, wages and salaries, office maintenance, utilities (gas, water, electicity consumed), interest paid, royalty paid.

(c) Profit / loss

Income > Expenses; organisation has made a profit

Profit = Income – Expenses

Expenses > Income; organisation has incurred a loss

Loss = Expenses – Income

Diagram 5: When profit is earned

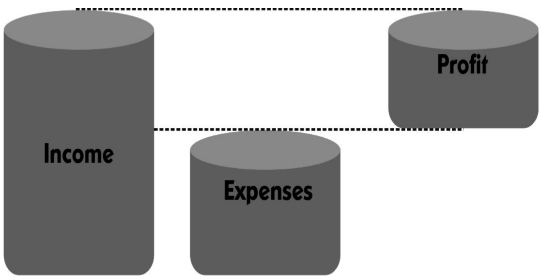
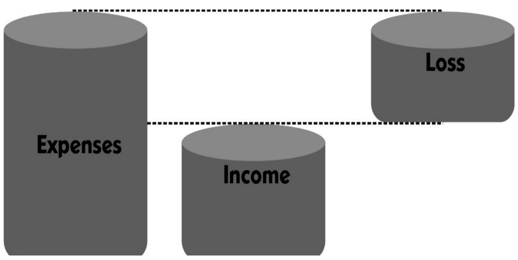


Diagram 6: When a loss is incurred



The elements of statement of changes in equity (SOCIE), statement of cash flows and notes to financial statements have already been discussed in Learning Outcome 2 of this Study Guide.

Test Yourself 8

Which of the following scenarios would generate a profit in the statement of profit or loss and other comprehensive income?

A Liabilities > Expenses
B Liabilities < Assets
C Income > Expense
D Assets > Expenses

Test Yourself 9

Which of the following items is not an asset?

A Plant and equipment
B Bank loan
C Computer software and hardware
D Land and buildings

---

4. Prepare statement of income as per guidance of IAS 1.
Prepare Statement of financial position as per guidance of IAS 1.
[Learning Outcomes e and f]

5.1 Financial statements for a sole proprietor

We have already discussed the proforma of all the financial statements in the Learning Outcome 2 of this Study Guide. Now, we will discuss the preparation of basic financial statements for various entities with the help of an example.

Example

Accounts preparation from a trial balance

Miti Mirefu, a sole trader provides you with the following trial balance, as at 31 May 20X3 – the end of his financial year.

Miti Mirefu - Trial balance as at 31 May 20X3

	Debit Tshs'000	**Credit Tshs'000**
Sales Purchase		241,320
Discounts allowed	150,000	
Discounts received	10,800	
Provisions for depreciation (as at 1 June 20X2)		2,880
on property		
on equipment		12,000
Inventory, as at 1 June 20X2		22,800
Capital, as at 1 June 20X2	30,000	
17% long-term loan		72,780
Irrecoverable debts		18,000
Returns outwards	2,760	
Wages and salaries		9,000
Drawings	35,280	
Loan interest	14,400	
Other operating expenses	3,060	
Accounts payables	10,620	
Accounts receivables		21,600
Cash in hand	22,800	
Bank	180	
Property, at cost	780	
Equipment, at cost	72,000	
Allowance for receivables	48,000	
		300
	400,680	**400,680**

Miti Mirefu provides you with the following additional information as at 31 May 20X3:

(a) Inventory as at 31 May 20X3 has been valued at cost at Tshs25,200,000 million.
(b) Accruals required for wages and salaries are Tshs480,000.
(c) Other operating expenses are pre-paid by Tshs180,000.
(d) The allowance for receivables is required to be maintained at 2% of accounts receivables.
(e) Depreciation for the year ended 31 May 20X3 has still to be provided for as follows.

Property: 1.5% per annum using the straight line method; and

Equipment: 25% per annum using the reducing balance method.

Required:

Prepare Miti Mirefu's Statement of profit or loss and other comprehensive income and statement of financial position for the year ended 31 May 20X3 as at that date.

Continued on the next page

Answer

Miti Mirefu - Statement of profit or loss and other comprehensive income for the year ended 31 May 20X3

	Tshs'000	Tshs'000
Sales		241,320
Less: Cost of sales		
Opening inventory	30,000	
Purchase	150,000	
Purchase returns	(9,000)	
	171,000	
Closing inventory	(25,200)	
		(145,800)
Gross profit		**95,520**
Add: Other income - discounts received		2,880
		98,400
Less: Expenses		
Operating expenses		
Wages and salaries (Tshs35.28 million + Tshs0.48 million) (W4)	35,760	
Discounts allowed	10,800	
Irrecoverable debts (W1)	2,916	
Loan interest	3,060	
Depreciation (W2) (W3)	7,380	
Other operating expenses (Tshs10.62 million - Tshs0.18 million) (W5)	10,440	(70,356)
Profit for the year		**28,044**

Miti Mirefu - Statement of financial position as at 31 May 20X3

	Tshs'000	Tshs'000
Non-current assets		
Property (cost)	72,000	
Less: Accumulated depreciation	(13,080)	58,920
Equipment (cost)	48,000	
Less: Accumulated depreciation	(29,100)	18,900
		77,820
Current assets		
Inventory	25,200	
Trade receivables net of allowance for receivables (Tshs22.8 million – Tshs0.456 million) (W1)	22,344	
Prepayments	180	
Bank	780	
Cash in hand	180	48,684
		126,504
Capital		
Balance at 1 June 20X2		72,780
Profit for the year 20X2-X3	28,044	
Less: Drawings	(14,400)	13,644
Current liabilities		
Trade payables	21,600	
Accruals	480	22,080
Long-term liabilities		
17% loan		18,000
		126,504

For sole traders and partnerships, there will be only a capital account in this group.

Continued on the next page

Workings

W1 Irrecoverable debts

	Tshs'000
Previous allowance	300
New allowance required (2% x Tshs22.8 million)	456
Increase in allowance	156
Irrecoverable debts as per trial balance	2,760
Transferred to statement of profit or loss and other comprehensive income	**2,916**

W2 Depreciation on property

	Tshs'000
Opening provision	12,000
Provision for the year on SLM (1.5% x Tshs72 million)	1,080*
Closing provision	**13,080**

W3 Depreciation on equipment

	Tshs'000
Opening provision	22,800
Provision for the year on RBM (25% x Tshs25.2 million (Tshs48 million – Tshs22.8 million))	6,300*
Closing provision	**29,100**
Total depreciation charged to Statement of profit or loss and other comprehensive income i.e. (1,080 + 6,300)*	**7,380**

W4

Accrued wages and salaries are expenses incurred for the current period so they will be included in the Statement of profit or loss and other comprehensive income.

W5

Prepaid operating expenses are expenses for the next year so they will be deducted from the Statement of profit or loss and other comprehensive income.

5.2 Financial statements of a partnership firm

A partnership is defined as 'the relationship between persons carrying on a business in common with a view of profit.' This definition is taken from the UK Partnership Act of 1890.

1. Partnership agreement

The partnership agreement is a written agreement between the partners, spelling out the agreed terms and conditions. It may contain many non-financial clauses such as name and address, business activity, duration etc.

The financial clauses in a partnership agreement are relevant for accountants. Such clauses are:

(a) Capital

Usually each partner puts in a share of capital. If specific amounts have been agreed, it should be stated. If a minimum fixed amount is agreed that will be mentioned.

Example

Initial capital of the firm shall be Tshs150 million, contributed equally by Tony, Boney and Soni.

(b) Profit sharing ratio

The purpose of a business is to earn and share profits.

Partnership agreements usually contain the profit sharing ratio. The profit sharing ratio depends upon:

- the experience of the partners
- the capital contribution of the partners or
- the efforts put in by the partners

In the absence of any specific agreement it is assumed that the partners share profits or losses equally.

Example

The partners shall share profits and losses in the following ratio:

Andy	50%
Sandy	30%
Wandy	20%

(c) Salaries to partners

Salaries to partners are not similar to salaries paid to employees.

Salaries to partners: are an appropriation (distribution) of profits – they are presented after the calculation of profits

Salaries to employees: are expenses – they are presented before the calculation of profits.

Example

Tit and Tat, being the working partners, shall receive a salary of Tshs4 million per month and Tshs3 million per month respectively.

The firm pays salaries of Tshs60 million to the employees.

These will be presented in the Statement of profit or loss as:

	Tshs'000	**Tshs'000**
Gross profit		**X**
Salaries to employees		(60,000)
Other expenses		(X)
Net profit		**X**
Less: Appropriations of profit		
Salary to partners		
Tit (Tshs4,000 x 12)	48,000	
Tat (Tshs3,000 x 12)	36,000	
		84,000
Residual Profit transferred to		
Current accounts		
Tit		X
Tat		X
		X

Residual profits (profits earned – salaries to partners) will be shared among all the partners in the profit sharing ratio.

(d) Interest on capital

Interest on capital is not similar to interest paid to third parties.

Interest on capital is an appropriation of profits: it is presented after the calculation of profits

Interest paid to third parties (e.g. on a loan from bank) are expenses: it is presented before the calculation of profits.

Residual profits (profits earned – salaries to partners – interest on capital): will be shared among all the partners in the profit sharing ratio.

Example

The partners shall be entitled to an interest on capital at 6% per annum (0.5% per month), calculated on the opening balance of each month.

(e) Withdrawals / Drawings

Usually the partners need to draw some money for their household expenses and other personal needs. Partners may agree on the maximum amounts per month or the maximum frequency of withdrawals.

Example

The partners shall draw in cash reasonable amounts per month for meeting their monthly household expenses.

(f) Interest on drawings

In order to discourage partners from frequent drawings the agreement provides for an interest on drawings.

Example

The partners shall be charged an interest on drawings at 6% per annum (0.5% per month), calculated on the opening balance of each month.

(g) Procedures to be followed at the time of reconstitution of the firm e.g. admission or retirement of partners.

Example

Any reconstitution of the firm shall be done only with the written consent of all the partners.

---

2. Appropriation of profits

Appropriation of profit is also known as division of profit. Net profits in a partnership are divided between the partners in a profit sharing ratio according to the partnership agreement. Before its division it is transferred from the Statement of profit or loss to an account known as the 'Appropriation account'. This account shows how the net profit is divided between the partners. The entire profit is not divided, salaries and interest on capital, if payable according to the agreement, are deducted from it. Once this has been done the interest on the drawings are added to the net profit. The remaining profit is known as residual profit which is shared among the partners using the profit sharing ratio.

Example

An extract of a typical Statement of profit or loss incorporating these is as follows:

Statement of profit or loss (with imaginary names and figures)

	Tshs'000
Revenue	100,000
Cost of sales	(70,000)
Gross profit	30,000
Other income	5,000
Distribution costs	(8,000)
Administrative expenses	(7,000)
Finance expenses (interest on - Sam's Loan)	(2,000)
Other expenses	(3,000)
Profit	15,000
Tax	(3,000)
Profit after tax	**12,000**

Appropriations of profit:

	Tshs'000	Tshs'000
Profit after tax		12,000
Less: Interest on Capital		
Sam	3,000	
Rocky	2,000	(5,000)
Profit transferred to capital accounts		**7,000**
Sam		3,500
Rocky		3,500

In both cases however, the current account of partners is credited.

The current account of Sam would appear as follows:

Sam's Current Account

Dr	Tshs'000		Cr Tshs'000
		Interest on capital	3,000
		Interest on loan	2,000
		Share of profit	3,500
Balance c/d	8,500		
	8,500		**8,500**

Presentation in the accounts

For all the appropriations that are due from the firm to the partners, an appropriation account is debited and the partners' current accounts are credited.

Example

Salary to partners and interest on capital will go through an appropriation account.

A proforma of appropriation account of a firm Statham which has three partners Arusha, Mbeya and Mwanza who share profits and losses equally (with imaginary figures)

Statham

Dr Appropriation account for the year ended 31/12/20X3 Cr

	Section reference		**Tshs'000**		**Section reference**		**Tshs'000**
Salaries	6			Net profit b/d (from SOPL)			40,000
Arusha			7,000	Interest on drawings	4		
Interest on capital	5			Arusha		1,500	
Arusha		3,000		Mbeya		1,100	
Mbeya		2,000		Mwanza		900	3,500
Mwanza		1,500	6,500				
Residual profits (Balancing figure)							
Arush		10,000					
a		10,000					
Mbeya		10,000	30,000				
Mwan			**43,500**				**43,500**

Note: the second effect of all these transactions will be entered in the opposite side of the respective current account e.g. salary to Arusha - Tshs7 million is credited to the current account of Arusha - Tshs7 million.

If there had been no interest or salaries, then the profit of Tshs40 million would have been shared equally i.e. Arusha, Mbeya and Mwanza would have received Tshs13.333 million each (Tshs40 million/3). However, in the above proforma, Arusha gets a higher amount. Why is this so?

She could have contributed higher capital or taken greater efforts than the others. These clauses will be agreed by the partners while signing the partnership agreement.

Tip

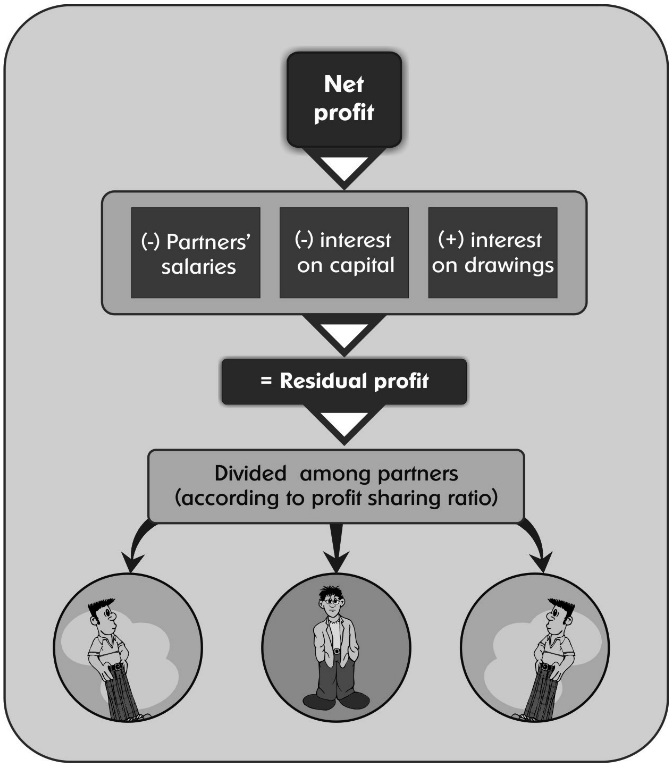
In the exam you will be given information about profit sharing arrangements and interest on capital etc. If you are not, assume an equal profit sharing arrangement between partners.

The residual profits are determined in the following manner:
Residual profit = Net profit + interest on drawings - salaries to partners - interest on capital.
= Tshs40 million + Tshs3.5 million - Tshs7 million - Tshs6.5 million = Tshs30 million

This appropriation account can also be prepared in a vertical form. In that case, net profits are taken as a starting figure and the adjustments are added or subtracted.

	Tshs'000	**Tshs'000**
Net profit b/d (from Statement of profit or loss)		40,000
Add: Interest on drawings		
Arusha	1,500	
Mbeya	1,100	
Mwanza	900	3,500
		43,500
Less: Salaries		
Arusha		(7,000)
Less: Interest on capital		
Arusha	3,000	
Mbeya	2,000	
Mwanza	1,500	(6,500)
Residual profits (Balancing figure)		**30,000**
Arusha	10,000	
Mbeya	10,000	
Mwanza	10,000	

Diagram 7: Appropriation of profit



3. Capital accounts

For starting and running a business, partners have to invest funds. A record of how much is contributed by different partners and how much is due to them is kept in capital accounts. The amount contributed by each partner depends upon the mutual agreement between the partners. It need not be the same for all the partners. For example, 1 partner may contribute lots of cash, but not work in the partnership at all, whereas another may contribute little cash, but be working full-time.

Capital accounts, being the amount payable by the firm to the partners, always show a credit balance i.e. the balance brought forward will be a credit entry.

When capital is introduced, the entry is

Dr	Cash or other assets	X	
Cr	Capital		X

Being capital introduced in the partnership firm

4. Current accounts

A current account, as the name indicates, is used to record the current transactions such as profit, salary or interest earned and the drawings made by the partners. It usually shows the profits retained in the business by a partner.

When current accounts are maintained, the relationship between capital and current accounts will be as follows:

the capital accounts remain static during the year. They change only if fresh capital is introduced or **capital** (not profits) is withdrawn.

since interest on capital, salary to partners, share of residual profits, drawings, and interest on drawings are **all reflected in the current accounts**, they will keep fluctuating continuously.

Usually current accounts are maintained separately from the capital accounts.

This has the benefit that if a partner draws more than his current dues (salary, interest and profit), his current account shows a debit balance and serves as a warning. As seen above, in these cases the capital accounts remain fixed. Therefore, the presence of current accounts also indicates the presence of fixed capital accounts.

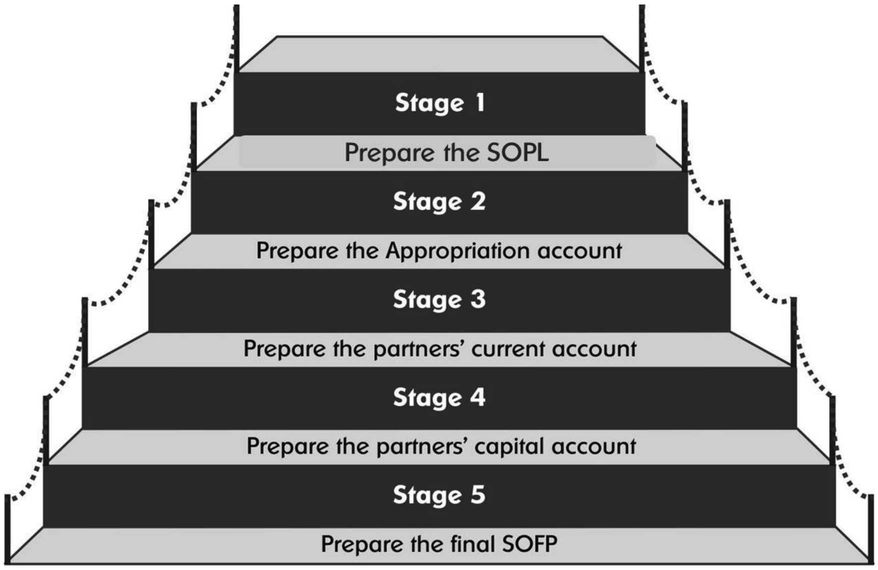
However, at times separate current accounts may not be maintained. Here, the capital accounts themselves will contain all the entries that would otherwise go to the current accounts. As a result, the capital accounts will keep fluctuating. Therefore, they are called fluctuating capital accounts.

5. Preparations of the final accounts

Now we will discuss how to prepare an Statement of profit or loss and other comprehensive income and statement of financial position of a partnership firm. It is also interesting to see how the capital and current accounts appear after incorporating these transactions.

The following steps will help you to prepare the final accounts of partnership from the given information.

Diagram 8: Steps to prepare final accounts of partnership



Example

Neil, Nicky and Jocky are in partnership, NNJ, sharing profits equally. They have agreed the following terms:

(a) Jocky and Neil will receive a salary of Tshs6 million and Tshs5.5 million per annum.
(b) Interest will be charged on drawings at the rate of 6%
(c) The interest rate on the loan by Neil is 5%
(d) All the partners will receive interest at 11% on capital.

The extract of the statement of financial position of the partnership as at 31 December 20X3 is given below:

Capital accounts	**Tshs'000**	**Tshs'000**
Neil	22,000	
Nicky	9,200	
Jocky	7,400	38,600
Current accounts		
Neil	4,100	
Nicky	920	
Jocky	(2,100)	2,920
Capital		41,520
Loan account (Neil)		7,200
Net assets		**48,720**

Drawings made during the year 20X3 were as follows:	**Tshs'000**
Neil	6,200
Nicky	4,400
Jocky	3,400

Sales for the year are Tshs405 million
Opening inventory is Tshs27 million and closing inventory is Tshs29.5 million

Continued on the next page

Expenditures are as follows:

	Tshs'000
Purchases	285,600
Salary	33,500
Traveling and Conveyance	6,870
Printing, stationery and postage	4,200
Bank interest	986
Sundry expenses	1,130
Vehicle expenses	13,680
Advertisement	12,650
Depreciation	3,584

Other information

Accounts payables	11,530
Accounts receivables	8,164
Cash	1,230
Non-current assets	56,240

Required:

Prepare the partners' current accounts, statement of profit or loss, and appropriation account, and the statement of financial position for the year ended 31 December 20X3

Answer

Stage 1

NNJ - Statement of profit or loss and for the year ended 31 December 20X3

	Tshs'000	Tshs'000
Sales		405,000
Less: expenses		
Cost of sales (W4)	283,100	
Salary	33,500	
Travelling and conveyance	6,870	
Printing and stationery	4,200	
Bank interest	986	
Sundry expenses	1,130	
Vehicle expenses	13,680	
Advertisement	12,650	
Depreciation	3,584	
Loan interest (Partner- Neil) W1	360	(362,560)
Profit for the year		**44,940**

Continued on the next page

Stage 2

NNJ
Appropriation Account
for the year ended 31 December 20X3

Dr					Cr
	Tshs'000	**Tshs'000**		**Tshs'000**	**Tshs'000**
Current accounts			Net profit b/d		44,940
(Partners' salaries)		11,500	Current accounts		
(Interest on capital) W3			(Interest on drawings) W2		
Neil	2,420		Neil	372	
Nicky	1,012		Nicky	264	
Jocky	814	4,246	Jocky	204	
					840
(Residual profits)					
Neil	10,011				
Nicky	10,011				
Jocky	10,012				
		30,034			
		45,780			**45,780**

Stage 3

Partners' Current Accounts
for the year ended 31 December 20X3

Dr							Cr
	Neil Tshs'000	**Nicky Tshs'000**	**Jocky Tshs'000**		**Neil Tshs'000**	**Nicky Tshs'000**	**Jocky Tshs'000**
Balance b/d			2,100	Balance b/d	4,100	920	
Interest on drawings (W2)	372	264	204	Loan interest (W1)	360		
Drawings	6,200	4,400	3,400	Interest on capital (W3)	2,420	1,012	814
				Salary	5,500		6,000
Balance c/d	15,819	7,279	11,122	Residual profits	10,011	10,011	10,012
	22,391	11,943	16,826		22,391	11,943	16,826
				Balance b/d	**15,819**	**7,279**	**11,122**

Stage 4

Partner's Capital Account
for the year ended 31 December 20X3

Dr							Cr
	Neil Tshs'000	**Nicky Tshs'000**	**Jocky Tshs'000**		**Neil Tshs'000**	**Nicky Tshs'000**	**Jocky Tshs'000**
				Balance b/d	22,000	9,200	7,400
Balance c/d	22,000	9,200	7,400				
	22,000	9,200	7,400		22,000	9,200	7,400
				Balance b/d	**22,000**	**9,200**	**7,400**

Continued on the next page

Stage 5

NNJ - Statement of financial position as on 31 December 20X3

	Tshs'000	**Tshs'000**
Capital and liabilities		
Capital accounts		
Neil	22,000	
Nicky	9,200	
Jocky	7,400	38,600
Current accounts		
Neil	15,819	
Nicky	7,279	
Jocky	11,122	34,220
Neil Loan account		7,200
Accounts payables		11,530
		91,550
Assets		
Non-current assets	56,240	
Less: Depreciation	3,584	52,656
Current assets		
Inventory		29,500
Cash		1,230
Accounts receivable		8,164
		91,550

Workings

W1 Interest on loan from Neil = Tshs7.2 million x 5% = Tshs0.36 million

W2 *Interest on drawings

		Tshs'000
Neil	6% of Tshs6.2 million	372
Nicky	6% of Tshs4.4 million	264
Jockey	6% of Tshs3.4 million	204
		840

* Charged on the end of year drawings balances

W3 Interest on capital

	Tshs'000
Neil (11% of Tshs22 million)	2,420
Nicky (11% of Tshs9.2 million)	1,012
Jockey (11% of Tshs7.4 million)	814
Interest on capital	**4,246**

W4 Cost of sales

	Tshs'000
Opening inventory	27,000
Add: Purchases	285,600
Less: Closing inventory	29,500
Cost of sales	**283,100**

5.3 Financial statements of a company

Before discussing the preparation of financial statements of a company, we will discuss about few specific items which are part of financial statements of a company.

1. Retained earnings

Retained earnings are the profits earned by a company that are retained in the business and not distributed as dividends. As seen earlier, when profits are earned, retained earnings on the liabilities side of a statement of financial position are increased and, simultaneously, the net assets of a company are increased, since the assets generated by way of the profit earned are retained in the business. Conversely, when profits are distributed by way of dividends, retained earnings are reduced and on the opposite side, net assets are also reduced, as dividends would mean an outflow of assets.

Why the heading, 'retained earnings', appears only in a company statement of financial position (and not in sole proprietorship / partnership statement of financial position)

For a sole trader or a partnership, the statement of profit or loss is closed by transferring the profit to the credit of the proprietor's capital account. In the statement of financial position, the profits for the year are usually not disclosed separately but included in the capital account in the following manner.

	Tshs
Opening capital	X
Add: Profits during the period	X
Less: Drawings during the period	(X)
Closing capital	**X**

For a partnership firm, the same principle is followed, except that the balance of profit after appropriations is transferred to partners' current accounts (for fixed capital) or capital accounts (for fluctuating capital accounts). Here too, the profit for the year is usually fully appropriated; no balance carried forward.

For a company, the nominal value of the share capital is disclosed in the share capital account. This total nominal value usually remains fixed and an accountant cannot change it with the amount of profits. As a result, the accountant is compelled to carry forward the balance of profit or loss for the year, in a separate account which is known as the **retained earnings** account. This balance in the retained earnings account is reduced to the extent that it is used for the distribution of dividends.

Example

Lugwadu started a business with a capital of Tshs200 million on 01 January

20X1. He earned profits of Tshs90 million from 20X1 to 20X3.
He withdrew Tshs50 million out of these profits.
What will be the balance of capital on 31 December 20X3?

What difference would there be if the business was run by Lugwadu Co Ltd and if it distributed dividends worth
Tshs50 million?

Answer

If the business was run as a sole trader

Capital account

	Tshs'000
Capital introduced	200,000
Add: Profits earned	90,000
Less: Drawings	(50,000)
Balance of capital on 31 December 20X3	**240,000**

Continued on the next page

If the business was run as a limited company

	Tshs'000
Share capital issued	200,000
Retained earnings	
Add: Profits earned	90,000
Less: Dividends distributed	(50,000)
Retained earnings on 31 December 20X3	**40,000**

Total capital = Tshs200 million + Tshs40 million = Tshs240 million

2. Reserves in the statement of financial position

A company statement of financial position mainly contains the following types of reserves:

(a) Revaluation reserve: as explained above, this is a reserve created because of an increase in the value of net assets after revaluation of assets and liabilities.

(b) Share premium: the Companies Act or similar legislations of some countries requires share premium to be disclosed under the group reserves and surplus. Share premium is the excess of the issue price of shares over their nominal or par value.

Example

A company issued ordinary shares of Tshs100 million for cash at Tshs125 million. The entry is

			Tshs'million	Tshs'million
Dr		Cash	125	
	Cr	Ordinary shares		100
	Cr	Share premium account		25

Being issue of ordinary shares at a premium

Tip

Share premium is not available for distribution of dividends.

(c) General reserve: this is a general purpose voluntary reserve. Generally it is not used for distribution of dividends. However, in extreme situations, amounts are drawn from this reserve for the purpose of dividends.

Refer the example below to understand the preparation of financial statements of a company.

Example

The following trial balance has been extracted from the books of Sanawari Ltd as at 30 September 20X8

	Tshs million	Tshs million
Administrative expenses	594	-
Share capital (3,500,000 ordinary shares of Tshs1,000 each)	-	3,500
Cash at bank and in hand	75	-
Distribution costs	750	-
Dividends received (on 31/03/20X8)	-	336
Freehold property:		
- at cost	3,375	-
- accumulated depreciation (at 01/10/20X7)	-	325
Interim dividend (paid on 30/06/20X8)	45	-
Investments	2,500	-
Plant and machinery:		
- at cost	6,500	-
- accumulated depreciation (at 01/10/20X7)	-	4,500
Retained earnings at 01/10/20X7		3,428
Purchases	20,000	-
Inventory (at 01/10/20X7)	2,875	
Trade payables	-	3,625
Trade receivables	3,375	-
Sales revenue	-	24,375
Total	**40,089**	**40,089**

Additional information:

(i) The inventory at 30 September 20X8 was valued at Tshs4,500 million

(ii) Depreciation for the year to 30 September 20X8 is to be charged on following assets:
Plant and machinery: Tshs169 million
Freehold property: Tshs975 million

(iii) On 30 September 20X8, the directors proposed a final dividend of Tshs2,670 million.

Required:

Prepare the statement of profit or loss, statement of changes in equity and statement of financial position of Sanawari for the year ended 30 September 20X8.

Answer

Sanawari Ltd – Statement of profit or loss for the year ended 30 September 20X8

	Tshs million	Tshs million
Sales revenue		24,375
Less: Cost of sales (W1)		(18,375)
Gross profit Distribution		**6,000**
costs Administrative expenses	750	
(W2)	1,738	(2,488)
		3,512
Other income (dividend received)		336
Profit before taxation		**3,848**

Continued on the next page

Baywatch Ltd – Statement of changes in equity for the year ended 30 September 20X8

	Share capital	Retained earnings	Total
	Tshs million	Tshs million	Tshs million
Balance (01/10/20X7)	3,500	3,428	6,928
Profit for the year		3,848	3,848
Dividend (given)		(2,670)	(2,670)
	3,500	**4,606**	**8,106**

Sanawari Ltd – Statement of financial position as on 30 September 20X8

	Tshs million	Tshs million
Non-current assets Land		
and buildings(W3) Plant	2,881	
and machinery (W4)	1,025	
Investments	2,500	6,406
Current assets		
Inventory	4,500	
Trade receivables	3,375	
Cash at bank	75	7,950
Total assets		**14,356**
Capital and reserves		
Share capital	3,500	
Retained earnings	4,606	**8,106**
Current liabilities		
Trade payables	3,625	
Proposed dividend	2,625	6,250
Total liabilities		**14,356**

Workings

W1 Cost of sales

	Tshs million
Opening inventory	2,875
Add: Purchases	20,000
	22,875
Less: Closing inventory	(4,500)
	18,375

W2 Administrative expenses

	Tshs million	Tshs million
Per trial balance		594
Add: Depreciation		
Property (given)	169	
Plant (given)	975	1144
		1738

W3 Freehold property

	Tshs million
Cost	3,375
Less: Accumulated depreciation	(325)
Less: Depreciation for the year (given)	(169)
	2,881

Continued on the next page

W4 Plant and machinery

	Tshs million
Cost	6,500
Less: Accumulated depreciation	(4,500)
Less: Depreciation for the year (given)	(975)
	1,025

Test Yourself 10

The following is the information provided by the Kiumbe Beauty Salon.

	Tshs'000
Equipment	8,800
Accumulated depreciation on equipment	1,400
Furniture and fixtures	8,400
Accumulated depreciation on furniture and fixtures	2,800
Computers	11,100
Accumulated depreciation on computers	4,600
Long-term loan from bank	30,000
Capital as at 1 April 20X2	44,260
Drawings during the year	6,000
Inventory	8,300
Accounts receivable	800
Bank overdraft	1,500
Cash in hand	2,110
Bills payable	6,000
Profit for the year	9,200
Tax payable	2,350
Accounts payable	1,150
Shop rent outstanding	680
Prepaid insurance	430
Investment in Peer Ltd	58,000

Required:

You are required to prepare a statement of financial position of Kiumbe Beauty Salon for the year ended 31 March
20X3:

Test Yourself 11

Which of the following sentences is incorrect?

A The amount due from an entity to an outsider is known as liability.
B The statement of financial position reflects the state of affairs of an entity on a given date.
C The accounting equation is: assets + capital = liabilities
D The statement of financial position is always balanced.

Test Yourself 12

Which of the following statements is incorrect?

A Capital accounts always show a credit balance
B Current accounts always show a credit balance
C Interest on capital is an appropriation of profit
D The residual profits are divided in profit sharing ratios

Answers to Test Yourself

Answer to TY 1

No, the financial statements do not satisfy the understandability criterion. The value of the property has increased by a material amount. So, the users of the statements will not have a clear understanding as to what led to the increase in the value of the property.

Answer to TY 2

Yes, following the accounting concept of **relevance,** it is essential that Mack discloses the new business venture which will help the users of financial information to assess the risks and opportunities for the company.

Answer to TY 3

Yes. The general public use the financial statements of an entity. The public is usually interested in knowing:

(a) the contribution made by the company for the benefit of the local economy in the form of providing employment, the business opportunities made available to the local suppliers.

(b) the impact that the company is making on the environment i.e. pollution, etc. That is why companies should minimise the water pollution, noise pollution as well as air pollution.

Answer to TY 4

The following items should be included in other comprehensive income:

Exchange differences on translating foreign operations
Gains on valuation of available for sale financial assets
Gains on property revaluation
Actuarial losses on defined benefit pension plans

Tip

The share of associates' needs to be in the comprehensive income part of the statement of profit or loss and other comprehensive income.

Answer to TY 5

The correct option is **C.**

This is because Kijani Kibichi Ltd decided to roll over the loan beyond the period of 12 months after the end of the reporting period.

Answer to TY 6

Maridadi Ltd – Statement of changes in equity – Year to 31 December 20X3

	Share capital	Revaluation reserve	Accumulated profits	Total
	Tshs'000	Tshs'000	Tshs'000	Tshs'000
Balance at 01/01/2003	3,000	1,100	5,400	9,500
Issue of shares	2,000			2,000
Surplus on revaluation of property		1,500		1,500
Net profit for the period			7,000	7,000
Ordinary dividends			(4,400)	(4,400)
Balance at 31/12/20X3	**5,000**	**2,600**	**8,000**	**15,600**

Total revaluation reserve:
Tshs400,000 + Tshs700,000

Answer to TY 7

The correct option is **A**.

Recognise it as an asset. It is a pre-paid expense and not related to the current year. It is treated as a current asset.

Answer to TY 8

The correct option is **C.**

When income is higher than expenses, it results in a profit. The other three alternatives mention elements from the statement of financial position which do not help determine whether an entity has made a profit or a loss.

Answer to TY 9

The correct option is **B**.

As the name itself suggests, a bank loan is a liability. All other items are assets.

Answer to TY 10

Kiumbe beauty salon - Statement of financial position as at 31 March 20X3

	Tshs'000	**Tshs'000**
Assets		
Non-current assets		
Equipments (Tshs8.8 million -Tshs1.4 million)	7,400	
Furniture and fixtures (Tshs8.4 million -Tshs2.8 million)	5,600	
Computers (Tshs11.1 million - Tshs4.6 million)	6,500	
		19,500
Long-term investment –Peer Ltd		58,000
Current assets		
Inventories	8,300	
Accounts receivable	800	
Prepaid insurance	430	
Cash	2,110	11,640
Total assets		**89,140**
Capital and liabilities		
Capital		
As at 1 April 20X2	44,260	
Add: profit for the year	9,200	
Less: drawings	(6,000)	
As at 31 March 20X3		47,460
Non-current liabilities		
Bank loan		30,000
Current liabilities		
Bank overdraft	1,500	
Accounts payable	1,150	
Bills payable	6,000	
Tax payable	2,350	
Outstanding shop rent	680	11,680
Total capital and liabilities		**89,140**

Answer to TY 11

The correct option is **C.**

The accounting equation is: Liabilities + Capital = Assets

Answer to TY 12

The correct option is **B**.

A current account is maintained to record all current transactions such as interest on capital or loan, salaries to partners, share of residual profits, drawings, and interest on drawings, etc. Therefore it keeps on fluctuating. Occasionally it may have a debit balance.

Self-Examination Questions

Question 1

Additional information provided about a business's financial condition and methods used in preparing the financial statements are called:

A Management summary
B Owners additional information
C Creditors notes
D Notes to financial statements

Question 2

What does a complete set of financial statements include?

A Statement of financial position and Statement of profit or loss
B Statement of financial position, Statement of profit or loss, statement of cash flows, statement of changes in equity and notes to the financial statements
C Statement of financial position, Statement of profit or loss, statement of cash flows, statement of changes in equity, notes to the financial statements, management performance reports, chairman's declaration and similar items
D Statement of financial position, Statement of profit or loss, statement of cash flows, and statement of changes in equity

Question 3

Why are a statement of financial position and statement of profit or loss prepared?

A To help declare the dividend and share price
B To please the owners
C To portray the financial position and performance of the entity over a given time period
D To publish in a newspaper

Question 4

Which of the following are the forms of disclosure notes?

(i) Narrative
(ii) Disaggregation of information presented elsewhere in the financial statements or any additional information which has not been presented elsewhere in the financial statements.
(iii) Cost sheet

A (i) and (ii)
B Only (i)
C (i) and (iii)
D All of the above

Question 5

State whether these statements are true or false

A Disclosures are not a part of financial statements
B Information in disclosure notes can be provided in descriptive and qualitative terms
C Disclosure note may include the information which is not given in the statement of financial position and the statement of profit or loss

Question 6

Which of the following items represents expense?

A Royalty received
B Share capital
C Dividend received
D Purchases of goods

Question 7

An accrual system of accounting prescribes:

A Recording the substance of the transaction and ignoring the form
B Recording all expenses when the payment is made
C Recording assets when they are incurred
D Overstating the expenses

Question 8

Retained earnings appear in the statement of financial position of the following business entities:
(i) Sole proprietor
(ii) Partnership firm
(iii) Company

A Only (i)
B Only (ii)
C Only (iii)
D (i) and (ii)

Question 9

The owner of Ngoma Traders gives you the following information:

Inventory	Tshs'000
1 January 20X3	15,700
31 December 20X3	12,300

Transactions during 20X3 are as follows:

	Tshs'000
Purchases at list price	80,000
Trade discount was received at 2.5% of list price	
Early settlement discount earned at 3% on a payment of Tshs50 million	
Sales	104,250
Cash payments	
Salaries	3,000
Electricity	900
Telephone	400
Printing and stationery	500
Refreshments	300
Unpaid expenses related to 20X3	
Telephone	50
Electricity	100
Salary	500

Required:

Prepare a statement of profit or loss for the year to 31/12/20X3.

Question 10

The following information provided by Mzuri Cosmetics for the year ended 31 March 20X3:

	Tshs'000
Building	90,000
Accumulated depreciation on building	12,000
Computers	17,250
Accumulated depreciation on computer	7,500
Vehicle	15,000
Depreciation on vehicle	3,900
Furniture and fixtures	14,200
Depreciation on furniture and fixtures	5,800
Inventory	12,450
Trade receivable	3,165
Cash in hand	1,200
Advance given to employees	5,000
Capital as at 1 April 20X2	73,640
Loan from bank Profit for	45,000
the year Drawings during	13,800
the year Trade payable	9,000
Tax payable	1,725
Prepaid insurance	3,525
Electricity expenses payable	645
	1,020

Required:

Prepare the statement of financial position for the year ended 31 March 20X3.

Question 11

Dhone, Boney and Toney are in a partnership, DBT, sharing profits in the ratio of 2:2:1. The following terms were agreed between them:

(i) All three should receive interest at 10% on the capital. The capital of the partners are as follows:

Dhone - Tshs35 million
Boney - Tshs45 million and
Toney - Tshs50 million

(ii) Dhone and Boney will get a salary of Tshs0.5 million per month.

(iii) Interest will be charged on the drawings at a rate of 6%. The drawings are as follows:

Dhone - Tshs0.5 million per month
Boney - Tshs0.75 million per month and
Toney - Tshs0.2 million per month

(assume the drawings are made in the middle of the month).

(iv) The partners' current account balance as on 1 December 20X3 are:

Dhone - Tshs3,871,000
Boney - Tshs4,961,000 and
Toney - Tshs6,568,000

(v) Profit for 20X8 is Tshs34 million

Other information related to DBT is given below:

	Tshs '000
Accounts payable	35,000
Accounts receivable	57,000
Inventory	45,000
Non-current assets	75,000
Cash and bank	33,000
Long-term loan	13,000

You are required to prepare the appropriation of profit, partners' capital and current account and statement of financial position (balance sheet) for the year ended 31 December 20X3.

Question 12

The following trial balance relates to Bristol Ltd for the year ended 31 March 20X9:

	Tshs'000	Tshs'000
Sales revenue		1,299,100
Purchases	703,175	
Purchase returns		7,425
Operating expenses	68,200	
Loan interest paid	13,200	
Buildings - cost	715,000	
Plant and equipment - cost	463,650	
Land - cost	22,000	
Accumulated depreciation and amortisation as on 1 April 20X8		
Building		143,000
Plant and equipment		133,650
Trade receivables	198,000	
Allowance for receivables on 1 April 20X8		5,500
Inventory- 01/04/20X8	106,975	
Bank		44,000
Trade payables		83,600
Ordinary shares of Tshs1,000 each		330,000
12% Loan note (issued 1 April 20X8)		220,000
Retained earnings – 1 April 20X8		23,925
Totals	**2,295,700**	**2,295,700**

The following notes are relevant:

(i) The inventory at 31 March 20X9 was counted at a cost value of Tshs46.75 million.

(ii) Building is depreciated on a straight-line basis at 10% per annum. Plant and equipment is depreciated at 20% per annum on the reducing balance basis.

(iii) The directors have estimated the provision for income tax for the year to 31 March 20X9 at Tshs62.15 million.

(iv) The allowance for receivables is to be increased to 5% of trade receivables. The allowance for receivables is treated as an administrative expense.

Required:

Prepare the statement of profit or loss and statement of financial position of Bristol Ltd for the year ended 31 March 20X9.

Question 13

The trial balance of Upendo Enterprises at 31st December 2014 showed the following:

	Dr (Tshs.)	Cr (Tshs.)
Discounts	150,000	160,000
Selling and Distribution expenses	5,400,000	
Cash and Bank	2,350,000	
Cost of sales	30,100,000	
Administration expenses	3,300,000	
Buildings	29,800,000	
Motor vehicles	18,600,000	
Sales		42,900,000
Returns	60,000	
Accumulated Depreciation: Buildings		1,100,000
Accumulated Depreciation: Motor vehicles		3,600,000
Drawings	180,000	
Finance expenses	2,130,000	
Capital		45,860,000
Debtors/Creditors	1,990,000	1,890,000
Stock	1,450,000	
	95,510,000	95,510,000

Additional Information:

(i) Depreciation on building is 2% on book value while depreciation on motor vehicle is 5% on cost. Depreciation is to be charged to administration expenses.

(ii) Prepaid selling and distribution expense are Tshs. 20,000 while accrued finance charges are Tshs. 30,000.

REQUIRED:

Prepare:

(a) The Statement of Income for the year ended 31st December 2014.

(b) The Statement of Financial Position as at 31st December 2014.

Question 14

You have been provided with a trial balance of Brown, a sole trader who started business on 1st July 2012.

Brown

Trial Balance as at 30th June 2016

	DR. TZS.	**CR. TZS.**
Equipment at cost	204,000,000	
Motor vehicle at cost	88,000,000	
Accumulated depreciation		
Equipment (30th June, 2015)		**45,000,000**
Motor vehicle (30th June 2015)		**18,000,000**
Trade receivables	102,000,000	
Trade payables		84,000,000
Bank		6,600,000
Sundry expenses	17,000,000	
Cash	1,000,000	
Capital as at (1st July 2015)		200,000,000
Accumulated profit (1st July 2015)		43,200,000
Sales		856,000,000
Sales returns	4,000,000	
Purchases	604,000,000	
Purchases returns		2,000,000
Carriage inwards	1,000,000	
Carriage outwards	1,800,000	
Wages and salaries	134,000,000	
Rent	28,000,000	
Heating and lighting	10,000,000	
Inventory (1st July 2015)	30,000,000	
Drawings	44,000,000	
Provision for doubtful debts		8,000,000
Tax liability		6,000,000
	1,268,800,000	**1,268,800,000**

The following additional information as at 30th June 2016 is also provided:

(i) Owing for heating and lighting expenses amounting to TZS.800,000

(ii) Rent prepaid amounting to TZS.1,400,000

(iii) Allowance for doubtful debt was estimated to increase by TZS.9,000,000 and bad debt of TZS.2,400,000 should be written off.

(iv) Depreciation is to be charged for the year as follows:

   i. Motor vehicle – 20% per annum (straight line method)

   ii. Equipment – 10% per annum (reducing balance method).

(v) Inventory as at 30th June 2016 was valued at TZS.33,000,000.

(vi) Tax provision for the year amount to TZS.2,300,000.

REQUIRED:

Prepare for Brown:

(a) Statement of profit or loss for the year ended 30th June 2016

(b) Statement of Financial Position as at 30th June 2016

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **D.**

Answer to SEQ 2

The correct option is **B.**

A complete set of financial statements consists of: a statement of financial position, a statement of profit or loss and other comprehensive income, a statement on changes in equity, statement of cash flow and notes to the financial statements.

Other reports may be included in an annual report but are not part of the financial statements e.g. management reports.

Answer to SEQ 3

The correct option is **C.**

The main purpose of the financial statement is to portray the financial position and performance of the entity and thus satisfy the information needs of stakeholders.

Answer to SEQ 4

The correct option is **A**.

Answer to SEQ 5

The correct answer is

A False
B True
C True

Answer to SEQ 6

The correct option is **D.**

Royalty and dividend received are income. Share capital is equity. Purchases of goods are expenses of the business. This is because it will amount to a decrease in future economic benefits on account of a decrease in an asset i.e. cash and the amount paid can be measured reliably.

Answer to SEQ 7

The correct option is **C**.
According to the accrual system of accounting, expenses should be recorded in the financial statements when they are incurred.

Answer to SEQ 8

The correct option is **C**.

Retained earnings appear only in the books of companies. In the case of sole proprietors, profit is added to the capital, and in the case of partnerships; profit is distributed amongst the partners.

Answer to SEQ 9

Statement of profit or loss for the year to 31/12/20X3

	Tshs'000	Tshs'000
Revenue Cost of		104,250
sales Opening		
inventory	15,700	
Purchases (W1)	76,500	
	92,200	
Less: Closing inventory	(12,300)	
Cost of goods sold		79,900
Gross profit		**24,350**
Expenses		
Salaries (3,000 + 500)	3,500	
Electricity (900 + 100)	1,000	
Telephone (400 + 50)	450	
Printing and stationery	500	
Refreshments	300	5,750
Profit for the year		**18,600**

W1 Purchases

	Tshs'000	Tshs'000
List price of purchases	80,000	
Less: Trade discount at 2.5% X Tshs80 million	(2,000)	78,000
Less: Settlement discount (Tshs50 million x 3%)		(1,500)
Net purchases		**76,500**

Answer to SEQ 10

Mzuri Cosmetics - Statement of financial position as at 31 March 20X3

	Tshs'000	Tshs'000
Assets		
Non-current assets		
Building (Tshs90 million – Tshs12 million)	78,000	
Furniture and fixtures (Tshs14.2 million - Tshs5.8 million)	8,400	
Vehicles (Tshs15 million - Tshs3.9 million)	11,100	
Computers (Tshs17.25 million - Tshs7.5 million)	9,750	
		107,250
Current assets		
Inventories	12,450	
Trade receivable	3,165	
Prepaid insurance	645	
Advance to employees	5,000	
Cash in hand	1,200	
		22,460
Total assets		**129,710**

Continued on the next page

	Tshs'000	Tshs'000
Capital And Liabilities		
Capital		
As at 1 April 20X2	73,640	
Add: Profit for the year	13,800	
Less: Drawings	(9,000)	
At 31 March 20X3		78,440
Non-current liabilities		
Bank loan		45,000
Current liabilities		
Trade payable	1,725	
Tax payable	3,525	
Electricity expenses payable	1,020	
		6,270
Total capital and liabilities		**129,710**

Answer to SEQ 11

DBT
APPROPRIATION ACCOUNT

Dr **Cr**

	Tshs'000	Tshs'000		Tshs'000	Tshs'000
			Profit for the year b/d		34,000
Partners' salaries		12,000			
Interest on capital (W2)			**Interest on drawings (W1)**		
Dhone	3,500		Dhone	180	
Boney	4,500		Boney	270	
Toney	5,000	13,000	Toney	72	522
Residual profits					
Dhone	3,809				
Boney	3,809				
Toney	1,904	9,522			
		34,522			**34,522**

Workings

W1 Interest on drawings

		Tshs'000
Dhone	Tshs6 million at 6% for 6 months	180
Boney	Tshs9 million at 6% for 6 months	270
Toney	Tshs2.4 million at 6% for 6 months	72
		522

W2 Interest on capital

		Tshs'000
Dhone	Tshs35 million at 10%	3,500
Boney	Tshs45 million at 10%	4,500
Toney	Tshs50 million at 10%	5,000
		13,000

Capital Accounts

Dr	Dhone Tshs'000	Boney Tshs'000	Toney Tshs'000		Dhone Tshs'000	Boney Tshs'000	Toney Tshs'000 Cr
				Balance b/d	35,000	45,000	50,000
Balance c/d	35,000	45,000	50,000				
	35,000	**45,000**	**50,000**		**35,000**	**45,000**	**50,000**

Current Accounts

Dr	Dhone Tshs'000	Boney Tshs'000	Toney Tshs'000		Dhone Tshs'000	Boney Tshs'000	Toney Tshs'000 Cr
Drawings	6,000	9,000	2,400	Balance b/d	3,871	4,961	6,568
Interest on drawings	180	270	72	Salary	6,000	6,000	
				Interest on capital (at 6%)	3,500	4,500	5,000
				Residual profit	3,809	3,809	1,904
Balance c/d	11,000	10,000	11,000				
	17,180	**19,270**	**13,472**		**17,180**	**19,270**	**13,472**

Statement of financial position as on 31 December 20X3

	Tshs'000	Tshs'000
Capital accounts		
Dhone	35,000	
Boney	45,000	
Toney	50,000	130,000
Current accounts		
Dhone	11,000	
Boney	10,000	
Toney	11,000	32,000
Long-term loan		13,000
Accounts payables		35,000
		210,000
Non-current assets		75,000
Current assets		
Accounts receivable		57,000
Cash		33,000
Inventory		45,000
		210,000

Answer to SEQ 12

Bristol Ltd – Statement of profit or loss for the year to 31 March 20X9

	Tshs'000
Revenue	1,299,100
Less: Cost of sales (W1)	(893,475)
Gross profit	**405,625**
Operating expenses	(68,200)
Administrative expenses (W3)	(4,400)
Finance cost (W4)	(19,800)
Profit before tax	**313,225**
Tax	(62,150)
Profit after tax	**251,075**

Bristol Ltd - Statement of financial position for the year ended 31 March 20X9

	Tshs'000	Tshs'000
Assets		
Non-current assets		
Property, plant and equipment (W2)		764,500
Land		22,000
Current assets		
Inventories	46,750	
Trade receivables (Tshs198,000 - Tshs9,900)	188,100	234,850
Total assets		**1,021,350**
Equity and Liabilities		
Share capital		
Ordinary shares of Tshs1,000 each		330,000
Retained earnings (W5)		275,000
Total equity		**6054,000**
Non-current liabilities		
Long-term borrowings – 12 % Loan notes		220,000
Current liabilities		
Trade payables	83,600	
Bank overdraft	44,000	
Accrued finance costs (W4)	6,600	
Income tax provision	62,150	196,350
Total equity and liabilities		**1,021,350**

Workings

W1 Cost of sales

	Tshs'000	Tshs'000
Opening inventory		106,975
Add: Purchases	703,175	
Less: Purchase return	(7,425)	695,750
Less: Closing inventory		(46,750)
Cost of material consumed		**755,975**
Depreciation / Amortisation (W2)		
- Building	71,500	
- Plant	66,000	137,500
		893,475

W2 Non-current assets

	Building	Plant
	Tshs'000	Tshs'000
Cost	715,000	463,650
Less: Accumulated depreciation	(143,000)	(133,650)
	572,000	**330,000**
Less: Depreciation / Amortisation for the year		
Building Tshs715,000 x 10%	(71,500)	
Plant Tshs330,000 x 20%		(66,000)
	500,500	**264,000**

Total of property, plant and equipment = Tshs500,500 + Tshs264,000 = Tshs764,000

W3 Allowance for receivables

	Tshs'000
Allowance to be maintained (5% of Tshs198,000)	9,900
Less: Existing allowance	(5,500)
To SOPL – administrative expenses	**4,400**

W4 Finance cost

	Tshs'000
Accrued loan interest 9 months (01/07/20X8 to 31/03/20X9): Tshs220,000 x 12% x 9/12	19,800
Less: Paid / Accounted for, according to question	(13,200)
Additional provision required	**6,600**

W5 Retained earnings

	Tshs'000
Per trial balance	23,925
Add: Profit for the year	251,075
	275,000

Answer to SEQ 13

(a)

Upendo Enterprises
The Statement of Income for the year ending 31st December 2014

	Tshs '000'	Tshs '000'
Sales	42,900	
Less: Returns	60	42,840
Cost of sales		30,100
Gross profit		12.740
Discount received		160
		12,900
Less: Operating expenses		
Selling and Distribution expenses (5400 – 20)	5,380	
Administration expenses 3,300 + 574 + 930	4,804	
Finance charges 2,130 + 30 + 150	2,310	12,494
Net Profit		406

(b)

Upendo Enterprises
The Statement of Financial Position at 31st December 2014

ASSETS

Non-current Assets		
Buildings 29.800 – 1100 – 574		28,126
Motor vehicles 18,600 – 3,600 – 930		14,070
		42,196
Current Assets		
Stocks	1,450	
Prepaid expenses	20	
Debtors	1,990	
Cash and Bank	2,350	**5,810**
Total Assets		**48,006**

EQUITY & LIABILITIES

Equity		
Capital beg	45,860	
Profits	406	
Less: Drawings	180	46,086
Liabilities		
Creditors	1,890	
Accrued exp	30	1,920
Total Equity & Liabilities		**48,006**

Answer to SEQ 14

(a) **BROWN**

INCOME STATEMENT FOR THE YEAR ENDING 30TH JUNE 2016

	TZS ('000')	TZS ('000')
Sales (856,000 – 4,000)		852,000
Loss: Cost of sales		
Opening stock	30,000	
+ Purchases	604,000	
+ Carriage inwards	1,000	
- Return outwards	(2,000)	
- Closing stock	(33,000)	600,000
Gross Profit		252,000
Sundry expenses	(17,000)	
Carriage outwards	(1,800)	
Wages & salaries	(134,000)	
Rent (28,000 – 1,400)	(26,600)	
Heat + Light (10,000 + 800)	(10,800)	
Increase provision & Doubtful debt	(9,000)	
Bad debt	(2,400)	
Depreciation		
M.V – (20% x 88,000)	(17,600)	
Equipt – (10% x (204,000 – 45,000)	(15,900)	(235,100)
Net profit before tax		16,900
Tax expense		(2,300)
Net Profit After Tax		14,600 =====

(b) BROWN

STATEMENT OF FINANCIAL POSITION AS AT 30TH JUNE 2016

	TZS ('000')	TZS ('000')
Non-Current Assets		
Equipment (204,000 – 45,000 – 15,900)		143,100
Motor vehicle (88,000 – 18,000 – 17,600)		52,400
		195,500
Current Assets		
Inventory	33,000	
Debtors (102,000 – 9,000 – 2,400 – 8,000)	82,600	
Cash	1,000	
Prepaid rent	1,400	118,000
		313,500
Financial by equity + liability		
Equity		
Capital	200,000	
+ Profit (43,200 + 14,600)	57,800	
- Drawings	(44,000)	213,800
Current Liabilities		
Trade payables	84,000	
Outstanding Heat exp	800	
Tax liability (6,000 + 2.300)	8,300	
Bank Overdraft	6,600	99,700
		313,500