

Dual effect

Every business transaction has an equal and opposite effect.

Example 1

Terry is a sole trader and commences business on 1 July 2015. The following transactions took place during his first week of trading:

- 1.7.2015 Terry put \$20,000 cash into the business.
- 3.7.2015 Terry purchased a motor vehicle for use within the business for \$9,500.
- 7.7.2015 Terry takes out a five-year loan from the bank for \$5,000.

Required:

Show the accounting equation for Terry at the end of the week.

ACCRUED EXPENSES

An accrual is required in the event that a business has received goods or a service, but has neither recorded an invoice or made payment in the relevant financial period.

The double entry journal to record an accrual is:

Dr Expense	(Statement of profit or loss)
Cr Accruals	(Statement of financial position)

Example 1

Fleetwood Designs Co incorporates on 1 February 2014. The business receives gas bills quarterly in arrears. The company's year-end is the 31 December. The following bills were received and paid:

30 April 2014	\$300
31 July 2014	\$310
31 October 2014	\$300
31 January 2015	\$300

Required:

What is the amount for the gas expense to be shown in the statement of profit or loss for the period ended 31 December 2014?

Example 2

Julia is a sole trader who has been in business for a number of years. At 1 March 2014 she had an accrual brought forward of \$1,200 in relation to rent.

Rent is paid as follows:

7 April 2014	\$1,500 (for the quarter ended 31 March 2014)
9 July 2014	\$1,950 (for the quarter ended 30 June 2014)
6 October 2014	\$2,250 (for the quarter ended 30 September 2014)
9 January 2015	\$1,650 (for the quarter ended 31 December 2014)
9 April 2015	\$1,650 (for the quarter ended 31 March 2015)

Required:

Prepare the rent ledger account showing the rent expense to be included in the statement of profit or loss for the year ended 28 February 2015.

PREPAID EXPENSES

A prepayment arises when an expense is recorded in the accounts which relates to a future accounting period.

The double entry journal to record a prepayment is:

Dr Prepayments	(Statement of financial position)
Cr Expense	(Statement of profit or loss)

Example 3

Mariah starts her business on 1 August 2014, and pays her insurance for the year to 31 July 2015 totaling \$1,800. Her year-end is 31 December each year.

Required:

What is the amount for the insurance expense to be shown in the statement of profit or loss for the year ended 31 December 2014?

Example 4

Continuing the previous example, on 1 August 2015 Mariah pays her insurance for the year to 31 July 2016 totaling \$2,200.

Required:

What is the amount for the insurance expense to be shown in the statement of profit or loss for the year ended 31 December 2015?

ACCRUED INCOME

Accrued income arises when goods/services have been provided in an accounting period, yet no income has been recorded.

The double entry journal to record accrued income is:

Dr Accrued income	(Statement of financial position)
Cr Income	(Statement of profit or loss)

Example 5

Jen has been sub-letting one of her properties to a tenant for many years. She receives rent quarterly in arrears. At 30 November 2014 she had a balance of rent in arrears of \$27,600. The total amount of rent received during the year ended 30 November 2015 was \$718,050. At 30 November 2015 there was still rent in arrears of \$31,800.

Required:

What is the amount of rental income to be shown in the statement of profit or loss for the year ended 30 November 2015?

DEFERRED INCOME

Deferred income arises when income has been recorded, but the goods/service has yet to be provided, which will take place during a future accounting period.

The double entry journal to record deferred income is:

Dr Income	(Statement of profit or loss)
Cr Deferred income	(Statement of financial position)

Example 6

Mandy receives rent quarterly in advance; her financial year-end is 30 April each year. She has a balance on deferred income at 1 May 2014 of \$200.

Rent is received as follows:

1 June 2014	\$600 (covering the quarter ended 31 August 2014)
1 September 2014	\$450 (covering the quarter ended 30 November 2014)
1 December 2014	\$500 (covering the quarter ended 28 February 2015)
1 March 2015	\$600 (covering the quarter ended 31 May 2015)

Required:

What is the amount of rental income to be shown in the statement of profit or loss for the year ended 30 April 2015?

Example 1

The following errors were discovered:

1. A purchase of stationery for \$500 cash has not been recorded in the ledger accounts.
2. Computer repairs worth \$400 were posted on the debit side of the computer equipment account.
3. Commission received of \$60 was posted to the credit side of the discount received account.
4. Cash paid of \$5,500 for property maintenance has been entered into the property maintenance account and cash account as \$550.
5. A contra between the receivables control account and the payables control account of \$1,000 has been posted to both accounts on the wrong side.

Required:

Prepare the journal entries to correct each error as well as describing the type of error in each instance.

Example 1 – Published accounts

The following information has been extracted from the books of Picklette for the year to 31 March 20X9.

	Dr	Cr
	\$000	\$000
Administrative expenses	170	
Interest paid	5	
Called up share capital (ordinary shares of \$1 each)		200
Dividend	6	
Cash at bank and in hand	9	
Income tax (remaining balance from previous year)	10	
Warranty provision		90
Distribution costs	240	
Land and buildings:		
at cost (Land \$110, Buildings \$100)	210	
accumulated depreciation (at 1 April 20X8)		48
Plant and machinery:		
at cost	125	
accumulated depreciation (at 1 April 20X8)		75
Retained earnings (at 1 April 20X8)		270
10% Loan (issued in 20X7)		80
Purchases	470	
Sales		1,300
Inventory (at 1 April 20X8)	150	
Trade payables		60
Trade receivables	728	
	2,123	2,123

Additional information

- (1) Inventory at 31 March 20X9 was valued at \$250,000.
- (2) Buildings and plant and machinery are depreciated on a straight-line basis (assuming no residual value) at the following rates:

On cost:	Buildings	5%
	Plant and machinery	20%
- (3) There were no purchases or sales of non-current assets during the year to 31 March 20X9.
- (4) The depreciation charges for the year to 31 March 20X9 are to be apportioned as follows:

Cost of sales	60%
Distribution costs	20%
Administrative expenses	20%
- (6) Income taxes is for the year to 31 March 20X9 (at a rate of 30%) are estimated to be \$135,000.
- (7) The loan is repayable in five years.
- (8) The year end provision for warranty claims has been estimated at £75,000. Warranty costs are charged to administrative expenses.

Required:

Prepare Picklette plc's statement of profit or loss for the year to 31 March 20X9 and a statement of financial position as at that date.

Test your understanding 1

The following trial balance has been extracted from the books of Arran as at 31 March 20X7:

	\$000	\$000
Administration expenses	250	
Distribution costs	295	
Share capital (all ordinary shares of \$1 each)		270
Share premium		80
Revaluation surplus		20
Dividend	27	
Cash at bank and in hand	3	
Receivables	233	
Interest paid	25	
Dividends received		15
Interest received		1
Land and buildings at cost (land 380, buildings 100)	480	
Land and buildings: accumulated depreciation		30
Plant and machinery at cost	400	
Plant and machinery: accumulated depreciation		170
Retained earnings account (at 1 April 20X6)		235
Purchases	1,260	
Sales		2,165
Inventory at 1 April 20X6	140	
Trade payables		27
Bank loan		100
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	3,113	3,113

Additional information

- (1) Inventory at 31 March 20X7 was valued at a cost of \$95,000. Included in this balance were goods that had cost \$15,000. These goods had become damaged during the year and it is considered that following remedial work the goods could be sold for \$5,000.
- (2) Depreciation for the year to 31 March 20X7 is to be charged against cost of sales as follows:

Buildings	5% on cost (straight line)
Plant and machinery	30% on carrying value (CV) (reducing balance)
- (3) Income tax of \$165,000 is to be provided for the year to 31 March 20X7.
- (4) Land is to be revalued upwards by \$100,000.

Prepare the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of financial position for year ended 31 March 20X7.

Test your understanding 2

The following trial balance relates to P at 31 March 20X1:

	Dr	Cr
	\$000	\$000
Revenue		5,300
Cost of sales	1,350	
Dividends received		210
Administration expenses	490	
Distribution costs	370	
Interest payable	190	
Prepayments	25	
Dividends paid	390	
Property, plant and equipment	4,250	
Short-term investments	2,700	
Inventory at 31 March 20X1	114	
Trade receivables	418	
Cash and cash equivalents	12	
Trade payables		136
Long-term loans (repayable 20X9)		1,200
Share capital		1,500
Share premium		800
Retained earnings at 31 March 20X0		1,163
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	10,309	10,309
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The following information should also be taken into account:

- (1) The tax charge for the year has been estimated at \$470,000.
- (2) The directors declared a final dividend of \$270,000 on 3 April 20X1.

Required:

Prepare, in a form suitable for publication, the statement of profit or loss and other comprehensive income, statement of financial position and statement of changes in equity for the year ended 31 March 20X1.