ACCOUNTING CONCEPTS

Fundamental Assumptions

Fair presentation

Going concern

Accruals

Consistency

Materiality / Aggregation

Faithful representation

Substance over form

Neutrality

Prudence

Completeness

Comparability

Understandability

Separate entity

Money measurement

BASES OF VALUATION

Historic cost

Replacement cost

Net realisable value

Economic value

IAS 8: ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

1. Changes in accounting policy should only be made if required by a standard, or if the change will result in a more appropriate presentation

2. The change should be applied retrospectively (unless not practical).

   Adjustments in respect of previous periods should be made to the opening balance of retained earnings, and to comparative figures.

IAS 2: INVENTORIES

1. Value at lower of cost and net realisable value

2. Measurement of costs:

   - actual cost
   - standard cost
   - retail method
   - FIFO
   - average cost

3. If we produce our own goods, the inventory is valued at the full cost of production.
   ie including all factory overheads.
   But, do not include any non-production costs (selling and administrative costs)

4. (Not in IAS 2, but remember)
   If we reduce closing inventory, then the profit for the year will reduce.
   (However, Opening Inventory of next year will reduce, so next years profit will increase)

IAS 38 - RESEARCH & DEVELOPMENT

Research: searching for new knowledge / searching for new product

Development: developing an idea into a new product

Treatment:

Research **must** be written off in the year of expenditure in the income statement.

Development expenditure must be written off in the year of expenditure, unless:

- clearly defined product
- expenditure is measurable
- market exists for the product
- adequate resources exist

in which case, expenditure **must** be capitalised as non-current asset, and amortised (depreciated).

(**Note:** tangible non-current assets involved in research & development (e.g. research building) treated as normal non-current assets - capitalised and depreciated over expected useful life)

IAS 37 - ACCOUNTING FOR CONTINGENCIES

Provision – a liability of uncertain timing or amount

Contingent liability – a possible obligation of uncertain timing or amount

	Liability	Asset
Certain (>95%)	Accrue (Provision)	Recognise in accounts
Probable (>50%)	Accrue (Provision)	Disclose as note
Possible (<50%)	Disclose as note – contingent liability	No action
Remote (<5%)	No action	No action

TYPES OF ERROR

Errors of omission

Entry is missed out

Errors of principle

Balance sheet item entered as if Income Statement item (or vice versa)
E.g. payment for car repairs entered to Motor Vehicle Account

Errors of transposition

Number reversed
E.g. 581 entered as 851

Errors of commission

Entry posted to the wrong account
E.g. rent payment entered on Electricity Account

Compensating errors

Two (or more) errors where the net effect is zero (or very small)

IAS 10: EVENTS AFTER THE REPORTING PERIOD DATE

Events after the reporting period: events occurring between the date of the Statement of Financial Position and the date on which the accounts are approved

Treatment:

If amounts as at the date of the Statement of Financial Position are changed - alter the figures in the accounts

If amounts at the date of the Statement of Financial Position are not changed - disclose as note if material

COMPANY ACCOUNTS – DISCLOSURES (1)

Income Statement

Significant categories of revenue

Finance costs

Staff costs

Depreciation and amortization

Tax

Profit / loss on discontinuing operations

Profit / loss on sale of part of business

Statement of Financial Position

Equity
- Share Capital
- Reserves
  - Capital reserves
  - Revenue reserves

Non-current assets (and movement over year)

Current assets

Non-current liabilities

Current liabilities

COMPANY ACCOUNTS – DISCLOSURES (2)

Statement of changes in equity

Profit / loss for the year

Proceeds of issue of shares

Profit on revaluation

Dividends

Prior year adjustments

COMPANY ACCOUNTS - TERMINOLOGY

SHARE CAPITAL:

Ordinary Shares (Equity shares) The amount of the dividend each year varies (depends how well the company is doing)

Preference Shares These shares get a fixed dividend each year. (10% Preference Shares get a dividend of 10% of nominal value each year, so if the nominal value is 50c, the dividend will be 5c per year.

DIVIDENDS:

Interim dividend dividend paid during the year

Final dividend dividend paid after the end of the year (when the profits are known)

Proposed dividend the amount of the dividend has been 'suggested' by the directors, but has not been paid. (The final dividend will normally be proposed)

(Only dividends actually agreed (voted on) appear in the financial statements – not dividends proposed)

RIGHTS ISSUE OF SHARES:

New shares sold to existing shareholders (to raise cash)

BONUS ISSUE OF SHARES:

New shares given free to existing shareholders (transfer from reserves)

RESERVES:

Everything owed to shareholders in addition to the share capital

Capital Reserves Can not be paid as dividend (Share Premium Account and Revaluation Reserve)

Revenue Reserves Can be paid as dividend (Retained earnings / Accumulated Profits)

BANK RECONCILIATIONS

At 31 December 2010, the balance on the cash account was $18,260 (DR), but the balance appearing on the bank statement was $19,750 (CR).

The reasons for the difference were as follows:

1. Bank charges of $30
2. A payment of $1,200 had been entered in the cash account as $120
3. A cheque for $500 had been dishonoured
4. There were unpresented cheques totalling $8,200
5. Lodgements of $5,100 had not yet appeared on the bank statement

You are required to calculate the correct balance on the cash account, and to prepare a bank reconciliation statement.

ACCRUALS AND PREPAYMENTS

A company pays rent quarterly in arrears on 31 March, 30 June, 30 September, and 31 December each year.

The rent was increased from $60,000 to $72,000 per year as from 1 August 2010.

What rent expense and accrual should be included in the company's financial statements for the year ended 30 November 2010?

BOOKS OF PRIME ENTRY

Cash Book (usually two books – Cash Receipts Book and Cash Payments Book)

- lists of cash receipts and cash payments
- analysed into columns based on reason for receipt or payment
- not double entry

Payables Journal (also known as Purchase Day Book)

- list of purchases on credit (credit purchases)
- not double entry

Receivables Journal (also known as Sales Day Book)

- list of sales on credit (credit sales)
- not double entry

(Other books may exist as required e.g. Petty Cash Book, Returns Journal)

Individual items in these books are entered to the relevant accounts for individual customer or suppliers in the Receivables Ledger and Payables Ledger, (also known as the Personal Ledgers)

The double entries are made in the Nominal (or General) Ledger using the totals from the Books of Prime Entry. (e.g. the total of the Payables Journal is debited to Purchases Account and credited to the Payables Account)

The Total Receivables Account in the nominal ledger is known as the Receivables Ledger Control Account.

The Total Payables Account in the nominal ledger is known as the Payables Ledger Control Account.

CONTROL ACCOUNTS

The balance on the Payables Ledger Control Account for S Ltd as at 1 January 2010 was $98,000.

The following is a summary of S Ltd's transactions during year ended 31 December 2010:

Credit purchases	$224,000
Cash purchases	$2,600
Returns to suppliers	$8,000
Discounts received	$1,200
Cash paid to suppliers	$216,000
Contras with Receivables	$1,700
Refunds from suppliers	$2,000

What was the balance on the Payables Ledger Control Account at 31 December 2010?

DEPRECIATION

1 The motor vehicles at cost account of a business for the year ended 31 December 2010 was as follows:

Motor Vehicles - cost

1 Jan	Balance	80,000	31 Mar	Transfer disposal account	20,000
1 Sep	Cash – purchase of car	10,000	31 Dec	Balance	70,000
		90,000			90,000

The company's policy is to charge depreciation at 25% per year on a straight line basis, with proportionate depreciation in the years of purchase and disposal.

What is the depreciation charge for the year ended 31 December 2010?

2 At 31 December 2010, P Ltd owned a building that had been purchased 20 years previously for $20,000. It was being depreciated at 2% per year.

On 31 December 2010 it was revalued at $210,000, and had a remaining useful life of 30 years.

a) what is the depreciation charge for the year ended 31 December 2011?

b) at what amount does the revaluation reserve stand at as at 31 December 2011?

INCOMPLETE RECORDS

1. The net assets of Orange at 1 January 2010 amounted to $128,000.

   During the year to 31 December 2010, Orange introduced a further $50,000 of capital and made drawings of $48,000.

   At 31 December 2010 the net assets of Orange were $184,000.

   What was Orange's profit for the year ended 31 December 2010?

2. Plum makes a standard mark up of 30% of cost.

   The following information is available for the month of January:

   Opening inventory $10,000
   Purchases $50,000
   Sales $58,500

   Calculate the value of the closing inventory.

INVENTORY VALUATION

1. X plc had no inventory on 1 October.
During October they made the following purchases and sales:

Purchases:

10 October	200 units	$15 per unit
15 October	300 units	$18 per unit
26 October	100 units	$22 per unit

Sales:

12 October	50 units
20 October	200 units
29 October	50 units

Calculate the value of the closing inventory at 31 October, using:

a) FIFO
b) Average cost

2. Y plc has a year end of 31 December 2010, but had counted inventory on 5 January 2011 and valued it at $254,800.

Between 31 December 2010 and 5 January 2011 they had received goods from suppliers at a cost of $2,300 and sold goods to customers which has cost $8,100.

What was the inventory valuation at 31 December 2010?

IRRECOVERABLE AND DOUBTFUL DEBTS

Trade receivables at 31 December 2010 were $76,000.

An irrecoverable debt of $3,000 is to be written off.
Specific allowances of $700 and $2,300 are to be made for two doubtful debts.
A general allowance of 6% is to be maintained. The opening balance on the allowance account was $4,000.
A debt of $1,500, which was written off as irrecoverable 2 years ago, was paid in full during 2010.

a) What is the charge in the Income Statement?
b) What will appear in the Statement of Financial Position?

SALES TAX

During October, Z Ltd made sales of $42,000 (excluding sales tax) and made purchases of $23,600 (including sales tax).

The balance on the sales tax account at the beginning of October was $850 (debit).

The rate of sales tax is 18%.

What is the balance on the sales tax account at the end of October?

Businesses not registered for Sales Tax

SUSPENSE ACCOUNTS.

The totals on the trial balance of Blue were:

Debit	$23,200
Credit	$24,100

and a suspense account was opened for the difference.

The following errors were found:

1. a receipt from a customer of $2,300 had been entered correct in the cash account, but had been posted to the receivables account as $3,200.

2. a payment of $8,000 for a car had been correctly entered in the cash account, but had been posted to the credit of the motor repairs account.

What balance will remain on the suspense account after correction of these errors?

FINANCIAL RATIOS

Profitability:

Return on Capital Employed

Net Profit Margin

Asset Turnover

Gross Profit Margin

Liquidity:

Current ratio

Acid-test / Quick ratio

Receivables Days

Inventory Days

Payables Days

Gearing:

Gearing Ratio

ISSUE OF SHARES

In 2002 a company was formed by an issue of 100,000 $0.50 shares at par.

In 2007 they had a 1 for 2 rights issue at $1.20.

In 2010 they had a 1 for 6 bonus issue.

What were the balances on the share capital and share premium accounts after the bonus issue?