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⇒ (MGT101)

Final term preparation

⇒ Module (10-18)

Most important topics

⇒ Lecture no- (10)

Accounting for fixed Assets and Depreciation

★ Fixed Assets:-

Fixed Asset are also known as long life Assets, tangible assets or property, plant and equipment. Fixed assets cannot easily converted into cash.

★ Type of fixed assets:-

Land

Building

Machinery

Furniture

Equipment

2)

★ Depreciation

Depreciation is an accounting method of allocating the cost of tangible assets over its useful life. Depreciation represents how much of an asset value has been used.

✓ calculating method of depreciation

1. Straight Line Method

Depreciation Amount $\div$ Useful life = depreciation

2. Reducing balance method

Residual value $\div$ cost $\times 100$ = depreciation %

3. Service hours method

Total Estimated hours $\div$ Depreciation Amount
= Depreciation Rate per Hour

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4. Units output / produced method

Total Estimated output $\div$ Depreciation Amount
 = Depreciation Rate per unit

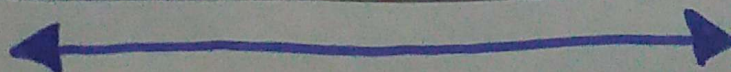
5. Sum of years digit method

We simply divide assets value on its useful life = depreciation of year.

Assets value $\div$ useful life = Depreciation year

★ Trade in allowance

When an old asset is exchanged with a new asset the seller of new asset will offer an allowance while receiving payment for selling asset in consideration of the exchange of old asset. Such allowance is known as "trade in allowance".



Lecture no- 11

Control Account

★ Ledger account

Ledger is an account that used to store bookkeeping entries for balance sheet and income statement. There are three types of ledger.

1. General
2. Debtor
3. Creditor

★ Format of Debtor and Creditor Control Account

While preparing Debtors control Accounts it must be noticed that its debit side should show the items that will cause increase in debtor's balance and items in credit side will

5)

Cause a decrease in debtor's balance

In the same way items that will cause increase in creditors balance are put in its credit side and items that will cause decrease in creditors balance are put in the debit side of creditors controls Account.

★ Control account

An account in the ledger for which a corresponding Subsidiary ledger has been created. In accounting control account also known as an adjustment account.

★ Journalizing:-

Posting all transaction from journal to ledger is called journalizing.

★ Book Keeping

Book Keeping is a process of recording all financial transaction made by a business. In book keeping we recording, classifying, and organizing all financial transaction.



Lecture no- 12

Rectification of errors

★ Rectification of errors

While performing in financial accounting classifying, recording, posting and reporting, there could be some instances of errors and omissions in the presence of which the financial statements do not present reliable and fair results of the economic phenomena of the entity. These errors and omissions need to be corrected according to the accounting rules.

★ Types of errors

- 1: Those errors that do not cause a difference in trial balance agreement.
- 2: Those errors that do ~~not~~ cause a difference in trial balance agreement.

★ Reasons of error

1. Error of Omission
2. Error of commission
3. Error of principle
4. Error of original entry
5. Compensating error.

1. Error of Omission:-

When financial information is completely omitted for recording in the books of original entry. Sales invoice of Rs. 1000 issued before closing date but not recorded in the books of original entry.

2. Error of Commission

When correct accounting effect (Dr/cr) is given in the wrong accounting head but the main head remains correct.

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e.g. purchase of computer Rs. 5000 for office was wrongly debited to the furniture account.

★3. Errors of principle

When correct accounting effect (Dr/Cr) is given in the wrong accounting head as well as the wrong main head e.g.

purchase of computer Rs. 5000 for office was wrongly debited to the stationery account. (both account belong to different main heads, like computer belongs to Asset and stationery belongs to Expense.

★4. Errors of Original entry:-

When correct accounting entry is recorded in the books of accounts but the amount in both accounting

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effect (Dr & Cr) is wrong although the amount is same.

★ 5. Compensating error

These are circumstances when the effect of one transaction is neutralized by another error. For example goods sold to Shoaib 5000 but posted into debit side with amount 500.

★ Suspense account

Whenever there is a difference in the trial balance, such amount of difference shall be named as suspense account. Suspense account is used to make both sides of trial balance equal.



Lecture no- 13

Final Accounts with Adjustment

★ What is accounting cycle process?

The Step involve in accounting cycle there are.

1. Accounting equation
2. Journal general
3. Ledger
4. Trial balance
5. Preparing final accounts (income statement and balance sheet)

★ Final Account:-

In final accounts we get an idea about the profitability and financial position of a business.

★ Preparation of final Account

Mostly the Sole proprietors prepare following two financial statements as final accounts.

1. Income Statement.
2. Balance Sheet.

1. Income Statement

Income Statement is prepared to know the financial performance of an entity. This is prepared with the help of all ledger account balance. Income statement is also called (Statement of profit or loss)

2. Balance Sheet

Balance sheet is prepared to know the financial position

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of an entity. Financial position refers to the financial strength of entity on a specific date.

★ These are five components of financial position:-

1. Statement of financial position.
2. Statement of profit or loss and other comprehensive income.
3. Statement of cash flows.
4. Statement of change in equity.
5. Notes to the financial statement.

Remember this equation:

1. $\text{Income} - \text{Expenses} = \text{Profit}$

2. $\text{Assets} = \text{Owner's equity} + \text{Liabilities}$



Lecture no- 14

Manufacturing Account

★ Manufacturing

The process of conversion from raw material into finished goods is called the manufacturing.

★ Manufacturing account:-

An account which is used to accumulate all the manufacturing costs of goods completed a business during an accounting period.

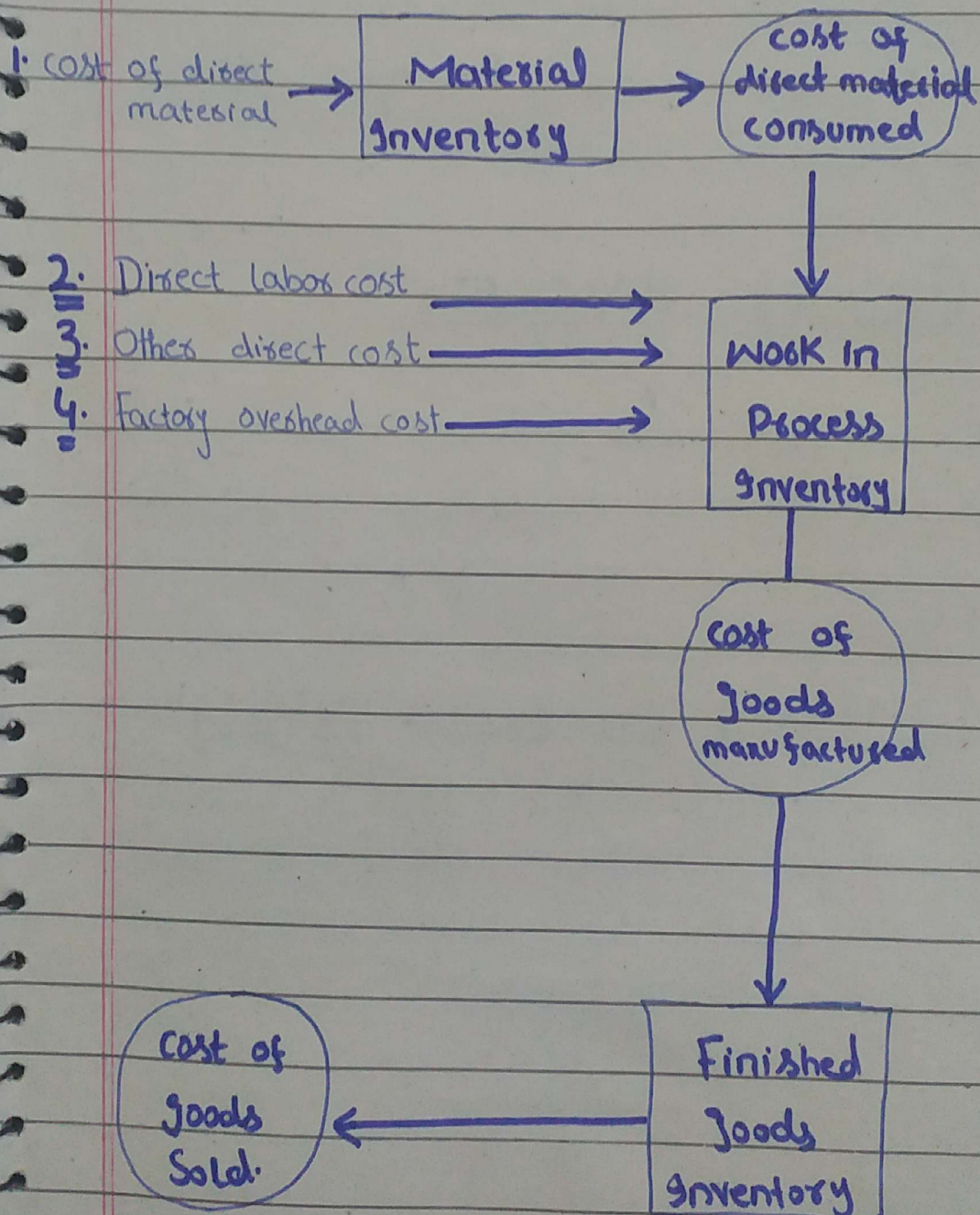
★ Manufacturing entities

A process through which raw-material is put into working where certain other costs

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are incurred to convert that raw-material into finished products. Example includes Furniture manufactures, jewelry makers.

Manufacturing cycle



★ Trading entities

Trading entities purchase goods in finished forms, make those goods available in the showroom do marketing to sell those goods to the customers. Examples include importers & exporters.

Types of Inventories

There are three types of inventories that can be identified in a manufacturing entity.

1. Material and Supplies inventory

This is the inventory for raw materials, store items, spare parts and indirect materials that are used in production.

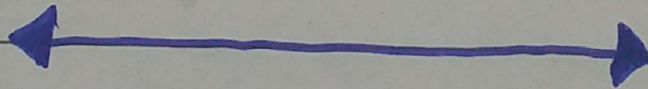
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2. Work in process inventory

This is the inventory of semi-finished goods. It is the cost that represents work in process.

3. Finished goods inventory

This is the inventory of completed products, which are ready for sale.



Lecture no- 15

Accounting for inventories

★ Inventories as per IAS2

Inventories are assets held:

(a) for sale in the ordinary course of business

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

★ Net realizable value (NRV)

It is the estimated selling price in the ordinary course

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of business less the estimated costs of completion and the estimated costs necessary to make such sale.

Important tips To remember (ITTRs)

(1)

If NRV of finished goods is less than its cost then the inventory of Raw material (which is used in production of such finished goods) shall be valued at lower of its cost and NRV (Replacement cost).

(2)

Whereas, if NRV of finished goods is greater than its cost then the inventory of Raw material (which is used in production of such finished good) shall be valued as its cost regardless of the fact that its NRV (replacement cost) is lower than its cost.

(3)

The amount of any reversal of any write-down of inventories arising from an increase in net realizable value shall be recognized as a reduction in expenses in the period in which the reversal occurs.

Inventory cost method:

If an entire inventory represents individually identifiable unit then the cost of inventory will be determined through the "Specific cost method" i.e. price per unit of individually identifiable inventory.

(i) FIFO

First in First out an

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assumption is made for costing purposes that the first items of inventory received are the first items to be sold/issued. The closing inventory comprises the item purchased most recently.

(III) (WAVCO)

Weighted average cost (WAVCO)
under this system the inventory is valued at the weighted average price of the inventory on hand. This is achieved by dividing the total cost by the total units. The average cost will be computed every time additional inventory is purchased or produced.

★ Accounting System to record inventories

There are two known methods that are used to account for inventories in the books of account;

1. Perpetual inventory System.
2. periodic inventory System.

1. Perpetual inventory System.

Under this system, a complete and continuous record of movement in each inventory item is maintained. perpetual records are useful in preparing monthly, quarterly or annual financial Statements. Records used normally a "Store ledger card" Specifying quantity wise receipt issue and balance together with values in chronological sequence.

(ii) Periodic inventory System or Physical system

Under this system, value of inventory is determined at the end of a reporting period through a physical count of inventory in store/warehouse. A continuous record is not ~~maintained~~ maintained to account for day to day movement in inventory.

★ Wages account

Wages account show cost of production.



Lectures no. 16

Accounting for partnership firms

★ Sole Proprietorship

In proprietorship the owner is one and he alone get full profit and loss.

★ partnership

In partnership the profit and loss is distributed among the partners.

★ Basis for distribution

1. Interest on capital
2. partner's salary
3. profit sharing ratio.

★ Reporting difference b/w Sole proprietorship and partnership entities

Sole proprietorship and partnership both entities prepare income statement (profit and loss account) and statement of financial position (Balance Sheet) in a same manner. The only difference that is identified while preparing reports of both types of entities is distribution of profits among the owners.

★ Profit distribution Statement

(1) For Sole proprietorship:-

The net profit/loss amount is directly transferred to the owner's capital account.

(ii) For partnership firms:-

A statement is prepared in addition to the income statement and statement of financial position (balance sheet). It shows how profit is distributed among the partners, outcome of which is the distributed profit that is then posted to the partner's current accounts.

★ Changes in constitution of partnership firm

- Admission of a new partner
- Retirement of an existing partner.
- Death of a partner.

(i) Admission of a new partner

A new partner may be admitted for different reason such as personal influence, need

of more capitals or special skills.

At the time of admission of a new partner, certain adjustments are necessary, like.

- calculation of new profit sharing ratio.
- calculations and accounting treatment of goodwill
- Revaluation of net assets

(2) Retirement of a partner

When a partner intends to retire, his/her capital account balance after adjustment for share in goodwill and revaluation gains or losses is recognized as loan (liability) to the entity.

3) Death of a partner

At the time of death of a partner, his/her share in current year's profits is estimated based on previous year's net profit or average profit of past few years' profit (it would be mentioned in partnership agreement).

★ Goodwill calculation methods

1. Average profit method
2. Super profit method
3. Market capitalization method.

1) Average profit method

Under this method, at first, average profit is calculated on the basis of the past few years' profits. After calculating average profit, it is multiplied

by a number (times) 3, or 4, or 5 whatever, as agreed.

(2) Super profit Method

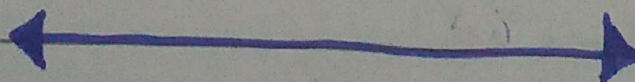
Super profit is the excess of actual profit (average profit) over the normal profit of an entity. A common method of valuation of goodwill in the Super profit method.

(3) Market Capitalization Method:-

Under this method value of the firm is first determined based on market capitalization rate using the following formula:

Market rate of return / Average profit of the firm $\times 100$

The above formula will give an estimate of firm's value in the market.



Lecture no. 17

Company Financial Statements (Final Account)

★ Statement of financial position - SoFP (Balance Sheet)

Statement of financial position is prepared at a specific date i.e., at the end of reporting period. It presents financial status of the company by representing recognizing assets, equity and liability items.

★ Fixed Tangible Assets

These are the property, plant and equipment that are held by the entity a) for production or selling of goods or services.

Examples: Land, ~~the~~ Building, plant and machinery, furniture and fixtures,

Motor vehicles, office equipment etc.

~~the~~ Fixed Intangible Assets

★ Fixed Intangible Assets

These are the identifiable non-monetary asset in control of the entity that have no physical existence and are expected to be useful for the entity for more than one accounting year.

Examples include; Trade mark

★ Current Assets

These are the assets recoverable and tradable within the normal operating cycle of an entity that is 12 months after the reporting date in normal circumstances.

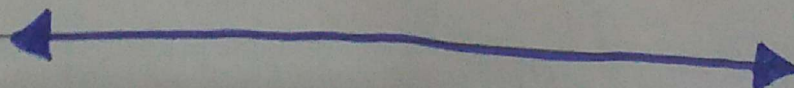
cash and cash equivalents are also current assets.

★ Current Liabilities

These are the present obligation of the entity that are payable within the normal operating cycle of an entity that is 12 months after the reporting date in normal circumstances. These also include bank overdraft and short-term debts.

★ Non-current Liabilities

These are the present obligation of the entity that are payable after one or more than one accounting year. These includes; lease liabilities, bank loans, issuance of loan certificates and bonds.



Lecture no- 18

Statement of cash flows

★ Purpose of Preparing statement of cash flows

Statement of cash flows is an analytical statement that is prepared to analyze all cash receipts and cash payment during an accounting period.

Cash Receipts = cash in flows

Cash Payments = cash out-flows.

★ Cash Book

It is maintained chronologically for all receipts and payments. It is a book of original entries to record cash transactions only. In the presence of cash.

Book, cash account and bank account are not maintained in a general ledger therefore cash Book is considered as a book of Secondary entry.

★ Receipt & Payment Account

It is a report that is prepared at the end of a reporting period. It is maintained for small entities. Particularly the non-profit organizations which do not follow accrual basis of reporting.

★ Statement of cash flows

It is an analysis of all receipts and payments that occurred during the reporting period. It is analyzed into three activities i.e., operating Activity, Investing Activity, Financing Activity. It is

prepared for a specific reporting period and becomes integral component of financial statements as per IAS 1.

★ All cash flows relating to investing activity originate from Non-current Assets.

★ All cash flows relating to financing activity originate from Owner's Equity and Non-current Liabilities.

The End

← Alhamdulillah →