

## **ACCOUNTING GRADE 10**

### **TERM 2 : 2020 REVISED ATP**

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### **YEAR-END ADJUSTMENTS**

**NOTE:** Adjustments are building blocks to Financial Statements hence reference will often be made to Financial Statements as introduced to you in Grade 9. It is imperative to read this document with understanding and seek assistance from your teacher when you will be encountering difficulties. You will receive relevant activities that will put principles contained in this document into practice. Enjoy!

### **TRADING STOCK DEFICIT/SURPLUS.**

Trading stock deficit will occur when the inventory balance in the Trial Balance is more than the actual physical stock.

#### **Example:**

Balance as per Pre-adjustment Trial Balance

Trading stock: R120 000

#### **Adjustment:**

**The value of inventory according to stock taking revealed that inventory on hand amounted to R105 000**

Balance of physical stock count on: R105000

This will result in a trading stock deficit of  $120000 - 105000 = 15000$ .

### Effect on elements of accounting equation

Account debited	Account credited	Effects on Assets	Effects on Equity	Effects on Liabilities
Trading stock deficit	Trading stock	- 15 000	- 15 000	0

The deficit will also be an operating expense in the Statement of Comprehensive Income (Income statement).

### Trading stock deficit (120000-105000) 15000

**Please show your workings in brackets as you earn part-marks.**

The trading stock surplus is just the opposite way and will be shown in the 'other incomes' of the Statement of Comprehensive Income (Income statement).

**NOTE:** Take any adjustment to inventory into account if it appears before this one in the question.

This is an important adjustment and is always asked. 2-3 easy marks so make sure you get them.

### Reason behind trading stock deficit

During the financial year some of the trading stock purchased by the business during the year, may have gone lost or stolen. A physical stock count is normally done by many businesses at month end and at year-end. A stock shortage or deficit occurs when the value of the physical stock items on hand, is less than the value of stock in the ledger or stock records. Trading stock shortage or deficit is an expense to the business.

## CONSUMABLE STORES ON HAND

Expense items such as stationery, packing material, consumable stores, etc. may have been purchased during the year to be used in the business activities. If any of these expenses are not yet used or consumed at the end of a financial year, they will be used or consumed in the next financial year. The unused stock of these items can be regarded as a consumable stores on hand at the end of the financial year. Consumable stores on hand is an **asset** for the business. **Note** that these are not the Trading Stock Items of the Business as they were not purchased for resale purposes. At the end of the financial year **Dr Consumable Stores on hand (assets increase) and Cr (consumable item e.g. Stationery, packing material, consumables stores) (expenses for the current year decrease and so Owners' Equity increases).**

### Example:

For example, the Pre-Adjustment Trial Balance reflects stationery expenses of R5 000. At the end of the financial year (on 28/29 February), after we have done a physical count of our stationery, we found that there was R400 of stationery on hand, which was not yet used or consumed. This R400 value of unused stationery will result into a Dr Consumable stores on hand (Asset) and Cr Stationery (Owners' Equity)

### Consumable item (Stationery)- Expense Recorded

When a business purchases **Stationery** cash or on credit ,they make necessary entries in the books of first and secondary entries, and will so also record on the Nominal Account Section of Pre-Adjustment Trial Balance (book of third entry) Stationery (as an expense). At the end of an accounting period, the consumable items on hand are counted and amount **used** is recorded as an expense in the Statement of Comprehensive Income (Income statement) (R4 600 (5 000- 400) in the example) and unused inventory of a consumable item will increase Consumable stores on hand (**asset**) and will be recorded in the Statement of Financial Position (**Balance Sheet**).

**Workings in the Statement of Comprehensive Income (Income Statement)** will appear as Stationery (5 000 – 400 = 4 600). In Inventories (Note 4), add R400 for consumable stores on hand.

## **What is Depreciation?**

In accounting terms, depreciation is defined as the reduction of recorded cost of a fixed asset in a systematic manner until the value of the asset becomes zero or negligible. Depreciation will affect Note 3 in the notes to the financial statements. When you will be preparing **notes and financial statements** you will see how Depreciation affect Tangible Assets.

An example of Fixed Assets (Tangible Assets) are Land and buildings, Equipment (such as computers, machines, etc), Vehicles, etc. Land and Buildings is the only exception which cannot be depreciated as the value of land appreciates with time (**later in your studies Buildings** will be stand-alone fixed assets)

## **What Is Accumulated Depreciation?**

The accumulated depreciation account is a negative asset account on a Sole Traders' Statement of Financial Position (Balance Sheet), meaning it has a credit balance. It appears on the Statement of Financial Position (Balance Sheet) as a reduction from the gross amount of fixed assets reported (**i.e. Cost of Tangible Assets – Accumulated Depreciation = Carrying value**).

The amount of **accumulated depreciation** for an asset or group of assets will increase over time as depreciation expenses continue to be credited against the assets. When an asset is eventually sold or put out of use (asset disposal), the amount of the accumulated depreciation that is associated with that asset will be calculated so as to get the carrying value of an asset at the date of sale. In the Statement of Financial Position (Balance Sheet) assets are recorded at carrying value (prudence principle).

**Depreciation is an expense** recognized on the Statement of Comprehensive Income (Income Statement) as a non-cash expense that reduces the businesses' net income. For accounting purposes, the depreciation expense is Debited, and the accumulated depreciation is Credited. Depreciation is considered a non-cash expense because the

recurring monthly depreciation entry does not involve a cash transaction (entry is made in the General Journal and not in the Cash Payment Journal).

### **BAD DEBTS MEANING**

A bad debt is a receivable (amount owed to the business) that is now irrecoverable from that person who supposed to pay the business. The reason for nonpayment by the debtors is that they have either go bankrupt, have financial problems or collection by the creditors (business in this context) due to various reasons is not possible.

### **REASONS FOR BAD DEBT**

- When debtors are **poorly managing their finances**, they cannot timely pay their debts.
- Debtors **inability or unwillingness** to pay is one of the major reasons for the debts to become bad.
- When the creditors are **not able to collect** the debts due to some of the other reasons.
- When **disputes** arise regarding the price, quality, delivery, product, credit term, etc; the debts become bad.

**Accounting entry required to write off a bad debt in General Journal is as follows:**

<b>Debit</b>	Bad Debts
<b>Credit</b>	Debtors' Control (Name of a debtor)

- The debit entry has the effect of cancelling/reversing the impact on profit of the sales that were previously recognized in the Statement of Comprehensive Income (Income Statement) at the point of sale (i.e. Dr Debtors' Control and Cr Sales). The credit entry reduces the debtors' balance to nil as no amount is expected to be recovered from the receivable. This will also affect Debtors' Ledger credit column of the debtor concerned.
- **Example**
- Cwangco Traders sells goods to Uyanda for R500 on credit. Cwangco Traders subsequently finds out that Uyanda is being liquidated and therefore the prospects of recovering its dues are very low.

- Cwangco Traders should write off the receivable from Uyanda in view of the circumstances. The double entry will be recorded as follows:

<b>Debit</b>	Bad Debts	<i>R500</i>
<b>Credit</b>	Debtors' Control (Uyanda)	<i>R500</i>

- **Bad Debts Recovered**

Occasionally, a bad debtor previously written off may subsequently settle its debt in full or in part. In such case, it will be necessary to cancel the effect of bad debt expense previously recognized up to the amount settlement.

- **Example**

- Cwangco Traders sells goods to Uyanda for R500 on credit. Cwangco Traders subsequently finds out that Uyanda is being liquidated and therefore the prospects of recovering its dues are very low. Cwangco Traders therefore writes off the receivable from its books. However, the administrator appointed to oversee the liquidation of Uyanda instructs the company to pay R300 (or 60 cents in a rand (**i.e.  $R300/500 \times 100 = 60 \text{ CENTS}$** ) to Cwangco Traders.
- As R300 of the bad debt has been recovered, it is necessary to cancel the effect of previously recognized bad debt expense up to this amount. The accounting entry will therefore be as follows:

<b>Debit</b>	Bank	<i>R300</i>
<b>Credit</b>	Bad Debt Recovered (Income)	<i>R300</i>

It therefore means in this scenario the amount to be written off will end up be 40 cents in the rand (100 cents – 60 cents) or R200 (R500 – 300).

### **Bad Debts Recovered**

**Q:** 1. Is recovery of bad debts included in the control accounts?

2. Once a debt is written off as a bad debt, when it is recovered, do we debit it in the debtors control account? Or we do not include it in the control account at all as the debt

is already written off as irrecoverable?

**A: 1. No.**

2. The journal entry for this would be:

**DR Bank**

**CR Bad debts recovered (income)**

So you are correct. As you can see from the **debit** and **credit** above it doesn't affect the debtor's control account at all.

Even if your business has **the best credit policies**, you still should anticipate delinquent and unpaid customer accounts as a cost of doing business. While collection efforts on certain customers may initially result in a business loss, some customers may desire to pay their outstanding debt at a future date. Recovering the payment on a businesses' books requires you to make a few simple entries to the businesses' general ledger that are later reflected on its financial statements.

### **Accrued Income**

It is income earned during the financial year but not received until the end of the financial year. It is **treated as an asset** for the business as it increases debtors' for the business. Journal entry for Accrued Income recognizes the accounting rule of "Debit the increase in assets".

**Examples of accrued income** – Interest on investment earned but not received, rent earned but not collected, commission due to being received, etc.

**Journal entry for accrued income is;**

<b>Accrued Income</b>	<b>Debit</b>	Debit the increase in asset
<b>Income</b>	<b>Credit</b>	Credit the increase in income

**Related adjustment – Journal Entry for Income Received in Advance\_ensure that you can distinguish between the two.**

Accrued income is also known as **income receivable, outstanding income** and **income earned but not received**.

As per GAAP ACCRUAL CONCEPT **income must be recognized during the period it is earned irrespective of when the money is received.**

### **Simplifying with an Example**

**Question** – On 31 December 2019 Manyano Traders calculated R50,000 as rent earned but not received for 12 months from 1 January 2019 to December 2019.

The same amount has been received in cash next year on 10 January 2020. Show all related rent entries including the journal entry for accrued income on these dates;

1. 31 December 2019 (Same day)
2. 10 January 2020 (When the payment is received)

1. 31 **December 2019** – (Rent earned but not received)

Accrued Income	R50 000
Rent Income	R50 000

2. 10 **January 2020** – (Received cash# **in lieu or instead** of accrued rent from 2019)

Bank	50 000
Accrued Income	50 000

**# improve your vocabulary (Language Across Curriculum)**

### **Treatment of Accrued Income in Financial Statements**

After **posting the journal entry** for accrued income a business records it in the financial statements as follows:

1. Shows it under 'other incomes' in the case of operating incomes in the Statement of Comprehensive Income (Income Statement) (e.g. Rent Income unknown amount received as per Pre-Adjustment Trial Balance + R50 000 receivable = total amount for rent)
2. Shows Accrued Income in the Statement of Financial Position (**Balance Sheet**) under the heading "Current Assets under Trade and other receivables".

### **Example – Journal Entry for Accrued Commission**

Let's assume that in March there was R30,000 as commission earned but not received due to business reasons.

At the end of the month, the company will record the situation into their books with the below journal entry.

Accrued income	30 000
Commission income	30 000

**(Commission earned but not received)**

### **Prepaid Expenses, Accrued Income and Income Received in Advanced**

As we know that accounting is done on the basis of the Accrual concept. As per this concept, we not only record the transactions that are in cash only but also those which relate to the Financial Year whether in cash or not. In order to determine the correct profit and loss and the true and fair financial position at the end of the year, we need to account for all the expenses and incomes pertaining to the current accounting period. Thus, Accrued Expenses, Prepaid Expenses, Accrued Income and Income Received In Advance require adjustment.

### **Accrued Expenses**

Sometimes in the normal course of business, a sole trader may have some expenses relating to the current accounting period, in which the payment is due at the end of the year. At the end of the accounting period the payment is not yet actually made.

Wages, salary, rent, interest on the loan, etc. are examples of such expenses that may remain due at the end of the accounting year. **However**, you need to record them as they relate to the expenses of the current year. Like all other expenses, they are also a charge against the profit of the current year.

Accrued Expenses is a Liability to the business. Why? As an outstanding expense of the business it increases creditors of the business. The business has not settled its dues and so liabilities are increasing.

**Worked Example:**

R5 000 is still owed to Buffalo City Municipality for water and electricity at the end of the financial year.

**Required:**

1. Journalise the adjustment
2. What will be the impact of this transaction on elements of accounting equation
3. How financial statements will be affected

**Answer:**

1.

Debit	Water and electricity
Credit	Accrued expenses

2.

<b>Assets</b>	<b>Owners' equity</b>	<b>liabilities</b>
0	- 5 000	+ 5 000

3.

### **Statement of Comprehensive Income (Income Statement)**

#### **Operating expenses**

Water and electricity (amount given in Pre-adjustment Trial Balance + 5000)

### **Statement of Financial Position (Balance Sheet)**

#### **Current Liabilities**

Trade and other payables (5 000)

#### **Income received in advance**

Sometimes earned revenue that **belongs to a future accounting period** is received in the current accounting period, such income is considered as income received in advance. This revenue is not related to the current accounting period, **for example**, Rent received in advance, Commission received in advance, etc. Under the Accrual Concept, when a business receives money from a customer prior to earning it, the business will have to make the following entry:

### **When money is received:**

Debit Bank

Credit Income Account

### **At the end of the financial year (Journal):**

Debit Income Account

Credit Income received in advance

Income received in advance is a **liability** account. At the end of the financial year the credit of Income received in advance implies increase to liabilities. In Accounting we state that the business is **deferring** the revenue until it is earned. **Income received in advance is also referred to as deferred income.** Once the money is earned, the liability will be decreased and an income account will be increased.

### **Treatment in the Financial Statements**

1. **Statement of Comprehensive Income (Income Statement)**- Other incomes e.g Rent Income (Amount as per Pre-adjustment Trial Balance – amount received in advance for the next accounting period)
2. **Statement of Financial Position (Balance Sheet) under Current Liabilities**- Trade and other payables (+ income received in advance)

### **Prepaid Expenses**

Prepaid expenses are future expenses that have been paid in advance. In other words, prepaid expenses are costs that have been paid but are not yet used up or have not yet expired. Prepaid expense is a current asset account of the business. Generally, the amount of prepaid expenses that will be used up within one year are reported on a sole traders' Statement of Financial Position (Balance Sheet) as a current asset. As the amount expires, the current asset is reduced and the amount of the reduction is reported as an **expense** on the Statement of Comprehensive Income (Income Statement).

### **Example of Prepaid Expenses**

Insurance premium of R7 500 belongs to the first quarter of the next accounting period

#### **Point of payment (CPJ):**

Debit : Insurance (overstatement of expenses of the current year)

Credit : Bank

#### **Journal entry end of the year:**

Debit : Prepaid Expenses

Credit: Insurance

#### **Statement of Comprehensive Income:**

Operating expenses e.g. (Insurance: amount as per Pre-adjustment Trial Balance less amount paid in advance)

#### **Statement of Financial Position (Balance Sheet)**

Current Assets

Trade and other receivables (+5 000)