



**NATIONAL OPEN UNIVERSITY OF NIGERIA**

**SCHOOL OF BUSINESS AND HUMAN RESOURCE MANAGEMENT**

**COURSE CODE: HCM334**

**COURSE TITLE: Financial Accounting/Management for Hospitality and Tourism**



**HCM334**  
**FINANCIAL ACCOUNTING/MANAGEMENT FOR**  
**HOSPITALITY AND TOURISM**

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## **Introduction**

The course, Financial Accounting/Management for Hospitality and Tourism (HCM334), is a core course which carries three credit units. It is prepared and made available to all the students of Hotel and Catering Management (HCM) Programme at the appropriate level. The course is a useful material to you in your academic pursuit as well as in your workplace as a hotel and catering manager.

## **What You will Learn in this Course**

The course is made up of fifteen units, covering major introductory areas of accounting (both management accounting and financial accounting). The scope, concept and conventions of accounting are discussed; the historical development of accounting as a discipline of study is discussed; Journalization, posting of transactions to ledger accounts and balancing off of the accounts are discussed; and final accounts without and with adjustments for a sole proprietorship business are discussed. Areas such as preparation of bank reconciliation statement, correction of book keeping errors and treatment of single and incomplete records are all discussed. Major areas of management accounting such as budgeting and budgetary improvement techniques and cost accounting are also adequately discussed.

This Course Guide is meant to provide you with the necessary information about the course, the nature of the materials you will be using and how to make the best use of the materials towards ensuring adequate success in your programme as well as appreciating the sensitivity of records keeping and accounting in whatever you do in life. Also included in this course guide are information on how to make use of your time and information on how to tackle the Tutor-Marked Assignment (TMA) questions.

There will be tutorial sessions during which your instructional facilitator will take you through your difficult areas in the Course, and at the same time, you are expected to have meaningful interactions with your fellow learners.

## **Course Aims**

The main aim of this course is to develop and sustain your interest in book keeping and accounting to the extent that you might wish to further your study in the discipline to the highest level possible. The course also aims at making you have greater appreciation of the role of accounting in ensuring prudence, transparency and accountability in both the private and public sector organizations.

## Course Objectives

After completing of this course, you should be able to accomplish the aims mentioned above, which would be possible by achieving the following objectives:

- Explaining the concept of Accounting
- Understanding the objectives of accounting
- Knowing the various branches of accounting
- Knowing the various sources of accounting information
- Knowing the users of such information.
- Appreciating the historical development of accounting in Nigeria
- Understanding that accounting is a discipline whose history could be traced to the time of Adam and Eve.
- Appreciating the necessary features of accounting, as a discipline.
- Understanding the contribution of various institutions and bodies to the development of accounting profession in Nigeria
- Defining ledger and explaining its various classifications
- Knowing how to post transactions to the relevant ledger accounts
- Applying the principles of double entry
- Balancing off individual accounts in the ledger.
- Defining trial balance and explaining its importance
- Extracting the trial balance of an enterprise
- Appreciating the errors that may occur in the preparation of ledger accounts and extraction of a trial balance
- Correcting those book keeping errors
- Understanding the components of final accounts
- Preparing an income statement of an enterprise
- Appreciating the income and expenses recognition principles
- Preparing a Balance Sheet
- Defining Depreciation and explaining its causes
- Appreciating various methods of providing for depreciation
- Computing depreciation for different categories of fixed assets
- Defining incomplete records and appreciating their disadvantages
- Understanding the indication of incomplete records
- Determining profit of a business from incomplete sets of records
- Preparing final accounts from sets of incomplete records
- Appreciating the meaning/ Definition of cost accounting.
- Explaining the purposes cost accounting information is serving for the attainment of organizational objectives.
- Describing the qualities of cost accounting information.
- Appreciating the benefits of having a cost accounting system and the factors to be considered before installing one.

- Differentiating between cost accounting and financial accounting.
- Appreciating the concept of budget and its necessity to organizations.
- Understanding the objectives of budgeting.
- Appreciating different types of budgets.
- Appreciating the major techniques used in budgetary improvement.

### **Working through this Course**

The course consists of the basis of book keeping and accounting issues that have been highlighted in the set objectives above. Financial Accounting is adequately introduced, and Management Accounting is also fairly introduced to whet the appetite of students of Hotel and Catering Management to develop sustained interest in accounting.

### **Course Materials**

Major components of the course are:

1. Course Guide
2. Study Units
3. Textbooks and Other Reading Materials
4. Assignment Guide

### **Study Units**

There are 15 units in this course, broken into 3 modules. These should be studied carefully. They are as follows:

#### **Module 1**

- Unit 1 Concepts and Scope of Accounting
- Unit 2 Accounting Principles and Standards
- Unit 3 Historical Development of Accounting
- Unit 4 Journalization of Transactions
- Unit 5 Posting Transactions to Ledger

#### **Module 2**

- Unit 1 Understanding Cash Book
- Unit 2 Trail Balance and Book keeping Errors
- Unit 3 Banking Relationship and Transactions
- Unit 4 Bank Reconciliation Statement
- Unit 5 Final Accounts Without Adjustments

**Module 3**

Unit 1	Depreciation Adjustments in Final Accounts
Unit 2	Other Adjustments in Final Accounts
Unit 3	Final Accounts from Incomplete Records
Unit 4	Introduction to Cost Accounting
Unit 5	Budgeting and Budgetary Improvement Techniques

**Module 1**

The first unit presents Concept and Scope of Accounting, Objectives of Accounting, Branches of Accounting, Sources of Accounting Information, Qualities of Accounting Information and Users of Accounting Information. These issues are adequately discussed for the student to appreciate their importance in book keeping and accounting. In the second unit, Accounting Principles, Accounting Concepts and conventions, Regulation of Accounting Practices in Nigeria, Production of Accounting Standard Process, and the Statement of Accounting Standards Issued so far by the NASB are the areas covered.

The third unit presents Definitional Issues in the historical development of accounting, The History of Accounting Before 1850 AD, The History in the Second Half of the 19<sup>th</sup> Century, the Historical Development of Accounting in the 20<sup>th</sup> Century, and the History of Accounting Related Professional Bodies/Associations in Nigeria. The fourth unit treats the area of Journalization of Transactions, discussing Divisions of a Journal, Credit Goods Journal, Cash Receipt Journal, Cash Payments Journal, and General Journal.

The fifth unit is used to discuss the aspects of Posting Transactions to ledger, emphasizing on Definition of Ledger, Classification of Ledger, the design of a Ledger Account, Postings of transactions to ledger, and Balancing off of Accounts. The sixth unit is about cash book and issues discussed are: Meaning of Cash Book, The Concept of Cash Book, Cash Account, and Columnar Cash Book for double column and three column cash book.

**Module 2**

The first unit discusses the Concept of Trial Balance, emphasizing on issues like: Preparation of Final Accounts from Extracted Trial Balance, Trial Balance Errors, Correction of Book keeping Errors, and Effect of a Book keeping Error on Profit. The eighth unit is about Relationship with Banks, including Roles of Banks to the development of businesses, Bank Services to be accounted for and Other Means of Bank Payments.

The second unit presents Bank Reconciliation Statement, discussing the Idea behind the Statement, Causes of Discrepancies in the balances obtainable in the cash book and the bank statement, and the Procedure for Reconciliation. The tenth unit is used to discuss Final Accounts without Adjustments, divided into Components of Final Accounts, Preparation of an Income Statement, Incomes and Expenses Recognition Principles, Balance Sheet structure, and some Important Terms Regarding Balance Sheet.

The third unit presents discussions on Depreciation Adjustments, highlighting Definition of Depreciation, Causes of Depreciation, Methods of Computing Depreciation, Methods of Recording Depreciation, and Disposal of an Asset. The twelfth unit is about Other Final Accounts Adjustments related to Expenses like Prepaid Expenses and Accrued Expenses, Income in Advance and Income Due, Bad Debts, Provisions and Reserves, Drawings and treatment of opening and closing Stock.

The fourth unit discusses Preparation of Final accounts using Incomplete Records, dividing the discussion into Meaning of Incomplete Records, Indication of Incomplete Records, and Determination of Profit and other Items of Final Accounts. The fourteenth unit is about introduction to cost accounting, including Meaning/Definition of Cost Accounting, Purposes/Uses of Cost Accounting, The Benefits of Operating Cost Accounting System, Factors to be considered before Installing a Cost Accounting System, Qualities of Cost Accounting Information, Differences between Cost Accounting and Financial Accounting, Cost Control, Cost Coding and Cost Classification and Cost Accounting Terminologies.

The fifth unit is about Introduction to Budgeting Process, emphasizing on: The Concept of Budget, Types of Budget, which is looked at from time, activity and quantitative perspectives, and Budgetary Improvement Techniques like Incremental Budgeting (IB), Zero Based Budgeting (ZBB), and Continuous (Rolling) Budgeting (CB).

### **Assignment File**

There are many self-assessment exercises and many tutor marked assignments in this Course and you are expected to do all of them by following the schedule prescribed for them, by your tutor, in terms of when to attempt them and submit same for grading.

## **Tutor-Marked Assignment**

In doing the tutor-marked assignments, you are to apply your residual knowledge and what you have learnt in the contents of the study units. These assignments which are many in number are expected to be turned in to your Tutor for grading. They constitute 30% of the total score for the Course.

## **Final Examination and Grading**

At the end of the Course, you will write the final examination. It will attract the remaining 70%. This makes the total final score to be 100%.

## **Conclusion**

The Course, Financial Accounting/Management for Hospitality and Tourism (HCM334) exposes you to the rudimentary aspects of accounting, including its historical development as a discipline. The two main branches of accounting: Financial Accounting and Management Accounting were fairly introduced. On successful completion of the Course, you would be empowered with the necessary knowledge for efficient and effective functioning as an accountant with any hotel and catering organization.

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**MODULE 1**

Unit 1	Concepts and Scope of Accounting
Unit 2	Accounting Principles and Standards
Unit 3	Historical Development of Accounting
Unit 4	Journalization of Transactions
Unit 5	Posting Transactions to Ledger

**UNIT 1 CONCEPT AND SCOPE OF ACCOUNTING****CONTENTS**

1.0	Introduction
2.0	Objectives
3.0	Main Content
3.1	Concept of Accounting
3.2	Objectives of Accounting
3.3	Branches of Accounting
3.4	Sources of Accounting Information
3.5	Qualities of Accounting Information
3.6	Users of Accounting Information
4.0	Conclusion
5.0	Summary
6.0	Tutor-Marked Assignment
7.0	References/Further Reading

**1.0 INTRODUCTION**

Accounting, being the language of business, has to be clearly conceptualized for its vocabulary, objectives, sources, quality and users to be well understood. This unit will introduce you to the concept of accounting and its objectives. It will also familiarize you with the main branches of accounting, as well as address the various sources, qualities and users of accounting information.

**2.0 OBJECTIVES**

At the end of this Unit, you should be able to:

- define Accounting
- identify the objectives of accounting
- examine the various branches of accounting
- explain the various sources of accounting information and
- identify the users of such information.

### 3.0 MAIN CONTENT

#### Concept and Scope of Accounting

#### 3.1 Concept of Accounting

Accounting is often referred to as the language of business. It represents the means of communicating the affairs of the business to the various user groups. Although, accounting is not restricted to business alone, governments and individuals (like workers, housewives, investors, etc) also use some accounting concepts in their day-to-day activities. For example, these persons keep records of their incomes and spending during a given period. This resembles the cashbook or income and expenditure account. Accounting is about record keeping and using the kept records in preparing financial statements that would show the result of operations of an entity and its financial position.

Accounting is defined by the American Accounting Association (AAA) in 1966 as the process of identifying, measuring and communicating economic information to permit informed judgment and decision by users of the information. This definition suggests that accounting is about records keeping for the recognition of various transactions, preparation/measurement of financial statements (to show financial position and result of operations) and communication/publication of the information to various groups of users for them to take informed decisions, using the information.

#### SELF-ASSESSMENT EXERCISE 1

1. Why is accounting a language of business?
2. Different between the phrases 'financial position' and 'result of operations'.

#### 3.2 Objectives of Accounting

Accounting like every other field of human endeavor has a purpose. The purposes/objectives of accounting include:

- (a) **Keeping of Records:** Accounting is done in order to keep a systematic record of financial transactions. Without proper record/book keeping, there would be a great burden on the human memory to provide such information which may be less accurate due to the nature of humans.
- (b) **To ascertain Profit or Loss:** Accounting helps in the determination of profit or loss. This is achieved through proper

record keeping of revenues and expenditures during a given period.

- (c) **To ascertain the financial position of a business:** Accounting also helps in the determination of the financial position of a business through the provision of information on what the business owns, what it owes and who owes it.
- (d) **Facilitate Decision Making:** Decision making is only possible where the required information is provided. For example, if a business makes a profit of N20, 000, how is the profit improved upon? Is it by reducing avoidable costs or by increasing productivity?
- (e) **Reports stewardship:** Accounting recognizes the separation of business from its owner(s). This separation makes it possible for the efficient management and reporting of the business performance at regular intervals.

## SELF-ASSESSMENT EXERCISES 2

1. Discuss three objectives of accounting.
2. How is accounting a field of human endeavor?

### 3.3 Branches of Accounting

Accounting as field of study is aimed at satisfying the needs of its users. These users can be categorized into internal and external users. In view of this, two main branches of accounting have emerged. These are:

- (i) **Financial Accounting:** This branch of accounting is aimed at the preparation of financial statements (income statement and balance sheet) for the use of outsiders and insiders, like investors, creditors, governments, employees, etc. Accounting standards at the local and international levels are mainly skewed to this branch.
- (ii) **Management Accounting:** As the name implies, it is accounting meant to be used by management. This branch of accounting provides management with the requisite information for decision making. It covers areas such as cost accounting, budgeting and budgetary control, inventory control, statistical methods and capital budgeting.

## SELF-ASSESSMENT EXERCISE 3

1. Mention two differences between financial and management accounting.
2. What do you understand by accounting standards?

### 3.4 Sources of Accounting Information

Accounting information is a set of data collected to facilitate the preparation of financial statement and aid users in making informed economic decisions. Sources of accounting information are often referred to as source documents. They represent the original documents from which accounting records emanate. Below are some of the common sources of accounting information:

- (a) **Invoice:** This is a business document prepared when goods are sold and is normally sent by the seller to the buyer. It gives details of the goods and the value of the transaction. To the seller of the goods, the copy of the invoice is a sales invoice while to the buyer it is a purchase invoice.
- (b) **Debit Note:** This document is used when it becomes necessary for one reason or the other, to increase the amount due from a debtor. For example, where the seller has undercharged a customer on an invoice, a debit note is to be issued to show additional charge to the account of the customer.
- (c) **Credit Note:** This document is used to reduce a customer's indebtedness.  
Reducing a customer's indebtedness may result from any of the following transactions:
  - i. A customer has been overcharged on the sales invoice.
  - ii. The customer returns some of the goods previously sold to him;or  
Some allowance is to be made to the customer in respect of goods sold.
- (d) **Cheque Book:** This document contains a cheque and a counterfoil. A cheque as defined by the Bill of Exchange Act 1882, as "a Bill of Exchange drawn on a banker, payable on demand". A counterfoil on the other hand is a small rectangular strip containing all the information on a cheque for the use of the Account Holder.
- (e) **Receipts:** This document is issued to acknowledge that money or valuable property has been received. The date and details of the transaction as well as the receipt number are usually stated.
- (f) **Vouchers:** The document is used for obtaining authorization for all payments irrespective of magnitude or mode, i.e. whether by cash, cheque or letter.

## SELF-ASSESSMENT EXERCISE 4

1. Why are sources of accounting information referred to as source documents?
2. Discuss any three sources of accounting information.

### 3.5 Qualities of Accounting Information

For accounting information to be useful, the preparer should ensure that it possesses the following qualities:

- 1) **Relevance:** Accounting information should be relevant to the information needs of its users.
- 2) **Accuracy:** The information should be sufficiently accurate for the intended purpose. To ensure that information is accurate for the intended purpose, it should be prepared in accordance with accounting principles.
- 3) **Understandable:** Accounting information should be capable of being understood by the recipient without difficulty. To ensure a thorough understanding of information, the preparer should take note of the following: a) avoiding the use of unexplained terminology; b) good report statement layout.
- 4) **Objectivity:** Information should be objective and not biased towards the interest of a particular user group.
- 5) **Complete:** The information should provide users with a rounded picture of the economic activities of the enterprise.
- 6) **Timely:** Accounting information should be produced in time for it to be used effectively. The information should be made available when the need arise.
- 7) **Reliable:** Accounting information should be prepared in such a way that users could rely upon it. To ensure reliability, the information should reflect the underlying economic realities and should be capable of being verified independently.

## SELF-ASSESSMENT EXERCISE 5

1. Discuss any five qualities of accounting information.
2. Who is responsible for accounting information quality assurance?

### 3.6 Users of Accounting Information

These are categories of persons/ institutions having a reasonable right to information concerning an entity. Such right may arise from public accountability to statutory powers to obtain information. This includes:

- 1) **Owners:** These category of users group have provided a substantial proportion of the organization's financial resources and are interested not only in the earnings which result from the management use of these resources but also in what proportion they can reasonably withdraw for personal use without making the organization worse-off than before in its capacity to use these resources to generate future earnings.
- 2) **Creditors:** These have supplied goods and services to the organization and are interested in receiving payment for them. There must therefore be information available to potential creditors, which show the organization's financial ability to meet its obligations to creditors.
- 3) **Suppliers of Loan:** Information is needed by this group about the organization's ability to pay interest on loans and repay the capital when it becomes due.
- 4) **Government:** Information is needed by Government in order to ascertain the amount of tax to impose on profits. Government also requires accounting information for planning and analysis of economic activities in a country.
- 5) **Employees:** These have provided labor and are interested in being adequately remunerated for their services. They require information about the organization's ability to provide a rewarding and stable employment in the foreseeable future.

#### **SELF-ASSESSMENT EXERCISE 6**

1. Differentiate between internal and external users of accounting information.
2. Justify investors and creditors as the 'primary users' of accounting information.

#### **4.0 CONCLUSION**

In this unit, the essence of accounting has been explained. Accurate record keeping can, therefore, be linked to accounting, since nothing in business functions effectively without proper records keeping and these records could be obtained from the various source documents explained in this unit.

#### **5.0 SUMMARY**

This unit has explained what accounting stands for and its main branches. It has also been shown that accounting information is obtained from normal business documents such as invoice, debit note, credit note, cheque book, receipts and vouchers while such information must possess certain qualities for its users to rely on it.

## **6.0 TUTOR-MARKED ASSIGNMENT**

1. Define Accounting and state its objectives.
2. Explain the qualities of good accounting information.
3. Differentiate between financial accounting and management accounting, using five bases of comparison.
4. State five users of Accounting information and their information needs.
5. Briefly explain the various sources of accounting information.

## **7.0 REFERENCES/FURTHER READING**

Inanga, E.L. *Principles of Accounting*.

Dandago, K.I. *Financial Accounting Simplified*.

Mashwari, K. *Introduction to Financial Accounting*.

Lafferty, J. L. *Accountancy*.

## **UNIT 2     ACCOUNTING PRINCIPLES AND STANDARDS**

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- 2.0 Objectives
- 3.0 Main Content
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    - 3.1.1 Accounting Concepts
    - 3.1.2 Accounting Conventions
  - 3.2 Regulation of Accounting Practices in Nigeria
  - 3.3 Production of Accounting Standard
  - 3.4 Statement of Accounting Standards Issued by NASB
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

Accounting has been described as the means of communicating business affairs. For accounting to be universal, it should be guided by certain principles which its preparers adopt in the preparation and presentation of financial statements. These principles are what we shall discuss in this Unit.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define and explain accounting principles
- distinguish between accounting concepts and its conventions
- describe the various concepts and conventions used by accountants
- appreciate the role of accounting standards and the various standards in use by accountants in Nigeria.

### 3.0 MAIN CONTENT

#### Accounting Principles and Standards

#### 3.1 Accounting Principles

Accounting principles could be defined as those rules of action or conduct, which are adopted by the Accountants universally while recording accounting transactions. IAS 1 defines Accounting principles as “*a body of doctrines commonly associated with theory and procedures of Accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist*”.

Accounting principles can be classified into two categories, namely:

- a) Accounting concepts and
- b) Accounting conventions.

##### 3.1.1 Accounting Concepts

This refers to those basic assumptions or conditions upon which the science of Accounting is based. SAS 1 identified seven of these concepts.

- 1) **Entity Concept:** According to the standard, “*every economic unit, regardless of its legal form of existence, is treated as a separate entity from parties having propriety or economic interest in it*”. In Accounting, business is considered to be a separate entity from the proprietor(s). This concept is applicable to all forms of business organizations.
- 2) **Going-Concern Concept:** This is the assumption that a business unit will operate in perpetuity; that is, the business is not expected to liquidate in the foreseeable future.
- 3) **Periodicity Concept:** According to this concept, the life of the business is divided into appropriate segments for studying the results shown by the business after each segment. In accounting, such a segment or time interval is called “*accounting period*”. It is usually a year.
- 4) **Realization Concept:** This concept states that revenue is recognized when a sale is made. Sale is considered complete at the point when the property in goods passes to the buyer and he becomes legally liable to pay.

- 5) **Matching Concept:** According to this concept, the earned revenue and all the incurred costs that generate that revenue must be matched and reported for the period. The term “*matching*” means appropriate association of related revenues and expenses.
- 6) **Consistency Concept:** This concept holds that when an enterprise has adopted a method, it should continue to use that method in subsequent periods so that comparison of accounting figures overtime could be made.
- 7) **Historical Cost Concept:** This concept states that the basis for initial accounting recognition of all assets acquisitions, services rendered or received, expenses incurred, creditors and owners’ interests is the actual cost for the transaction(s).

### 3.1.2 Accounting Conventions

These are customs or traditions, which guide the Accountant while preparing the accounting statements. Accounting conventions includes:

- 1) **Substance over Form:** This convention states that business transaction should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.
- 2) **Objectivity:** According to this convention, data presented on the financial statements should be supported by verifiable evidence and demand the independence of judgment on the part of the Accountant preparing the financial statements.
- 3) **Fairness:** This convention requires that accounting reports should be prepared not to favor any group or segment of society.
- 4) **Prudence:** Also known as “*conservatism convention*”. It states that greater care in the recognition of profit should be exercised whilst all known losses are adequately provided for.
- 5) **Materiality:** The principle holds that only items of material values are accorded their strict accounting treatment.

### SELF-ASSESSMENT EXERCISE 1

1. Enumerate and discuss any four concepts of accounting.
2. Critically review any three conventions of accounting.

### 3.2 Regulation of Accounting Practice in Nigeria

The Nigerian Accounting Standards Board (NASB) is the body recognized by law in Nigeria to issue authoritative statements to guide accountants in the preparation and presentation of accounting information. The Board was established in 1982 to take into cognizance of our peculiar business environments, customs, laws and economic developments in the production of accounting standard. From inception to date, the membership of the Board has changed considerably from 8 to 13, 13 to 14 and the present arrangement which provided for a four strata membership comprising of 17 members all of which are appointed by the President. The present composition of the Board, as provided in S. 2(2) of NASB Act, is as follows:

1. The Chairman.
2. Two members each from the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN).
3. A representative each from the following:
  - i. Federal Ministry of Commerce;
  - ii. Federal Ministry of Finance;
  - iii. Central Bank of Nigeria;
  - iv. Corporate Affairs Commission;
  - v. Nigeria Stock Exchange;
  - vi. Nigerian Accounting Association;
  - vii. Federal Inland Revenue Service;
  - viii. Nigerian Deposit Insurance Corporation;
  - ix. Securities and Exchange Commission;
  - x. Auditor General for the Federation;
  - xi. Accountant General of the Federation;
  - xii. Chartered Institute of Taxation of Nigeria;
  - xiii. Nigerian Association of Chambers of Commerce, Industries, Mines and Agriculture.
4. The Executive Secretary of the Board

Each member of the Board shall hold office for a period of four years or on such terms or conditions that may be specified in their letters of appointment.

**SELF-ASSESSMENT EXERCISE 2**

1. What do you understand by the Nigeria Accounting Standards Board?
2. Justify the enclosure of any four member organizations of the NASB.

**3.3 Production of Accounting Standard**

The procedure to be adopted in the production of an accounting standard is as follows:

- a) Choice of a topic for standardization;
- b) Constitution of technical committee of at least six relevant experts;
- c) Development of working paper for the committee by the secretariat of the Board;
- d) Preparation and publication of exposure drafts for three months;
- e) Collation and composition of responses to the exposure draft;
- f) Conduct a public hearing, where necessary;
- g) Issue a statement of accounting standard on the chosen topic.

**SELF-ASSESSMENT EXERCISE 3**

1. What do you understand by the term 'exposure draft'?
2. Why should there be public hearing on an accounting standard to be issued?

**3.4 Statement of Accounting Standards Issued by NASB**

Since its establishment in 1982, the NASB has issued thirty (30) accounting standards to date (August, 2009), which include:

SAS 1	Disclosure of Accounting Policies
SAS 2	Information to be Disclosed in Financial Statements
SAS 3	Accounting for Property, Plant and Equipments
SAS 4	Stocks
SAS 5	Construction Contracts
SAS 6	Extraordinary Items and Prior Year Adjustments
SAS 7	Foreign Currency Conversions and Translations
SAS 8	Accounting for Employees Retirement Benefits
SAS 9	Accounting for Depreciation
SAS10	Accounting for Banks and Non-Banks

## Financial Institutions (Part I)

SAS11	Leases
SAS12	Accounting for Deferred Taxes
SAS13	Accounting for Investments
SAS14	Accounting in the Petroleum Industry:

## Upstream Activities

SAS15	Accounting for Banks and Non-Banks
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## Financial Institutions (Part II)

SAS16	Accounting for Insurance Companies
SAS17	Accounting in the Petroleum Industry:

## Downstream Activities

SAS18	Statement of Cash flows
SAS19	Accounting for Taxes
SAS20	Abridege Financial Statements
SAS21	Earnings Per Share
SAS22	Research and Development Costs
SAS23	Provisions, Contingent Liabilities and

## Contingent Assets

SAS24	Segment Reporting
SAS25	Telecommunications Activities
SAS26	Business Combinations
SAS27	Consolidated and Separate Financial

## Statements

SAS28	Investments in Associates
SAS29	Interests in Joint Ventures
SAS30	Interim Financial Reporting

Note: SAS 12 was withdrawn and replaced with a more elaborate standard i.e. SAS 19.

**SELF-ASSESSMENT EXERCISE 4**

1. Briefly differentiate between SAS 14 and SAS 17.
2. Which is the most interesting SAS to you, and why?

## 4.0 CONCLUSION

In this Unit, we have shown that accounting is more than just a discipline of study but rather a profession whose principles have wide coverage. The essence of this is that accountant can practice their profession anywhere in the world provided that these principles cum standards are strictly adhered to in the preparation and presentation of financial statements for the use of its various stakeholders.

## 5.0 SUMMARY

We have explained the various accounting principles which provide a guide for the accountant in the course of preparation of a financial statement. The Unit has also introduced the students to the various accounting principles, concepts, conventions and standards in Nigeria.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Define accounting principles and list its two major components.
2. Briefly explain **five** accounting concepts you know.
3. Distinguish between accounting concepts and accounting conventions.
4. What do you understand by accounting standard?
5. You received the following letter from your neighbor; **Mr. Confusion**, concerning some views held by his Accountant and needed clarification having learnt that you are now undergoing a course in Accounting at the National Open University of Nigeria.

## 7.0 REFERENCES/FURTHER READING

NASB Act 2003

Dandago, K.I. *Financial Accounting Simplified*.

Igben, R.I. *Financial Accounting Made Simple*.

Statements of Accounting Standards (1 -30).

## **UNIT 3 HISTORICAL DEVELOPMENT OF ACCOUNTING**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Definitional Issues
  - 3.2 The Period Before 1850 AD
  - 3.3 The Second Half of the 19<sup>th</sup> Century
  - 3.4 Development in the 20<sup>th</sup> Century
  - 3.5 History of Accounting in Nigeria
  - 3.6 Other Accounting Related Professional Bodies/Associations in Nigeria
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

Accounting is a subject with a very long historical background; its history is as old as that of mankind, in view of the fact that the cultures of records keeping and accounting were developed right from the creation of Adams and Eve. The holy religious books contain a lot of accounts of the happenings in the world and reasons for all these. This unit traces the historical development of accounting in Nigeria and beyond with a view to appreciating the necessity of the discipline in the scheme of things in Nigeria and beyond.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- appreciate the historical development of accounting in Nigeria
- classify accounting as a discipline whose history could be traced to the time of Adam and Eve
- identify the necessary features of accounting, as a discipline
- explain the contribution of various institutions and bodies to the development of accounting profession in Nigeria.

### 3.0 MAIN CONTENT

#### Historical Development of Accounting

#### 3.1 Definitional Issues

Accounting has been defined by the American Accounting Association (AAA) in 1966 as “The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”.

This definition, which is only one out of many other similar definitions, emphasized the fact that accounting is a language of business, and like all other languages it has its vocabularies, terminologies and conventions and, because of these, it has its own difficulties of interpretation and understanding. However, since it is a language which covers all spheres of social life, it is important that everyone should be familiar with it.

In all forms of societies, individuals and groups make decisions which entail the exchange of goods and services at agreed prices. Money has for long become the medium of exchange for such goods and services, and is used to assign price and values to them. Because of coetaneous need to price or value or even measure goods and services, all societal endeavors require quantitative information. This is where accounting comes in. Accounting responds to the need for quantitative and, in particular, financial information. Consequently, the scope and boundaries of accounting change as society changes and new demand for information emerge. Accounting, therefore, is a dynamic course-moving continuously with time and that is why accounting standards are continuously being released, at the local and international levels, so as to catch up with the societal development.

The AAA definition reveals some silent features which are necessary for a good knowledge of accounting:

- (i) Identification of transactions and their classifications into relevant books of original entries and ledger accounts;
- (ii) Measurement of economic activities by way of preparation of statement of Affairs, and final accounts (Trading, Profit and Loss Account and Balance Sheet) in accordance with statutory and institutional requirements;
- (iii) Communication of economic information by way of releasing or publishing financial statements for the consumption of various users;

- (iv) Aiding decision –making, which can be economic, political or social in nature through choice between alternatives ; and
- (v) Users of accounting information, which can be internal (management, directors and other employees) and external (shareholders, creditors, government, potential investors, analysts, etc.).

The foregoing discussion is a pointer to the fact that Accounting has always been with the society, and is as old as commercial activities. Its history can be broken down into three (3) stages.

### **SELF-ASSESSMENT EXERCISE 1**

1. What do you understand by the term ‘accounting’?
2. Discuss any three salient features of accounting.

### **3.2 The Period Before 1850 A.D.**

Though the first accounting records pre-dated in the invention of money by several thousand years, it seems that financial accounting become widespread in classical Greece and Rome around 600 BC. Accounting then was only in relation to record keeping which was primarily concerned with money transactions. Records of financial transactions were kept in different modes/styles e.g. marble tablets, papyrus, etc.

The crusades in Italy around 11<sup>th</sup> to 13<sup>th</sup> centuries gave rise to the development of trade. As trade expanded, more wealth was accumulated and there was increased need for record-keeping. Development of the art of writing, of arithmetic and the use of money as a common denominator aided the development of accounting. Rudiments of double-entry book-keeping was developed in the form of ‘**charge**’ and ‘**discharge**’ for transactions which were later termed ‘**debit**’ and ‘**credit**’. This system, then called Venetian method, was in use in Venice, Genoa, Florence, and many other Italian cities.

However, the first complete recorded work on double entry book-keeping was the treatise published by an Italian monk and a teacher of mathematics, Luca Pacioli (1445-1515) in 1494, in Venice. The treatise was titled “Summa de Arithmetica, Geometrica, proportionate, el propotionalita (All about Arithmetic, Geometry, Proportions and proportionalities) which contained a few chapters on Accounts and Records. In the book, Pacioli described three waste books of Account: the waste book (rough note showing transactions), the journal and ledger. Then, extraction of trial balance was done only when the ledger was full, and a new one was being opened. Pacioli opened that the recording of economic transaction ns lends itself to a twofold effect

which forms the basis of any algebraic function—the giver and the receiver are of the same value.

Later development in the period after Pacioli's initiative included the gradual replacement of the waste book with invoices and receipts, use of subsidiary books, the regular extraction of trial balance, determination of profit through the profit and Loss Account and the preparation of the Balance Sheet.

### **SELF-ASSESSMENT EXERCISE 2**

1. What was the primary concern of accounting before 1850 AD?
2. Discuss similarities and differences between 'charge and discharge' and 'debit and credit'.

### **3.3 The Second Half of the 19<sup>th</sup> Century**

The industrial revolution in Britain in the half of the 18<sup>th</sup> century and the first half of the 19<sup>th</sup> century gave rise to the establishment of factories. With factories and mass production, fixed assets costs became sizeable and their continued use also indicated the need to provide for their depreciation. Before this period, commerce and industry only cared about stock inventory. With significant fixed assets cost and the need for inventory valuation and allocation of overheads to product, including depreciation cost, development of cost accounting concepts became necessary.

Growth of railways and large industrial enterprises in Italy, UK, USA and many other industrialized countries became too expensive to be undertaken by an individual or small group of backers (investors). These massive projects were financed by joint stock companies, whose shareholders had little control over the management of their funds. Joint Stock Company concept is about the complete separation between ownership and management of a business. The owners (shareholders) are entrusting the management of their funds to a board of directors (management) and the management has to be periodically accounting for how it is managing the funds entrusted to it, through financial statements to be certified "true and fair" by an external auditor, who must be a qualified accountant, after examining the company's books of accounts, using various sources of audit evidence.

### **SELF-ASSESSMENT EXERCISE 3**

1. Discuss two main issues related to the historical development of accounting in the second half of the 19<sup>th</sup> Century.
2. Discuss the concept of joint stock companies.

### 3.4 Developments in the 20<sup>th</sup> Century

The impact of developments in other disciplines such as economics, mathematics, operations research, computer science, management etc. on Accounting, has been very tremendous. Accounting has clearly been exposed as a borrowing subject, and that has been responsible for the refreshment of its methods and development of its theoretical basis to the extent that it is now the most popular subject among student at all level.

The discipline is highly recognized as a profession with standard setting bodies at international and various local levels. The professional accountants have their guiding institutes, apart from the guidance contained in the provision of their local laws.

There is also the development of numerous accounting concepts, postulates, principles or conventions which, together with accounting standards released at local and international levels by the relevant bodies, make the preparation and presentation of financial statements highly standardized. During the period also, there was the introduction of corporate social responsibility accounting; which means the businesses have to account for how they contribute to the development of their immediate environments.

#### SELF-ASSESSMENT EXERCISE 4

1. Argue for what you consider as the main issues in the history of accounting in the 20th Century.
2. Discuss the relationship between accounting and corporate social responsibility.

### 3.5 History of Accounting in Nigeria

The institutionalization of Accounting started in Britain, from where Accounting was imported to Nigeria. During the pre-independence period, in Nigeria, especially before the establishment of the Collages of Arts and Sciences (particularly the one in Ibadan), people who wanted to enroll into accounting profession had to be trained through article ship. This meant that, they had to be attached as apprentices to those in the profession already. When the College of Arts and Sciences in Ibadan (now university of Ibadan) was established, it offered courses in accounting; students were prepared for the intermediate level of ACCA (Chartered Association of Certified Accountants), a British Accounting Body.

In 1960, the University of Nigeria Nsukka started offering courses in accounting, the Ahmadu Bello University, Zaria and the University of

Lagos joined in offering accounting courses from 1962. Other Nigerian Universities (most of them) and many polytechnics follow suit in the later years. Together they produce large number of accounting graduates (B. Sc. And HND holders) year in year out!

In 1960, specifically on 17<sup>th</sup> November, some Nigerians who had some professional training in accounting from different parts of the world, got together and formed an association called Association of Nigerian Accountants. This was the first attempt at forming a national and indigenous accountancy professional body in Nigeria. It included people working in companies, industries, government offices, etc. The Association was formed with the view to provide and maintain a high standard of accounting in Nigeria.

The Association was granted official recognition by the Federal Government of Nigeria on 28<sup>th</sup> September 1965 with the name Institute of Chartered Accountants of Nigeria (ICAN), through an Act of parliament, Act No. 15 of 1965. ICAN was then inaugurated on 21<sup>st</sup> October 1965. From then onwards to August 1968, the Institute was granting automatic membership status to deserving individuals.

On 1<sup>st</sup> September 1968, ICAN made it compulsory for all those who wanted to go into practice as accountants in Nigeria to sit and pass its qualifying examination(s). To date, one must pass the qualifying professional Examinations of the Institute before she/he become a member, that is a professional Accountant. However, there are provisions for exemption of some stages or subjects, depending on the result shown by the academic transcript of a student. For example, a B.Sc. Accounting graduate from a recognized and accredited University would be exempted from foundation and PE1, while a B.Sc. Accounting graduate from a recognized but non-accredited university would only be exempted from Foundation stage. Other exemption guidelines and many more information about the Institute are contained in its students' Regulations and Syllabuses.

Since 1981, another accountancy body—the Association of National Accountants of Nigeria (ANAN) had been working hard to be registered and obtain recognition of the government. It was on 25<sup>th</sup> August, 1993 that the Association was granted its charter by Decree no 76 of 1993. It became the second recognized body of accountants in Nigeria. From the period of its recognition up to December 1995, the Association was granting automatic membership to applicants. The association has the plan of convincing the government to allow accounting graduates to attend its Accountancy College for the period of nine months before proceeding to their National Service (NYSC). At the college, students would be exposed to practical applications of accounting so that as they

go to the National Service they would be holding their certificates as Certified Accountants.

The Nigerian Accounting Teachers Association (NATA) now called the Nigerian Accounting Association (NAA), was formed in 1972 and inaugurated on 19<sup>th</sup> march 1974. Its objective is to contribute, through research and education, to the improvement of the Accounting profession and Accounting Education in Nigeria. Only Accounting lecturers are qualified to be members of NAA and they are entitled to use the Association's acronyms such as FNAA, AMNAA, etc. based on their qualifications and commitment to the activities of the Association. The idea is to make the Association fully professional in line with what obtains in other countries of the world, like the USA, Australia, Canada, etc.

The professional training, development and control of accounting practice is to be carried out by the recognized accounting professional bodies in conjunction with universities and polytechnics. There is, therefore, the need for *healthy competition*.

#### **SELF-ASSESSMENT EXERCISE 5**

1. Discuss any two contributions of educational institutions towards the development of accounting profession in Nigeria.
2. How do you expect healthy competition to exist among accountancy professional bodies in Nigeria?

### **3.6 Other Accounting Related Professional Bodies/Associations in Nigeria**

There is the Chartered Institute of Taxation of Nigeria (CITN), recognized by a 1992 Act, the Chartered Institute of Stockbrokers(CIS), also recognized since 1992, and the Chartered Institute of Bankers of Nigeria (CIBN). These are fully recognized accounting related bodies. In the pipeline, there is Institute of Certified Public Accountants of Nigeria (ICPAN), Institute of Cost and Management Accountants (ICMA), Institute of Treasury Management of Nigeria (ITMN), Institute of Cost Management (ICM), etc. All this goes to show that accounting is a very popular discipline in Nigeria and beyond.

## SELF-ASSESSMENT EXERCISE 6

1. Giving two concrete reasons, argue FOR or AGAINST the recognition of additional accountancy professional bodies in Nigeria.
2. How do you differ between ICMA and ICM, based on your perception of what they stand for?

## 4.0 CONCLUSION

Historically speaking, accounting bears the best origin than any other profession in the world, in view of the fact that the first thing Adam and Eve were asked to do by their Creator was to account for what they did in Heaven. It is also marked by the record keeping assignment on the angels of God on the goings on in this world. It is also enjoying the credit of the only profession that would be brought to play in the Hereafter, as everybody would stand before God to “account” for what he/she has done on earth! Everybody should therefore, be conversant with the history of this great profession!

## 5.0 SUMMARY

In this unit, we have learnt about the main features of accounting, derived from its comprehensive definition; its historical development from time immemorial; its history in the Nigerian economy; and the trend it is taking in Nigeria, going by the proliferation of accounting and related bodies that are now existing in the country. The Unit influences readers to appreciate reasons why accounting is arguably the most popular profession in Nigeria and beyond.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Justify the argument that accounting is the language of business.
2. Discuss four main features of accounting as a discipline.
3. Highlight any five major historical notes of accounting up to the end of the 20<sup>th</sup> Century.
4. Trace the historical contribution of Universities to the development of accountancy profession in Nigeria.
5. Discuss the historical rivalry between ICAN and NAN. How should the relationship be normalized?

## 7.0 REFERENCES/FURTHER READING

Dandago, K.I. *Financial Accounting Simplified*.

Lafferty, J. L. *Accountancy*.

## **UNIT 4 JOURNALIZATION OF TRANSACTIONS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Journalization of Transactions
  - 3.1 Main Content
  - 3.2 Credit Goods Journal
  - 3.3 Cash Receipt Journal
  - 3.4 Cash Payments Journal
  - 3.5 General Journal
  - 3.6 Illustration
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

In previous units, much has been said about the keeping of proper records of transactions. One way of achieving this, is through the use of journal. A journal is often referred to as a business diary used in recording financial transactions as they happen. It is treated as the book of first entry or a prime book. This Unit discusses major issues on journal as a principal book in accounting, and how transactions are to be captured in it before to relevant ledger accounts.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define Journal and its various classifications
- state the uses of a general journal
- prepare credit goods journal and general journal
- appreciate other important issues related to Journalization of transactions.

### **3.0 MAIN CONTENT**

#### **Journalization of Transactions**

#### **3.1 Divisions of Journal**

A journal is a book, which is used in recording business transactions as they occur. It is a book in which transactions are first recorded under the double entry system. For this reason, a journal is a book of original entry and the process of recording transactions in a journal is referred to as “journalizing”. A journal is therefore a business diary.

In order to avoid delay in collecting information from the journal, a business often divides its journal into many subsidiary books. The common divisions are:

1. Credit Goods Journal;
2. Cash Receipts Journal;
3. Cash Payments Journal;
4. General Journal.

### SELF-ASSESSMENT EXERCISE 1

1. Briefly describe journal for records keeping.
2. What is journalizing?

### 3.2 Credit Goods Journal

This journal is used for recording all the day-to-day transactions relating to goods purchased or sold on credit. Its major components are:

- a) **Purchases Journal:** This journal is also known as the “Purchases daybook” or “Bought daybook”. It is used for recording all the day-to-day credit purchases of goods by a business. The journal has a column for Date of Purchase, Name and Particulars, Folio and Amount.
- b) **Sales Journal:** This journal is used for recording all the day-to-day credit sales of a business. It is also known as the “Sales daybook” or “Sold daybook”. It has columns similar to that of Purchases daybook.
- c) **Returns Outward Journal:** Also known as the “Purchases Returns Journal”. It is used for recording returns of goods purchased on credit.
- d) **Returns Inward Journal:** Also known as the “Sales Returns Journal”. It is used for recording returns of goods sold on credit.
- e) **Columnar Journal:** This Journal is used when a business deals with more than one line of goods. The journal is prepared with a column for each line of goods in which the business deals. The journal could be any of the ones mentioned above.

### SELF-ASSESSMENT EXERCISE 2

1. Briefly differentiate between Sales and Purchases Journals.
2. What is a Columnar Journal?

### **3.3 Cash Receipts Journal**

This Journal is used for recording all cash receipts. The total of cash received as shown by this Journal is debited to the Cash Account at the end of a period usually at the end of a week.

### **3.4 Cash Payments Journal**

This Journal is used for recording all cash payments. At the end of a period, cash account is credited with the total cash paid during the period.

### **SELF-ASSESSMENT EXERCISE 3**

Briefly differentiate between Cash Receipts and Cash Payments.

### **3.5 General Journal**

The Journal is meant for recording such transactions, which do not occur frequently in the business and, therefore, do not warrant setting-up of special journals. The journal has columns for Date, Particulars and Amounts columns, divided into Debit (DR.) and Credit (CR.).

In General Journal, each entry is appended with an explanation of the transaction or narration. The explanation or narration enables one to ascertain the origin of, and reason(s) for, the treatment given. The narration should, therefore, contain full information as to the nature of the transactions and their dates of occurrence.

### **SELF-ASSESSMENT EXERCISE 4**

1. Explain Date, Particulars and Amount Columns in Journal.
2. What is narration in journal?

### **3.6 Uses of General Journal**

Instances where a general journal could be used include:

- 1) **Opening Entries:** When a new set of books is started, the old accounts have to be brought forward in the beginning of the year from last year's books. The general journal is meant for recording these transactions.
- 2) **Closing Entries:** At the end of the accounting year, the nominal accounts are closed by transferring them to trading account or

profit and loss account. The entries passed for this purpose are termed as “Closing Entries”.

- 3) **Adjustment Entries:** At the end of the accounting year, adjustment entries are to be passed for outstanding/ prepaid expenses, accrued/ outstanding income, etc. Entries for all these adjustments are passed in the General Journal.
- 4) **Rectification Entries:** Rectification entries are passed for rectifying the errors, which might have been committed in the books of accounts.
- 5) **Transfer Entries:** Transfer entries are required for transferring one account to the other. Entries for such transfers are passed in the General Journal.
- 6) **Purchase of Fixed Assets:** The entries for the purchase of fixed assets such as Plant, Machinery, and Furniture etc. on credit are also passed in this Journal.

### SELF-ASSESSMENT EXERCISE 5

1. Briefly differentiate between Adjustment and Transfer Entries.
2. Briefly discuss Journalization of purchase of fixed assets.

### 3.7 Illustrations

#### Illustration One

The following transactions were obtained from the records of Alhaji Ado Traveler for the month of January, 2008:

- Jan.1 Assets: Machinery ₦94, 000; Motor Vehicles ₦129, 000; Stock ₦82, 250; Debtors ₦2, 975; Cash ₦385.  
Liabilities: Creditors ₦4, 450; Bank overdraft ₦17, 250.
- Jan. 3 Bought from Alh. Yusuf Isa & Sons Ltd:  
50 bags of Millet @ ₦2,500 a bag  
25 bags of Wheat @ ₦4,000 a bag  
10 bags of Maize @ ₦3,000 a bag  
Invoice subject to 20% trade discount.
- Jan.8 Sold to B.B Jafaar & Co.  
15 bags of Wheat @ ₦5,000 a bag
- Jan.10 Returned to Alh. Yusuf Isa & Sons Ltd  
3 bags of Millet  
1 bag of Maize  
All damaged in transit
- Jan.12 B.B Jafaar & Co. returned  
2 bags of Wheat
- Jan.15 Bought from Idi Trader  
60 bags of Maize @ ₦2,900 a bag

40 bags of Wheat @ ₦4,100 a bag  
 50 bags of Millet @ ₦2,450 a bag  
 Invoice subject to 15% trade discount

Jan.22 Sold to Musa Minjibir

40 bags of Millet @ ₦3,000 a bag  
 20 bags of Maize @ ₦3,500 a bag  
 Whole transaction subject to 20% trade discount

Jan.30 Musa Minjibir returned

2 bags of Maize  
 4 bags of Millet  
 All defective.

You are required to prepare the various journals to record the above transactions for the month of January, 2008.

## SOLUTION

### Alhaji Ado Traveler's Book General Journal for the month of January, 2008

Date	Particulars	Dr.	Cr.
2008 Jan. 1	Assets:	₦	₦
	Machinery	94,000	
		129,00	
	Motor Vehicles	0	
	Stock	82,250	
	Debtors	2,975	
	Cash	385	
	Creditors		4,450
	Bank Overdraft		17,250
			286,91
	Capital		0
	Being Assets, Liabilities and Capital at this date.		

**Purchases Journal for the month of January 2008**

Date	Name & Particulars	Folio	₦	₦
2008				
Jan. 3	Alh. Yusuf Isa & Sons Ltd. 50 bags of Millet @ N2,500 a bag 25 bags of Wheat @ N4,000 a bag 10 bags of Maize @ N3,000 a bag		125,000 100,000 30,000	
			255,000	
	Less: 20% trade discount		(51,000)	204,000
Jan. 15	Idi Trader 60 bags of Maize @ N2,900 a bag 40 bags of Wheat @ N4,100 a bag 50 bags of Millet @ N2,450 a bag		174,000 164,000 122,500	
			460,500	
	Less: 15% trade discount		(69,075)	391,425
Jan. 31	Purchases Account			<u>595,425</u>

**Sales Journal for the month of January 2008**

Date	Name & Particulars	Folio	₦	₦
2008				
Jan. 8	B.B. Jafaar & Co. 15 bags of Wheat @ N5,000 a bag			75,000
Jan. 22	Musa Minjibir 40 bags of Millet @ N3,500 a bag 20 bags of Maize @ N3,000 a bag		140,000 60,000	
			200,000	
	Less: 20% trade discount		(40,000)	160,000
Jan. 31	Sales Account			<u>235,000</u>

**Returns Outward Journal for the month of January****2008**

Date	Name & Particulars	Folio	₦	₦
2008				
Jan. 10	Alh. Yusuf Isa & Sons Ltd 3 bags of Millet @ N2,500 a bag 1 bag of Maize @ N3,000 a bag		7,500 3,000	
			10,500	
	Less: 20% trade discount		(2,100)	8,400
Jan. 31	Returns Outward Account			<u>8,400</u>

**Returns Inward Journal for the month of January 2008**

Date	Name & Particulars	Folio	₦	₦
2008				
Jan. 22	Musa Minjibir			
	2 bags of Maize @ N3,500 a bag		7,000	
	4 bags of Millet @ N3,000 a bag		12,000	
			19,000	
	Less: 20% trade discount		(3,800)	15,200
Jan. 31	Returns Inward Account			<u>15,200</u>

**Illustration Two**

**Baba 'Yargo & Sons**, a wholesaler, divides his business into 3 departments: Clothing, Hardware and Sundries.

Rule up a suitable columnar Purchases Book to record the following transactions for the month of September 2008.

Sept. 1. Bought from **K. Nwosu & Sons**:

240 Shirts @ ₦600 for twelve  
60 Singlets @ ₦350 for twelve  
48 Buckets @ ₦200 each.

Sept. 7. Bought from **Namu and Co. Ltd**:

22 Buckets @ ₦200 each  
1 carton ,Nescafe Coffee @ ₦1,800 a carton

Sept. 16. Bought from **Oodua Trading Company**:

40 tablets of Premier Soap @ ₦85 a tablets  
Less 5% trade discounts.

Sept. 24. Bought from **Igwe Brothers**:

400 yards of Shaddah @ ₦250 a yard  
3 cartons, Nescafe Coffee @ ₦1,480 a carton.

**SOLUTION**

**Baba 'Yargo & Sons**  
**Columnar Purchases Journal for the month of**  
**September 2008**

Date	Names & Particulars	Folio	₦	Clot hing ₦	Hard ware ₦	Sun dries ₦	Tot al ₦
2008 Sept. 1	K. Nwosu & Sons Ltd. 240 Shirts @ ₦600 for twelve 60 Singlets @ ₦350 for twelve		12,000 1,750	13,750			23,350
	48 Buckets @ ₦200 each		9,600		9,600		
Sept. 7	Namu & Co. Ltd.  22 Buckets @ ₦200 each 1 Carton Nescafe Coffee @ ₦1,800 a Carton		4,400 1,800		4,400	1,800	6,200
			0			0	0
Sept. 6	Oodua Trading Co. 40 Tablets of Premier Soap @ ₦85 a Tablet  Less: 5% trade discount		3,400 (170)			3,230	3,230
Sept. 4	Igwe Brothers 400 yards of Shaddah @ ₦250 a yard 3 Cartons of Nescafe Coffee @ ₦1,480 a Carton		100,000 4,440	100,000		4,440	104,440
Sept. 30	Purchases Account			<u>113,750</u>	<u>14,000</u>	<u>5,030</u>	<u>132,780</u>

**4.0 CONCLUSION**

This Unit has explained the process of recording business transactions on a daily basis as they occur for easy accessibility. Also, for transactions that do not occur frequently, the means of recording such transactions have been addressed. The Unit emphasizes that all transactions have to pass through the process of Journalization if proper

records keeping is to be honestly observed, for true and fair final accounts to be prepared.

## 5.0 SUMMARY

In this Unit, we have been able to define journal, and its various divisions explained. The uses of general journal and the preparation of both the day books and the general journal are the issues raised in the Unit. Comprehensive illustrations were given to make things clear to the students.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. What is a Journal? List and briefly discuss its various divisions.
2. The following transactions were obtained from the books of KANDE & SONS for the month of August, 2008.

Aug. 5	Bought from D. Usman & Sons: 5 dining tables @ ₦3,200 each 20 armless chairs @ ₦4,000 each Invoice subject to 25% trade discount.
Aug. 7	Returned by D. Usman & Sons: One dining table which was damaged in transit
Aug. 13	Sold to F. Johnson & Sons: 10 bags of Dangote Cement @ ₦1,800 per bag 80 bags of Dangote Flour @ ₦2,200 per bag Invoice subject to 15% trade discount.
Aug. 25	F. Johnson returned 4 bags of Cement which coagulated.

### Required:

You are required to prepare the purchases, sales and returns day books for the month of August, 2008.

3. List and explain six uses of a general journal.
4. **Alangubro** is in business as a dealer in building materials. His transactions in January, 2009 were as follows:

January 3	Bought on credit from <b>Emmanson Trading Co.:</b> 60 bags of cement @ ₦450 a bag.
January 6	Bought from <b>Wuru-Wuru &amp; Sons</b> on credit: 6 pairs of louver frames @ ₦100 a pair 100 piece of louver blades @ ₦20 a piece.
January 10	Sold on credit to <b>P. Paulinus:</b> 10 bags of cement @ ₦550 a bag.

- January 15 Sold to **H. Hamzat** on credit:  
20 bags of cement @ ₦550 a bag  
6 pairs of louver frames @ ₦120 a pair  
50 pieces of louver blades @ ₦30 a piece  
The whole transaction is subject to 15% trade discount.
- January 20 Bought on credit from **Deluxe Paints Ltd.:**  
100 tins of gloss star paints @ ₦85 a tin  
20 tins of emulsion star paints @ ₦69 a tin, less 10%  
trade discounts.
- January 21 Returned to **Deluxe Paints Ltd.:**  
2 tins of gloss star paints  
2 tins of emulsion star paints.
- January 25 Sold to **M. Umar:**  
80 tins of gloss star paints @ ₦100 a tin
- January 29 **M. Umar** returned:  
2 tins of gloss star paints.

**You are required to prepare:**

- (a) Purchases Journal;
- (b) Sales Journal;
- (c) Returns Outward Journal; and
- (d) Returns Inward Journal.

**7.0 REFERENCES/FURTHER READING**

Etuk Udo, J.S. *Book Keeping and Accounting*.

Omuya, J.O. *Frankwood's Business Accounting* .

Dandago, K.I. *Financial Accounting Simplified*.

Inanga E.L. *Principles of Accounting*.

## **UNIT 5      POSTING TRANSACTIONS TO LEDGER**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main content
  - 3.1 Definition of a Ledger
  - 3.2 Classification of Ledger
  - 3.3 Ledger Account
  - 3.4 Postings
  - 3.5 Balancing off of Account
  - 3.6 Illustrative Example
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

In the previous Unit, we have emphasized on the recording of business transactions in the books of prime/original entry (Journal). In this Unit, we shall discuss how posting of transactions is made from the books of original entry to the relevant accounts in the ledger, with a view to ensuring that a classified set of accounting information is properly determined for the use of various stakeholders.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define ledger and explain its various classifications
- determine how to post transactions to the relevant ledger accounts
- apply the principles of double entry
- balance off individual accounts in the ledger.

### **3.0 MAIN CONTENT**

#### **Posting Transactions to Ledger**

#### **3.1 Definition of a Ledger**

A ledger can be defined as the collection of various accounts in one form. The ledger is the book of final entry. An account is a record of

transactions of a particular type usually expressed in financial terms. A ledger may be kept in the following forms:

- i) **Card Ledger:** Under the card ledger system, each ledger card represents a ledger account, which is arranged in alphabetical order in a cabinet. Once a card is filled, it is removed and replaced with another card.
- ii) **Loose-leaf ledger:** Under this system, the ledgers are kept in the form of leaves of paper which are inserted in a binder with a locking mechanism to enable only authorized officer's access to the ledgers. Once the leaf is filled it is removed and replaced with another leaf.
- iii) **Bound ledger:** Under this system, the ledgers are kept in the form of a book bounded together.
- iv) **Electronic ledger:** This involves the use of electronic devices such as computer to capture business transactions. Under this system, a file is opened for each ledger account where transactions of similar nature are posted.

### SELF-ASSESSMENT EXERCISE 1

1. What is a ledger?
2. Discuss any three forms of ledger.

### 3.2 Classification of Ledger

There are various ways of classifying ledger, depending on the business needs, but the most common classifications are:

- i) **Personal ledger:** This ledger contains accounts of persons with whom the business transacts. The ledger could be further divided into: a) Sales ledger (for customers) and b) Purchases/ Creditors ledger (for Suppliers).
- ii) **Private ledger:** This ledger contains accounts of the proprietor(s) and it includes such account as Capital Account, Drawings Account, etc.
- iii) **General ledger:** This ledger contains all other accounts other than the ones mentioned above.

### SELF-ASSESSMENT EXERCISE 2

1. Differentiate between private and general ledgers.
2. Personal ledger could be for debtors or creditors. Discuss.

### 3.3 Ledger Account

This is a page in a ledger, which is devoted solely to transactions with a specific entity, or of a particular kind. A ledger account is drawn as follows:

#### Ledger Account

Date	Particulars	Folio	Amount	Date	Particulars	Folio	Amount

From the above, we could observe the following as features of a ledger.

- i. **Date:** The date in which the transaction that took place is recorded in the account.
- ii. **Particulars:** The nature of the transaction is recorded here, usually the corresponding account.
- iii. **Folio:** This column is used for referencing.
- iv. **Amount:** This is the column where the monetary worth of the transaction is recorded.

Ledger could accommodate a set of the following types of accounts, depending on the book keeping policy of a reporting entity:

- a) **Nominal Accounts:** Nominal accounts include accounts of all expenses, losses, incomes and gains. These accounts are kept in General ledger.
- b) **Real Accounts:** These are accounts of assets (real things) e.g. motor vehicles, land, cash etc. These accounts are also kept in general ledger.
- c) **Personal Accounts:** These are the accounts of persons with whom the business deals. Some of these accounts may be found in the personnel ledger and others in the private ledger.

### SELF-ASSESSMENT EXERCISE 3

1. Justify the necessity of 'Particulars' and 'Folio' columns in an account.
2. What do you understand by real account?

### 3.4 Postings

This refers to the transfer of transactions from the Journal to the debit and credit side of the relevant account in the ledger. Postings are made using the principles of double entry. Double entry principle is the technique of recording business transaction in two-fold; debit one account and credit a corresponding account.

The system recognizes that every transaction, which can be recorded in terms of money, involves the receiving of value by one or more persons

and the giving of equivalent value by another or other persons. The receipt of a benefit by one and the surrender of a like benefit by another are referred to as “*Debit*” and “*Credit*”. This system of book keeping is almost employed universally in recording business transactions.

The rules of double entry applicable to business activities are stated below:

<b>Business Activities Resulting in:</b>	<b>Entry Required:</b>
Asset Increase	Debit
Increased Expenses	Debit
Liability Decrease	Debit
Decreased Income	Debit
Asset Decrease	Credit
Decreased Expenses	Credit
Liability Increase	Credit
Increased Income	Credit

#### **SELF-ASSESSMENT EXERCISE 4**

1. Briefly discuss the principle of double entry.
2. How should purchase of motor van by cash be entered in the relevant accounts?

### **3.5 Balancing Off of Accounts**

A balance refers to the sum by which one side of an account is greater than the other. The common types of balances in accounting are:

- a) **Balance Carried Down:** Written as “c/d”. This is the period’s balance in an account.
- b) **Balance Brought Down:** Written as “b/d”. This is the period’s balance taken to the next accounting period.
- c) **Balance Carried Forward:** Written as “c/f”. This is the total on a page of an account to be taken to another page.
- d) **Balance Brought Forward:** Written as “b/f”. This is the total on a page of an account taken to the next or new page.

The procedure for Balancing off an Account is as follows:

- i. Add up amount column on the Dr. and Cr. Side of an account;
- ii. Compare the sum of the amount on both side;
- iii. If the sum of the entries are not the same, find the difference;
- iv. Enter the difference in the smaller side in order to make both sides equal;

- v. Check that the totals are now equal and write the total of the Dr entries on the same level as the total of the Cr entries;
- vi. The balancing figure is to be brought down to the bigger side.

**SELF-ASSESSMENT EXERCISE 5**

1. Justify the necessity of comparing both sides of an account in the course of balancing it off.
2. Differentiate between balance carried down and balance brought down.

**3.6 Illustrative Example**

From the information below, record the transactions which took place during the first ten days of July 2007 in a firm’s ledger.

	N
Jul.1 Capital paid into bank-----	10,000
Jul.1 Paid rent by cheque-----	1,200
Jul.2 Bought goods on credit from Omar Stores-----	2,650
Jul.4 Sold goods on credit to Iliya Bakery-----	2,850
Jul.5 Bought goods on credit from Omar Stores-----	3,790
Jul.8 Sold goods on credit to Iliya Bakery-----	4,930
Jul.9 Received cheque from Iliya Bakery-----	2,500
Jul.10 Paid cheque to Omar Stores-----	2,700

**Solution:**

Bank Account

	N		N
Jul. 1 Capital	10,000	Jul. 1 Rent	1,200
Jul. 9 Iliya Bakery	2,500	Jul. 10 Omar Stores	2,700
	<u>12,500</u>	Jul. 10 Bal. c/d	8,600
			<u>12,500</u>

Purchases Account

	N		N
Jul. 2 Omar Stores	2,650	Jul. 10 Bal. c/d	6,440
Jul. 5 Omar Stores	3,790		
	<u>6,440</u>		<u>6,440</u>

Sales Account

	N		N
Jul. 10 Bal. c/d	7,780	Jul. 4 Iliya Bakery	2,850
	<u>7,780</u>	Jul. 8 Iliya Bakery	4,930
			<u>7,780</u>

Omar Stores Account					
		₺			₺
Jul. 10	Bank	2,700	Jul. 2	Purchases	2,650
Jul. 10	Bal. c/d	3,740	Jul. 5	Purchases	3,790
		<u>6,440</u>			<u>6,440</u>

Iliya Bakery Account					
		₺			₺
Jul. 4	Sales	2,850	Jul. 9	Bank	2,500
Jul. 8	Sales	4,930	Jul. 10	Bal. c/d	5,280
		<u>7,780</u>			<u>7,780</u>

Capital Account					
		₺			₺
Jul. 10	Bal. c/d	<u>10,000</u>	Jul.1	Bank	<u>10,000</u>

Rent Account					
		₺			₺
Jul.1	Bank	<u>1,200</u>	Jul.10	Bal. c/d	<u>1,200</u>

#### 4.0 CONCLUSION

We have seen how transactions are posted to the ledger from the books of prime entry. It has also been shown that accounting information is classified by means of a ledger. The classification makes it easier to access accounting record of a business since a transaction involving persons can be found in the personal account ledger without having to check all the ledger accounts. Transactions are recorded in ledger accounts, to be balance off before the account balances are used in preparing financial statements to be used by different stakeholders as they take various informed decisions.

#### 5.0 SUMMARY

In this unit, discussions are focused on posting of transactions into the various ledger accounts, while balancing off of accounts and its procedures have also been discussed. The Unit also explains when to use the balance “c/d”, c/f”, b/d and b/f”, as accounts are balanced off.

#### 6.0 TUTOR-MARKED ASSIGNMENT

1. Define ledger and explain its classifications.

2. Differentiate between debtors' ledger and creditors' ledger.
3. The following transactions were obtained from the books of KANDE & SONS for the month of August, 2008.

Nos. 411B  
Kauyen Alu,  
Jankanwa  
Avenue, Kano.  
28 July, 2009.

Mr. Would-be Accountant,  
Jakara Road, Kano.

Dear Sir,

### **REQUEST FOR CLARIFICATION**

I write to request for clarification on the following issues:

- (a) I bought a motor van some 2 years ago for ₦220, 000. The van is still in the garage but i intend using it in my business. My friend has just informed me that the van now cost ₦400, 000. In view of this, I would like the Motor Van to be recorded in the books at the present market value but my accountant declined insisting that it is the ₦220, 000 that should be recorded.
- (b) Recently, I acquired a machine on Hire Purchase from Risk International. When my legal adviser submitted documents for the transaction he stopped me from recording the machine among my assets until I finished paying for it. This however contradicts my Accountant's view, who to my knowledge had already recorded it among my assets.
- (c) My Accountant is always insisting on pessimistic ideas by anticipating all forms of losses even though I am still hopeful that these amounts can still be realized. I see no justification for this as it will minimize my profit and undermine my effort.
- (d) Mr. Dabo, a customer, had just finished negotiating on some articles which I trade-in. While preparing my account for this month, my Accountant had already included it as part of sales even though the customer in question has not paid.
- (e) Since I employed him in January this year, my Accountant always reports to me, the financial position of my business on monthly basis. In this month, he said I made a profit of ₦26, 000 out of which he deducted the sum of ₦3, 000 I collected in order to fuel my personal car. I frowned at this action of my Accountant because the business is mine.

I will be grateful if you would reply me on the above issues.

*Yours sincerely,*

Mr. Confusion.

**Required:** Write a reply to the above letter stating why the Accountant has held the views mentioned above.

- Aug. 5 Bought from D. Usman & Sons:  
5 dining tables @ ₦3,200 each  
20 armless chairs @ ₦4,000 each  
Invoice subject to 25% trade discount.
- Aug. 7 Returned by D. Usman & Sons: 1 dining table which was damaged in transit.
- Aug. 13 Sold to F. Johnson & Sons:  
10 bags of Dangote Cement @ ₦1,800 per bag  
80 bags of Dangote Flour @ ₦2,200 per bag  
Invoice subject to 15% trade discount.
- Aug. 25 F. Johnson returned 4 bags of Cement which coagulated.

**Required:**

You are required to post these transactions to the various ledger accounts.

4. Indicate what ledger account should be Debited or Credited in the following transactions:

Transactions	Debit	Credit
Cash paid into business by owner		
Building introduced into business by owner		
Purchase of goods for cash		
Sale of goods on credit to Mallam Shehu		
Purchase of motor vehicle on credit from SCOA Ltd.		
Paid Cash for electricity		
Owner withdraws cash from business		
Cash Sales		

5. Indicate what ledger account should be Debited or Credited in the following transactions:

<b>Transactions</b>	<b>Debit</b>	<b>Credit</b>
Owner pays money into business bank account		
Paid rent in cash		
Paid cash for goods purchased		
Delivery Van is acquired for cash		
Sold goods for cash		
Purchase goods on credit from S.Ogunde		
Paid half-month wage of Shop Assistant in cash.		
Sold goods on credit to N.Mahadi		
Paid cash for electricity		

## **7.0 REFERENCES/FURTHER READING**

Etuk Udo, J.S. *Principles of Accounting*.

Dandago, K.I. *Financial Accounting Simplified*

Lafferty, J.L. *Accountancy*.

Omuya, J.O. *Frankwoods Business Accounting*.

**MODULE 2**

Unit 1	Understanding Cash Book
Unit 2	Trail Balance and Book keeping Errors
Unit 3	Banking Relationship and Transactions
Unit 4	Bank Reconciliation Statement
Unit 5	Final Accounts Without Adjustments

**UNIT 1 UNDERSTANDING CASH BOOK****CONTENTS**

1.0	Introduction
2.0	Objectives
3.0	Main Content
3.1	The Concept of Cash Book
3.2	Cash Account
3.3	Columnar Cash Book
3.3.1	Two-Column Cashbook
3.3.2	Three-Column Cashbook
3.3.3	Petty Cashbook
3.4	Illustration Examples
4.0	Conclusion
5.0	Summary
6.0	Tutor-Marked Assignment
7.0	References/Further Reading

**1.0 INTRODUCTION**

Most business transactions are conducted on cash basis, especially in the public sector and in small and medium scale enterprises. In Unit 4, we have been able to discuss how credit transactions are recorded by all businesses selling goods or services on credit. In this Unit, efforts will be made to explain how cash transactions are recorded, when and where.

**2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define cash book
- appreciate the various types of cash book
- prepare Cash book on various columns.

### **3.0 MAIN CONTENT**

#### **Understanding Cash Book**

#### **3.1 The Concept of Cash Book**

The Cashbook or Cash Journal is meant for recording all cash transactions. The Cashbook serves the dual purpose of a book of prime entry and a ledger account. It is the book of original entry for all cash transactions. Unlike other daybooks, it is ruled like a ledger account, with debit and credit sides. All cash received being debited and cash paid credited. A Cashbook is a ledger for cash transactions; an entry in the Cashbook constitutes one part of the double entry and it only remains to make the other part.

#### **SELF-ASSESSMENT EXERCISE 1**

1. What do you understand by the term cashbook?
2. Briefly discuss the duality of cashbook.

#### **3.2 Cash Account**

This is the simplest form of cashbook and is like a typical ledger account with one amount column on both the Dr. and Cr. sides. As stated earlier, all cash receipts are debited to this account, while all cash payments are credited to the account. The balance of this account represents the Cash in hand.

#### **SELF-ASSESSMENT EXERCISE 2**

1. Briefly differentiate between debit and credit entries in cashbook.
2. Why is cashbook always having a debit balance?

#### **3.3 Columnar Cashbooks**

Apart from the cash account other forms of cashbook are kept in columnar form. The various forms of cash transaction and payments adopted by an organization determine the types of column in the cashbook. The most common forms of columnar cashbook are:

- a) Two-column cashbook;
- b) Three-column cashbook; and
- c) Petty cashbook.

### 3.3.1 Two-Column Cashbook

A cashbook becomes two-column if it possesses two amount columns of cash and bank, bank and discount or cash and discount.

- a) **Cashbook consisting of Cash and Discount Columns:** In organizations, which buys and sell goods, it is possible to grant discount. This discount could be given either as a means of inducing patronage (**trade discount**) or encouraging prompt settlement (**cash discount**). There exists differences between these two forms of discounts in accounting because cash discount has a direct impact on cash transactions and as such it is usually shown alongside its origin i.e. cash sales or cash purchases in the cashbook. Trade discount, on the other hand, is rebate granted on the marked price of an item. It is often deducted from the selling price before arriving at the net invoice value. Trade discount is usually applied irrespective of whether the transaction is a cash or credit transaction.
- b) **Cashbook consisting of Cash and Bank Columns:** In some organizations, in addition to the cash till, a bank account is usually maintained. The bank column records transactions relating to bank, this could be evidenced through the issuance of a cheque for payments or deposits of money into the bank account. The deposits appear on the Dr. side of the bank while payments made are reflected on the Cr. side of the bank column in the cashbook.

Sometimes a business may take its excess cash in hand to bank or withdraw cash from bank to office for use; this is termed as “*contra entry*”. It is so called because it involves transfer of money from bank to cash or cash to bank; it is usually represented with the letter “C” in the folio column.

- c) **Cashbook consisting of Bank and Discount Columns:** This cashbook is used in businesses where all receipts are paid into the bank and all payments are made by cheque. Under this circumstance, if the organization grants discount, an additional column is added to record the discount, making it a two-column cashbook.

### 3.3.2 Three-Column Cashbook

This cashbook is similar to the two-columns except that it has column for cash, bank and discount on both sides of the ledger. The rules that apply in the preparation of cash account also apply here.

### 3.3.3 Petty Cashbook

A petty cashbook is a record in columnar form of small cash payments made on a day-to-day basis. The petty cashbook is different from a regular cashbook in that the amounts recorded here are usually small and the payments may be more frequent. The essence of the columnar ruling in the petty cashbook is to analyze small payments according to the type of expenditure. The petty cashbook is usually operated using the imprest system. The imprest system reimburses the petty cashier with the total amount expended. In this way, the total amount in the cashier's possession is restored to a fixed amount called "float".

### SELF-ASSESSMENT EXERCISE 3

1. Differentiate between two-column and three-column cashbook.
2. Briefly discuss the concept of imprest.

### 3.4 Illustration Examples

#### Illustration One:

J. Adams had the following balances for the first week of February 2006:

	₦
Feb. 1. Balance of cash in hand	8,400
Feb. 1. Purchased goods for cash	5,600
Feb. 1. Received from L. Na' Allah and Sons in full settlement of account after allowing for a discount of	₦300. 6,500
Feb. 1. Paid Musa Beбето after receiving a discount of ₦200	9,400
Feb. 2. Cash Sales	13,500
Feb. 3. Paid electricity bill for January	900
Feb. 3. Paid Buba Stores (Received discount of ₦400)	7,700
Feb. 4. Received cash from T.Tata stationeries in full settlement of account less ₦100 cash discount	5,200
Feb. 5. Received from Abdussalam printers	3,200
Feb. 6. Paid Kyauta on account	2,400
Feb. 7. Purchased goods for cash (Trade discount of ₦500 Was allowed)	7,800
Feb. 7. Sold for cash goods, ₦8, 200 (allowed customer a trade Discount of ₦400)	8,200

Enter the above transactions in a two-column cashbook.

**Solution:****J. Adams****Cash book for the first week of February, 2006**

Date	Particulars	Folio	Discount	Cash	Date	Particulars	Folio	Discount	Cash
2006			₦	₦	2006			₦	₦
Feb.1	Bal. b/d			8,400	Feb.1	Purchases			5,600
Feb.1	L. Na'Allah		300	6,500	Feb.1	Musa Beбето		200	9,400
Feb.2	Sales			13,500	Feb.3	Electricity			900
Feb.4	T. Tata		100	5,200	Feb. 3	Buba Stores		400	7,700
Feb.5	Abdussalam			3,200	Feb. 6	Kyauta			2,400
Feb.7	Sales			8,200	Feb. 7	Purchases			7,800
					Feb. 7	Bal. c/d			11,200
			<u>400</u>	<u>45,000</u>				<u>600</u>	<u>45,000</u>
Feb8	Bal. b/d			11,200					

**Illustration Two:**

**Hajjo Ummi** commenced business on 1<sup>st</sup> April, 2006 with a cash of ₦16, 000 and a bank account of ₦64,000. The following is a summary of her other transactions for the month. April 4. Bought furniture costing ₦13,760 by cheque April 9. Settled the following accounts by cheque deducting 5% discount in each case:

	₦
Alibaba	20,000
Bashir	9,600
Ciroma	3,200

April 16. Withdrew cash from bank ₦22, 400 to office

April 21. Cash sales paid directly into bank. 28,800

April 24. The following persons settled their account in cash deducting 4% cash discount:

	₦
Danjuma	8,000
Iro	3,500
Abba Enterprises	6,000

April 25. Paid local rate of ₦2,000 in cash.

April 26. Paid for insurance in cash. 1,360

April 29. Paid for salaries in cash. 20,800

April 30. Banked all cash in till except ₦16, 000.

You are required to prepare for Hajjo Ummi, a **Three-Column Cashbook** for the month of April, 2006.

**Solution:**

**Hajjo Ummi**  
**Three Column Cash Book for the month of April 2006**

Date	Particulars	Folio	Disc	Cash	Bank	Date	Particulars	Folio	Disc	Cash	Bank
2006			₦	₦	₦	2006			₦	₦	₦
Apr. 1	Capital			16,000	64,000	Apr. 4	Furniture				13,760
Apr. 16	Bank	C		22,400		Apr. 9	Alibaba		1,000		19,000
Apr. 21	Sales				28,800	Apr. 9	Bashir		480		9,120
Apr. 24	Danjuma		320	7,680		Apr. 9	Ciroma		160		3,040
Apr. 24	Iro		140	3,360		Apr.16	Cash	C			22,400
Apr. 24	Abba Ent.		240	5,760		Apr.25	Local Rate			2,000	
Apr. 30	Cash	C			15,040	Apr.26	Insurance			1,360	
						Apr.29	Salaries			20,800	
						Apr.30	Bank	C		15,040	
			700						1,640		
						Apr.30	Bal. c/d			16,000	40,520
				55,200	107,840					55,200	107,840
May. 1	Bal. b/d			16,000	40,520						

**Illustration Three:**

The following items are to be entered in a petty cash book. Columns are to be headed up for Traveling expenses, Postages, Motor expenses, Stationery and Sundry expenses. The book is to be maintained on the imprest system, reimbursement takes place on the last day of each month. The opening petty cash float is ₦5,000 received on 1<sup>st</sup> January, 2004.

	₦
Jan.1. Motor spare parts	2,200
Jan.3. Post office stamps	150
Jan.6. Bus fare	190
Jan.8. A.A Rano - Petrol	1,000
Jan.9. E.P& Co.-Stationery	80
Jan.10. Bus fares	50
Jan.11. Post office: Stamps	210
Jan.13. Sundry expenses	40
Jan.15. Scrubbing brushes	20
Jan.16. E.Mahmud-Stationery	180
Jan.20. Bus fare	130
Jan.28. Sundry expense	50
Jan.30. Dankano Oil-Petrol	600

Jan.31. Received reimbursement to bring cash float to desired level.

**Solution:**

**Petty Cash Book for the month of January 2004**

Date	Particulars	Folio	Amount	Date	Particulars	Folio	Analysis of Payment					Total
							TravExp.	Postage	Motor Exp.	Stationery	Sundry Exp.	
2004			₦	2004			₦	₦	₦	₦	₦	₦
Jan. 1	Float		5,000	Jan. 1	Motor Spare Parts				2,200			2,200
	Reimbursement		4,900	Jan. 3	Post Office Stamps			150				150
				Jan. 6	Bus Fare		190					190
				Jan. 8	A.A. Rano-Petrol				1,000			1,000
				Jan. 9	E. P & Co.					80		80
				Jan. 10	Bus Fare		50					50
				Jan. 11	Post Office Stamps			210				210
				Jan. 13	Sundry Expenses						40	40
				Jan. 15	Scrubbing Brushes						20	20
				Jan. 16	E. Mahmud					180		180
				Jan. 20	Bus Fare		130					130
				Jan. 28	Sundry Expenses						50	50
				Jan. 30	Dankano Oil- Petrol				600			600
							370	360	3,800	260	110	4,900
				Jan. 31	Bal. c/d							5,000
			9,900									9,900

**4.0 CONCLUSION**

In this Unit, we have discussed the procedures involved in recording cash transactions and the role of the cash journal (cash book). It has also been shown that a cash book combines the cash receipt and cash payments journal discussed earlier.

**5.0 SUMMARY**

This unit has explained the various forms of cash books that can be used by businesses for the purpose of recording its cash transactions and how these cashbooks are prepared to enable businesses know their cash balances at periodic intervals. The Unit contains useful illustrative examples on all forms of cashbook.

**6.0 TUTOR-MARKED ASSIGNMENT**

1. What is a Columnar Cash Book and how is it different from a Cash Account?
2. Differentiate between cashbook and journal proper.
3. The following transactions were extracted from the books of **Mercy Trading Company** as at 31<sup>st</sup> December 2008. All payments were made by cheque and all receipts were paid to the bank. The Company maintains a float of ₦21, 000.

		₦
Dec. 2:	Cash at First Bank	20,000
Dec. 2:	Petty Cash in hand	1,400
Dec. 3:	Drew cheque for petty cash	19,600
Dec. 5:	Received from Enahoro, cheque in settlement of his debt ₦32, 600 less 10% discount	
Dec. 6:	Settled Tanimu's account of ₦25, 900 less 10% discount.	
Dec. 7:	Sold for 25 Celtel cards at ₦500 per card.	
Dec. 8:	Transferred to current account from deposit account 70,000	
Dec.10:	Paid Ola	4,800
Dec.16:	Paid cheque for motor repairs	8,000
Dec.20:	Paid Adamu	3,800
Dec.26:	Paid Kabiru	4,050
Dec.28:	Paid Khaleed	4,200
Dec.30:	Payments from petty cash during the month were:	
		₦
	Salaries and wages	8,000
	Trade expenses	2,000
	Sundry purchases	9,200

You are required to prepare:

- a) Two column cash book for the month of December 2008
  - b) Petty cash book for the same period.
- 4). Write-up the cash account of **NALADO and Sons** for the month of April 2005.

	₦
April 1. Commenced business with cash	100,000
Bought office furniture for cash	15,000
8. Bought goods for cash	20,000
10. Credit purchases	30,000

13. Withdrew cash from business for own use	10,000
18. Credit sales	28,000
21. Cash purchases	21,000
26. Paid local taxes in cash	4,000
27. Paid for rent in cash	12,000
29. Cash sales	40,000
30. Loan from Musa	40,000
30. Cash sales	15,000

5. Enter the following transactions in a double column cashbook of **Mr. MATI** for the month of October, 2006.

Oct.1.	Balances from the last month:	₦
	Office	16,460
	Bank	399,020
Oct.3.	Cash sales	64,470
Oct.5.	Purchased goods by cheque	192,000
	Paid sundry expenses in cash	5,000
Oct.7.	Cash sales	80,060
Oct.9.	Paid cash into bank	152,000
Oct.11.	A.A Baffa paid cheque on account	32,000
Oct.14.	Withdrew cash from bank for office use	16,000
Oct.17.	Paid M.Mustafa by cheque	24,220
Oct.24.	Cash sales paid directly into the bank	40,340
Oct.27.	Paid wages in cash	19,200
Oct.28.	Cashsales	24,000
Oct.31.	Banked balance of cash in hand retaining in office only	₦9,070.

## 7.0 REFERENCES/FURTHER READING

Anao, A.R. *An Introduction to Financial Accounting*.

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## **UNIT 2 TRIAL BALANCE AND BOOK KEEPING ERRORS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Concept of Trial Balance
  - 3.2 Preparation of Final Accounts from Extracted Trial Balance
  - 3.3 Trial Balance Errors
  - 3.4 Correction of Book keeping Errors
  - 3.5 Effect of a Book keeping Error on Profit
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### **1.0 INTRODUCTION**

Trial balance is one of the means of checking the accuracy of transactions posted into the ledger accounts. In this Unit, we shall discuss the procedures involved in drafting trial balance and correcting the book keeping errors that may emanates in the course of preparing ledger accounts before the extraction of a trial balance.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define trial balance and explain its importance
- extract the trial balance of an enterprise
- appreciate the errors that may occur in the preparation of ledger accounts and extraction of a trial balance
- correct those book keeping errors
- compute revised profit of a business.

### 3.0 MAIN CONTENT

#### Trial Balance and Its Errors

#### 3.1 The Concept of Trial Balance

A trial balance can be defined as the listing of the ledger accounts, with either their totals or balances shown in columns of debit and credit. The totals of the debit and credit columns are expected to agree, if the accounts have been correctly kept under the double entry principle. Using balances, a trial balance could be defined as the list of all balances extracted from the ledger accounts, both debit and credit balances. In extracting a trial balance, there are two methods used by accountants:

- i) **Total Entries Method:** Under this method, all debit and credit entries in the ledger are summed up under the individual accounts and the totals are taken into the respective column of the trial balance.
- ii) **Account Balance Method:** Under this method, each account is balanced off and the net difference, whether debit or credit, is taken to the respective column of the trial balance.

The basic difference between the total entries and account balance method is that, the total entries method may have two separate amounts entered for it in the ledger while under the account balance method, only one amount representing net, is taken to the trial balance.

Although the total entries appear simpler, it is rarely used in practice because it does not yield very valuable information.

#### SELF-ASSESSMENT EXERCISE 1

1. Briefly discuss the concept of trial balance.
2. Distinguish between the two methods of extracting trial balance.

#### 3.2 Preparation of Final Accounts from Extracted Trial Balance

From the trial balance extracted, it should be noted that:

1. Items on the debit represent either Assets or Expenses.
2. Items on the credit represent either Liabilities or Incomes.

To prepare a final account from the extracted trial balance, the expenses and incomes appear in the trading, profit and loss account, while the assets and liabilities appear in the balance sheet. If the trial balance totals agree, both assets and liabilities in the balance sheet will agree, thus satisfying the accounting equation.

## SELF-ASSESSMENT EXERCISE 2

1. What are final accounts?
2. How is trial balance related to final accounts?

### 3.3 Trial Balance/Book keeping Errors

An error represents an unintentional mistake. It may occur at any stage of business transaction. It could occur at the stage of negotiation, documentation, recording, final entry, summarization or preparation of financial statements. A book keeping error may be mathematical, clerical, descriptive, or based on application of accounting principles. But in relation to a trial balance, errors are often categorized as:

- i. Errors not affecting the trial balance totals; and
- ii. Errors affecting the trial balance totals.

#### 3.3.1 Errors Not Affecting Trial Balance Totals

These errors when committed do not affect the agreement of the trial balance. The sums of both debit and credit columns will still agree but the true state of affairs is not presented. The following are the common types of errors in this category:

- a) **Error of Omission:** This occurs where a transaction is completely left-out of the book-keeping system. This means that there was neither posting to debit nor credit side of the affected ledger accounts and the transaction will, therefore, be eliminated for representation in the trial balance.
- b) **Error of Original Entry:** This error occurs where the initial figure on which double entry was observed is taken wrongly from the source document. For example, Sales of ₦2, 000 recorded on the sales invoice as such was posted as ₦2,020 in the ledger account.
- c) **Error of Compensation:** This type of error occurs where two errors cancel out each other, wonderfully. If, for example, there was overcast in sales account of ₦5,000 and overcast in the purchases account of ₦5,000, these two sums though appearing on different side of the trial balance will cancel out each other. It

should be noted that an error of compensation usually involves at least two transactions.

- d) **Error of Complete Reversal of Entry:** This type of error occurs where a transaction is given the correct double entry treatment, but in the reverse order. For example, cash sales of ₦4, 000 was debited to sales account and credited to cash account.
- e) **Error of Commission:** This occurs when a transaction is posted to the wrong account of the same class. For example, a purchase of ₦2, 500 on credit from B. Baba was posted to the credit of A. Baba's account.
- f) **Error of Principles:** This occurs when a transaction is posted to the wrong class of account. For example, motor vehicles repairs of ₦200 were posted to the debit of motor vehicle account.

### 3.3.2 Errors Affecting Trial Balance Agreement

These errors when committed affect the agreement of the trial balance. Such errors result in either the debit side being greater than the credit side or the credit side being greater than the debit side. It, therefore, follows that the arithmetical accuracy of postings in the ledger accounts cannot be trusted. The following are the major types of errors in this category:

- a) **Error of Loop-side:** This type of error occurs when two entries are made to the same side of the ledger in different accounts. For example, cash sales of ₦3,000 was debited to both sales and cash accounts.
- b) **Error of Partial Omission:** This type of error occurs when only single entry was made in the books with regard to a particular transaction. For example, wages of ₦2, 000 paid in cash was recorded in cash account only.
- c) **Error of Casting:** This occurs when in one of the two relevant accounts; an amount recorded is different from the amount in the corresponding account. The error could be either overcast or under cast.
- d) **Error of Transposition:** This occurs when the figures used for posting in one of the ledger accounts is interchanged. For example, sales of ₦778 recorded as ₦787 in sales account.

### SELF-ASSESSMENT EXERCISE 3

1. What is a bookkeeping error?
2. Discuss the two main categories of bookkeeping errors.

### 3.4 Correction of Book keeping Errors

There is no clear-cut format for correcting book keeping errors, the guiding principles is that of understanding the nature of the error(s) and determining how best it could be rectified. However, the following questions will serve as a guide towards solving problems in connection to correction of errors.

- 1) What has been done in the books?
- 2) What ought to have been done in the books?
- 3) What should the book keeper do to put the matters right?

It is usually good while correcting errors to make the correcting entries in a general journal or journal proper first before making postings to relevant ledger accounts. But for errors affecting trail balance totals, in addition to the journal, a suspense account is required. The suspense account is an account of temporary balance, in which differences in the books (i.e. differences in trial balance totals) is posted before ascertaining the cause of the difference.

#### **SELF-ASSESSMENT EXERCISE 4**

1. Discuss any two reasons why bookkeeping errors should be corrected?
2. Discuss the procedure of correcting bookkeeping errors.

### **3.5 Effects of Bookkeeping Errors on Profit**

Errors which affect profit are errors in relation to ledger accounts which are closed to the Profit and Loss Account, as financial statements are prepared. Such errors have the effects of overstating or understating profit.

	<b>Effects on Profit</b>	<b>Action Required</b>
Errors resulting in increased income.	Overstate profit	Reduce profit by the extent of income overstated.
Errors resulting in increased expenses.	Understate profit	Increase profit by the extent of expenses overstated.
Errors resulting in reduced income.	Understate profit	Increase profit by the extent of income reduced.
Errors resulting in decreased expenses.	Overstate profit	Reduce profit by the extent of expenses understated.

**SELF-ASSESSMENT EXERCISE 5**

1. Discuss the effects of errors in expenses and incomes on the profit of a reporting entity.
2. What actions are needed to normalize overstatement of profit?

**3.6 Illustrative Examples**

**Illustration One:**

Alh. Mudi started business on December 1, 2001 with a capital of ₦160,000. The following transactions were carried out during the month of December.

Dec. 1	Purchased furniture by cash	₦24,000
Dec. 2	Purchased stationery by cash	₦2,000
Dec. 3	Purchased goods by cash	₦35,000
Dec. 4	Purchased goods on credit from Mallam Gogo	₦50,000
Dec.15	Sold goods for cash	₦60,000
Dec.18	Sold goods to Charles Ufot on credit	₦24,000
Dec.20	Paid advertisement expenses in cash	₦2,000
Dec.25	Paid Mallam Gogo ₦35,000 cash being part of settlement of goods purchased	
Dec.28	Paid rent in cash	₦3,000
Dec.31	Paid salaries and wages	₦6,000 cash

**Required:**

You are required to write up Ledger Accounts recording the above transactions and extract a Trail Balance.

**Solution:**

Alh. Mudi's Ledger			
Cash Account			
		₦	₦
	Capita	160,00	
Dec. 1	1	0	Dec. 1
Dec.			Dec. 2
15	Sales	60,000	Stationery
			2,000
			Dec. 3
			Purchases
			35,000
			Dec.
			20
			Advertisement
			2,000
			Dec.
			Mallam Gogo
			35,000

	25		
	Dec.		
	28	Rent	3,000
	Dec.		
	31	Salaries & wages	6,000
	Dec.		
	31	Trial Balance	113,000
			0
			<u>220,00</u>
			<u>0</u>

Capital Account

		₦		₦
Dec. 31	Trial Balance	<u>160,000</u>	Dec.1	Cash
				<u>160,000</u>

Purchases Account

		₦		₦
Dec. 3	Cash	35,000	Dec. 31	Trial Balance
Dec. 4	Mallam Gogo	50,000		
		<u>85,000</u>		<u>85,000</u>

Sales Account

		₦		₦
Dec. 31	Trial Balance	84,000	Dec. 15	Cash
			Dec. 18	Charles Ufot
		<u>84,000</u>		<u>84,000</u>

Mallam Gogo Account

		₦		₦
Dec. 25	Cash	35,000	Dec. 4	Purchases
Dec. 31	Trial Balance	15,000		
		<u>50,000</u>		<u>50,000</u>

Charles Ufot Account

		₦		₦
Dec. 18	Sales	<u>24,000</u>	Dec. 31	Trial Balance
				<u>24,000</u>

Furniture Account

		₦		₦
Dec. 1	Cash	<u>24,000</u>	Dec. 31	Trial Balance
				<u>24,000</u>

Stationery Account

		₦		₦
Dec. 2	Cash	<u>2,000</u>	Dec. 31	Trial Balance
				<u>2,000</u>

Advertisement Expenses Account

Dec. 20	Cash	N <u>2,000</u>	Dec. 31	Trial Balance	N <u>2,000</u>
Rent Account					
Dec. 28	Cash	N <u>3,000</u>	Dec. 31	Trial Balance	N <u>3,000</u>
Salaries and Wages Account					
Dec. 31	Cash	N <u>6,000</u>	Dec. 31	Trial Balance	N <u>6,000</u>

## Trial Balance as 31 December 2001

	DR. N	CR N
Cash	113,000	
Capital		160,000
Purchases	85,000	
Sales		84,000
Creditors: Mallam Gogo		15,000
Debtors: Charles Ufot	24,000	
Furniture	24,000	
Stationery	2,000	
Advertisement	2,000	
Rent	3,000	
Salaries & Wages	6,000	
	<u>259,000</u>	<u>259,000</u>

**Illustration Two:**

The trial balance of Hamdallah Company Ltd failed to agree, the debit side in excess by N6,297 and the difference was posted to a suspense account. An investigation into the books revealed the following:

- a) A balance of N156 on Sales Day Book was carried forward as N516.
- b) A sum of N140 paid for wages was recorded only in the Cash Book.
- c) A payment of N840 made by Mallam Mohammed was credited to Mallam Ahmed's account.
- d) An amount of N800 posted to machinery account included N60 for machine repairs.
- e) Purchases Day Book was over casted by N440.
- f) A payment of N3,150 for postage was posted to the credit side of the account.

g) A balance of ₦118 due from a debtor was brought down as ₦181.

**You are required to prepare:**

- i) Journal entries to correct the errors and
- ii) A suspense account.

**Solution:**

Hamdallah Company Ltd.  
Journal Entries

	DR	CR
	₦	₦
Sales	360	
Suspense		360
Being correction of sales overcast		
Wages	140	
Suspense		140
Being correction of wages not posted		
Mallam Ahmed	840	
Mallam Mohammed		840
Being correction of an error of commission		
Furniture Repairs	60	
Furniture		60
Being correction of an error of principle		
Suspense	440	
Purchases		440
Being correction of an overcast in purchases a/c.		
Postage	6,300	
Suspense		6,300
Being correction of reversal entry in postage a/c.		
Suspense	63	
Debtors		63
Being correction of amount transposed in debtors a/c.		

Suspense Account

	₦		N
Difference in books	6,297	Sales	360
Purchases	440	Wages	140
Debtor	63	Postage	6,300
	<u>6,800</u>		<u>6,800</u>

**Illustration Three:**

Mr. Achaba, a trader, engaged the services of an inexperienced book keeper. The book keeper produced the following Balance Sheet as at 31<sup>st</sup> December, 2003:

<b>Balance Sheet as at 31<sup>st</sup> December 2003</b>			
	N		N
Capital	50,224	Fixed Assets	72,208
Loan- Junaidu 12%	20,000	Stock	18,826
Trade Creditors	26,000	Debtors	26,016
Accruals	282	Prepayments	600
Bank Overdraft	14,634	Drawings	8,260
Profit & Loss Account	18,400	Suspense Account	2,930
		Cash	700
	<u>129,540</u>		<u>129,540</u>

An investigation into the accounts revealed the following:

- a) The suspense account balance represents the difference on the trial balance.
- b) The purchases day book total for October of N8, 240 was posted to the purchases account as N8, 420.
- c) Closing stock were over casted by N2, 000.
- d) Cash in hand should be N110.
- e) Fixtures and fittings Account balance of N4,600 has been omitted from the Trial Balance.
- f) Interest for a half year on loan account has not been paid and no provisions made for it.
- g) An invoice for N500 has been included in stock and purchases but not posted to the personal account.
- h) A sales return of N200 has been debited to Adamu's account.

**You are required to prepare:**

- i) Suspense Account and
- ii) Revised Balance Sheet as at 31<sup>st</sup> December 2003  
(Adapted from WAEC 1995)

**Solution:**

Mr. Achaba's Ledger  
Suspense Account

	N		N
Difference in books	2,930	Fixtures & Fittings	4,600
Purchases	180		
Cash	590		
Creditors	500		
Adamu	400		
	<u>4,600</u>		<u>4,600</u>

Revised Balance Sheet as at 31 December 2003

	N	N		N	N
Capital		50,224	Fixed Asset		76,808
Add: Revised Profit (working)		15,380			
		<u>65,604</u>			
Less: Drawings		(8,260)			
		<u>57,344</u>			
Long Term Liabilities			Current Assets		
12% Loan		20,000	Stock	16,826	
Current Liabilities			Debtors	25,616	
Creditors	26,500		Prepayment	600	
Accruals	282		Cash	110	<u>43,152</u>
Bank Overdraft	14,634				
Loan Interest Outstanding	1,200	<u>62,616</u>			
		<u>119,960</u>			<u>119,960</u>

**Workings:**

Computation of Revised Profit

	N	N
Net profit per account		18,400
Add: Purchases Overcast		<u>180</u>
		18,580
Less: Closing Stock Overcast	2,000	
Interest loan outstanding	<u>1,200</u>	<u>(3,200)</u>
Revised Profit		<u>15,380</u>

**4.0 CONCLUSION**

We have seen that trial balance is a means of checking the arithmetical accuracy of the book keeping entries under the double entry system and it provides for the easy preparation of the final accounts. However, the trial balance is subject to errors which could alter true financial position and result of operations of the business which can be corrected when detected.

## 5.0 SUMMARY

In this Unit, preparation of trial balance has been discussed as well as the errors affecting and those not affecting the agreement of the trial balance. The Unit also explains how such errors could be effectively corrected to pave way for the preparation of final accounts that would show true and fair view of the financial position and result of operations of the reporting entity.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Explain five errors which do not affect the agreement of the trial balance totals.
2. Discuss any three errors that affect the agreement of a trial balance.
3. Differentiate between the two methods of extracting trial balance.
4. An inexperienced Book keeper prepared a Trial Balance which failed to agree.

The difference of N85 credit was kept in a suspense account. The following errors were later discovered.

- a) A cash payment of N180 had been posted as a receipt in the bank column of the cash book.
- b) The sales account was overcast by N350 and the purchases account was also overcast by N350.
- c) A return inwards of N190 was not recorded in the books.
- d) Bank charges of N185 had been posted into the cash book. No entry was made elsewhere in the books.
- e) The opening balance of a debtor's account had been brought down as N1,785 instead of N1,875.
- f) An item of fixed asset sold for N2, 500 had been debited to cash and included in sales.

### You are required to:

- (i) Prepare Journal entries to effect the necessary corrections
- (ii) Write up the Suspense Account.

5. The following balances were extracted from the books of Babarodo Enterprises on 31 December, 2008.

	N
Freehold Property	50,000
Capital	81,445
Trade debtors	28,750
Trade creditors	26,150
Furniture and Fittings	16,250
Rent	950
Electricity	675
Provision for bad debts	288
Office equipment	15,500
Stock (1/1/2008)	7,750
General expenses	2,350
Rates	625
Cash in hand	137
Bank Overdraft	4,475
Bank charges	373
Purchases	60,750
Sales	74,000
Carriage inwards	395
Salari	1,700
Discount allowed	485
Discount received	332

**Required:**

You are required to write up a Trial Balance from the balances given above.

**7.0 REFERENCES/FURTHER READING**

Anao, A.R. *An Introduction to Financial Accounting*.

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Inanga E.L. *Principles of Accounting*.

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## **UNIT 3     BANKING RELATIONSHIP AND TRANSACTIONS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Roles of Banks
  - 3.2 Bank Services
  - 3.3 Other Means of Bank Payments
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

Banks (especially commercial banks) are the commonest form of financial institutions that relate with businesses by way of accepting deposits and granting of loan to support businesses. In this Unit, we shall explain the functions of banks and the services that they render to businesses. We shall also appreciate how to transact business with banks.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- appreciate the roles of banks
- describe the services rendered by banks to individuals and businesses
- appreciate some special means of Bank Payments.

### **3.0 MAIN CONTENT**

#### **Banking Relationship and Transactions**

#### **3.1 Roles of Banks**

Banks are financial institutions established for the purpose of accepting deposit and other valuables from customers. Banks are of different types; such as the Central Bank, which is the apex authority in the

Banking industry and is the bank responsible for the implementation of the country's monetary policies. Beside the Central Bank, there is the merchant bank which is established for the purpose of facilitating commerce and industry. The Merchant Bank provides long and medium term finances to businesses, while Development Banks are usually government owned, established for the purpose of providing loans for industrial development. Savings Banks, on the other hand, are usually non-profit oriented organizations established for the purpose of encouraging savings among the low income earning groups in the society. Commercial Banks are the closest to the people and performed numerous roles in the economy. Some of the roles performed by commercial banks include:

- a) Acceptance of deposits and other valuables from the public. The valuables could be in the form of certificates, jewelries, etc;
- b) Acting as agents of its customers in the payment or receipt of statutory money. For example, standing order for the payments of electricity, water and telecommunication bills. Also, it can act as an agent for the collection of customers' monies such as rent and dividend payment which are periodic in nature;
- c) It also renders services to its customers such as brokerage and facilitation of international trade documents;
- d) Commercial bank grants loan to its customers by way of an overdraft or a long term loan;
- e) It advises customers on technical issues.

It should be noted that the consolidated banks operating in Nigeria presently (2009) are Universal banks, meaning that they combine the role of commercial banks, merchant banks, etc.

### **SELF-ASSESSMENT EXERCISE 1**

1. Differentiate between merchant bank and development bank.
2. Discuss any three roles of commercial banks.

### **3.2 Bank Services**

Universal Banks rendered different services to their customers, as mentioned earlier. These services are possible from the deposits received. The deposits are received from the various account facilities which the banks operate. A customer could choose to maintain any of the following account with his/her bank.

- a) Current Account
- b) Savings Account
- c) Fixed Deposit Account

- a) **Current Account:** A bank current account is the one from which a customer can make a withdrawal at will. Deposits are made by the customer into the current account by means of a paying-in-slip while withdrawals are made by cheque. Payments, can also be made by customer's standing instruction, this is called standing order. For the purpose of security and convenience, a customer can make use of any of the following cheques:
- i. **Open Cheque:** This is any form of cheque that has not been crossed. The monies written on it will be paid to the bearer or his/her order. This type of cheque is common with individuals that maintains personal current account.
  - ii. **Closed Cheque:** This is a cheque that has two parallel lines on it and may or may not contain some words within the lines. The line itself is a directive on the bank not to pay cash over the counter to the bearer of the cheque instead, the amount written should be paid into the account of the bearer. The lines could carry much more information for further restrictions such as "not negotiable"; indicating that the cheque cannot be transferred to another person.
- b) **Savings Account:** This account earns an interest on the amount deposited. Unlike the current account, a withdrawal from the account is made by means of a passbook or a savings withdrawal slip while deposit into the account is made by means of a saving deposits account. A savings account therefore differs from a current account because it does not make use of a cheque book. However, there are banks that have introduced some form of savings accounts on which holders can make use of cheques for withdrawal.
- c) **Fixed Deposits Account:** In this account, the customer gives a specific period of notice to the bank before withdrawals are made. The rate of interest on this account is usually higher. It therefore means that money that is required for day-to-day transactions cannot be put into a fixed deposit account. A fixed deposits account is similar to a savings account except that its deposits are kept for a longer period of time.

## SELF-ASSESSMENT EXERCISE 2

1. Differentiate between savings account and fixed deposit account.
2. What do you understand by the term 'non-negotiable'?

### 3.3 Other Means of Bank Payments

- a) Automated Teller Machines (ATM): This is an electronic card that enables its holders to draw money from his/her account at will without regard to the account type or bank. The ATM card is operated on the ATM of any bank.
- b) Bank Drafts: This is a type of cheque which a bank draws on another bank to make payments on its deposits in that other bank. Bank draft can be obtained at any bank not necessarily the bank where one has an account, at a fee.

### SELF-ASSESSMENT EXERCISE 3

1. Briefly comment on any two advantages of ATM.
2. What is a bank draft?

### 4.0 CONCLUSION

We have seen how businesses relate with banks and the type of services which the banks rendered to its customers, even though the banking industry is witnessing dynamism in its operations and products which it introduces to the public. Such innovations are not substantially different from what has been presented in this Unit.

### 5.0 SUMMARY

This Unit has explained the various dimensions of banking services in Nigeria and the major roles banks play in the economy. It clearly highlights some of the specific services which banks rendered to the business community and other customers, including the instruments used in facilitating the transactions signifying the delivery of the services.

### 6.0 TUTOR-MARKED ASSIGNMENT

1. State the different types of banks in Nigeria before consolidation.
2. Write short notes on the following account types:
  - a) Current Account
  - b) Savings Account
  - c) Deposits Account
3. Differentiate between open and closed cheques

4. Briefly explain the role of commercial banks.
5. Explain the various means of payment used by banks.

## **7.0 REFERENCES/FURTHER READING**

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## **UNIT 4     BANK RECONCILIATION STATEMENT**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Idea behind the Statement
  - 3.2 Causes of Discrepancies
  - 3.3 Procedure for Reconciliation
  - 3.4 Illustrative Examples
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

In dealing with a bank, both customers and the bank maintain records of the deposit and withdrawals. A deposit made by a customer at the bank is debited to the bank column of the customers' cash book by his/her book keeper and the bank credits the customer's personal account with it. Also, where a withdrawal is made, the customers' cash book (bank column) is credited while the personal account of the customer is debited at the bank. At periodic intervals, the bank sends a statement to the customer giving details of the transactions involving his/her account at the bank during the period. Thus, the balance as shown in the customer's cash book is expected to agree with that on the bank statement, but this rarely happen as a result of the factors we shall discuss in this Unit.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- determine the meaning of a reconciliation statement
- appreciate factors responsible for differences between the bank statement and the cash book balances
- prepare a reconciliation statement to agree the two balances.

### 3.0 MAIN CONTENT

#### Bank Reconciliation Statement

##### 3.1. The Idea Behind the Statement

This is a statement which reconciles the balance shown by the Bank Statement obtained from the bank, by an account holder, and the balance as per the Cash book of the same account holder. The essence of this exercise is to know the causes of the difference that is bound to arise, at any given time, between the two balances. Having identified the causes, an adjustment is made to agree the two balances. The process of the correction does not require any journal entry.

##### SELF-ASSESSMENT EXERCISE 1

1. Discuss the concept of Bank Reconciliation Statement.
2. Who is an account holder?

##### 3.2 Causes of Discrepancies

The following are the causes of the differences between bank statement and the cash book balances:

- a) **Uncredited Cheques:** These are cheques that have been received and debited in the customer's cashbook, but for one reason or another, have not been credited to his account by the bank at the time of preparing the bank statement. Under this circumstance, the cashbook balance will be more than the bank statement balance.
- b) **Unpresented Cheques:** These are cheques that have been issued and credited to the customer's cashbook but for some reasons, the cheques have not been presented and as such, the bank cannot record it as part of the daily bank collection.
- c) **Bank Charges:** These include bank interest, cheque charges, commission on turnover, etc. These charges are debited directly to the customer's account without notification to the customer. The amounts involved cannot, therefore, be known until the bank statement is received, so they will not be recorded in the business cashbook until after the bank statement has been checked and the amount entered.
- d) **Standing Order Receipts:** These are direct remittances to the bank in the form of dividends on shares, interest on debentures,

etc which might be paid directly to the bank to be credited to the customer's account and the customer may not know of these remittances until the bank statement is received.

- e) **Standing Order Payments:** These are orders by a customer, requesting the bank to make certain payments on the customer's behalf at regular intervals e.g. of such payments are insurance premiums, rental expense, NEPA bills, etc. When the bank makes such payments, the customer's account will be debited but may not be entered in the customer's cashbook until the bank statement is received.
- f) **Dishonored Cheques:** A dishonored cheque is one that the bank on which it is drawn has refused to pay due to insufficient funds in the drawer's account, or some irregularities on the cheque. On receipt of the cheque from the customer, the business will have debited its cash account and send the cheque for banking in the normal way. As soon as the cheque is dishonored, the bank refuses to credit the account of the customer with the amount. Until the customer receives bank statement there would be a time lag before the customer makes the necessary entry in his cashbook, crediting bank column of the book.
- g) **Book-keeping Error:** This could be an error of commission, omission, transposition, casting, etc committed either in the bank statement or in cashbook. The correction required is to be effected in the normal way.

## SELF-ASSESSMENT EXERCISE 2

1. Discuss the differences between Uncredited and Unpresented Cheques.
2. What are the two bank standing orders that are possible?

### 3.3 Procedure for Preparing Bank Reconciliation Statement

The procedures for the preparation of this statement are as follows:

- i. Compare the debit entries in the cashbook with the credit entries in the bank statement and tick those figures that appear in both. The unticked items in the cashbook represent uncredited cheques.
- ii. Compare the credit entries in the cashbook with the debit entries in the bank statement and tick those figures that appear in both. The unticked items in the cashbook represent unpresented cheques.
- iii. Compare the credit side of the bank statement and the debit side of the cashbook and tick those figures that appear in both, the unticked items in the bank statement represent standing order receipt.

- iv. Compare the debit side of the bank statement and the credit side of the cashbook and tick those figures that appear in both, the unticked items in the bank statement represent standing order payment.

Having noted these items, an adjusted cashbook should be prepared taking into account, items which ought to appear in the cashbook while the bank reconciliation takes into account the uncredited cheques, unrepresented cheques and errors only.

**Format One:**

Balance as per adjusted cash book	xx
Add: Unpresented Cheques	x
Errors	<u>x</u>
	xxx
Less: Uncredited Cheques	x
Errors	<u>x</u>
	(xx)
Balance as per bank statement	<u>xxx</u>

**Format Two:**

Balance as per bank statement	xx
Add: Uncredited Cheques	x
Errors	<u>x</u>
	<u>x</u>
	xxx
Less: Unpresented Cheques	x
Errors	<u>x</u>
	(xx)
Balance as per cash book	<u>xxx</u>

**SELF-ASSESSMENT EXERCISE 3**

Justify the necessity of comparing the debit of bank statement with the credit of:

- i. Cashbook.
- ii. Why should cashbook be adjusted before preparing the bank reconciliation
- iii. Statement?

**3.4 Illustrative Examples**

**Illustration One:**

**Prince Adetula's** Cash book showed a debit balance of ₦6,688 on 31<sup>st</sup> December, 2007. His bank statement for December 2007 however, showed a credit balance of ₦6,848. When investigation was carried out, it was discovered that:

- a) The opening balance in the Cash Book for the month had been wrongly brought down as ₦3,010 instead of ₦3,100.
- b) A customer had paid ₦1,200 directly into the bank.
- c) Payment for rent of ₦500 had been debited into the Cash Book.
- d) The bank had honoured his standing order of ₦600 to his insurance company on his behalf.
- e) A cheque for ₦1,740 deposited in the bank on 22<sup>nd</sup> December was not credited until 4<sup>th</sup> January, 2008.
- f) The bank had paid a cheque of ₦1,360 in error from Dr. Adetutu's Account.
- g) Cheques issued to suppliers totaling ₦3,750 had not been presented for payment.
- h) Cost of bank charges amounting to ₦180 had not been entered in the Cash Book.

You are required to prepare:

- i) Adjusted Cash Book
- ii) Bank Reconciliation statement as at 31<sup>st</sup> December, 2007.  
(Adapted from NECO 2002)

**Solution:**

Prince Adetula's  
Adjusted Cash Book for the period 31 December 2007

	₦		₦
Bal. b/d	6,688	Rent (Error)	1,000
Balance under cast	90	Standing Order	600
Direct receipts from customer	1,200	Bank charges	180
		Bal. c/d	6,198
	<u>7,978</u>		<u>7,978</u>
Bal. b/d	6,198		

Bank Reconciliation Statement as at 31 December 2007

	₦
	₦
Balance as per adjusted cash book	6,198
Add: Unpresented cheque	<u>3,750</u>
	9,948
Less: Uncredited cheque	1,740
Cheque paid out of Adetutu's account	<u>1,360</u>
	<u>(3,100)</u>

Balance as per bank statement 6,848

**Illustration Two:**

The following is an extract from the bank column of the Cash Book of Adamson Ltd, for the month of June 2005.

DR.		CASH BOOK		CR.	
		₦			₦
4-Jun	Bello	1,220	1-Jun	Balance b/f	2,216
18-Jun	Tatama	1,396	8-Jun	Adeolu	1,132
28-Jun	Nneji	1,242	17-Jun	Peace	1,312
30-Jun	Balance c/f	1,960	27-Jun	Inyang	1,158
		<u>5,818</u>			<u>5,818</u>
			1-Jul	Balance b/d	1,960

The bank sent the following Statement for the same period:

**BANK STATEMENT AS AT  
30TH JUNE, 2004**

		DR.	CR.	BALAN
		₦	₦	CE
				₦
1-Jun	Balance			2,216 OD
11-Jun	Bello		1,220	996 OD
12-Jun	Adeolu	1,132		2,128 OD
19-Jun	Tatama		1,396	732 OD
22-Jun	Peace	1,312		2,044 OD
28-Jun	Dividend		400	1,644 OD
28-Jun	Bank Charges	200		1,844 OD
29-Jun	Standing Order	100		1,944 OD

You are required to:

- (i) Write an adjusted cash book up to date;
- (ii) Draw up a bank reconciliation statement as at 30<sup>th</sup> June 2004. (NECO 2008)

**Solution:**

<b>Adamson Ltd.</b>			
<b>Adjusted Cash Book for the month of June 2004</b>			
	<del>₦</del>		<del>₦</del>
Dividend	400	Bal. b/d	1,960
		Bank charges	200
Bal. c/d	1,860	Standing order	100
	<u>2,260</u>		<u>2,260</u>
		Bal. b/d	1,860

<b>Adamson Ltd.</b>	
<b>Bank Reconciliation Statement as at 30 June 2004</b>	

	<del>₦</del>
Balance as per adjusted cash book	(1,860)
Add: Unpresented cheque: Inyang	<u>1,158</u>
	(702)
Less: Uncredited cheque: Nneji	<u>(1,242)</u>
Balance as per Bank Statement	<u>(1,944)</u>

**4.0 CONCLUSION**

This Unit has explained the causes of discrepancy between the cash book and the bank statement balance. Efforts have also been made to show how to reconcile the differences in the accounts. The Unit concludes that for proper transparency and accountability in financial management, bank reconciliation statement should be regularly prepared by all public and organizations in the private sector.

**5.0 SUMMARY**

In this Unit, meaning, idea and reasons behind bank reconciliation have been discussed, as well as procedures for reconciling such differences that are bound to occur between a bank statement balance and that of the cash book in the bank column. Practical illustrations have been used to show how the reconciliation can be done, and the statement prepared.

**6.0 TUTOR-MARKED ASSIGNMENT**

1. Explain five causes of differences between bank statement and cash book balances.
2. Discuss the two format of preparing bank reconciliation statement.

3. The bank statement of SSK and Co. for the period ended 31 March 2002 showed an overdraft of ₦132, 000. The company's cashbook showed a debit balance of ₦315, 425. On cross checking the details in the bank statement and the cashbook, it was discovered that the discrepancy was due to the following:
- a) A dividend of ₦65, 325 paid direct to the bank had not been recorded in SSK's cashbook.
  - b) A cheque paid for advertising ₦89,500 was recorded as ₦98,500.
  - c) A cheque was received from a customer, less 5% cash discount for goods invoiced at ₦60,000. The full invoiced value was recorded in the cashbook.
  - d) Cheques drawn and recorded in the cashbook (bank column) but not recorded in the bank statement:
 

Hauwa Usman	₦105,425
Shehu Zubair	₦185,575
  - e) Bank charges amounting to ₦15,050 had not been recorded in the cashbook.
  - f) A cheque to the value of ₦750,400 paid into the bank was not credited.
  - g) An amount of ₦400 for cheque books issued had not been recorded in the cashbook.
  - h) A standing order for ₦31,500 was paid by the bank but did not appear in the cashbook.
  - i) A cheque for ₦12,400 had been returned by the bank marked R/D, this had not been recorded in the cashbook.

**You are required to:**

- i. Show the appropriate adjustments to be made in the cashbook, and;
  - ii. Prepare a bank reconciliation statement as at 31 March 2002.
4. On 31st December 2004 the cashbook of MUSTY, a retailer showed an overdraft of N200. The bank balance was N1930CR.

You are given the following additional information:

- a) A cheque for N280 received by Musty and entered in his cashbook on 31 December 2004 was not credited by bank until 2 January 2005.
- b) A credit transfer of N1, 140 in settlement of a debt by a customer has not been entered in the cashbook.
- c) Cheque drawn by Musty on 26 December 2004 amounting to N2,680 was not paid by the bank until after 31 December 2004.

- d) In December 2004 the bank debited Musty's account with N140 for bank charges. No entry has been made in Musty's book.
- e) A dividend of N580 was paid directly to bank.
- f) Standing order on Insurance for N200 was paid by the bank.
- g) A cash payment of N120 made by a customer was not recorded in the bank column of the cashbook.
- h) A cheque of N630 lodged by Musty was credited to Mubarak's account.
- i) A dishonored cheque of N1,230 was not recorded in the cashbook.
- j) A cheque for rates of N670 on 10 December 2004 had been entered in the cashbook as N760.

**You are required to:**

- i. Prepare an adjusted cashbook,
  - ii. Bank reconciliation statement as at 31 December 2004.
- 5) On 31st December 2006, Johnsen & Son's cash book showed a debit balance of N70,000 whereas the bank statement showed a balance of N46,500.

On investigation the following items were discovered to have caused the difference:

- a) The bank had made charges of N6,200 which had not been entered in the cash book.
- b) A cheque received for N40,000 entered in the cash book was not entered by the bank until January 5, 2007.
- c) A standing order for payment of subscription of N3,000 had been entered in the bank statement as paid but not in the cash book.
- d) The following cheques were drawn, but not yet presented for payment in the bank.

	N
Olu & Sons	6,000
Adetunji Ola	12,000
Ali Daroma	5,000

- e) A cheque drawn for N1,000 had been entered as N1,200.
- f) A cheque for N700 previously received and paid into the bank had been returned by the bank.
- g) A customer paid N3,200 directly into their account in the bank. It had not been entered in the cash book.

**You are required to prepare:**

- i) Adjusted cash book
- ii) Bank reconciliation statement as at 31<sup>st</sup> December 2006. (ICAN ATSWA)

## **7.0 REFERENCES/FURTHER READING**

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## **UNIT 5 FINAL ACCOUNTS WITHOUT ADJUSTMENTS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Components of Final Accounts
  - 3.2 Preparation of an Income Statement
  - 3.3 Incomes and Expenses Recognition Principles
  - 3.4 Balance Sheet
  - 3.5 Important Terms Regarding Balance Sheet
  - 3.6 Illustrative Example
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

The purpose of keeping accounting records is to be able to determine at any point in time the result of operations of an enterprise as well as to ascertain the financial status of the enterprise. This is achieved through the preparation of final accounts which comprise of an Income Statement and Balance Sheet. This Unit guides us to understanding the modalities of preparing final accounts without the usual accounting adjustments.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- describe the components of final accounts
- prepare income statement of an enterprise
- appreciate the income and expenses recognition principles
- prepare a Balance Sheet.

### **3.0 MAIN CONTENT**

#### **Final Accounts without Adjustments**

#### **3.1 Components of Final Accounts**

Final accounts are sets of accounts which are prepared to ascertain the result of operations and the financial status of a business at any given date (usually a year). From this definition, one could therefore state that the objectives of final accounts are to determine:

- a) The result of a business's operations; and
- b) The financial status of the business.

The statement prepared for determining the result of a business's operation is the income and expenditure statement. This statement could be called a trading, profit and loss account (for merchandising business); a manufacturing, trading, profit and loss account (for manufacturing concern), a profit and loss account for any other forms of a profit making concern or an income and expenditure account for non-profit making concern.

On the other hand, the financial status of a business could be ascertained from the statement of assets of the business and the liabilities of the business, which is known as a balance sheet. In summary, the components of final accounts are:

- i. Income statement;
- ii. Balance sheet.

### **SELF-ASSESSMENT EXERCISE 1**

1. What are the two main issues final accounts help reporting entities to determine?
2. What constitute income statement of an enterprise?

### **3.2 Preparation of an Income Statement**

The preparation of an income statement is based on the application of the "matching concept". This concept states that "the earned revenue and all the incurred costs that generated that revenue must be matched and reported for the period. If revenue is carried over from a prior period or deferred to a future period, all elements of cost and expense relating to that revenue are usually carried over or deferred as the case may be" (SAS 1).

From the definition above, expenses which are incurred in earning the revenue should be compared with the revenue generated. If the total income is greater than the total expense, profit is realized while the excess of expenses over incomes will result in a loss. Below is a format of an income statement.

**Trading, Profit and Loss Account for the year ended 31st  
December, 2xxx**

	N	N		N
Opening Stock		xxx	Sales	Xxx
Purchases	xx		Less: Returns	<u>(xx)</u>
Less: Returns	<u>(x)</u>	xxx		
Carriage Inward		xxx		
Cost of Goods Available		xxx		
Less: Closing Stock		<u>(xx)</u>		
Cost of Goods Sold		xxx		
Gross profits c/d		xxx		
		<u>xxxx</u>		<u>Xxxx</u>
Discount Allowed	xx		Gross Profit b/d	Xxx
Rent	xx		Discount received	Xx
Insurance	xx		Reduction in Provisions	Xx
Travelling Expenses	xx		Rental Income	Xx
Increase in provisions	xx		Other Income	Xx
Depreciation	xx		Net Loss	Xx
Other business expenses	xx			
Net Profit	xx			
		<u>xxxx</u>		<u>Xxxx</u>

**SELF-ASSESSMENT EXERCISE 2**

1. What do you understand by 'matching concept'?
2. Discuss the major elements of profit and loss account.

**3.3 Income and Expense Recognition Principles**

The matching of these expenses and incomes is based on certain principles which are discussed below:

**3.3.1 Income Recognition Principles**

To recognize revenue, accountants make use of the realization principle. This principle states that revenue is generally recognized when the following conditions are met:

- i. The earning process is complete or virtually complete; and
- ii. An exchange has taken place.

The principle of recognizing revenue when sale is made or when the service is performed is known as the "*accrual concept*". Where revenue

is recognized only when cash is received for the sale or service, irrespective of when the sale is made or service rendered that is referred to as “*cash concept*”.

### 3.3.2 Expense Recognition Principles

In matching expenses with incomes, 3 recognition principles may be adopted:

- i. **Principle of Cause and Effect:** This principle recognizes the fact that certain expenses expire in a particular accounting period because they can be associated with specific revenue recognized during that period. Examples of such expenses are cost specifically related to producing certain goods that are sold.
- ii. **Principle of Systematic and Rational Allocation:** This principles deals with those expenses which expire to generate revenue during a period but cannot be directly associated with the specific revenue. The principle states that such costs should be allocated in a systematic and rational manner among the accounting periods in which they benefit revenue. Examples are depreciation and other provisions.
- iii. **Principle of Immediate Recognition:** This principle states that all those expenses which will not provide any future benefits should be recognized immediately. For example, selling and administrative expenses and all losses. When an asset (or cost) expires without benefiting a business in terms of revenue is called a “loss”. For example, goods or assets lost by fire, assets sold for less than their book values, etc.

### SELF-ASSESSMENT EXERCISE 3

1. What are the procedures of recognizing income?
2. Discuss any two principles of recognizing expenses.

### 3.4 Balance Sheet

This is an itemized list of the assets, liabilities and proprietorship of a business as at a certain date. A balance sheet is not an account but only a statement containing the assets and liabilities of a business on a particular date. The horizontal format of balance sheet has two sides. On the left hand side, the “*liabilities*” of the business are shown while on the right hand side; the “*assets*” of the business appear. There is no prescribed form for the preparation of the balance sheet for a sole-trader.

However, the assets and liabilities may be shown in any of the following order:

- i. **Liquidity Order:** Where a concern adopts the liquidity order, the assets which are more readily convertible into cash come first and those which cannot be so readily converted come next and so on. Similarly, those liabilities which are payable first come first, and those payable later come next and so on.
- ii. **Permanency Order:** Where the permanency order is adopted, assets which are more permanent come first, less permanent come next and so on. Similarly, liabilities which are more permanent come first, less permanent come next and so on. In other words, the permanency order is the complete reversal of the liquidity order. Below is an example.

<b>Balance Sheet As at 31 December 2xxx</b>					
	₦	₦		₦	₦
			<u>Fixed Assets:</u>		
			Land & Building	xx	
Capital		Xxx	Less:		
			Depreciation	(x)	Xxx
Add: Net Profit		Xx	Plant & Machinery	xx	
			Less:		
Less: Drawings		(xx)	Depreciation	(x)	Xxx
			Motor Vehicles	xx	
		Xxxx	Less:		
<u>Long Term Liabilities:</u>			Depreciation	(x)	Xxx
Loan		Xx		xx	Xxxx
			<u>Current Assets:</u>		
<u>Current Liabilities</u>			Stock	xx	
Creditor	x		Debtors	x	
Accrued Expenses	x		Less: Provision	(x)	Xx
Bank Overdraft	x	Xxx	Prepayments		Xx
			Cash at Bank		Xx
			Cash in Hand		Xx
		<u>Xxxx</u>			<u>Xxxx</u>
		<u>x</u>			<u>x</u>

N.B: The above balance sheet is prepared using the permanency order; the liquidity order is the reverse.

## SELF-ASSESSMENT EXERCISE 4

1. Briefly discuss the horizontal format of balance sheet.
2. Differentiate between order of liquidity and order of permanence in balance sheet preparation.

### 3.5 Important Terms Regarding Balance Sheet

#### 3.5.1 Liabilities

These are categorized into two:

- i. Current Liabilities:** These are liabilities which are payable within a year from the date of the balance sheet either out of existing current assets or by creation of new current liabilities. Examples of current liabilities include:
  1. Accounts payable, i.e. bills payable and trade creditors.
  2. Outstanding expenses, i.e. expenses for which services have been received by the business but for which payments have not been made.
  3. Bank Overdraft
  4. Advance payments received by the business for the services to be rendered or goods to be supplied in future.
- ii. Long Term Liabilities:** These are all other liabilities other than current liabilities. In other words, these are liabilities which do not require current assets for their settlement.

#### 3.5.2 Assets

These may be categorized into the following:

- i. Current Assets:** These are those assets which are acquired with the intention of converting them into cash during the normal business operations. Current assets include cash and bank balances, stocks, debtors, bills receivable, short term investments, prepaid expenses, etc.
- ii. Fixed Assets:** These are assets which are acquired for a relatively long period for carrying on the business of the enterprise. They are not ordinarily meant for resale. Examples of fixed assets include land and building, machinery, furniture, motor vehicles etc.

- iii. **Liquid Assets:** These are assets which are immediately convertible into cash without much loss. Liquid assets are current assets except that stocks and prepaid expenses are deducted while other current assets are taken.
- iv. **Intangible Assets:** These are assets which cannot be seen or touched, but they exist. For example Goodwill, Patents, Trademarks etc.

### SELF-ASSESSMENT EXERCISE 5

1. Write short notes on any two categories of assets.
2. Discuss the concept of liability.

### 3.6 Illustrative Example

*Godwin Okigbo* carries on trading business in Sabon Gari Market, Kano. The trial balance extracted from his books as on 31<sup>st</sup> March, 2005 was as follows:

	DR.	CR.
	₦	₦
Freehold Property	50,000	
Capital		81,445
Trade Debtors/Creditors	28,750	26,150
Furniture & Fittings	16,150	
Rent	950	
Electricity	675	
Returns Outward		288
Office Equipment	15,500	
Stock (1/4/2004)	7,750	
General expenses	2,350	
Rates	725	
Cash in Hand	137	
Bank Overdraft		4,475
Bank charges	373	
Purchases and sales	60,750	74,000
Carriage Inwards	395	
Salaries	1,700	
Discount	485	332
	186,690	186,690

Stock at 31/3/2005 was valued at ~~₦~~6, 635.

You are required to prepare the Trading, Profit and Loss Account for the year ended 31st March, 2005.

**Solution:**

Godwin Okigbo

**Trading, Profits and Loss Account for the year ended 31st March, 2005**

	₦	₦		₦
Opening Stock		7,750	Sales	74,000
Purchases	60,750			
Less: Returns Outward	<u>(288)</u>	60,462		
Carriage Inwards		<u>395</u>		
Cost of goods available for sale		68,607		
Less: Closing stock		<u>(6,635)</u>		
Cost of goods sold		61,972		
Gross profit c/d		<u>12,028</u>		
		<u>74,000</u>		<u>74,000</u>
Rent		950	Gross profit b/d	12,028
Electricity		675	Discount received	332
General expenses		2,350		
Rates		725		
Bank charges		373		
Salaries		1,700		
Discount allowed		485		
Net profit		<u>5,102</u>		
		<u>12,360</u>		<u>12,360</u>

**Balance Sheet as at 31 March 2005**

	₦	₦	Fixed Assets:	₦	₦
Capital		81,445	Freehold		
Add: Net Profit		<u>5,102</u>	Property	50,000	
		86,547	Furniture & Fittings	16,150	
Current Liabilities:			Office Equipment	<u>15,500</u>	81,650
Creditors	26,150		Current Assets:		
Bank Overdraft	<u>4,475</u>	30,625	Stock	6,635	
			Debtors	28,750	
			Cash in hand	<u>137</u>	<u>35,522</u>
		<u>117,172</u>			<u>117,172</u>

**4.0 CONCLUSION**

We have been able to explain record keeping procedures up to the point of the preparation of final accounts of an enterprise. This Unit has clearly demonstrated the essence of keeping adequate records as it will enable the easy ascertainment of the profit or loss of an enterprise as well as determining its financial status.

## 5.0 SUMMARY

In this Unit, we have explained the processes leading to the preparation of the final accounts of a firm as well as the various principles involved in determining whether an item of expense should be recognized in the profit and loss account or not. The Unit has also given a guide on income recognition principles. The modalities for the preparation of balance sheet have also been discussed, completing discussion on the basic principles of final accounts preparation for a reporting entity.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Briefly explain the two methods of presenting assets and liabilities in the balance sheet.
2. Explain the principles involved in revenue and expenses recognition in the income statement.
3. Discuss the distinguishing differences between order of permanence and order of liquidity in final accounts preparation.
4. The following trial balance has been extracted from the books of *S. Ufom* for the year ended 31<sup>st</sup> December, 2004.

	DR	CR
	₦	₦
Building (cost)	300,000	
Cash at bank	76,000	
General expenses	14,400	
Rent and rates	4,000	
Purchases and sales returns	2,400	3,000
Fixtures and fittings at cost	48,000	
Debtors and Creditors	60,000	24,000
Cash in hand	18,000	
Purchases and Sales	320,000	720,000
Discounts	2,800	4,000
Capital	256,000	
Salaries and wages	100,000	
Dividend received from First Bank		7,800
Drawings	6,000	
Stock 1 <sup>st</sup> Jan. 2004	80,000	
Insurance	7,200	
Rent income		<u>24,000</u>
	<u>1,038,800</u>	<u>1,038,800</u>

Closing stock was valued at ₦108, 000.

**Required:**

You are required to prepare the Trading, Profit and Loss Account for the year ended 31<sup>st</sup> December, 2004.

5. The following trial balance has been extracted from the ledgers of Ya'u Isa Enterprise:

Trial Balance as at 31st December, 2006

	<b>DR</b>	<b>CR</b>
	<b>₦</b>	<b>₦</b>
Sales		10,500
Purchases	4,500	
Carriage inwards	700	
Rent, rates and insurance	1,400	
Stationery	500	
Salaries and wages	1,250	
Bad debts	350	
Dividend received		145
Debtors	12,000	
Creditors		18,000
Cash in hand	10,000	
Cash at bank	24,000	
Stocks	720	
Equipment	8,000	
Motor vehicles	9,500	
Buildings	10,000	
Capital		60,525
Drawing	<u>6,250</u>	
	<u>89,170</u>	<u>89,170</u>

Stock at 31 December, 2006 was valued at ₦700.

**Required:**

You are required to prepare the Trading, Profit and Loss Account for the year ended 31<sup>st</sup> December, 2006.

(Adapted from ICAN/ATSWA, 2008)

## **7.0 REFERENCES/FURTHER READING**

Dandago, K. I. *Financial Accounting Simplified*.

Inanga, E. L. *Principles of Accounting*.

Mashwari, K. *Introduction to Financial Accounting*.

Igben, R.O. *Financial Accounting Made Simple*.

**MODULE 3**

Unit 1	Depreciation Adjustments in Final Accounts
Unit 2	Other Adjustments in Final Accounts
Unit 3	Final Accounts from Incomplete Records
Unit 4	Introduction to Cost Accounting
Unit 5	Budgeting and Budgetary Improvement Techniques

**UNIT 1 DEPRECIATION ADJUSTMENTS IN FINAL ACCOUNTS****CONTENTS**

1.0	Introduction
2.0	Objectives
3.0	Main Content
3.1	Definition of Depreciation
3.2	Causes of Depreciation
3.3	Methods of Computing Depreciation
3.4	Methods of Recording Depreciation
3.5	Disposal of an Asset
3.6	Illustrative Example
4.0	Conclusion
5.0	Summary
6.0	Tutor-Marked Assignment
7.0	References/Further Reading

**1.0 INTRODUCTION**

In Module 1, Unit 5, we have seen that there are capital expenditures that were incurred for the purpose of generating revenue in the future and, since the benefit will accrue to more than one accounting period, it is usual to spread the cost over the expected years when such expenditures are expected to bring benefit. The process of spreading the cost is referred to as depreciation, which shall be the focus of our discussion in this Unit.

**2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define Depreciation and explain its causes
- appreciate various methods of providing for depreciation

- compute depreciation for different categories of fixed assets
- maintain accounting records for depreciation.

### 3.0 MAIN CONTENT

#### Depreciation Adjustments

#### 3.1 Definition of Depreciation

Depreciation may be defined as the permanent and continuing diminution in the quality, quantity or value of a fixed asset. Depreciation is therefore the proportion of the cost of an asset that is deducted from revenue for assets services used in the operation of a business. Depreciation is simply about decrease in the value of a fixed asset, as a result of wear and tear, passage of time, heat of sun, etc. However, there are other terms used in defining depreciation. These terms are “depletion” and “amortization”. Depletion refers to the depreciation of an available but irreplaceable resource such as extraction of coal from coal mine or oil out of an oil well. Amortization, on the other hand, refers to the writing off of an obligation like loan.

The basic differences between depreciation and these other concepts is that depreciation is used to refer to the process of charging the cost of man- made fixed assets to operations whereas depletion refers to the cost allocations of natural resources such as oil and mineral deposits while amortization relates to cost allocation for intangible assets such as patents and copyrights.

#### SELF-ASSESSMENT EXERCISE 1

1. What do you understand by the concept of depreciation?
2. Discuss any two other concepts related to depreciation.

#### 3.2 Causes of Depreciation

Assets get depreciated as a result of some factors which are discussed below:

1. ***Wear and Tear***: Constant use of fixed assets gets the asset worn or torn.  
Examples of these assets are plant and machinery, furniture and fixtures, etc.
2. ***Exhaustion***: An asset may get exhausted through utilization. This is the case with mineral mines, oil wells, etc.
3. ***Obsolescence***: Some assets are discarded before they are worn out as a result of improvement in technology. Such loss as a

result of new innovations is referred to as loss on account of obsolescence.

4. ***Efflux of Time***: Certain assets get depreciated in their value with the passage of time. This is the case with leasehold properties, patents and copy rights.
5. ***Accidents***: An asset may meet an accident and, therefore, it may get depreciated in its value.

## **SELF-ASSESSMENT EXERCISE 2**

1. Define asset in the context of this Unit.
2. Discuss any three causes of depreciation.

### **3.3 Methods of Computing Depreciation**

There are numerous methods of computing depreciation, broadly grouped into the following:

#### **1. Uniform charge methods:**

- i. Fixed installments method;
- ii. Depletion method;
- iii. Machine hour rate method.

#### **2. Declining charge methods:**

- i. Diminishing balance method;
- ii. Sum of the years' digit method;
- iii. Double declining method.

#### **3. Other Methods:**

- i. Group depreciation method;
- ii. Inventory or revaluation method;
- iii. Annuity method;
- iv. Sinking fund method; and
- v. Insurance policy method.

For the purpose of this course, we shall restrict our discussion to the fixed installment, diminishing balance method, sum of the years' digit and inventory methods.

#### **3.3.1 Fixed Installments Method**

This is also termed as Straight line method. Under this method, depreciation is charged evenly every year throughout the effective life of an asset. Depreciation is calculated as:

$$\text{Depreciation} = \frac{C-S}{N}$$

Where C: Original cost of the Asset;  
S: Estimated Scrap Value; and  
N: Effective life of the Asset.

The depreciation to be charged each year can also be expressed as a percentage of cost. This percentage can be calculated as follows:

$$R = \frac{D}{DV} * 100$$

Where R: Rate of depreciation;  
D: Depreciation computed; and  
DV: Depreciable Value i.e. cost less scrap value.

### Example 1:

Baba 'Yargo acquired a Motor Vehicle for ₦10, 000. The vehicle was planned to be used in the business for four years and its scrapped value estimated for ₦2, 000. Calculate the annual depreciation charge and the rate.

### Solution:

$$\begin{aligned} \text{Annual Depreciation} &= \frac{C-S}{N} \\ &= \frac{\text{₦}10,000 - \text{₦}2,000}{4} \\ &= \text{₦}2,000 \end{aligned}$$

$$\begin{aligned} \text{Depreciation Rate} &= \frac{D}{DV} * 100 \\ &= \frac{\text{₦}2,000}{\text{₦}8,000} * 100 \\ &= 25\% \end{aligned}$$

### 3.3.2 Diminishing Balance Method

This method is also termed as reducing balance method. Under this method, depreciation is computed as a fixed percentage of the book value of an asset. The book value of an asset is the difference between

the cost of the asset and the accumulated depreciation on the asset. Depreciation is calculated as:

$$\text{Depreciation} = R * \text{NBV}$$

Where R: Rate of depreciation; and

NBV: Net book value.

$$\text{Depreciation rate (R)} = \frac{\{1 - n\sqrt[n]{\frac{\text{Net residual value}}{\text{Cost}}}\} * 100}{n}$$

Where n: number of expected life of the asset.

### Example 2:

*Alh. Ado* purchased an item of office fittings for ₦1, 296 on 1<sup>st</sup> Jan. 2001. The balance at 31<sup>st</sup> December 2001 was ₦1, 100. At 31<sup>st</sup> December 2002 and 2003, the residual value of the asset was ₦850 and ₦625 respectively. Calculate the depreciation charge for 2001, 2002 & 2003.

### Solution:

$$\text{Depreciation} = R * \text{NBV}$$

$$R = \sqrt[n]{\frac{S}{C}}$$

$$S = \text{N}625, \quad C = \text{N}1, 296 \quad n = 3$$

$$R = \sqrt[3]{\frac{625}{1296}}$$

$$\frac{25}{36} * 100$$

### 3.3.3 Sum of the Years' Digits Method

The amount of depreciation to be charged to the profit and loss account under this method goes on decreasing every year. The depreciation is calculated based on the following formula:

$$\frac{\text{Remaining Life of the Asset (including the current year)}}{\text{Sum of all the digits of the life of the asset in years}} * \frac{\text{Original Cost}}{1}$$

### Example 3:

Use the above example to calculate the amount of depreciation using the sum of the years' digits method.

**Solution:**

$$\begin{aligned} \text{Depreciation for 2001 } 3/6 * (\text{N}1,296 - \text{N}625) &= \text{N } 336 \\ \text{Depreciation for 2002 } 2/6 * (\text{N}1,296 - \text{N}625) &= \text{N } 224 \\ \text{Depreciation for 2003 } 1/6 * (\text{N}1,296 - \text{N}625) &= \text{N } 111 \end{aligned}$$

**3.3.4 Inventory System of Depreciation**

This method is mainly used for those assets with relatively small values such as loose tools or where the life of the assets cannot be ascertained with certainty e.g. live stock etc. Under this method, depreciation is calculated using the following basis:

	N
Cost of assets purchased at the beginning accounting year	x
<i>Add:</i> cost of the assets purchased during the accounting year	x
Less: cost of the assets at the end of the accounting year	<u>x</u>
Depreciation charged	<u>x</u>

**Example 4:**

Refer to the question in example 2 above. Compute depreciation using the revaluation method.

**Solution:**

Depreciation for 2001:	N
Opening Balance of Office fittings	1,296
Less: Closing Balance at 31 December 2001	<u>1,100</u>
Depreciation for the year	<u>196</u>
Depreciation for 2002:	
Balance at 1 <sup>st</sup> January 2002	1,100
Less: Closing Balance at 31 December 2002	<u>850</u>
Depreciation for the year	<u>250</u>
Depreciation for 2003:	
Balance at 1 <sup>st</sup> January 2003	850
Balance at 31 December 2003	<u>625</u>
Depreciation for the year	<u>225</u>

**3.3.5 Depreciation on an Asset Acquired during the Year**

There are two alternatives available regarding charging of depreciation on an asset which has been acquired during the course of an accounting year:

- a) Depreciation may be charged for the full year irrespective of the date of purchase at the given rate.
- b) Depreciation may be charged only for the part of the year for which the asset has been made available for use as a result of it being acquired during the year.

Students should note that where instruction as to the computation of depreciation on asset acquired during the year is not clearly given; assumption made should be stated categorically.

### **SELF-ASSESSMENT EXERCISE 3**

1. Discuss Straight Line Method of providing for depreciation.
2. Differentiate between the Diminishing Balance Method and the Sum of the Years' Digit Method of providing for depreciation.

### **3.4 Methods of Recording Depreciation**

Depreciation can be recorded in the books of account using two different methods:

#### **1. Provision for Depreciation Account Method**

Under this method of accounting for depreciation, the amount of depreciation to be charged is debited to the profit and loss account and credited to the provision for depreciation account. The asset account appears at original cost.

#### **2. Depreciation Account Method**

Under this method, the amount of depreciation is debited to the depreciation account and credited to the assets account. The asset account thus appears at net book value. The depreciation account is closed to the profit and loss account like any other item of expense.

### **SELF-ASSESSMENT EXERCISE 4**

1. Why is depreciation account an expense account?
2. Differentiate between the two methods of recording depreciation.

### **3.5 Disposal of an Asset**

Where an asset is disposed, the amount realized from the sale of the asset should be credited to the Disposal account (if provision for depreciation account method is in use) or Asset account (if depreciation account method is in use). Depreciation for the period for which the asset has been used should be written off in the usual manner. Any balance in the Asset Disposal Account representing profit or loss on sale of the asset should be transferred to the Profit and Loss Account.

### SELF-ASSESSMENT EXERCISE 5

1. What is an asset disposal account?
2. Explain the entries to be made in the asset disposal account.

### 3.6 Illustrative Example

Chukwu & Son Ltd. started production on 1 January 2004. He purchased factory plant as follows:

2004		₦
1 January	Machine A	80,000
1 July	Machine B	40,000
2006		
1 April	Machine C	60,000

**Depreciation, at the rate of 10% p.a., is to be provided on a straight line basis. On 1 July 2005, machine B was sold for ₦24, 000.**

#### Required:

You are required to write up the relevant Ledger Accounts and Balance Sheet Extract for the years 2004, 2005 and 2006, using:

- (a) Provision for depreciation account method
- (b) Depreciation account method (Adapted from ICAN/ATSWA, 2008).

**Solution:**

## Provision for Depreciation Account Method

**Chukwu & Sons Ltd**

## Machinery Account

2004		₦	2004		₦
1-Jan	Bank (Machine A)	80,000	31-Dec	Balance c/d	120,000
1-Jul	Bank (Machine B)	40,000			
		<u>120,000</u>			<u>120,000</u>
2005			2005		
1-Jan	Balance b/d	120,000	1-Jul	Disposal (Machine B)	40,000
		<u>120,000</u>	31-Dec	Balance c/d	80,000
					<u>120,000</u>
2006			2006		
1-Jan	Balance b/d	80,000	31-Dec	Balance c/d	140,000
1-Apr	Bank (Machine C)	60,000			
		<u>140,000</u>			<u>140,000</u>
	Balance b/d	140,000			

## Machinery Disposal Account

2005		₦	2005		₦
1-Jul	Machine	40,000	1-Jul	Prov. For depreciation	4,000
			1-Jul	Bank	24,000
		<u>40,000</u>	1-Jul	Profit & Loss	<u>12,000</u>
					<u>40,000</u>

## Provision for Depreciation Account

2004		₦	2004		₦
31-Dec	Balance c/d	<u>10,000</u>	31-Dec	Profit and loss	<u>10,000</u>
2005			2005		
1-Jul	Disposal (Machine B)	4,000	1-Jan	Balance b/d	10,000
31-Dec	Balance c/d	<u>16,000</u>	31-Dec	Profit and loss	<u>10,000</u>
		<u>20,000</u>			<u>20,000</u>
2006			2006		
31-Dec	Balance c/d	28,500	1-Jan	Balance b/d	16,000
		<u>28,500</u>	31-Dec	Profit and loss	<u>12,500</u>
					<u>28,500</u>
				Balance b/d	28,500

**CHUKWU**  
**BALANCE SHEET (EXTRACTS) AS AT 31ST DECEMBER**

	Fixed Assets	₦	₦
2004	Cost (Machines)	120,000	
	Accumulated depreciation	<u>(10,000)</u>	
			110,000
2005	Cost (Machines)	80,000	
	Accumulated depreciation	<u>(16,000)</u>	
			64,000
2006	Cost (Machines)	140,000	
	Accumulated depreciation	<u>(28,500)</u>	
			111,500

**Workings:**

**Computation of Depreciation**

			₦
2004	Machine A = 10% x 80,000 =		8,000
	Machine B = 10% x 40,000 x <sup>6</sup> / <sub>12</sub> =		<u>2,000</u>
			<u>10,000</u>
2005	Machine A = 10% x 80,000 =		8,000
	Machine B = 10% x 40,000 x <sup>6</sup> / <sub>12</sub> =		<u>2,000</u>
			<u>10,000</u>
1 July	Disposal = 10% x 40,000 x <sup>12</sup> / <sub>12</sub> =		<u>4,000</u>
2006	Machine A 10% x 80,000 =		8,000
	Machine C = 10% x 60,000 x <sup>9</sup> / <sub>12</sub> =		<u>4,500</u>
			<u>12,500</u>

b) Depreciation Account Method

Machinery Account					
		₦			₦
2004			2004		
1-Jan	Bank (Machine A)	80,000	31-Dec	Depreciation	10,000
1-Jul	Bank (Machine B)	40,000	31-Dec	Balance c/d	<u>110,000</u>
		<u>120,000</u>			<u>120,000</u>
2005			2005		
1-Jan	Balance b/d	110,000	1-Jul	Disposal (Machine B)	36,000
			31-Dec	Depreciation	10,000
			31-Dec	Balance c/d	<u>64,000</u>
		<u>110,000</u>			<u>110,000</u>
2006			2006		
1-Jan	Balance b/d	64,000	31-Dec	Depreciation	12,500

1-Apr	Bank (Machine C)	60,000	31-Dec	Balance c/d	111,500
		<u>124,000</u>			<u>124,000</u>
	Balance b/d	124,000			

**Depreciation Account**

2004	₦	2004	₦
31-Dec	Machinery	31-Dec	Profit & Loss Account
	<u>10,000</u>		<u>10,000</u>
2005		2005	
31-Dec	Machinery	31-Dec	Profit & Loss Account
	<u>10,000</u>		<u>10,000</u>
2006		2006	
31-Dec	Machinery	31-Dec	Profit & Loss Account
	<u>12,500</u>		<u>12,500</u>

**Machinery Disposal Account**

2005	₦	2005	₦
1-Jul	Machinery	1-Jul	Bank
	36,000		24,000
		31-Dec	Profit & Loss
	<u>36,000</u>		<u>12,000</u>
			<u>36,000</u>

**Chukwu & Sons Ltd**

**Balance Sheet as at 31st December**

Fixed Asset	₦
2004 Machinery	110,000
2005 Machinery	64,000
2006 Machinery	111,500

**4.0 CONCLUSION**

This Unit has discussed the method of writing off the cost of fixed assets into the depreciation account of a reporting entity in order to ensure that correct profit/loss is determined to show the entity’s result of operations for a period ending. Correct amount of profit/loss can only be ascertained if all expenditures (recurrent and capital) that provide the income are fully accounted for in the relevant section of the final accounts.

**5.0 SUMMARY**

In this Unit, we have defined depreciation, causes of depreciation, methods of providing for depreciation and the methods of recording depreciation into the books of account. Of note is that, depreciation is not charged for the purpose of replacing fixed asset, but as a means of charging the fair share of the asset cost to the profit and loss account, to show its extent of utilization in the course of generating income for the reporting entity.

**6.0 TUTOR-MARKED ASSIGNMENT**

- 1(a) What is depreciation?  
 (b) Outline any four causes of depreciation.
2. Write a short note on the following concepts:
- (a) Amortization  
 (b) Depletion  
 (c) Obsolescence
3. Discuss any three methods of providing for depreciation.
4. An extract from the account of *XYZ and Sons* is shown below:

	<i>Plant and Machinery</i>	<i>Motor vehicle</i>	<i>Total</i>
	₦	₦	₦
Cost at 30/9/2004	58,750	42,820	101,570
Depreciation to date	<u>26,250</u>	<u>23,140</u>	<u>49,390</u>
Net book value	<u>32,500</u>	<u>19,680</u>	<u>52,180</u>

In the year to 30<sup>th</sup> September 2005 there were additions and disposals as follows:

	<i>Plant and Machinery</i>	<i>Motor vehicle</i>	<i>Total</i>
	₦	₦	₦
Cost of disposed Asset	14,200	9,060	23,260
Depreciation on disposed assets	11,100	5,900	17,000
Sale proceeds	2,000	5,400	7,400
Cost of additions	12,500	14,730	27,230

The following rates of depreciation apply:

Plant and Machinery: 10% of cost.  
 Motor Vehicles: 10% of net book value.

**Required:**

You are required to write-off the various assets, depreciation and disposal accounts for the year ended 30<sup>th</sup> September, 2005.

5. Ankara textiles manufacturing company has the following machines in the factory on 1st January, 2006:

<b>Model</b>	<b>Cost</b>	<b>Depreciation written-off to date</b>
	<b>N</b>	<b>N</b>
Machine A	72,000	28,800
Machine B	48,000	19,200
Machine C	60,000	16,200

During the year ended 31<sup>st</sup> December, 2006, the following machines were bought on the dates shown:

<b>Model</b>	<b>Date of purchase</b>	<b>Cost</b>
		<b>N</b>
Machine D	01/02/2006	84,000
Machine E	31/03/2006	96,000
Machine F	01/08/2006	120,000
Machine G	01/12/2006	144,000

On 30 June 2006 Machine C was sold for N36, 000.

Depreciation is written off at the rate of 12% per annum on cost, new machines being depreciated from the date of purchase and any machine disposed off is depreciated up to the date of sale.

**You are required to:**

- a) Prepare a statement showing the depreciation on each machine for the year ended 31<sup>st</sup> December, 2006.
- b) Record the above transactions in the relevant ledger account, using
  - (i) Provision for depreciation account method
  - (ii) Depreciation account method

**7.0 REFERENCES/FURTHER READING**

Damagum, Y.M. *Introduction to Financial Accounting*.

Mashwari, K. *Introduction to Financial Accounting*.

Dandago, K.I. *Financial Accounting Simplified*.

Inanga E.L. *Principles of Accounting*.

## **UNIT 2 OTHER ADJUSTMENTS IN FINAL ACCOUNTS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Expenses
    - 3.1.1 Prepaid Expenses
    - 3.1.2 Accrued Expenses
  - 3.2 Income
    - 3.2.1 Income in Advance
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  - 3.3 Bad Debts, Provisions and Reserves
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- 5.0 Summary
- 6.0 Tutor-Marked Assignment
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### **1.0 INTRODUCTION**

There are transactions which take place after the books of accounts have been closed and trial balance prepared. In order to give the actual results of the year's operations and to ensure that the balance sheet gives a true and fair view of the financial position, these transactions need to be adjustably incorporated into the final accounts for them to give a correct picture of the financial position of the reporting entity, as at the period ended. This Unit shall discuss these adjustments to be made, why and how.

### **2.0 OBJECTIVES**

At the end of this Unit, you should be able to:

- derive prepaid and accrued expenses
- explain income received in advance and Income due to accrue
- describe bad Debts, Provisions and Reserves
- explain drawings and Stock.

### **3.0 MAIN CONTENT**

#### **Other Final Accounts Adjustments**

#### **3.1 Expenses**

These are amounts incurred for the purpose of earning an income. Expenses are written off to the income statement in line with the principles of cause and effect. However, there are times when such expenses are either not paid in full or the amount paid for exceeds the current accounting period of the receiving business. These instances are discussed below:

##### **3.1.1 Prepaid Expenses**

These are payments made in respect of a period beyond the date of account. It is in the nature of an asset; that is, the benefit of the expenditure is still to be derived. The portion which relates to the current period is transferred to the profit and loss and the balance which relates to the future period is shown under the current asset in the balance sheet.

##### **3.1.2 Accrued Expenses**

This occurs where an expense has been incurred but not brought into the account as a result of it not being paid for. The amount of expenses shown in the ledger must be increased to allow for the expenses due but not yet entered. The accrued expenses are shown in the balance sheet under current liabilities at the end of the period.

#### **SELF-ASSESSMENT EXERCISE 1**

1. Why is prepaid expense an asset item?
2. How is an accrued expense treated in the balance sheet?

#### **3.2 Incomes**

These are proceeds realized from transacting business. Incomes are the primary aim of being in business without which survival becomes difficult. Some incomes are often received in advance such as rental income while some are paid after being due. The adjustments required in either of the scenario mentioned are discussed below:

##### **3.2.1 Income in Advance**

This is where sums have been received during a period in respect of future services. Only part of such sums which relates to the current period is transferred to the profit and loss account as earned income, while the portion relating to future period is shown in the balance sheet under current liabilities.

### **3.2.2 Income Due**

These are incomes which are due but not yet received at the trial balance date. The amount of income shown in the ledger must be increased to allow for income due but not yet entered. The income accrued is shown in the balance sheet under current asset at the end of the period.

## **SELF-ASSESSMENT EXERCISE 2**

1. Why is income the primary aim of being in business?
2. Differentiate between income due and income in advance.

### **3.3 Bad Debts and Provisions**

#### **3.3.1 Bad Debts**

These are debts which are found to be irrecoverable. If detected before drafting the trial balance, it should simply be posted as an expense to the profit and loss account and no more. But where such losses are detected after drafting the trial balance, the amount so detected is posted as an expense to the profit and loss account and deducted from the debtors balance in the balance sheet.

DR: Bad Debt Account  
CR: Debtor's Account

The bad debt account is to be closed to the profit and loss account, as an expense.

Where a debt already written off as bad is recovered in whole or in part in subsequent period, the entries required are:

DR: Cash/Bank Account  
CR: Bad Debt Recovered Account

The bad debt recovered account is to be closed to the profit and loss account, as a gain.

#### **3.3.2 Provision**

This refers to the commitment made out of profit on the likely diminutions in the value of an asset or for any known liability for which the amount involved cannot be determined with substantial accuracy. Provisions commonly found in the profit and loss account of a business are:

- i. Provision for doubtful debt;
- ii. Provision for discount on debtors; and
- iii. Provision for depreciation.

Under this heading we shall discuss I and II only as III has already been discussed in Unit 11.

**a) Provisions for Doubtful Debts:**

This is provision made out of profit to meet debt which is likely to turn bad. It is usually provided for after all debt which is known to be irrecoverable has been written off. A provision for doubtful debt may be calculated either by:

- i) Reference to the amount of the specific debt (specific provision for bad debt);
- ii) As a percentage of the total debt outstanding after deducting irrecoverable one (general provision for doubtful debt).

In practice, the percentage most likely to turn bad is arrived at based on the debtor(s) history. This percentage therefore constitutes the rate which shall be used in providing for doubtful debts and those not fluctuating widely.

The Accounting entries required for recording provisions for doubtful debts are:

DR: Bad debt account  
CR: Provision for doubtful debts account

To create provisions for doubtful debts; bad debt account is to be closed to the profit and loss account, while provision for doubtful debt account is to be closed to the balance sheet.

DR: Provision for doubtful debts account  
CR: Profit and loss account

With a decrease in the provision for doubtful debts

The provision for doubtful debts (closing balance) is deducted from the debtors balance in the balance sheet to ascertain the net good debtors.

#### **b) Provision for discount on debtors**

This provision is allowed on good debtors and it is usually based on a fixed percentage of good debtors i.e. debtors less bad debt less provision for doubtful debts. The account is provided in a similar manner as that of provision for doubtful debts.

### **SELF-ASSESSMENT EXERCISE 3**

1. Discuss the concept of bad debt.
2. Describe the entries to be made in bad and doubtful debt accounts.

### **3.4 Drawings**

The effect of drawings by the owner of a business for personal use is to decrease the capital invested into it. Drawings may be made in cash or in the form of goods and services. Drawings made in cash require a credit entry in the bank account and debit entry in the drawings account. If drawings are made in the form of goods purchased by the business for resale, then Drawings account is debited and sales account credited with the value of goods withdrawn. The balance of the drawings account is subsequently closed at the end of the year and deducted from the capital.

### **SELF-ASSESSMENT EXERCISE 4**

1. Discuss the concept of drawings in accounting.
2. Describe two ways through which drawings would decrease capital.

### **3.5 Stock**

The usual practice in accounting is to value the goods at the lowest cost or current market price (i.e. net realizable value). This means that the closing stock of goods should not be valued above the original price paid, but if the current price is lower than original price, the current price should be taken as the valuation basis.

### **3.6 Illustrative Examples**

#### **Illustration One:**

Madam Titilayo is a trader whose financial year ends on 31<sup>st</sup> December. For the financial year 2004, the following information was obtained from her records.

- a) **Motor Expenses:** Paid in the year to 31<sup>st</sup> December, 2004 ₦4, 275. Owing as at 31<sup>st</sup> Dec.2003 ₦162; owing as at 31<sup>st</sup> December, 2004, ₦338.
- b) **Insurance:** Paid in 2004 ₦3, 360. Prepaid at 31<sup>st</sup> December, 2003, ₦200; prepaid at 31<sup>st</sup> December, 2004 ₦280.
- c) **Rent and Rates:** Paid in the year, ₦5, 835; Rent owing at 31<sup>st</sup> December, 2003 ₦240; Rent paid in advance at 31<sup>st</sup> December, 2004 ₦375; Rates paid in advance 31<sup>st</sup> December, 2003; ₦308; Rates owing at 31<sup>st</sup> December, 2004 ₦540.
- d) **Commission Received:** Received for the year to 31<sup>st</sup> December, 2004 ₦1,275; owing at 31<sup>st</sup> December, 2003 ₦120; owing at 31<sup>st</sup> December 2004, ₦218.
- e) Titilayo sublets parts of the premises. Receives ₦4, 400 during the year ended to 31<sup>st</sup> December, 2004. Tenants had paid in advance at 31<sup>st</sup> December, 2003, ₦1,400 and on 31<sup>st</sup> December, 2004, ₦1,680.

**Required:**

- i) Prepare all the necessary ledger accounts to reflect the various adjustments above and amount taken to profit and loss account;
- ii) Show an extract of the profit and loss account for the year ended 31<sup>st</sup> December, 2004.
- iii) Show the balance sheet extract as at 31<sup>st</sup> December, 2004.

**Solution:**

Motor Expenses Account					
2004		₦		2004	₦
Dec. 31	Cash	4,275		Jan. 1	Bal. b/d 162
Dec. 31	Bal. c/d	338		Dec.31	Profit & Loss 4,451
		<u>4,613</u>			<u>4,613</u>
2005				2005	
				Jan. 1	Bal. b/d 338

Insurance Account					
2004		₦		2004	₦
Jan. 1	Bal. b/d	200		Dec. 31	Profit & Loss 3,280
Dec. 31	Cash	3,360		Dec. 31	Bal. c/d 280
		<u>3,560</u>			<u>3,560</u>
2005				2005	

Jan. 1	Bal. b/d	280
--------	----------	-----

Rent and Rates Account

2004			2004		
		₹			₹
Jan. 1	Bal. b/d	375	Jan. 1	Bal. b/d	240
Dec. 31	Cash	5,835	Dec. 31	Profit & Loss	6,202
Dec. 31	Bal. c/d	540	Dec. 31	Bal. c/d	308
		<u>6,750</u>			<u>6,750</u>
2005			2005		
Jan. 1	Bal. b/d	308	Jan. 1	Bal. b/d	540

Commission Received Account

2004			2004		
		₹			₹
Jan. 1	Bal. b/d	120	Dec. 31	Cash	1,275
Dec. 31	Profit & Loss	1,373	Dec. 31	Bal. c/d	218
		<u>1,493</u>			<u>1,493</u>
2005			2005		
Jan. 1	Bal. b/d	218			

Rent Received Account

2004			2004		
		₹			₹
Dec. 31	Profit & Loss	4,120	Jan. 1	Bal. b/d	1,400
Dec. 31	Bal. c/d	1,680	Dec. 31	Cash	4,400
		<u>5,800</u>			<u>5,800</u>
2005			2005		
			Jan. 1	Bal. b/d	1,680

Profit and Loss Account Extract

2004			2004		
		₹			₹
Dec. 31	Motor Expenses	4,451	Dec. 31	Commission Received	1,373
Dec. 31	Insurance	3,280	Dec. 31	Rent Received	4,120
Dec. 31	Rent & Rates	6,202			

Balance Sheet Extract As at 31 December 2004

Current Liabilities		₹	Current Assets:		₹
Motor Expenses			Insurance Prepaid		280
Owed		338	Rates in Advance		308
Rent Due		540	Rent Received in		
Commission			Advance		1,680
Receivable		218			

**Illustration Two**

*Mal. Mamuda Zubair* had the following trial balance as at 31<sup>st</sup> December, 2005.

	DR. ₦	CR. ₦
General expenses	2,110	
Sales and Purchases	435,860	486,990
Debtors and Creditors	28,380	16,930
Salaries and Wages	17,620	
Insurance	1,300	
Carriage Inwards	2,860	
Capital		172,950
Carriage Outward	590	
Bad debts	1,060	
Drawings	12,000	
Office Equipment at cost	55,000	
Sales and Purchases Returns	1,950	9,870
Cash in hand	1,270	
Provision for Depreciation:		
Motor vehicles		6,300
Office Equipment		4,700
Furniture		3,400
Motor Vehicles at cost	72,000	
Stock on 1 <sup>st</sup> Jan. 2005	39,720	
Lighting and Cooling	1,180	
Rent	3,600	
Discounts	4,080	6,270
Furniture at cost	32,500	
Provision for doubtful debts		2,000
Provision for discount allowed		500
Bank		<u>3,170</u>
	<u>713,080</u>	<u>713,080</u>

The following additional information is given:

- a. Additional general expenses of ₦650 are yet to be paid.
- b. Stock on 31<sup>st</sup> December, 2005 amounted to ₦43,860.
- c. A bill of ₦420 for insurance is still outstanding.
- d. Lighting and Cooling of ₦270 has been paid in advance.
- e. Rent paid is for 9 months up to 30<sup>th</sup> September, 2004.

- f. A provision should be made as follows:  
5% for bad and doubtful debt  
2.5% for discount allowed.
- g. Provide for depreciation as follows:  
Motor vehicle        5% p.a. on cost  
Office Equipment    10% p.a. on cost  
Furniture            5% p.a. on cost

**You are required to prepare:**

- i. A trading, profit and loss account for the year ended 31<sup>st</sup> December, 2005; and
- ii. A Balance sheet as at that date.

**Solution:****Mal. Mamuda Zubair**Trading, Profits and Loss Account for the year ended 31<sup>st</sup> December, 2005

		₹	₹			₹	₹
Opening Stock			39,720	Sales		486,990	
Purchases	435,860			Less: Returns	(1,950)		485,040
Less: Returns	<u>(9,870)</u>	425,990					
Add: Carriage Inwards			2,860				
Cost of goods available for sale			<u>468,570</u>				
Less: Closing Stock			<u>(43,860)</u>				
Cost of goods sold			424,710				
Gross Profit c/d			<u>60,330</u>				
			<u>485,040</u>				<u>485,040</u>
General expenses	2,110			Gross Profit b/d			60,330
Add: Amount unpaid	<u>650</u>	2,760		Discount Received			6,270
Salaries and Wages			17,620	Provision for doubtful debts	2,000		
Insurance	1,300			Less: New provision	<u>(1,419)</u>	581	
Add: Amount Outstanding	<u>420</u>	1,720					
Carriage Outwards			590				
Bad Debts			1,060				
Lighting & Cooling	1,180						
Less: Amount Prepaid	<u>(270)</u>	910					
Rent	3,600						
Add: Amount owing	<u>1,200</u>	4,800					
Discount Allowed			4,080				

Provision for discount	674		
Less: Old Provision	<u>(500)</u>	174	
Provision for Depreciation:			
Motor vehicle	3,600		
Office Equipment	5,500		
Furniture	<u>1,625</u>	10,725	
Net Profit		<u>22,742</u>	
		<u>67,181</u>	<u>67,181</u>

Balance Sheet As At 31<sup>st</sup> December 2005

	₦	₦	Fixed Assets:	₦	₦
Capital		172,950	Office Equipment	55,000	
Add: Net Profit		<u>22,742</u>	Less: Provision for Depreciation	<u>(10,200)</u>	44,800
		195,692	Motor Vehicles	72,000	
Less: Drawings		<u>(12,000)</u>	Less: Provision for Depreciation	<u>(9,900)</u>	62,100
		183,692	Furniture	32,500	
			Less: Provision for Depreciation	<u>(5,025)</u>	27,475
					134,375
<u>Current Liabilities:</u>			<u>Current Assets:</u>		
Creditors	16,930		Stock		43,860
Bank Overdraft	3,170		Debtors	28,380	
General Expenses Unpaid	650		Less: Provision for doubtful debts	<u>(1,419)</u>	
Insurance Outstanding	420		Less: Provision for discount	<u>(674)</u>	26,287
Rent Owed	<u>1,200</u>	22,370	Lighting & Cooling in advance		270
			Cash in hand		<u>1,270</u>
		<u>206,062</u>			<u>206,062</u>

**4.0 CONCLUSION**

We have discussed most of the adjustments that may arise in the course of preparation of final accounts for any form of business. We have also discussed various methods that may be applicable in the treatment of an item of expense and income in the final accounts. The Unit compliments Unit 11 on the issue of adjustments to final accounts, carrying many illustrative examples.

**5.0 SUMMARY**

In this Unit, we have explained the accounting treatments of prepaid and accrued expenses, income received in advance and income due, bad debts, provisions for bad and doubtful debts, and provision for discount

on debtors, drawings and stock. We have also demonstrated how these issues are incorporated in the final accounts.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Briefly explain the accounting treatment for the following items:
  - a) Prepaid Expenses;
  - b) Accrued Expenses
  - c) Income in Advance
  - d) Income Due
  - e) Provision for bad debts
  - f) Stock
  
2. Differentiate between provision for doubtful debt and provision for discount.
  
3. *CHOP-CHOP* is one of the easy going traders in Sabon Gari market, who deals in ladies clothing. Below is his trial balance as at 30<sup>th</sup> June, 2004.

	DR. ₦	CR. ₦	
Directors Loan	7,500		
Drawings		3,000	
Capital		60,000	
Sales and Purchases	26,100	42,000	
Carriage	3,000		
Returns	450	1,200	
Land and Building		43,000	
Mortgage Loan		7,100	
Postage and Stationery	700		
Creditors and Debtors	18,000	12,700	
Stock 1 <sup>st</sup> July 2003		3,000	
Furniture and Fittings (cost ₦4, 500)		4,050	
Rent	4,200	3,750	
Motor Van (cost ₦10, 000)		8,500	
Wages and Salaries		4,650	
Motor Repairs		900	
Lighting and Heating		750	
Insurance		1,450	
Discounts		1,050	1,350
Bank		12,000	
Provision for doubtful debts			600
Provision for discount on debtors			400
Cash		2,250	
Provision for depreciation:			

Motor Van		1,500
Furniture and Fittings	500	
Suspense Account		<u>450</u>
	<u>139,050</u>	<u>139,050</u>

The following additional information is provided:

- a. Stock at 30<sup>th</sup> June, 2004 was valued at ₦4,250.
- b. Insurance prepaid amounts to ₦200.
- c. Of the carriage, ₦600 is for carriage inwards.
- d. Wages and salaries paid is made up of ₦1,650 and ₦3,000 respectively; while ₦450 salaries is still being owed.
- e. A fire incident occurred in the store on 25<sup>th</sup> June, 2004, stock valued ₦4,000 was destroyed, this stock has been insured and the insurance company accepted the claim in full.
- f. 10% of the Debtors is considered bad; while provision on the good debtors is to be made as follows:

Doubtful debts 5%  
Discount 2%

- g. Depreciation is to be charged at the rate of 10% on cost and 20% on reducing balance for Motor van and Furniture and fittings.
- h. The suspense account appearing in the books was for the sales of an item of furniture bought on 1/1/2001 for ₦1,000 and the cash account has been debited with the proceeds received.

**You are required to prepare:**

- i. A trading, profit and loss Account for the year ended 30<sup>th</sup> June, 2004; and
  - ii. A balance sheet as at that date.
4. The following trial balance has been extracted from the ledgers of Yaa Tundela Enterprise.

Trial Balance as at 31 December, 2006

	<b>DR</b>	<b>CR</b>
	<b>₦</b>	<b>₦</b>
Sales		10,500
Purchases	4,500	
Carriage inwards	700	
Rent, rates and insurance	1,400	
Stationery	500	
Salaries and wages	1,250	

Bad debts	350	
Provision for doubtful debt		145
Debtors	12,000	
Creditors		18,000
Cash in hand	10,000	
Cash at bank	24,000	
Stocks	720	
Equipment	8,000	
Motor vehicles	9,500	
Buildings	10,000	
Capital		60,525
Drawing	<u>6,250</u>	
	<u>89,170</u>	<u>89,170</u>

The following additional information is relevant:

- i) Rent prepaid at the end of the year is ₦150
- ii) The provision for bad debt is to be increased by ₦355
- iii) Stock at the end of the year was ₦250
- iv) Depreciate all fixed assets at the rate of 15%

**You are required to:**

Prepare a trading, profit and loss account for the year ended 31<sup>st</sup> December 2006 and a balance sheet as at that date.

(Adapted from ICAN/ATSWA, 2008)

5. *Mr. Wala Wala* carries on trading business. The trial balance extracted from his books as on 31<sup>st</sup> March, 2005 was as follows:

	<del>₦</del>	<del>₦</del>
Stock at 1 <sup>st</sup> April, 2004	3,710	
Purchases	20,480	
Wages	4,610	
Rent, rates and insurance	770	
Salaries	5,120	
Discount allowed	200	
Carriage inwards	380	
General expenses	2,690	
Professional charges	320	
Carriage outwards	470	
Motor vehicles	1,220	
Plant and machinery at cost	4,800	
Leasehold Factory Premises Purchased 1 <sup>st</sup> April, 2004	7,000	
Capital		10,000
Sales		42,080

Discount received		250
Provision for doubtful debts		500
Sundry Creditors		2,950
Provision for depreciation:		
Plant and machinery		1,340
Motor Vehicles		580
Sundry Debtors	3,950	
Balance at bank	<u>1,980</u>	
	<u>57,700</u>	<u>57,700</u>

You are given the following information:

- i. The value of stock on the premises at cost on 31<sup>st</sup> March, 2005 was ₦3,970. The replacement value of such stock was ₦4,000.
- ii. Insurance paid in advance at 31<sup>st</sup> March, 2005 amounted to ₦20 and there was ₦50 owing for electricity (included in general expenses) at that date.
- iii. A debt of ₦50 is to be written off and the provision for doubtful debt reduced to ₦400 at the year end.
- iv. During the year, a motor vehicle which had cost ₦600 and which has been written down to ₦200 was sold for ₦480. The amount had been credited to motor vehicles account. Any profit or loss on this sale is to be in the profit and loss account.
- v. *Mr. Wala wala* had drawn ₦20 a week for his own use. These amounts have been entered in the salaries account.
- vi. Provision for the year for depreciation of motor vehicles and plant and machinery is to be made in the sums of ₦190 and ₦250 respectively.
- vii. An amount of ₦140 in respect of legal charges on the acquisition of the leasehold premises is included in the professional charges account.
- viii. The total cost of the lease is to be written off by equal installments over 20 years.

**You are required to prepare:**

- a) Trading, Profit and loss account for the year ended 31<sup>st</sup> March, 2005 and a
- b) Balance Sheet as at 31<sup>st</sup> March, 2005.  
(CIBN Exams)

## 7.0 REFERENCES/ FURTHER READING

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## **UNIT 3 FINAL ACCOUNTS FROM INCOMPLETE RECORDS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning of Incomplete Records
  - 3.2 Indication of Incomplete Records
  - 3.3 Determination of Profit and other Items of Final Accounts
  - 3.4 Illustrative Examples
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

An incomplete record is a set of accounts in which no full accounting records are available for the extraction of trial balance, yet the determination of profit from such records is necessary to show the result of the business operations and its financial position. This Unit will enable you to learn the preparation of final accounts from incomplete records.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- define incomplete records and appreciate their disadvantages
- describe the indication of incomplete records
- determine profit of a business from incomplete sets of records
- prepare final accounts from sets of incomplete records.

### **3.0 MAIN CONTENT**

#### **Final Accounts from Incomplete Records**

#### **3.1 Meaning of Incomplete Records**

An incomplete record is any system of records which are kept but are not in complete compliance with double entry principles. The level of incompleteness of the records varies from having double entry in respect of certain transactions to no entry in respect of certain transactions. The system, therefore, has the following disadvantages, and these are difficulty in:

- i) ascertaining the arithmetical accuracy of records;
- ii) ascertaining the actual profit of a business;
- iii) determining the exact financial position of a business;
- iv) planning and decision making for the business's future.

### **SELF-ASSESSMENT EXERCISE 1**

1. What do you understand by Incomplete Record?
2. Discuss any two difficulties in using incomplete records.

### **3.2 Indication of Incomplete Records**

The following are the indications of incomplete records:

- a) **Availability of Personal Accounts:** In most incomplete records, personal accounts are usually kept to enable the business know how much it owes or owed by its customers. The personal accounts are those of various debtors and creditors.
- b) **Reliance on Source Documents:** In order to obtain adequate records of business transactions one has to rely on source documents such as invoices for purchases and sales, receipts, credit and debit note, etc.
- c) **Availability of Cash Book:** Cash book is usually maintained which takes into account both the personal and business transactions.

### **SELF-ASSESSMENT EXERCISE 2**

1. Discuss any two indications of incomplete records.
2. Why is bank statement important in preparing final accounts for a business that keeps incomplete records?

### **3.3 Determination of Profit and Other Items of Final Accounts**

In determining the profit or loss of a business, one of the following approaches can be adopted:

- a) **Net Worth Method:** Under this method, the profit of the business is deemed to be the difference between the net worth at two different dates. The date at the beginning and the date at the end of the period. The net worth is often determined as the difference between assets and liabilities. Some adjustments might be required when using this method, as follows:

**Drawing:** This is considered a part of the closing capital of business that was withdrawn for private use. For the purpose of ensuring that a true profit figure is ascertained, drawing is added back to the closing capital in the profit statements.

**Further Capital:** Where in the course of a period, the proprietor introduced additional capital, this will make the capital at end to be higher than expected which might imply that a profit has been realized but it does not reflect profit per se. Such capital is usually deducted from the closing capital in the profit statement.

- b) **Conversion Method:** This method is applied when single entry records are maintained for certain transactions. It enables detailed information of revenue and expenses of a business to be ascertained. In using this method, certain figures are implied as discussed below:

**Sales:** This can be determined where the opening and closing debtors' figures are provided as well as receipts from debtors. The balancing figures can be implied to be the sales value.

**Purchases:** This can be determined where the opening and closing figures for creditors are available and payments to suppliers are also given.

**Cash and Bank Balances:** These are determined by preparing a cash book. Total of receipts is compared with the total of payments and the difference is implied to be cash in hand or at bank.

**Capital:** This can be ascertained by comparing the opening assets and liabilities. The difference, that is the excess of assets over liabilities, represents capital.

**Accounting Ratios:** Sometimes one has to rely on past ratios in determining key financial information. Ratios that are to be used are mark-up, margin, stock turnover and net profit to sales. These ratios help in the determination of sales, purchases, stock and expenses.

### SELF-ASSESSMENT EXERCISE 3

1. Discuss the Net worth Method of Profit Determination.
2. Illustrate how to determine any three key financial items of information using accounting ratios.

### 3.3.1 Illustrative Examples

#### Illustration One:

Umar Musa keeps his books of accounts on single entry basis. The following information relates to his business for the years 2004 and 2005:

Assets and Liabilities	1/4/2004	31/3/2005
	₦	₦
Machinery	60,000	60,000
Stock	30,000	37,500
Debtors	63,000	102,000
Cash in hand	4,500	6,000
Creditors	52,500	57,000
Bills Payable	3,000	9,000
Loan from Abbati	15,000	
Investment		30,000

In addition, Umar Musa has withdrawn ₦15, 000 from his account and also introduced ₦6, 000 additional Capital.

#### Required:

You are required to ascertain his net profit and prepare the balance sheet as at 31<sup>st</sup> March, 2005.

#### Solution:

Umar Musa Statement of Affairs As At				
	1/4/2004		31/3/2005	
	₦	₦	₦	₦
Assets:				
Machinery		60,000		60,000
Investment		-		30,000
Stock		30,000		37,500
Debtors		63,000		102,000
Cash in hand		<u>4,500</u>		<u>6,000</u>
Total Assets		157,500		235,500
Less: Liabilities:				
Loan from Mr. Abbati			-	15,000
Creditors		52,500		57,000
Bills payable		<u>3,000</u>	<u>(55,500)</u>	<u>9,000</u>

Net worth/ Capital	<u>102,000</u>	(81,000)	<u>154,500</u>
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Statement of Profit or Loss as at 31<sup>st</sup> March 2005

	₹	₹
Closing capital		154,500
Add: Drawings		<u>15,000</u>
		169,500
Less: Opening capital	102,000	
Additional capital	<u>6,000</u>	<u>(108,000)</u>
Profit for the year		<u>61,500</u>

Balance Sheet as at 31st March, 2005

	₹	₹		₹	₹
Capital		102,000	<u>Fixed Assets:</u>		
Add: Profit		61,500	Machinery		60,000
Add: Additional Capital		6,000	Investment		<u>30,000</u>
Less: Drawings		<u>(15,000)</u>			90,000
		148,500			
<u>Long Term Liabilities:</u>			<u>Current Assets:</u>		
Loan from Mr. Abbati		15,000	Stock	37,500	
<u>Current Liabilities:</u>			Debtors	102,000	
Creditors	57,000		Cash in hand	<u>6,000</u>	145,500
Bills payable	<u>9,000</u>	66,000			
		<u>235,500</u>			<u>235,500</u>

**Illustration Two:**

Double- Man is in business as a painter and decorator. He does not keep proper accounting records. The following information relates to his business.

Balance as at 1<sup>st</sup> January, 2004

	₹
Equipments and loose tools	150,000
Debtors	17,500
Stocks and work in progress	64,500
Prepaid rent	3,000

Creditors	12,600
Accrued electricity bill	1,200

Enquiries provided the following about the business for the year ended 31<sup>st</sup> December 2004.

- (a) He received ₦258,400 for decorating work while ₦9,600 was still owed to him.
- (b) He draws cheques for:
- |                          |         |
|--------------------------|---------|
| Suppliers                | ₦83,200 |
| Drawings                 | 40,000  |
| Rent and rates           | 1,800   |
| New decorating equipment | 60,000  |
| Sundry business expense  | 1,700   |
| Electricity              | 2,400   |
- (c) He owed ₦5,600 for decorating materials and ₦200 for electricity.
- (d) His equipment was valued at ₦180,000 and stock at ₦58,500 on 31<sup>st</sup> December, 2004.

**Required:**

You are required to prepare his Trading, Profit and Loss Account for the year ended 31<sup>st</sup> December, and a balance sheet as at that date.

**Solution:**

Double- Man		
Statement of Affairs as at 1 <sup>st</sup> January, 2004		
<u>Fixed Assets:</u>	₦	₦
Equipment and Loose tools		150,000
 <u>Current Assets:</u>		
Stock and work in progress	64,500	
Debtors	17,500	
Prepaid rent	<u>3,000</u>	<u>85,000</u>
Total Assets		235,000
 Less: <u>Liabilities:</u>		
Creditors	12,600	
Accrued electricity bill	<u>1,200</u>	<u>(13,800)</u>
Capital as at 1 <sup>st</sup> January 2004		<u>221,200</u>

## Bank Account

N		N	
Debtors	258,400	Suppliers	83,200
		Drawings	40,000
		New Decorating Equipment	60,000
		Rent & Rates	1,800
		Sundry business expenses	1,700
		Electricity	2,400
		Bal. c/d	69,300
	<u>258,400</u>		<u>258,400</u>

## Debtors Account

N		N	
Bal. b/d	17,500	Bank	258,000
Sales	250,500	Balance c/d	9,600
	<u>268,000</u>		<u>268,000</u>
Bal. b/d	9,600		

## Creditors Account

N		N	
Bank	83,200	Bal. b/d	12,600
Bal. c/d	5,600	Purchases	76,200
	<u>88,800</u>		<u>88,800</u>
		Bal. b/d	5,600

## Electricity Account

N		N	
Bank	2,400	Bal. b/d	1,200
Bal. c/d	200	Profit & Loss	1,400
	<u>2,600</u>		<u>2,600</u>
		Bal. b/d	200

## Rent and Rates Account

N		N	
Bal. b/d	3,000	Profit & Loss	4,800
Bank	1,800		
	<u>4,800</u>		<u>4,800</u>

Equipment and Loose Tools Account

	₹		₹
Bal. b/d	150,000	Depreciation	30,000
Bank	60,000	Bal. c/d	180,000
	<u>210,000</u>		<u>210,000</u>
Bal. b/d	180,000		

Trading, Profit and Loss Account for the year ended 31  
December, 2004

	₹		₹
Opening Stock	64,500	Sales	250,500
Purchases	76,200		
Cost of goods available for sales	140,700		
Less: Closing Stock	(58,500)		
Cost of goods sold	82,200		
Gross Profit c/d	188,300		
	<u>250,500</u>		<u>250,500</u>
Rent and Rates	4,800	Gross Profit b/d	188,300
Sundry business expenses	1,700		
Electricity	1,400		
Depreciation of Loose tools	30,000		
Net profit	130,400		
	<u>168,300</u>		<u>168,300</u>

Balance Sheet as at 31<sup>st</sup> December, 2004

	₹	₹		₹	₹
Capital		221,200	Fixed Assets:		
Add: Net Profit		130,400	Equipment and Loose tools		180,000
Less: Drawings		(40,000)			
		<u>311,600</u>	Current Assets:		
Current Liabilities:			Stock	58,500	
Creditors	5,600		Debtors	9,600	
Electricity accrued	200	5,800	Cash at bank	69,300	137,400
				<u>69,300</u>	

317,400317,400

#### 4.0 CONCLUSION

This Unit has explained the alternative methods for profit determination where a business fails to maintain adequate accounting records under the double entry system of book keeping. However, it is desirable that adequate records are kept by business since regulatory authorities such as the Board of inland/ internal revenue may not rely on income statement prepared under this system.

#### 5.0 SUMMARY

This Unit concludes our discussion on financial accounting aspect of the syllabus. It addresses issues relating to ascertainment of profit from an incomplete records, using either the net worth or conversion methods. It is clear that despite the difficulties in relying on and using the single entry and incomplete records, final accounts could still be determined to show the financial position and result of operations of the reporting entity.

#### 6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss any two methods of profit determination, using incomplete records.
2. On 1 January 2005 Henry Chukwuma commenced business. At that date, he purchased a shop premises for ₦1, 400,000 and paid ₦200, 000 for interior furniture and fittings. He also paid ₦400, 000 into the business Bank account. On 31 December 2006, he realized the need for a profit figure for the two years he had been in business, but his records were completely inadequate. At this date, the assets he possessed in addition to the premises and furniture and fittings were:

	₦
Stock/Inventories	600,000
Debtors/Receivables	104,000
- Motor vehicle-purchased (30 June 2006)	800,000
Cash at bank	250,000

He owed ₦140, 000 to trade suppliers and had borrowed ₦1, 000,000 from a friend. Interest accrued but unpaid on the loan amounted to

₦20, 000. Henry estimated that he was drawing ₦30, 000 a month from the business.

**Required:**

Compute the Net Profit for the period. (ICAN/ATSWA, 2008)

3. The following is the summarized Cash Book of Danjuma & Sons for the year ended 31<sup>st</sup> March, 2005.

CASH BOOK			
	₦		₦
Bal. c/d	2,343	Cash paid to creditors	11,056
Cash from debtors	18, 235	Salaries	1,080
Additional capital	6,000	Postages and Stationeries	240
		General expenses	1,234
		Drawings	2,500
		Rent and Rates	570
		Bal. c/d	<u>9,898</u>
	<u>26,578</u>		<u>26,578</u>

Additional Information:

	1 <sup>st</sup> April, 2004	31 <sup>st</sup> March, 2005
	₦	₦
Stock	560	340
Debtors	1,202	988
Creditors	980	1,051
Accrued Salaries	420	75
Prepaid Rent	44	67

**Required:**

You are required to prepare a Trading, Profit and Loss Account for the year ended 31<sup>st</sup> March, 2005 and a Balance Sheet as at that date.

4. Al-Mustapha Trial keeps his books of accounts on single entry basis. The following information relates to his business for the year 2004 and 2005:

	31/12/2004	31/12/2005
	₦	₦
Buildings		450,000
Furniture	90,000	150,000
Motor Van	250,000	
Stock	150,000	250,000

Debtors	230,000	300,000
Loan		40,000
Creditors	23,000	35,000
Cash in hand	120,000	25,000
Bank Overdraft	17,000	

Almustapha Trial withdrew ₦250 per week. He sold an old motor vehicle for ₦10, 000 which proceed was invested in the business during the year.

**Required:**

You are required to determine his profit and prepare a balance sheet as 31/12/2005.

- Iyabo High keeps a cash book as her only major book– keeping record. The following is a summary of her transactions for the year ended 30<sup>th</sup> June, 2003.

Cash book Summary

	₦		₦
Opening balance	1,642	Cash paid to creditors	37,248
Cash received from debtors	48,528	Salaries	4,498
Closing balance	2,060	Rent and Rates	1,648
		Lighting and Heating	336
		General expenses	3,562
		Drawings	4,938
	<u>52,230</u>		<u>52,230</u>

Her Assets and Liabilities on the 30<sup>th</sup> June, 2002 and 2003 were as follows:

	30/6/2002	30/6/2003
	₦	₦
Fixed assets at cost	4,400	4,400
Stock	4,242	5,296
Debtors	6,438	6,776
Rent and Rates prepaid	200	240
Creditors	3,684	3,782
Lighting and Heating accrued	62	84

Fixed assets should be depreciated at 10% on Cost.

**Required:**

You are required to prepare the trading, profit and loss account of Iyabo High for the year ended 30<sup>th</sup> June 2003 and a Balance Sheet as at that date. (NECO 2006)

## **7.0 REFERENCES/FURTHER READING**

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Damagum, Y.M. *Introduction to Financial Accounting*.

Inanga, E.L. *Principles of Accounting*.

Mashwari, K. *Introduction to Financial Accounting*.

## **UNIT 4 INTRODUCTION TO COST ACCOUNTING**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning/Definition of Cost Accounting
  - 3.2 Purposes/Uses of Cost Accounting
  - 3.3 The Benefits of Operating Cost Accounting System
  - 3.4 Factors to be Considered Before Installing a Cost Accounting System
  - 3.5 Qualities of Cost Accounting Information
  - 3.6 Differences Between Cost Accounting and Financial Accounting
  - 3.7 Cost Control, Cost Coding and Cost Classification
  - 3.8 Cost Accounting Terminologies
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

One of the principal functions of management of any organization is decision making. This is with a view to facilitating the smooth operations of the activities of the organization and makes the attainment of organizational goals or objectives possible. Decision can only be made where and when relevant information is available.

For managers to be able to carry out their management responsibilities they need much detailed information than the summarized cost results reported in the financial statements. This is to enable them to identify and control those costs for which they are individually responsible and also to identify the profit or loss arising from each product or services. Hence, it is the responsibility of the management to know the cost of each product or service and the benefit accruing to the organization as the cost is incurred.

Therefore, cost accounting is a subject that is relevant to all forms of businesses and all types of organizations (Companies, partnership or sole proprietorship). Businesses need costing information before taking any decision against their future activities. All private and public sector organizations need information relating to cost of goods or services they produce or render, buy or enjoy. Thus, cost accounting can be a source of useful information to the management.

## **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- appreciate the meaning/ Definition of cost accounting
- explain the purposes cost accounting information is serving for the attainment of organizational objective
- describe the qualities of cost accounting information
- appreciate the benefits of having a cost accounting system and the factors to be considered before installing one
- differentiate between cost accounting and financial accounting.

## **3.0 MAIN CONTENT**

### **Introduction to Cost Accounting**

#### **3.1 Meaning of Cost Accounting**

Cost accounting can be defined as the processes of identifying, analyzing, computing and reporting cost to management. It is also defined as the process of Identifying, Computing, Summarizing, Analyzing and Reporting (ICSAR) in monetary terms relevant information to the management on the cost and the benefit of pursuing each of the available courses of action open to management.

Cost accounting is a pre-condition, pre-requisite for an efficient and effective management of any organization. Unlike financial accounting, the scope of cost accounting is restricted to the provision of relevant information to and exclusively for management to enable it make necessary economic decision.

#### **SELF-ASSESSMENT EXERCISE 1**

1. Define and explain cost accounting.
2. Why is cost accounting important to an organization?

#### **3.2 Purposes/Uses of Cost Accounting**

The main objective of cost accounting is planning and control and at the same time it aids or assists management in decision making. Other objectives include:

- (1) It provides information for management to enable it make a choice among competing alternative courses of action
- (2) It helps in determination of cost and profit
- (3) It also assists in setting standard of performance
- (4) It helps in performance evaluation and cost control
- (5) It is useful in the determination of the value of inventory (material valuation)
- (6) It can be as a basis for assessing the viability of a project.

### **SELF-ASSESSMENT EXERCISE 2**

1. Discuss any four objectives of cost accounting.
2. Relate the management functions of planning and control to cost accounting.

### **3.3 The Benefits of Operating Cost Accounting System**

Several benefits are derived from operating cost accounting system, some of which include:

- i) There is timely historical cost information;
- ii) Identifying areas of wastages or inefficiency;
- iii) Stocks can be controlled;
- iv) Information is readily available to decide on:
  - Whether to continue or to discontinue a product line
  - Which price to accept
  - Whether to make or buy any from outside;
- v) Variance can be calculated and monitored;
- vi) Cost reduction can be proposed and followed up.

### **SELF-ASSESSMENT EXERCISE 3**

1. Discuss any four benefits of operating a cost accounting system.
2. How can effective cost accounting system amount to cost effectiveness?

### **3.4 Factors to be considered Before Installing a Cost Accounting System**

The following are the factors to be considered before installing a cost accounting system:

- i) Objectives of the management in installing the system and the need for information;
- ii) Understanding the technical characteristics of the class of industry concerned;
- iii) The organization opportunities and threat, strength and weakness from the environmental scanning exercise;
- iv) The stages through which the product must pass before it is completed, the layout of the factory, the nature of the material to be used and method of storage, the method of remunerating labor and the personality of key management and the capacity of the staff generally;
- v) Methods/procedures involve in production system.

#### **SELF-ASSESSMENT EXERCISE 4**

1. What do you understand by a cost accounting system?
2. Discuss any three factors to be considered before installing a cost accounting system.

### **3.5 Qualities of Cost Accounting Information**

To give room for good planning, effective control and visionary decision making, information must be obtained. Cost accounting information is always needed for managerial planning, control and decision making in both private and public sector organizations. The information should bear certain qualities for it to be seen as capable of assisting management towards bringing about positive changes in the affairs of the organization. The following are some of the required qualities of cost accounting information:

1. Relevance
2. Reliability
3. Timeliness
4. Understandability
5. Accuracy
6. Cost effectiveness
7. Objectivity
8. Comparability

Cost accounting information should therefore possess the above qualities together with others for it to be used by the management or users to make decisions with a view to achieving desired goal.

**SELF-ASSESSMENT EXERCISE 5**

1. Discuss any five qualities of cost accounting information.
2. Cost accounting information is needed for managerial planning, control and decision making. Discuss

**3.3.2 Differences between Cost Accounting and Financial Accounting**

The following bases are used in differentiating between the two:

**1. Users**

In financial accounting the users are both internal and external, that is to say the management, shareholders etc use it internally, while externally the potential investors, creditors, government agencies, etc all use financial statements of an organization before making decision. For cost accounting information, it is only the management that should be seen as the user.

**2. Accounting principles**

Financial accounting is guided by generally accepted accounting principles (GAAP) and some laws of the land. In the case of cost accounting there is no any generally accepted principle. It information is just to be prepared it in any way that can be understood by the management, or line with the management policies.

**3. Units of measurement**

The unit of measurement in financial accounting is in Naira and Kobo, Dollar, Pound etc that is to say we only use economic parameter in determining financial accounting information, but in cost accounting we make use of both economic and qualitative parameter i.e. we use Naira and Kobo, Kilograms, Labor hour, etc

**4. Time focus**

Financial accounting is only concerned with the past that is to say we make use of history in preparing the financial statements of an enterprise. In the case of cost accounting, we use the past and present to project the future.

**5. Time of the report**

In financial accounting the law requires some organizations to prepare and publish a report at the end of every year, for example all public companies. But cost accounting information can be reported at any time to the management at its instance, e.g. weekly, monthly, half yearly, etc.

## **6. Coverage**

Financial accounting information covers the entire organization, not a department/ section. But in the case of cost accounting information, it may cover only a department, or a segment of the organization.

## **7. Other Bases of Comparison**

Other basis that can be used to differentiate between cost accounting and financial accounting include objective, degree of details, use of estimation and approximation, necessity to keep record, etc.

### **SELF-ASSESSMENT EXERCISE 6**

1. Using any four bases of comparison differentiate between cost accounting and financial accounting.
2. Discuss any two reasons why cost accounting information is for the use of management alone.

## **3.7 Cost control, Cost coding and Cost classification**

### **3.7.1 Cost control**

This refers to the ability of management to make sure that expenditures (recurrent and capital) are monitored and supervised, to ensure that things are going according to plan and that actual results (cost incurred) are obtained for comparison against planned results (cost to be incurred) so that appropriate corrective actions can be taken on the Variance that is bound to arise before it is too late. Before any cost control can be effective, standards or targets of performance must be set against which actual costs can be measured and compared. This would reveal inefficiencies so that appropriate actions could be taken to guard against the future.

### **3.7.2 Cost coding**

A code is defined as a system of symbol designed to be applied to a classified set of items. It is the assigning of numbers or letters to cost

items in order to facilitate their identification in terms of both their nature and location or use.

Coding is important with manual accounting system and computerized system. It reduces data storage and processing in computer.

### 3.7.3 Cost classification

There are many ways of classifying costs. These include:

- (i) Fixed and variable cost
- (ii) Controllable and uncontrollable cost
- (iii) Avoidable and unavoidable cost
- (iv) Direct and indirect cost
- (v) Joint and separate cost
- (vi) Full and marginal cost
- (vii) Incremental and sink cost

Cost accounting is clearly a sub-set of management accounting- a broader branch, since it only deals with accounting techniques used to guide management on 'cost' decisions to be taken, whereas management accounting techniques include those to be used in guiding managerial decisions in respect of cost to be incurred, 'profit; to be made, 'assessment' of present and future performance of units, etc.

### SELF-ASSESSMENT EXERCISE 7

1. Discuss the concept of cost control.
2. Discuss any two ways of classifying costs.

### 3.8 Cost Accounting Terminologies

1. **Cost:** Is the value of economic resource used in production of a given product or service
2. **Cost unit:** This is about a unit of quantity of product or service in relation to which costs may be ascertained or expressed; some examples include.
  - i) **Unit of product:-** contracts, tons of cement, gallons of liquid, books etc
  - ii) **Unit of service:** - kilowatt-hours, cinema seats, passenger miles, hospitals operations, consulting hours etc.

- 3. Cost centre:** This refers to a location, a person or an item of equipment in relation to which costs may be ascertained and used for the purpose of control.

A location may mean a department, store-yard, sales area, or a factory. A person may be sales manager, production manager, personnel manager, finance manager or work engineer.

An item of equipment may be machine, delivery vehicles, car, truck, lathe, etc. as the purpose of cost centre is to aid effective cost control within an organization, the costs incurred will have to be charged to the relevant cost centre. It is then that cost control could be exercised.

- 4. Cost allocation:** It is the allotment of whole item of costs to a cost center or cost unit.
- 5. Cost apportionment:** It is the allotment of items of cost to relevant cost centers.
- 6. Overhead absorption:** It is the allotment of overhead to cost units or cost centers.

### SELF-ASSESSMENT EXERCISE 8

1. Differentiate between cost unit and cost center.
2. Discuss the concept of overhead absorption.

### 4.0 CONCLUSION

Having a cost accounting system is beneficial to organizations as it will help it in achieving set objectives. Organizations with a good cost accounting system can cost their product appropriately and accurately, decide whether or not to produce, and make forecast of future profit, etc. Therefore, having a good system is of utmost importance to any public and private sector organization.

### 5.0 SUMMARY

This Unit covers introductory aspect of cost Accounting, where the reader is taken through the meaning of cost accounting; the purposes for which cost accounting system is set up; differences between cost accounting and financial accounting; cost accounting terminologies; etc, with a view to empowering the reader with the rudimentary knowledge of cost accounting and whetting his/her appetite towards furthering his/her study in cost accounting and management accounting.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Cost Accounting has been defined as “the process of identifying, analyzing, computing, and reporting cost to management”. In the light of the above definition, how can you establish that cost accounting is really a service to management?
2. Differentiate between Cost Accounting and Financial Accounting.
- 3a) Mention three advantages of coding in cost accounting.
- b) Outline five factors that should be taken into consideration before installing a cost accounting system.
  - i. Differentiate between Cost Unit and Cost Center.
  - ii. Discuss the Concept of Cost Control.
  - iii. Discuss any five reasons why cost accounting system must be put in place by any serious organization.

## 7.0 REFERENCES/FURTHER READING

- Dandago, K.I. & Tijjani, B. (2005). *Cost and Management Accounting*. (2<sup>nd</sup> Edition). Kano-Nigeria: Gidan Dabino Publishers Limited.
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## **UNIT 5 INTRODUCTION TO BUDGETING PROCESS**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 The Concept of Budget
  - 3.2 Types of Budget
    - 3.2.1 Time Perspectives of Types of Budget
    - 3.2.2 Activity Perspectives of Type of Budget
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  - 3.3 Budgetary Improvement Techniques
    - 3.3.1 Incremental Budgeting (IB)
    - 3.3.2 Zero Based Budgeting (ZBB)
    - 3.3.3 Continuous (Rolling) Budgeting (CB)
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
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### **1.0 INTRODUCTION**

A budget is a means to an end, and not an end in itself. It is a plan that depicts the focus of a short or long term objective of an organization. It covers the area of responsibility of an organization or a specified person, so that performance can be measured at the end of the budget period. It follows that the budget should be prepared in conjunction with those who are to be responsible for achieving the budgeted performance. In this way, a head of department translates his goal in the departmental budget for approval by the higher authority. This approach offers motivation to the managers/head of departments and other employees in an organization (public or private). This Unit introduces the concept of budget, its types and its improvement techniques.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- appreciate the concept of budget and its necessity to organizations
- determine the objectives of budgeting
- appreciate different types of budgets
- appreciate the major techniques used in budgetary improvement.

### **3.0 MAIN CONTENT**

#### **Introducing Budgeting Process**

#### **3.1 The Concept of Budget**

Budget is a very popular term to the official group, informed group and even layman group. It has been widely popularized by government through its annual budget pronouncements. Budget is, however, not restricted to governments (local, state and federal) and their agencies. All the three components of the economy (individuals, firms and governments) need budget as part of their everyday lives. Finance, time, material, men and other resources need to be budgeted for in view of the fact that they are all scarce, to each of the three components of the economy, when compared against their needs. Budget is very strong instrument of managing scarcity!

Government at various levels must budget for revenue to be generated and the expenditure to be incurred using its scarce resources to cater for the general well being of the masses (Dandago, 2001). Budget indiscipline on the part of any of the three components of the economy, especially the government, would surely lead to a lot of problems in the economy. This has to be avoided through the concerted efforts of the citizenry, who should always blow whistle on noticing any infringement of the laid down rules and regulations on the budgeting exercise, in particular, and governmental financial management, in general.

The term budget has been defined in several ways, each emphasizing the issue of planning and control of future activities. It could be viewed as a process of setting performance standard for future activities so as to exercise control (on cost, revenue, income and other financial or non financial activities). It could also be viewed as a means of obtaining accountability and control over the use of money or over all activities (Omolehinwa, 1989).

The Institute of Cost and Management Accountants (ICMA) defined budget as a plan quantified in monetary terms, prepared and approved prior to a defined period of time, usually showing planned incomes to be

generated and/or expenditures to be incurred during that period, and the capital to be employed to attain a given objective (ICMA, as cited in Dandago and Tijjani, 2003).

These and many other definitions that could be attempted on budget are emphasizing the need for good planning and control of financial and non-financial activities by all the three components of an economy. The definitions also show that since resources are scarce, there is need for proper and adequate planning as to how to utilize them to achieve maximum satisfaction.

### **SELF-ASSESSMENT EXERCISE 1**

1. What do you understand by the term budget?
2. Discuss any three reasons why budget is necessary to any organization.

### **3.2 Types of Budget**

Traditionally, budget may take different forms, depending on the situation. For proper discussion on types of budget, some perspectives have to be borne in mind. As time period could be used to differentiate budget, we can take *Time Perspective* to classify budgets into two: short-term budget and long-term budget, and probably a medium-term budget. The activities involved could dictate the classification as we can differentiate budget into financial budgets and non-financial (Operational) budgets. This categorization could be seen as *Activity Perspective*. Another way of differentiating types of budget, which is more popular in the public sector, could be termed *Quantitative Perspective* as budget could be classified into surplus budget, deficit and balanced budget.

#### **3.2.1 Time Perspectives of Types of Budget**

- (a) **Short-term budget:** This relates to current condition and it usually covers a period of one year. Even annual budgets are in turn broken down into quarterly, monthly, fortnightly or weekly budgets for control purposes. A widely used variant of the short term annual budget is the rolling or continuous budget. The budget is formulated initially for a period of one year or more and is broken down into smaller periods (Ojaide, 1991). As each month, quarter or week passes, two actions take place. First, a budget for the corresponding period of the following year is prepared, ensuring that a short term budget is always in existence for the immediate future of twelve (12) month; and second, the budget is to be revised in the light of the results of the period

which has elapsed, so ensuring that the current budget is revised constantly and kept up-to-date.

- (b) **Long-term budget:** This relates to the development of the organization/nation over many years. It is drawn up in any general terms that cover the nature of the nation, its position in the continent/globe, the expected level of inflation and its impact on the world politics. A period of between three to ten years may be appropriate for long-term budget. Matters such as capital assets purchase and long-term sources and uses of finance are considered in long terms budgeting decisions.
- (c) **Medium-term budget:** This could be formulated to relate to any financial or non-financial budgets that cover the period of between one to five years with a period of thirteen (13) months as the floor and period of fifty-nine months as the ceiling. This categorization is not popular, since long-term budget is serving its purpose.

### 3.2.2 Activity Perspectives of Types of Budget

- (a) **Operating Budgets:** These are budgets that reflect day-to-day activities or operations of an organization. This category deals with items of manufacturing, trading and profit and loss account like material purposes, labor cost, production and overhead, sales, purchases, ending inventory, opening inventory, etc, budget. It also deals with revenue or income budgets and expenses or expenditure budgets. Operating budget is synonymous with recurrent expenditure budget of the government financial year.
- (b) **Financial Budget:** This relates to financing of assets and generally indicates cash inflow and outflow. Capital budget is part of financial budget. This category is about the budget to be prepared on the funds to be generated through different sources of financing projects. Capital budget, which is part of financial budget, is synonymous with capital expenditure budget of the government financial year.
- (c) **Master Budget:** This is the summary of all operating and financial budgets and it consists of a budgeted income statement, a budgeted balance sheet and a cash flow statement. The master budget is, therefore, an overall budget (Dandago & Tijjani, 2003).

### 3.2.3 Quantitative Perspectives of Types of Budget

- (a) **Surplus Budget** is arrived at when the total estimated revenue is greater than the total estimated expenditure. While some ministries of government are revenue centers, generating more revenue than the cost they incur, most government ministries are cost centers – incurring more cost than the revenue they generate. The total of the estimated revenue of the relevant ministries and the total of the estimated expenditures of all ministries are aggregated and compared when the budgets are approved (Dandago, 2006).
- (b) **Deficit Budget** is the reverse of surplus budget, that is, it is arrived at where the total anticipated expenditure is greater than the total anticipated revenue.
- (c) **Balance Budget** is arrived at where the total estimated expenditure is equal to the total estimated revenue or the difference between the two is insignificant.

## SELF-ASSESSMENT EXERCISE 2

1. Discuss the time perspectives of budget in the private sector.
2. How are the quantitative perspectives of budget relevant to the Nigerian private sector organizations?

Budgets preparation, in an organization, is to start from certain time and is to be a continuous exercise. As the organization continues to prepared budgets, there is the need for improvement to be brought about on the previous budgets. To bring about improvement in the budget exercise, there are techniques that should be put to use in order to achieve the desired organizational objectives.

Although the techniques for budgetary improvement are more popular and more applicable in the government sector than in any other sector of the economy, the government and the other two components of the economy are consciously or unconsciously using one of the techniques or the other in their continuous budget preparation.

The most popular of these budgetary improvement techniques are (1) incremental budgeting (IB), (2) Zero Based budgeting (ZBB); (3) Continuous (Rolling) Budgeting (CB) and (4) Planning, Programming, Budgeting System (PPBS). We shall discuss the first three.

### 3.3.1 Incremental Budgeting (IB)

This technique does not believe in any comprehensive budgeting that requires budget holders to look beyond one year in their budget

preparation. They are not required to critically justify all their proposed expenditures as they are based on the previous year's budgets.

Proponents of incremental budgeting would argue that budgeting is incremental, not comprehensive, and that budget is almost never actively reviewed as a whole every year; that budgeting is to be based on last year's budget with special attention given to a narrow range of increases and decreases; and that budget preparer's attention is to be focused on small number of items over which the budgetary battle is fought (Omolehinwa, 1989).

The basic assumption of this technique is that the previous period's level of expenditure or activity is appropriate and, so, there is no need for comprehensive review of activities, no need for much defense of proposal, no need for looking beyond the specific budget period, no need for coming up with various alternatives to a proposed project or activity and no need for taking long term decision(s). All that is needed in budgeting is a decision on the activities to be dropped, added, expanded or reduced, based on the available resources.

This technique is a clear reflection of the budgetary behavior of the vast majority of governments in developing countries, like Nigeria.

*Advantages of incremental Budgeting: One can contend that IB has the following advantages:*

- (i) **Moderation of conflicts:** Conflicts between managers of the interdependent departments or units of an organization could easily be moderated or avoided since decision as to what to allocate to what unit, department or project would be based on last period's budget.
- (ii) **Reduction of cost:** Search costs as to the overall review of projects, feasibility studies, comparison of alternative courses of action would be avoided or reduced to the barest minimum, using the IB technique.
- (iii) **Saving of Time:** The technique brings about reduction of the amount of time that budget holders must invest in budgeting, if it is to be comprehensive.

*Disadvantages of Incremental Budgeting: The technique has a number of disadvantages, which could be summarized as follows:*

- (i) **Future Cost Implication ignored:** The focus of the technique is one year or shorter period only, without looking at the future cost implications of the decision to be taken in the short period. The

philosophy is that of attaining a level of activity in the short period, even if that would bring about setback in the future.

- (ii) **Transferring Inefficiency to the Future:** By beginning the budgeting process for each period with the funding level of the previous period, the technique assumes that the activity performed in the previous period are efficient and cost effective. As a result, any inefficiencies of the past are enshrined as standard for the future.
- (iii) **Provision of Poor Information:** The technique does not emphasize on the provision, by budget holders, of adequate information on the services (projects) to be provided, the reason(s) for providing the services, the beneficiaries of the services or the resources needed to maintain specific levels of services.
- (iv) **No Evaluation of Alternatives:** The technique does not provide any meaningful way of evaluating alternative courses of action to executing projects or programmes, alternative methods of providing a service or tradeoff between different services or level of services. In short, the technique does not encourage the development of alternative courses of action to various activities or projects.
- (v) **Lack of Budget Expertise:** Budget committees, in an organization using IB technique, do not need to be made up of experts – the composition is usually that of heads of budget centers and very few accounting staff. It is for this reason that departments, units of ministries inflate their *blindly prepared budget* in anticipation of arbitrary cuts by the committee (Dandago & Tijjani, 2003).

It is in response to the above criticisms of IB that many other budgetary improvement techniques emerged in the budgeting literature.

### 3.3.2 Zero Based Budgeting (ZBB)

This budgetary improvement technique assumes that current operation will start from zero level. It, therefore, calls for total review of all proposed activities and expenditures of an organization, irrespective of whether they are new or continuous. The idea is to justify every Naira of an organization's expenditure. This rational model of decision-making assumes that the decision makers in government and industry know where they are going and that what is needed is a decision on how to get there through the choice of the most efficient route (Omolehinwa, 1989).

That route can only be found after a comprehensive and critical assessment of all the proposals that would embody an organization's budget.

ZBB involves allocation of the resources of an organization on the basis of the cost benefit analysis to be conducted on each of its activities. In essence, positive and practical attempts are to be made to eliminate inefficiencies and waste from all operations. The technique's basic philosophy is that budget holders are to look at their activities or priorities afresh and that they have to justify their entire budget requests anew.

Major Steps of ZBB: The major steps of ZBB are three:

- (a) Breaking down each activity or project into decision packages. A decision package is a document containing information about: (i) cost benefit-analysis on a proposal, (ii) a comparison of the result of the analysis on one alternative with those of other alternatives, and (iii) the consequences of not approving the proposal.
- (b) Comprehensive evaluation of various alternative courses of action to a proposed activity or project and ranking of the alternatives in order of decreasing benefit or importance to the organization.
- (c) Allocation of resources to the competing projects or activities in accordance with the final ranking established (Dandago & Tijjani, 2003).

### **Advantages of ZBB**

The following advantages could be derived from the application of ZBB techniques:

- (i) **Availability of alternatives:** Budget holders must discover and present various alternative courses of action to achieving a given objective. This means that bases of comparison must be provided by anybody proposing projects or activities to be undertaken. The alternatives would be extensively evaluated before decision is taken.
- (ii) **Future Cost Implications of Decision are considered:** The technique considers all the future cost implications of current decisions as part of the cost-benefit-analysis to be conducted on each proposed project or activity.
- (iii) **Elimination of Low Priority programmes:** This could be done with more confidence since decision as to where to allocate

scarce resource would be based on the ranking made after a comprehensive cost-benefit analysis.

- (iv) **Creativity and Initiative Enhanced:** ZBB model makes budget preparers to be creative and initiative, since they have to think afresh when drafting their budgets and they have to forward alternative ways of achieving a desired objective. The presentation of alternatives would be done with greater clarity so as to give way for objective analysis and review before decision is taken.

**Disadvantage of ZBB:** All the advantages of IB technique could be the disadvantages of ZBB. Specifically, the following are the disadvantages of ZBB:

- i. **Conflict of interest:** The technique is bound to bring about conflict of interest among various budget holders, since it encourages defense of budget proposal so as to justify every Naira of a proposed expenditure. The competition for favorable allocation of the scarce resource may result into a conflict that may prove difficult to moderate.
- ii. **High cost:** The cost of preparing the budget, which must be initiated afresh, and from the bottom upward, would be high.
- iii. **Time Wasting:** A lot of time must be spent preparing budgets using ZBB technique, since everything would start as original and be subjected to justification.
- iv. **Difficulty of Understanding:** Inadequate understanding of the aims, strengths and weaknesses of ZBB among most budget holders, would affect their ability to gather relevant data needed for its implementation.
- v. **High Level of paper work:** ZBB model entails high degree of analysis and scrutiny, which would be energy and other resources consuming (Omolehinwa, 1989).

All the problems (disadvantages of ZBB) mentioned above can be overcome through proper training of budget holders and foresighted administration of the entire ZBB technique. The technique requires the commitment of a lot of resources: money, time and energy to succeed; but it is more comprehensive, accurate and objective than the incremental model.

### 3.3.3 Continuous (Rolling) Budgeting (CB)

A rolling budgeting can be defined as the continuous updating of short-term budgets so that previously prepared budgets for future periods could reflect current conditions. This is, therefore, an attempt to prepare short-term budgets which are very realistic. A rolling budget is formulated initially for a period; say one year or one decade. This would be broken down into monthly, quarterly or yearly budgets for execution. As each month, quarter or year passes, two actions take place:

- (i) a budget for the corresponding period of the following period is prepared, ensuring that a budget is always in existence for the immediate future of 12 months or ten years; and
- (ii) the budget of the following month or year would be revised in the light of the results of the period which has elapsed, so ensuring that the current budget is revised constantly and kept up to date.

This budgetary improvement technique has the same philosophy as ZBB model. The only difference between the two is that, while ZBB is about starting a fresh always, CB is about rolling the assessed result of the previous period to adjust the budget prepared for the present period. The budgets to be initiated under the rolling budget thinking are to be based on the principles of ZBB. So, all the advantages and disadvantages of ZBB technique are applicable to CB technique.

### **SELF-ASSESSMENT EXERCISE 3**

1. Discuss any three advantages of Zero Based Budgeting.
2. How is ZBB similar to rolling budgeting?

## **4.0 CONCLUSION**

Budgeting is the process by which the long term corporate plan is converted into action or activities. A budgeting system ensures co-ordination, assignment of responsibilities, communication, control, direction and goal congruency. This will help to avoid sub-optimality.

A good budgeting system must fulfill the following conditions: support of the top management, clear definition, full involvement of every one at all levels, appropriate accounting system put in place and administration in a flexible manner.

Of importance to any budgeting activity is the availability of budget manual, budget committee and budget officers. All the various budgets discussed in this Unit are related and they are to be made to form the guiding the master budget of a serious organization.

## **5.0 SUMMARY**

Budget is a financial and/or quantitative plan of operations for a forthcoming accounting period. Budgets are classified into functional budgets and master budgets. However, many functional budgets (a budget of income or expenditure for individual functions of a business such as the sales budget, production budget, direct labour budget, etc.) are incorporated into a master budget.

Any budgeting system needs to be handled with some strategies in order to adequately organize, prepare and approve budgets. The commonest budgeting techniques being employed these days are the flexible budgeting technique, zero-based budgeting technique, activity-based budgeting technique, planning and programming budgeting technique and continuous budgeting technique. This Unit has introduced some of these techniques to wet the appetite of the reader for further study in the area of budgeting techniques and budgetary control processes.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the necessity of budgeting in the Nigerian public and Private sector organizations, giving two concrete reasons to make justification.
2. Do you agree that public sector organizations are more skewed towards incremental budgeting than zero based budgeting? Give five scientific reasons.
3. Relate activity perspectives of type of budget to the Nigerian public sector.
4. Compare and contrast Zero Based budgeting and Rolling Budgeting.
5. Write short notes of each of the following terms:
  - a) Budget Expertise
  - b) Master Budget
  - c) Decision Package
  - d) Low Priority Project
  - e) Conflict Moderation

## 7.0 REFERENCES/FURTHER READING

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