Common end year Adjustments in the preparation of Financial Statements

DEPRECIATION

Depreciation – is the decrease in value of an Asset over time due to wear and tear.

Each year, a business should calculate the depreciation of non-current assets and recognizes the depreciation figure as an Expense in the Statement of Profit and loss

If a business buys a Motor-Vehicle on 1st Jan 2015 for 560,000, and in December 2015, they are preparing their financial statements, they need to determine the value the vehicle has lost that year.

Let's assume the Motor vehicle has depreciated by 70,000, the 70,000 will be recognized as a depreciation expense in the Statement of profit and loss and in the statement of financial position the Motor vehicle will be shown to have a remaining value of (560,000-70,000) = 490,000

Terminologies to consider

Cost of asset –This is the Original price an Asset was purchased at (historical cost)

Accumulated depreciation/Provision for depreciation- These are the total previous depreciations of an asset as at a particular date. Balances on provision for depreciation account are shown as **CR balances on the Trial balance**

Net book value/ Carrying amount of an Asset – This is the remaining value of an asset after deducting all the accumulated depreciation from the Cost of the Asset.

Consider the below example

Z Advocates purchased a Car for use in the business on January 2018, @ Ksh 900,000. They have assumed the car will depreciate at 80,000 each year. Prepare a table showing the cost, depreciation, accumulated depreciation and the Carrying amount of the car for the first Five years

year	COST	Depreciation each year	Accumulated Depreciation	Remaining value of Asset in SOFP
1(2018)	900,000	80,000	80,000	820,000
2(2019)	900,000	80,000	160,000	740,000
3(2020)	900,000	80,000	240,000	660,000
4(2021)	900,000	80,000	320,000	580,000
5(2022)	900,000	80,000	400,000	500,000

METHODS OF CALCULATING DEPRECIATION CHARGE

1. Straight Line Depreciation method - This is where it is assumed that the depreciation charge for an asset is the same each year.

A (%) for depreciation is given based on the Cost of the Asset

E.g. KK proprietors purchased an Asset for KSH 240,000. The asset is to be depreciated at a rate 25% per annum straight line.

What is the Depreciation Amount each year = 240,000*25% = 60,000

2. **Reducing Balance Method** – This is where the depreciation for the current year is calculated as a Percentage of the Remaining value of the Asset

E.g. KK proprietors purchased an Asset for KSH 240,000. The asset is to be depreciated at a rate 25% per annum reducing balance Method

Show the depreciation charge each for the first four years and the remaining balance

Year	Cost	Depreciation (figure in the Statement of profit or loss as expense)	Accumulated depreciation	Remaining balance of the asset (figure in the SOFP) at the end of year)
1	240,000	25%*240,000= 60,000	60,000	180,000
2	240,000	25%*180,000 = 45,000	105,000	135,000
3	240,000	25%*135000= 33,750	138,750	101,250
4	240,000	25%*101,250= 25,313	164,063	75,937

Illustration 3

You are provided with the following figures from the Trial balance as at 31st Dec 2016

Motor vehicle Cost Ksh 120,000

Motor vehicle Provision for Depreciation (as at 31 Dec 2015) Ksh 19,800

Furniture Cost Ksh 320,000

Furniture Provision for Depreciation (as at 31st Dec 2015) Ksh 37,000

Additional information

Motor vehicle are to depreciated for the year at 20% *reducing balance* method while Furniture is to be depreciated at 15% *straight line method*

Required: i) **find the Depreciation expense figures to be shown in the Statement of profit and loss**

Depreciation expense for Motor vehicles = 20 %*(120,000 -19,800) = 20,040

Depreciation expense for Furniture = 15% * (320,000) = 48,000

ii) **Find the carrying amount of Asset figures for Motor vehicle and Furniture to be shown on the Statement of Financial position at 31st Dec 2016**

Calculate the new provision for depreciation for each asset

New Motor vehicle provision for depreciation = 19800 + 20,040 = 39,840

New Furniture Provision for Depreciation = 37,000+ 48,000= 85,000

Carrying amount= Cost – provision for depreciations

Motor vehicle carrying Amount = 120,000 – 39,840 = **Ksh 80,160**

Furniture Carrying Amount = 320,000 – 85,000 = **Ksh 235,000**

THE ASSET COST AND PROVISION FOR DEPRECIATION ACCOUNTS

Asset Cost a/c

Opening Balance	KK	Cost of sold Asset	KK
Purchase of New Asset	KK	Bal C/d	KK
	KK		KK
Bal B/d	KK		

Provision for Depreciation A/c

Provision for Depr of Sold Asset	KK	Opening Balance	KK
Bal C/d	KK	Depreciation for the year	KK
	KK		KK
		Bal b/d	KK

ACCRUALS AND PREPAYMENTS

This is an application of the Accruals concept we covered in topic One. Expenses and incomes should relate to the period in which they occur whether the cash has been received or not.

Accruals – these are outstanding expenses which have not been paid for at the end of the accounting period. (Accruals are also known as Expenses owing).

Illustration

John enterprises pays yearly business rent of Ksh 110,000. In the year ended 2020, John has only paid Ksh 95,000. – This will indicate John has an outstanding Accruals balance of Ksh 15000 on the rent expense.

In the Statement of profit and loss the total rent to be recognized will be the annual rent of 110,000

Then an Accrual liability of 15,000 will be shown in the statement of financial position at the year-end under Current Liabilities

Prepayments- These are expenses which have been overpaid at the end of the period.

John enterprises pays yearly business rent of Ksh 110,000. In the year ended 2020, John has paid Ksh 120,000 – This will indicate John has prepaid rent by Ksh 10,000

In the statement of Profit and loss the total rent to be recognized will still be the annual rent of Ksh 110,000

However in the statement of financial position (SOFP) a Prepayment of Ksh 10,000 will be shown under Current assets

Illustration 3

The Trial balance of 31st Dec 2021 shows the following expense

Rent	Ksh 18,000
Insurance	Ksh 27,600

Additional information

The rent for the year is Prepaid By 2000

The Insurance expense for the year is accrued by 1500

Required, what figure for rent and insurance should be shown in the statement of profit and loss

S***olution***

Expense in The TB + accrual – Prepayment

Rent = 18,000 -2,000 = Ksh 16,000 (the 2000 will be shown as Current Asset in the SOFP)

Insurance = 27,600 + 1,500 = Ksh 29,100 (the 1500 will be shown as Current liability in SOFP)

ADJUSTING FOR BAD DEBTS AND PROVISION FOR DOUBTFUL DEBTS

Bad debts – these are debts that cannot be recovered by a business. They are also referred to as irrecoverable debts. When a business sells gods on credit and the buyer defaults, dies or goes bankrupt, the business will write off the debts as a bad debt.

Bad debts are shown as (recognized) as expenses in the Statement of profit and loss and deducted from the Accounts receivable/Debtors figure.

Note that if the Bad debts are shown on the Trial balance, they have already been deducted from the accounts receivable figure

However if the bad debts are given as additional information, they need to be deducted from the Accounts receivable figure.

Provision for doubtful debts - This is recognising debts that are doubtful (may become bad debts in the future). They are also referred to as **Allowance for doubtful debts**. ***The balance of the doubtful debts account is usually shown as a CR balance on the Trial balance and***

Calculating the provision for Doubtful debts/ Allowance for Doubtful debts

The provision for Doubtful debts is given as % (percentage) of remaining accounts receivables

Provision for doubtful debts for the year = % *(Accounts receivable figure on Trial Balance – any bad debts given in additional information)

E.g. At the end of 2021 a Company has Accounts receivables of 624,000. The Allowance for doubtful debts is to be provided at 4%. Calculate the closing figure for doubtful debts

=4%* (624,000-0) = 24,960

When there is a figure for allowance for doubtful debts in the trial balance, it is compared to the calculated figure for the year to find the Increase (expense) or the decrease (income) to be shown in the statement of profit and loss.

Consider the below illustration

Thika Enterprises trial balance Extract at 31st December 2020 shows the following balances

Trade Accounts Receivable balance	Ksh 24,500
Allowance for doubtful debts	Ksh 512
Bad debts	Ksh 2,008

Additional information

The allowance for doubtful debts is to be adjusted at 3% of trade accounts receivable

Required, i) show the figures to the statement

Solution

Bad debts expense of Ksh 2,008 will be taken as an expense to the Profit and loss account

Allowance for doubtful debts for the year = 3% * (24500-0) = 735

Compare the calculate allowance of Ksh 735 and the One in the trial balance of 512. There is an increase in allowance of doubtful debts of (735-512) Ksh 223.

The increase in allowance of doubtful debts of Ksh 223 is taken as an expense to the statement of profit and loss.

(***Note that- had the change been a decrease, it could have been taken as income to the statement of profit and loss***)

ii) Calculate the Accounts receivable figure to be shown in the Statement of financial position

Accounts receivable figure to be shown on SOFP = [Receivable figure on TB – Any bad debts given as additional information – Allowance calculated for the year)

Thus

Account receivable figure to be shown on SOFP = (24,500 – 0 – 735) = KSH 23,765

DISCOUNTS

Discounts are given by businesses to encourage credit customers to pay their debts earlier or on time.

Discount received – This is a discount that a business receives from its suppliers and its should be shown on the Credit (CR) side of the Trial Balance and taken as Income to the Statement of profit and loss

Discount Allowed – This is a discount that a business offers to its customers and its should be shown on the Debit (DR) side of the Trial balance and taken as an expense to the statement of profit and loss

RETURNS

Sales Returns /Return inwards - These are sales that have been returned by customers. Return inwards are shown on the Debit (DR) side of the Trial balance and will be deducted from the sales figure on the Trial balance when preparing the statement of Profit and loss.

Purchase returns/Return Outwards- These are Purchases returned back to suppliers. Return outwards are shown on the CR side of the Trial balance and will be deducted from the Purchases figure when preparing the Statement of Profit and Loss.

STOCK/INVENTORY

Opening stock – This is the goods at hand at the start of an accounting period or year. The Stock usually shown on the Trial balance is the Opening stock

Closing stock – These are goods unsold at the end of the Accounting period. Closing stock is not shown on the Trial balance instead it is given as additional information.

The Stock that will be shown on the statement of financial position is the closing stock

Format of the Statement of profit and loss for the year			
	KSH		**KSH**
Sales (Gross sales -return inwards/sales returns			YY
Less: Cost of Sales			
Opening stock	y		
Add Purchase (purchses -return outwards/purc returns	y		
Add carriage inwards expense	y		
Less Closing stock	(y)		
			(YY)
Gross profit			**KK**
Add other incomes			
Discount received			X
Decrease in allowance for doubtful debts			X
profit on sale of Non current Assets			X
Interest income			X
Less Expenses			
Carraige outwards	X		
Bad debts	X		
Increase in allowance of doubtful debts	X		
Depreciation	X		
Discount allowed	X		
Interest expense	X		
Rates, rent, general expense e.t.c	X		
			(XX)
Profit for the year/period			ZZ

Format of statement of Financial position for sole properietor

	KSH	KSH
Non Current Assets (NBV)		
Buildings	Y	
Motorvehicles	Y	
Furniture and equipment	Y	
Land	Y	
		YY
Current Assets		
Closing stock	Y	
Trade Receivables	Y	
Cash	Y	
Bank	Y	
Prepayments	Y	
		YY
Total Assets		ZZ
Capital		
Opening Capital on T.B	Y	
Add profit for the year	Y	
Less any Drawings	(Y)	
		YY
Non current liabilities		
Long term loans		Y
Current liabilities		
Payables/Trade creditors	Y	
Bank Overdraft	Y	
Accrued expenses	Y	
		YY
Total capital and Liabilities		ZZ

1. Mr. Muchai has been trading for some years as a soft drink merchant. The following list of balances has been extracted from his ledger as at 30th April, 2010

	Sh.
Capital	83,887
Sales	259,870
Trade Accounts payable	19,840
Returns Outwards	13,407
Allowance for doubtful debts	512
Discounts allowed	2,306
Discounts Received	1,750
Purchases	135,680
Returns Inwards	5,624
Carriage Outwards	4,562
Drawings	18,440
Carriage Inwards	11,830
Rent, Rates and Incurrence	25,973
Heating and Lighting	11,010
Postage, Stationery and Telephone	2,410
Advertising	5,980
Salaries and Wages	38,521
Bad Debts	2,008
Cash in Hand	534
Cash at Bank	4,440
Inventory as at 1st May, 2009	15,564
Trade Accounts receivable	24,500
Fixtures and Fittings	120,740
Provision for depreciation – as at 30th April, 2010	63,020
Depreciation	12,074

The following additional information as at 30th April, 2010 is available:

i) Inventory at the close of business was valued at Sh.17,750
ii) Insurances have been prepaid by Sh.1,120
iii) Heating and lighting is accrued by Sh.1,360
iv) Rates have been prepaid by Sh.5,435
v) The allowance for doubtful debts is to be adjusted so that it is 3% of trade accounts receivable.

Required:

Prepare Mr. Muchai's income statement for the year ending 30th April, 2010 and a balance sheet as at that date.

(15 marks)

2.

a) A company maintains its non-current assets at cost. Provision for depreciation accounts for each asset are kept.

At 31st December, 2009 the position was as follows:

	Total cost to date	Total depreciation to date
	Sh.	Sh.
Machinery	945,000	283,500
Office furniture	32,000	12,800

The following additions were made during the financial year ended 31st December, 2010

- Machinery Sh.160,000; office furniture Sh.160,000
- Machinery bought in 2005 for Sh.16,000 was sold for Sh.3,600 during the year

The rules for depreciation are:

- Machinery 20%
- Office furniture 10% using straight line basis, calculated on the assets in existence at the end of each financial year irrespective of the date of purchase.

Required:

i) Show the following accounts for the year ended 31 December, 2010:

   a) Machinery
   b) Office furniture
   c) Provision for depreciation for each

ii) Show the balance sheet entries as at that date **(10 marks)**

2. The trial balance of Matt Spode, a China Wholesaler had the following:

	£	£
Capital Account		112,000
Purchases and sales	92,400	157,240
Premises at cost	64,000	
Motor vehicles at cost	30,000	
Accumulated depreciation on motors		8,200
Fixtures and fittings at cost	6,500	
Accumulated depreciation of fixtures and fittings		1,100
Motor expenses	7,300	
Rates	2,300	
Wages and salaries	42,000	
Bank balance	4,200	
Drawings	9,600	
Insurance	2,000	
Trade debtors	18,000	
Provision for doubtful debts		360
Trade creditors		15,000
Sundry expenses	16,200	
Long term loan		20,000
Stock (1.1.2014)	19,250	
Cash in hand	350	
	314,100	314,100

The following information was available as at 31.12.2014:

i. Stock as at 31 December 2014 was £22,400
ii. There were wages and salaries of £1,200 owing
iii. There was a payment of £1,200 on 30 September 2014 to cover for 12 months insurance
iv. On reviewing debtors, it was discovered that a debt of £800 would not be recovered and that further £1,200 was doubtful
v. Depreciation is 25% reducing balance on motors and 10% straight line on fixtures and fittings
vi. Loan interest at 10% has not been allowed for

Draft an Income statement and balance sheet as at 31.12.2014. **(15 marks)**

Comprehensively practice the above questions to understand preparation of financial statements from a given trial balance