

# FINANCE & ACCOUNT

FOR

Senior Secondary School

# 2



EDUBASE

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**SS2**

**FIRST TERM NOTES ON  
FINANCIAL ACCOUNTING**

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## WEEK 1

### FIRST TERM NOTES ON FINANCIAL ACCOUNTING

#### Topic: Income and Expenditure

#### Contents

- **Preparation of income and expenditure account**
- **Format for income and expenditure account**
- **Similarities between receipt and payment account and income and expenditure account**
- **Difference between receipt and payment and income and expenditure**

#### **Preparation of income and expenditure account**

In order to prepare income and expenditure account from receipt and payment account the following step must be taken

1. Eliminate all capital receipt like cash receives sales of equipment and capital payment to purchase equipment and capital accounts.
2. Eliminate all item of revenue nature that is item that belong to the accounting period such as subscription for previous year and subscription for the next year collected this year, this is known as subscription paid in advance and it is treated as liability under current liability in the balance sheet
3. If there are members owing subscription pre-credited to the income and expenditure account left the club without paying such subscription will be written off, by debiting the income and expenditure account.

4. Make necessary adjustment for outstanding or accrual of the beginning and the end period e.g subscription in arrears.
5. Debit the income and expenditure account and the depreciation of fixed asset get like of trading concern
6. What is required to known is the gross profit activities like dance or bazaar, the revenue activity is matched with the relevant cost

<b>Format for income and expenditure account</b>		
Income and expenditure account for the year ended		
Expenditure	Income	
Rent	x Subscriptions	xx
xx	x	
Printing	xx Interest on investment	
x	xxx	
Postage	x Entrance	
xx	fee	xxx
Honorarium	x Arrival	
xx	dinner	xxx
Wages	xx Donations	x
x	xx	

## **Similarities between receipt and payment account and income and expenditure account**

- Both account follows the principle of double entry
- They are summarized financial statement
- Both are prepaid by non-profit making concern
- They are prepaid to lower the pare period

## **Difference between receipt and payment and income and expenditure**

Receipt and payment

Income and expenditure

1 real account

Nominal account

2 only actual cash receipt and payment are recorded

Cash accrual and prepayment are include

3 no record of depreciation

Give effect to depreciation

4 balance represent cash or bank overdraft

Balance represent purpose income or expenditure

5 another name for cash book prepared by club

Another name for profit and loss adopted by clubs

6 includes capital and revenue earns

Only revenue item are recorded

7 receipt is debited and payment is credited

Expenditure are debited and income are credited

Test and Exercise

1. State the differences between income and expenditure account and receipt and payment account
2. Highlight the steps to be taken for the preparation of income and expenditure account

3. State the similarities between income and expenditure and income and receipt account

## WEEK 2

### Topic: Depreciation of Fixed Asset

#### Contents

- **Meaning of Asset**
- **Meaning of depreciation**
- **Reasons for depreciation**
- **Element of depreciation**
- **Methods of calculating depreciation of Asset**

#### **Meaning of Asset**

An asset can be defined as an object which has a longer life span that is used in business .it is in inform of equipment, vehicles, machinery or plant and building.

An asset is a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide future benefit. Asst can be fixed or current

#### **Meaning of depreciation**

Depreciation is a fall or decrease in the value of an asset as a result of wear and tear in its uses. For accounting purposes, depreciation indicates how much of an asset's value has been used up.

## **Reasons for Depreciation**

1. **Physical Factors:** This Comes as Result of Change In Outlook, Rust, Depreciation Or change in colour Of the Asset
2. **Wear and Tear:** When Asset Are Used Over Time, They Get Worn out And May Not Perform as When It Was New
3. **Obsolescence:** is the state which occurs when an object, service, or practice is no longer wanted even though it may still be in good working order. When It becomes outdated i.e No Longer In use or due to change in technology.
4. **Inadequacy:** When the asset cannot perform much task as required, i.e it is said to be ineffective
5. **Passage of Time:** When it is no longer working due to its life span

## **Element of depreciation**

1. Original Cost-The Cost at Which the Asset Is Bought
2. Estimated Value or Residual Value or Scrap Value-The cost of the asset at the time of disposal
3. Estimated Useful Life-Number of Years the Asset Is Expected to Use

## **Methods of calculating Depreciation of Asset**

The Methods Of calculating Depreciation of Asset are:

1. Straight Line Method
2. Annuity Method
3. Sinking Fund Method
4. Sum Of The Year Digit Method
5. Reflection Unit Method

6. Insurance Policy Method

7. Revaluation Method

The method to be used depends on the policy the management of the business agreed on, however, consistency need to be applied. This means that all similar assets should be depreciated by the same method and the same method method every year.

But for the purpose of this study only one method will be dealt with. whatever method adopted the elements of depreciation must be take into consideration.

**Straight line method** : This method make provision for equal amount to be charged as depreciation for each year of useful life. It is calculated by thus; cost of asset less residual value divided by the number estimated as the useful life span

The formula to be adopted is

Cost-estimated value

Years of useful life

### **Illustration**

The cost of a machine is 10,000 and the residual value is 4000 it is expected to last for 4years use a straight-line method to prepare the depreciation on the asset

$10,000 - 4000 / 4 = 1500$

## Depreciation schedule

Years	Cost of asset	Depreciation	rate	accumulated
1	10,000	1,500	1,500	8,500
2	10,000	1,500	3,000	7,000
3	10,000	1,500	4,500	5,500
4	10,000	1,500	6,000	4,000

From the above schedule, equal amount was charge as depreciation every year

Note that column

- 1 represent the estimate useful life span
- cost of asset
- depreciation rate that is, using the formula
- accumulated depreciation that is, addition of annual depreciation
- Net book value-this is arrived at by deducting accumulated depreciation from the cost of the asset.

**Diminishing or reducing balance method:** By this method a fixed percentage is written off the diminishing balance of the asset yearly. The total depreciation is spread over the anticipated useful life of the asset by annual installment of diminishing amount. Depreciation is more artificially provided here for larger amount of depreciation

## Sum of the digit method

Under the sum of the digit method, a decreasing depreciation is computed by a simple mathematical procedure relating to arithmetical progression

each year of an asset life should be represented by a digit add these digits and charge from actions of the asset cost to the year in reverse order.

Illustration

A machine was bought in 1990 for 5500 it was estimated to 500 after 4years of usage using sum of the year digit method calculate the depreciation.

### Solution

Years	digit
1	4
2	3
3	2
4	1

Depreciation =cost -scrap value

$$5500-500=5000$$

Depreciation charge for each year will be

$$\text{Year 1} = 4/10 \times 5000 = 2000$$

$$\text{Year 2} = 3/10 \times 5000 = 1500$$

$$\text{Year 3} = 2/10 \times 5000 = 1000$$

$$\text{Year 4} = 1/10 \times 5000 = 500$$

**Revaluation method:** This method of depreciation is good for asset like loose tools like hammer, chisels, spanner, livestock. e.t.c. By this method the asset is revalue each tear and difference will be charged as depreciation to the profit and loss account the value of the asset at the beginning and at the end of the asset must be known.

## **Exercise**

### **Illustration**

On 1<sup>st</sup> Jan 1998 the value of loose tools was 16,000 on the 30<sup>th</sup> June new tools were bought for 3,000 on the 31<sup>st</sup> of Dec 1998 they were revalued at 17,600. show the loose tools account using revaluation method

## WEEK 3

### Topic: Bad debt and Provision for bad debt

#### Content

- **Meaning of bad debt**
- **Causes of bad debt**
- **Provision for bad debt**
- **Bad debt recovery**

#### Meaning of bad debt

In business, traders allow credit facilities to their customers where by traders will be the creditor while the buyer becomes the debtor. Inability to pay at the specified time makes the debt to become bad.

Bad debt therefor are debts which have become irrecoverable, this arises as a result of inability of the customer to pay back his/her debts

#### Cause of bad debt

1. **Death of a debtor:** The death of the debtor automatically makes a debt bad except the family member of the diseased are willing to pay off the debt of their dead relatives
2. **Insolvency or bankrupt:** A debt can also become bad if the debtor is not making profit and even gotten to the stage of selling his asset to run the business; he therefore finds it difficult to pay his debt.
3. **Poor money management:** Inability to manage available resources
4. **Financial illiteracy:** Lack of knowledge about money can make a person find it difficult to pay his/her debt

5. **Sickness:** A sick person is weak and they have no power to work with the money borrowed, the debt becomes bad cause of the inability to pay back

Bad debt appears at the debit side of profit and loss account as a charge on the expenses side. It therefore reduce the account of debtors in the balance sheet as well as the net profit of the business.

Profit and loss account

Expenses

Salaries	xx	gross profit	xx
Wages	xx		
Electricity	xx		
Insurance	xx		
Depreciation	xx		
Bad debt	xx		
Net profit	xx		

### **Provisions for bad debt**

They are amount set aside out of profit to provide for debts which cannot be determined. It is an estimated expense for bad debt, because it is charged in profit and loss account as an expense.

### **Bad debt recovery**

Recovery of bad debt and doubtful debt occurred when the debtor pays back what has already been written off

In business when a debt has stayed so long and has been written off from the books of account via the profit and loss account and the balance sheet for the trading period.

However, it is possible to recover debts written off earlier, when this occur the bookkeeping procedure are as follows

Debit: debtors account

Credit: bad debt recovered account.

When cash is recovered from debtors

Credit: debtors account

### **Exercise**

1. Define bad debt
2. When a debt is recovered; state what happens to the debtors account in book keeping
3. Under profit and loss account; bad debt is treated as-----
4. Explain the meaning of provision for bad debt

## WEEK 4

### Topic: Depletion and Amortization

#### Content

- Meaning of depletion
- Meaning of Amortization

#### Meaning of depletion

In business there are tangible asset as well as intangible asset i.e asset that cannot be seen with physical eyes are referred to as intangible asset while tangible asset are asset that can be seen with physical eye.

Depletion is a periodic charge to expense for the use of natural resources. Thus, it is used in situations where a company has recorded an asset for such items as oil reserves, coal deposits, or gravel pits. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves.

#### Types of depletion

- **Percentage depletion** to figure percentage depletion, you multiply a certain percentage, specified for each mineral, by your gross income from the property during the tax year.
- **Cost depletion** Cost depletion is an accounting method by which costs of natural resources are allocated to depletion over the period that make up the life of the asset. Cost depletion is computed by (1) estimating the total quantity of mineral or other resources acquired and (2) assigning a proportionate amount of the total resource cost to the quantity extracted in the period.

### **Example of Cost Depletion:**

Producer X has capitalized costs on Property A of \$40,000, originally consisting of the lease bonus, capitalized exploration costs, and some capitalized carrying costs. The lease has been producing for several years and during this time, X has claimed \$10,000 of allowable depletion. In 2009, X's share of production sold was 40,000 barrels and an engineer's report indicated that 160,000 barrels could be recovered after December 31, 2009.

The calculation of cost depletion for this lease is as follows:

Again the formula Cost depletion =  $S/(R+S) \times AB$  or  $AB/(R+S) \times S$

$$\begin{aligned} CD &= 40,000/(40,000 + 160,000) \times (\$40,000 - \$10,000) \\ &= 40,000/200,000 \quad \times \$30,000 \\ &= \$6,000 \end{aligned}$$

### **Meaning of Amortization**

Amortization is the write-off of an asset over its expected period of use, which shifts the asset from the balance sheet to the income statement. It essentially reflects the consumption of an intangible asset over its useful life.

The amortization concept also applies to such items as the discount on notes receivable and deferred charges. The term is also used in lending, where an amortization schedule itemizes the beginning balance of a loan, less the interest and principal due for payment in each period, and the ending loan balance. The amortization schedule shows that a larger proportion of loan payments go toward paying off interest expense early

in the term of the loan, with this proportion declining over time as more and more of the loan's principal balance is paid off.

### **Accounting for Amortization**

The journal entry to record amortization for an intangible asset is:

	Debit	Credit
Amortization expense	xxx	
Accumulated amortization		xxx

Provision for discount on debtors is a charge made against profit in order to provide for an expected loss in the shape of discount that will be calculated on the net amount of debtors after you have deducted all other provisions for doubtful debt

Provisions for discount on creditors-is an addition to the p[profit to provide for those discount expected to be received on payment of the firms creditors ,this is called provision for discount on creditors

### **Accounting entries:**

Debit: profit and loss account

Credit: provision for discount allowed

Debit : provision for discount received account

Credit: profit and loss account

## ASSESSMENT

1. The main object of providing depreciation is:
  - (a) To calculate true profit.
  - (b) To show true financial position.
  - (c) To reduce tax.
  - (d) To provide funds for replacement.
2. Depreciation arises because of:
  - (a) Fall in the market value of an asst.
  - (b) Physical wear and tear.
  - (c) Fall in the value of money.
  - (d) None of them.
3. Depreciation is a process of:
  - (a) Valuation
  - (b) Allocation
  - (c) Both valuation and allocation
  - (d) None of them.
4. Under the straight line method of providing depreciation it:
  - (a) Increase every year.
  - (b) Remain constant every year.
  - (c) Decreases every year
  - (d) None of them.
5. The cost of a plant asset was increased for the payment of this year's insurance premium. This error would cause \_\_\_\_\_.
  - (a) the period's net income to be overstated
  - (b) the period's net income to be understated
  - (c) the period's end assets to be understated

## ANSWERS

1. a

2. b

3. a

4. b

5. b

## **WEEK 5**

### **Topic: Pre- payment and Accruals**

#### **Content**

- Definition of pre-payment
- Definition of accruals

#### **Definition of pre-payment**

prepayment represent amount in advance period for a subsequent period i.e expense can be paid in advance another word for it is payment in advance

It can be divided into expenses of prepaid income recovered in advance. examples of prepaid income are rent in advance, insurance premium.

#### **Definition of Accruals**

An *accrual* allows an entity to record expenses and revenues for which it expects to expend cash or receive cash, respectively, in a future reporting period. It is nearly impossible to generate financial statements without using accruals, unless the cash basis of accounting is used. In double-entry bookkeeping, the offset to an accrued expense is an accrued liability account, which appears in the balance sheet

#### **End of the year adjustment**

These are adjustment which are made in the profit and loss account and balance sheet, thus will ensure that the final accounts of an organization show the true view of their transaction, they are closing adjustment or amendment made in the book at the end of the accounting period in order

to match revenue with expenses. this will show an accurate picture of the accounts. they are shown as additional information after the trial balance.

### **Reasons for end of the year adjustment**

1. To provide for depreciation of fixed asset
2. End of the year adjustment occurs because it will help in the application of the double entry principle
3. This will ensure that all the income for the year recorded
4. Also the expenses for the year are recorded
5. To ensure that the financial statement are prepaid in accordance concept of accounting
6. To avoid for valuation of stock at the year ended.

### **Types of adjustment**

1. Closing stock-stock at close should be adjusted and deducted from the cost of goods available for sales. it must be adjusted because it has not be recorded in the trail balance.
2. Depreciation of asset-this is another end of the year adjustment the asset is depreciated to show the asset value. the value of depreciation is deducted from asset value and the value is posted to profit and loss account as expenses.
3. Drawing by the owner- trader will after take item from their business for personal use without payment. therefore goods withdrawn by the owners should be deducted from purchase and added to drawing.
4. Accrued and prepaid income-income can be accrued or prepaid, when it is so it has to be adjusted accordingly. Accrued income is added to

income and it is treated as an asset and prepaid income is deducted and it is treated as a liability.

5. Accrued and prepaid expenses –can also be paid in advance or owing, an accrued expenses is added to the expenses and it is a liability and on the other hand prepaid expenses are deducted and it is treated as an assets.
6. Bad debt and provision for doubtful debt and provision for discount on debtors–all these are also adjusted from the relevant account for bad debt, provision for doubtful debt and discount, necessary entries should made to write them off from profit and deduct them from debtors in the balance sheet.
7. Provision for discount on creditors–this is added to profit after the year end.it is known as provision for discount receivable.

## **ASSESSMENT**

1. Accrued expenses are considered as
  - (a) Assets
  - (b) Liabilities
  - (c) Gain
  - (d) Income
2. Prepaid expenses are regarded as
  - (a) Asset
  - (b) Liability
  - (c) Loss
  - (d) Capital

3. Which of the following is correct: Where accounting records are maintained on accrual basis:
- (a) Expenditure should be accounted for only to the extent they have been paid for
  - (b) Income and expenditure relating to the accounting period should be fully accounted for even if income is still to be received and expenditure is yet to be paid for.
  - (c) Income should be accounted on accruals basis and expenditure on payments basis
  - (d) Income should be accounted for only when received
4. An accrued expense amounting to £18,000 was overlooked when ascertaining the profit for the year. The effect of this error is that:
- (a) Net profit is not affected but liability is understated
  - (b) Net profit as well as liability are understated
  - (c) Net profit is overstated and liability understated
  - (d) Net profit as well as liability are overstated
5. Expenses relevant to the accounting period which remain unpaid by period end should be:
- (a) included in with expenses paid and shown as a liability at the period end
  - (b) ignored until they are paid for in the next period.
  - (c) deducted from amount already paid and shown as a liability at the period end
  - (d) included with expenses paid and shown as an asset at the period end

## ANSWERS

1. b

2. a

3. b

4. b

5. a

## **WEEK 6**

### **Topic: Control Account**

#### **Content**

- **Introduction to control account**
- **Uses of Control Account**
- **Classification of Control Account**

#### **Control Account**

A control account is a summary-level account in the general ledger. This account contains aggregated totals for transactions that are individually stored in subsidiary-level ledger accounts. Control accounts are most commonly used to summarize accounts receivable and accounts payable, since these areas contain a large volume of transactions, and so need to be separated into subsidiary ledgers

#### **Uses of control Account**

1. Control account are used to locate errors
2. Through control account fraud can be easily detected.
3. Management control is aided by the result of the speed at which information is obtainable
4. Internal check on ledger clerk
5. Easy detection of missing figure
6. Ascertainment of debtors and creditors balance
7. Preparation of interim final account
8. It saves time

9. It helps in the grouping of account

### Classification of control Account

1. Sales ledger control account
2. Purchase ledger control account

Sales ledger control account is also known as debtors debtors control account, it is the control account for sales debtors ledger this will represent all the entries posted in the sales ledger as if only one debtor existed

### Format of sales ledger control Account

Dr		Cr	
Balance b/f	x	cash received from	
debtors	x		
Sales on credit	x	cheque from	
customer	x		
Interest charge	x	discount	
allowed	x		
Dishonored bill	x	bills	
receivable	x		
Carriage			
outward	x	allowance	
	x		
Discount disallowed	x	bad	
debt	x		

Debit note issued	x	return
inward	x	
Payment to debtors for claim	x	credit note
issued	x	
Service charges	x	contra
setting	x	
Balance c/d	x	

Purchase ledger control account is also known as the total creditors control account, it is control account for purchases or creditors, this will represent all the entries posted to the ledger as if only one creditor existed

### FORMAT FOR CREDITORS CONTROL ACCOUNT

	Dr	Cr
Cheque to		
creditors	x	balance
b/f	x	
Cash to		
supplier	x	purchase on
credit	x	
Discount received		x
fund	x	cash
Bills payable		
discount	x	withdrawn
	x	
Credit note received		x

Return outward	x
Balance c/d	x

## **ASSESSMENT**

1. The information for preparing a Control account is obtained from:
  - (a) The General Journal
  - (b) The Cash Book
  - (c) The books of prime entry
  - (d) The Ledger
2. Which of the following will not appear in the Trade Receivables Control account:
  - (a) Bad debts written off
  - (b) Credit Sales
  - (c) Cash sales
  - (d) Amounts received from credit customer
3. Which of the following will not appear in the Purchase Ledger Control account:
  - (a) Discount allowed
  - (b) Amounts paid to trade creditors
  - (c) Returns outwards
  - (d) Credit purchases
4. The periodical totals of the Returns Inwards Day Book are:
  - (a) Credited to the Trade Receivables Control account
  - (b) Credited to the Trade Payables Control account
  - (c) Debited to the Trade Receivable Control account
  - (d) Debited to the Trade payables Control account

5. The periodical totals of the Discount Column on the receipt side of the Cash Book are:
- (a) Debited to the Trade Payables Control account
  - (b) Debited to the Trade Receivables Control account
  - (c) Credited to the Trade Receivables Control account
  - (d) Credited to the Trade Payables Control account

**ANSWERS**

- 1. c
- 2. c
- 3. a
- 4. a
- 5. c

## WEEK 7

### Topic: Manufacturing Account

#### Content

- **Meaning of Manufacturing Account**
- **Analysis of Cost**
- **Format of a Manufacturing Account**

The scope of activities of a manufacturing company is wider than that of a merchandising which is merely to sell products which are acquired in a form while a manufacturing firm produces and acquires raw materials, engages labour service and other inputs to ensure the material is changed into finished goods. Examples of such manufacturing concerns are textile industries.

#### **Analysis of cost**

**Cost:** The cost of an article is the amount of expenditure which has been incurred on the article, the three principal elements are;

- Material
- Labor
- Expense

Each of these is divisible into direct (prime cost) and indirect expenditure (factory overhead)

**Prime cost:** these are expenditures which are charged directly to a particular unit of output like direct labor, direct expenses and direct material.

1. Direct materials: these are the materials which can be traced directly to the production of a particular output, e.g tobacco for cigarette, flour for bread. they are actually things that will be part of the finish goods
2. Direct labor: these refers to cost of labor which are easily and directly traceable to the production of a product e.g wages of operators
3. Direct expense: these are those cost that do not relate to direct material or labor but are incurred specifically on a particular product and on every unit used e.g royalty, excise duty, franchise e.t.c

Non-manufacturing cost: these are cost which are treated as expenses and deducted from the revenue of the period in which they are incurred, they are not part of production cost, these includes;

1. Selling expenses: expenses include salaries and commission of salesman, advertising, sales office stationery
2. Distribution expenses: this covers the cost of warehouse, transport, material handling and control of finished goods from the moment they leave the factory to the moment they are delivered to the customer e.g carriage outwards, packing material, lighting of warehouse
3. Administration of expenses: this comprise of cost of accounting and secretarial work it includes office rent, rates, lighting, insurance, salaries e.t.c
4. Work-in-progress: work in progress consist of partly finished goods or work yet not completed the opening work in progress must be added to the cost of production while the closing stock of work in progress will be deducted.

## Manufacturing Account Format

Opening stock of raw materials	xxxx	
Add purchase of raw materials	xxxxx	
Add carriage inwards ( if any )	<u>Xxxx</u>	
	Xxxxx	
Less Returns outwards (of raw materials)	<u>xxxx</u>	
	Xxxxx	
Less Goods drawings ( if any )	<u>xxxx</u>	
	xxxxx	
Less Closing stock of raw materials	<u>xxxx</u>	
Cost of Direct Materials		xxxxxxx
Add Direct labour		xxxxxxx
Add Direct expenses (Eg: royalties)		<u>xxxxxxx</u>
<b>Prime Cost</b>		<b>xxxxxxx</b>
<u>Add Factory overhead expenses</u>		
Factory lighting	xxxxxx	
Factory heating	xxxxxx	
Factory insurance	xxxxxx	
Factory rent	xxxxxx	
Factory maintenance	xxxxxx	
Factory indirect wages	xxxxxx	

Factory supervisor's wages	xxxxxx	( + )
Depreciation on plant & machinery	xxxxxx	
Depreciation on factory building	xxxxxx	
Depreciation on factory furniture	xxxxxx	
Depreciation on factory motor van	xxxxxx	
Depreciation on other factory fixedassets	<u>xxxxxx</u>	<u>XXXXXXXX</u>
		XXXXXXXX
Add Opening stock of work in progress		xxxxxx
		XXXXXXXX
Less Closing stock of work in progress		xxxxxx
<b>Cost of production</b>		<b>XXXXXXXX</b>

In a manufacturing concern, usually there are three kinds of stocks:

*Stock of Raw materials* (the materials which are mainly used for production of the item)

*Stock of Work in progress* (the materials on which some work process have been completed)

*Stock of Finished goods* (The materials on which all the production processes are completed and ready for sale to the customers)

## **ASSESSMENT**

1. Direct material costs are added into direct manufacturing costs to calculate
  - (a) discuss costs
  - (b) prime costs
  - (c) resale cost
  - (d) merchandise costs
2. Terms used in manufacturing cost systems are
  - (a) manufacturing costs
  - (b) prime costs
  - (c) conversion costs
  - (d) both B and C
3. If total manufacturing cost is \$60000 and total units manufactured is 3000 units, then per unit cost will be
  - (a) \$40
  - (b) \$20
  - (c) \$60
  - (d) \$80
4. Cost computed by dividing total manufacturing cost and total manufactured units is known as
  - (a) per unit cost
  - (b) total cost

- (c) total indirect cost
- d) total effective cost

5. What is prime cost?

- (a) The total of all the direct costs and all of the manufacturing overhead
- (b) The total of all the direct materials costs and all of the direct labour costs
- (c) The total of all the direct material costs, all of the direct labour costs and all other direct expenses
- (d) The total cost of all the most important costs

## **ANSWERS**

- 1. b
- 2. d
- 3. b
- 4. a
- 5. c

## WEEK 8

### What are Accounting Errors?

#### INTRODUCTION

An **accounting errors are** errors that arise in the process of systematically recording, measuring and communicating information about financial transactions. Such accounting errors can include anything from discrepancies in naira figures to incorrect use of agreed accounting policy. It is important to stress that accounting errors are not the same thing as financial fraud; the latter being an intentional error in an accounting item usually to hide or alter data for personal gain.

Accounting errors can occur in double entry bookkeeping for a number of reasons. Accounting errors are not the same as fraud, errors happen unintentionally, whereas fraud is a deliberate and intentional attempt to falsify the bookkeeping entries. Also note that an accounting error can cause the trial balance not to balance, which is easier to spot, or the error can be such that the trial balance will still balance due to compensating bookkeeping entries, which is more difficult to identify.

Errors that affect the trial balance are usually a result of a one sided entry in the accounting records or an incorrect addition. As a temporary measure, to balance the trial balance. the difference in the trial balance is allocated to a suspense account, and a suspense account reconciliation is carried out at a later stage.

Some errors however do not affect the trial balance. Examples of the most common of them are listed below-

## Types of Accounting Errors

**Errors of Omission in Accounting:** Errors of omission in accounting occur when a bookkeeping entry has been completely omitted from the accounting records. If the payment 2,000 to a supplier has been omitted then the correcting entry would be as follows:

### Accounting Errors – Errors of Omission in Accounting Example

Account	Debit	Credit
Accounts payable	2,000	
Cash		2,000

**Error of Commission:** An accounting error of commission occurs when an item is entered to the correct type of account but the wrong account. For example is cash received of N3,000 from Customer A is credited to the account of Customer B the correcting entry would be.

### Accounting Errors – Error of Commission

Account	Debit	Credit
Accounts receivable – Cust. B	3,000	
Accounts receivable – Cust. A		3,000

**Compensating Error:** A compensating error occurs when two or more errors cancel each other out. For example, if the fixed assets account is incorrectly totalled and understated by N600, and the rent account is incorrectly totalled and overstated by 600, then the posting to correct the error would be as follows:

### Accounting Errors – Compensating Error

Account	Debit	Credit
Fixed assets	600	
Rent		600

**Error of Original Entry:** An error of original entry occurs when an incorrect amount is posted to the correct accounts. A particular example of an error of original entry is a transposition error where the numbers are not entered in the correct order. For example, if cash paid to a supplier of 2,140 was posted as 2,410 then the correcting entry of 270 would be. A good indicator for a transposition error is that the difference (in this case 270) is divisible by 9.

#### Accounting Errors – Error of Original Entry

Account	Debit	Credit
Cash	270	
Accounts payable		270

**Complete Reversal of Entries:** Complete reversal of entries errors occur when the correct amount is posted to the correct accounts but the debits and credits have been reversed. For example, if a cash sale is made for 400 and posted incorrectly as follows:

#### Accounting Errors – Incorrect posting

Account	Debit	Credit
Sales	400	
Cash		400

Then to correct the accounting error the original entry must be reversed and the correct entry made, this can be achieved by doubling the original amounts as follows:

#### Accounting Errors – Complete Reversal of Entries

Account	Debit	Credit
Sales		800
Cash	800	

The type of accounting errors that do not affect the trial balance are summarized in the table below.

### **ASSESSMENT**

1. \_\_\_ are errors that arise in the process of systematically recording, measuring and communicating information about financial transactions
  - (a) accounting errors
  - (b) programming errors
  - (c) computing errors
  - (d) mathematics errors
2. Types of accounting errors include the following except
  - (a) errors of omission
  - (b) errors of commission
  - (c) errors of original entry
  - (d) errors of imputing figures
3. Accounting errors are not the same thing as financial fraud
  - (a) true
  - (b) false

- (c) neither true nor false
  - (d) none of the above
4. Errors of \_\_\_\_\_ in accounting occur when a bookkeeping entry has been completely omitted from the accounting records
- (a) errors of omission
  - (b) errors of commission
  - (c) errors of original entry
  - (d) errors of imputing figures
5. A \_\_\_\_\_ error occurs when two or more errors cancel each other out
- (a) omission
  - (b) commission
  - (c) original entry
  - (d) compensating

## **ANSWERS**

- 1. a
- 2. d
- 3. a
- 4. a
- 5. d

## WEEK 9

### Correction of Errors with Journal Paper

#### INTRODUCTION

**Definition of Errors:** Errors can be define simply as mistakes made in the penetration of accounts. Errors can be categorized into two:

1. Errors that will affect the trial balance
2. Errors that do not affect the trial balance

Errors that do not affect the Agreement of the trial balance

Since the trial balance is a test of arithmetical accuracy of the ledger, then, as a matter of fact, it must balance i.e the debit side must be equal to the credit side . Some categories of errors occur, yet the trial balance will still be balance, the categories of errors are:

1. **Errors of omission:** This error occurs when transactions are completely omitted from the debit and credit side of the books.It is interesting to note that the error will not affect the balance of the trial balance. It is corrected by entering the omitted amount in the journal and posting in the ordinary way

Example: Payment of rent #60 cash has been omitted from the books

Correction

Journal	Dr	Cr
Rent	60	
Cash		60
<u>Correction of omission of rent</u>		

2. Error or Original Entry: This is a situation where a wrong amount is entered on the debit and credit sides. Since wrong amounts is entered

on the both sides, the trial balance will still be okay. The difference of the amount must be posted to the account

Example: Purchase of goods #301 from Ayo entered in the books are #103

Correction:

Journal		Dr	Cr
#	#		
Purchase		198	
Ayo			198

Correction of undercast of purchases

Note: the difference between the two figures (301- 103= 198) must be posted to the accounts

3. Errors of principle: Here wrong classes of accounts are involved . A real account item is entered in a nominal account or vice versa e.g motor van bought entered in motor expenses account

Example: Office furniture #50 purchased was entered in office expenses account.

Correction

Journal		Dr	Cr
#	#		
Office furniture		50	
Office expenses			50

Purchases of furniture entered in office expenses

now

corrected

**Errors of Commission:** This is a situation whereby an item of transaction is recorded in a wrong person's account, it will only affect the names of individuals and not the figure in the trial balance

Example : Sales of goods #30 to Olotu entered Otu's account

Correction

Journal		Dr	
	Cr		
#	#		
Olotu			30
Otu		30	

Sales entered in wrong account now corrected

**Compensating Errors:** The compensating error occurs when the dr and cr side may be overcast or undercast by the same amount

Example: Purchase is undercast by #350 so also is commission received by the same amount.

Correction

Journal		Dr	Cr
#	#		
Purchases		350	
Commission received			350

Correction of purchases and commission received undercast

**Error of complete reversal of Entry:** This is when an item is posted to the wrong side of the accounts. An account to be debited is credited and vice versa. In this type of error, the figure will be corrected by multiplying it by two. The amount must cancel the error and then come the actual entries.

Example: Receipt of cheque #1,000 from Okoye's was debited to Okoye's account and credited to bank account.

Correction

Journal	Dr
<u>Cr</u>	
#	#
Okoye	
2,000	
Bank	2,000
<u>Correction of complete reversal of entry</u>	

### Procedures to correction of errors

Where there are errors in the account, the following must be followed closely-

1. The student must be able to identify the type of error
- b. The two accounts involved must be identified
  1. Familiarity with whether an account has debit or credit balance; which means
    - All assets account must have debit balance
    - All liabilities account must have credit balance

- All income account must have credit balance
- All expenses account must have debit balance
- Sales accounts must have credit balance
- Purchases account must have debit balance
- Interpret the errors in the ledgers
- Lastly, correct the ledgers first before posting to the journal

## **ASSESSMENT**

1. Which of the following statements is incorrect:  
In the double entry accounting system maintained manually, a journal entry
  - (a) should be substantiated by appropriate voucher and authorized at proper level
  - (b) is needed only in the absence of other suitable book of prime entry for the transaction
  - (c) should always consist of a single debit entry matched by a corresponding credit entry
  - (d) should always end with a narration explaining the need for it
2. The journal entry to account for the acquisition on credit of factory machinery from Millet plc should require which of the following:
  - (a) Debit Factory account and credit Millet plc account
  - (b) Debit Millet plc account and credit Machinery account
  - (c) Debit Machinery account and credit Millet plc account
  - (c) Debit Machinery account and credit Cash account

3. Funke commenced business introducing as his capital furniture worth £21,000, a car valued at £30,000 and £48,000 in cash. The journal entry for recording this would require:
- (a) No journal entries
  - (b) Debit in the two asset accounts other than cash and a credit in the Capital Account
  - (c) Debit in the cash Account and credit in the Capital Account
  - (d) Debit in the three asset accounts, including cash and a credit in the Capital Account
4. The prime entry for the acquisition of a cash book, ledgers and a journal for £240 from W.Smith Ltd, on credit would be in the:
- (a) None of the above
  - (b) Purchases Day Book
  - (c) Cash Book
  - (d) Journal
5. If an amount paid for servicing vehicles has been posted in error to Motor Vehicles account the journal entry necessary to correct this error should require which of the following:
- (a) Debit Vehicle maintenance account and credit Motor Vehicles account
  - (b) Debit Cash account and credit Motor vehicles account
  - (c) Debit Vehicle maintenance account and credit Cash account
  - (d) Debit Motor vehicles account and credit Vehicle maintenance account

## ANSWERS

1. c

2. c

3. b

4. d

5. a

## WEEK 10

### What is Control Account?

#### INTRODUCTION

A *Control Account* is a summary-level account in the general ledger. The control account contains aggregated totals for transactions that are individually stored in subsidiary-level ledger accounts. Control accounts are most commonly used for accounts receivable and accounts payable, since these areas contain a large volume of transactions, and so need to be separated into subsidiary ledgers, rather than cluttering up the general ledger with too much detailed information. The balance in a control account should match the total for the related subsidiary ledger. If the balance does not match, it is possible that a journal entry was made to the control account that was not also made in the subsidiary ledger.

Please note that the typical level of activity in a control account is on a daily basis. For example, all payables entered during one day will be aggregated from the subsidiary ledger and posted as a single summary-level number into the accounts payable control account. Posting into all control accounts must be completed before the books can be closed for a reporting period; otherwise, transactions may be stranded in a subsidiary ledger.

If anyone wants to see detailed transactional information for accounts payable, they can review the detail located in the subsidiary ledger, since it is not located in the general ledger.

Control accounts are most commonly used by large organizations, since their transaction volume is very high. A small organization can typically

store all of its transactions in the general ledger, and so does not need a subsidiary ledger that is linked to a control account.

### **Balancing the Ledger Accounts**

The account must be balanced off before extracting the trial balance at regular intervals during the financial year. In other words, it is a matter of necessity to balance each account in order to ascertain the overall position recorded in the book-keeping system.

### **Procedure for Balancing the Ledger Account**

1. In order to balance the an account it will be necessary to:
2. Add all items on the debit side
3. Add all items on the credit side.
4. Compare both side.
5. “debit balance” is an excess of debit items over credit items.
- 6.
7. “credit balance “ is an excess of credit items over debit items.

### **Reasons for Account Control**

**1. To Ensure Accuracy:** Account control serves as a means to checking on the accuracy of entries made in the personal accounts in the sales ledger and purchase ledger. It is very easy to make a mistake in posting entries, because there might be hundreds of entries to make. Figures might get transposed. Some entries might be omitted altogether, so that an invoice or a payment transaction does not appear in a personal account as it should.

**2. Location of Errors:** It could also assist in the location of errors, where posting to the control accounts are made daily or weekly, or even monthly. If a clerk fails to record an invoice or a payment in a personal account, or makes a transaction error, it would be a formidable task to locate the error or errors at the end of a year, say, given the hundreds or thousands of transactions during the year. By using the control account, a comparison with the individual balances in the sales or purchase ledger can be made for every week or day of the month, and the error found much more quickly than if accounts did not exist.

**3. For Internal Checks:** Where there is a separate of clerical bookkeeping duties, the control account provides an internal check. The person posting entries to the accounts will act as check on a different person whose job it is to post entries to the sales and purchase ledger accounts.

**4. More simply and quickly:** To provide debtors and creditors balances more quickly for producing a trial balance or balance sheet. A single balance on a control account is obviously expected simpler and quickly than many individual balances in the sales or purchase ledger. This means also that the number of accounts in the double entry bookkeeping system can be kept down to a manageable size, since the personal accounts are memorandum accounts only and the control accounts instead provide the accounts required for a double entry system.

### **The Limitations of Control Account**

1. Control accounts may themselves contain errors.

2. Control accounts do not guarantee the accuracy of individual ledger accounts, which may contain compensating errors, for example items posted to the wrong accounts.

### **The Sales Ledger Control Account**

The *Sales Ledger Control Account* is part of the balance sheet and shows at any given time how much your customers owe you and your company. All the individual transactions posted to the customer ledger cards, invoices, credit notes and receipts are reflected in this account.

### **ASSESSMENT**

1. Which of the following is another term for debtor control account?
  - (a) Sales account
  - (b) Receivable account
  - (c) Creditor control account
  - (d) Sales ledger control account
2. Control accounts are most commonly used for which of the following purposes?
  - (a) Preparing cash flow statement
  - (b) Making entries in other accounts
  - (c) Accumulating the total balances of related accounts
  - (d) Detecting errors in accounting records
3. Bad debts written off during a period of accounting are entered in which side of a control account?
  - (a) Debit side of creditor control a/c
  - (b) Credit side of creditor control a/c

- (c) Debit side of debtor control a/c
  - (d) Credit side of debtor control a/c
4. Which of the following accounts is used to record the cash sales
- (a) Sales account
  - (b) Sales ledger control account
  - (c) Debtor control account
  - (d) Revised debtor control account
5. An account receivable was charged with the interest of \$500, but no entry was made in the debtor control account. What would be the adjustment in the debtor control account?
- (a) \$500 will be credited in the debtor control a/c
  - (b) \$500 will be debited in the debtor control a/c
  - (c) \$1000 will be credited in the debtor control a/c
  - (d) \$1000 will be debited in the debtor control a/c

## **ANSWERS**

- 1. d
- 2. d
- 3. d
- 4. a
- 5. b

## WEEK 11

### What is Purchase Ledger Control Account?

Purchase Ledger Control Account is an account in the nominal ledger to which the totals of the entries in the purchase day book are posted at regular intervals. With this procedure the balance on the purchase ledger control account should, at any time, equal the aggregate of the balances on all the individual accounts in the ledger. The balance also represents the total of trade creditors.

In other words, it is a system in accountancy by which a business records and monitors its creditors. The purchase ledger contains the individual accounts of suppliers from whom the business has made purchases on credit. Information on invoices and credit notes received, and payments made, are recorded in the supplier's account using the debits and credits system, with the balance of each account at a given moment representing the amount currently owed to that supplier.

It can also be defined as part of the balance sheet and shows at any given time how much you owe to your suppliers. All the individual transactions posted to your supplier **ledger** cards so invoices, credit notes and payments are reflected in this **account**.

## **Purpose of the Purchase Ledger Control Account**

1. The purchase Ledger will enable accountants to set up a basic record-keeping system
2. It records all purchases made by your business.
3. It helps you to monitor:
  - your business' outgoings
  - how much money you owe (creditors) at any one time
4. In addition, it gives you a record of your most regular suppliers and how much you have spent with each.

## **ASSESSMENT**

1. A business sells goods to a customer value £3,240 plus VAT at 20%.  
How much will the customer pay for the goods including VAT?
  - (a) £3,567
  - (b) £3,240
  - (c) £3,888
  - (d) £3,800
2. A business sells goods to a customer totaling £780 including VAT.  
How much has the business charged for VAT assuming a rate of 20%?
  - (a) £780
  - (b) £130
  - (c) £650
  - (d) None of the above
3. A business sells goods to a customer and issues an invoice showing goods with a list price of £27,000. The invoice was subject to a trade

discount of 15% and a cash discount of 2.5%. VAT is charged at 20%.  
How much VAT should be shown on the invoice.

- (a) £4,590.00
- (b) £4,745.25
- (c) £4,475.25
- (d) £5,400.00

4. An invoice is:

- (a) Is for the sellers use only
- (b) Sent by the seller to the purchaser
- (c) Sent by the buyer to the seller
- (d) Sent only when goods are sold for cash

5. A remittance advice is:

- (i) A document sent by the bank to the seller :
  - (ii) Shows details of goods purchased:
  - (iii) Accompanies payments by cheque :
  - (iv) Is used to provide details of payments via BACS
- (a) (ii) and (iv)
  - (b) (i) and (ii)
  - (c) (i) and (iv)
  - (d) (iii) and (iv)

## **ANSWERS**

- 1. c
- 2. b
- 3. c
- 4. b

5. d

## WEEK 12

### MANUFACTURE ACCOUNT

#### Introduction

The scope of activities of a manufacturing company is wider than that of a merchandising which is merely to sell products which are acquired in a form while a manufacturing firm produces and acquires raw materials, engages labour service and other inputs to ensure the material is changed into finished goods. Examples of such manufacturing concerns are textile industries.

#### **What then is Manufacturing Account?**

Manufacturing Account is a statement used in the accounting process of a manufacturing organization. This financial statement does not show profit and loss figures but rather the cost of direct materials and labor. A manufacturing account also includes production overhead.

#### **Reasons for Manufacturing Account**

The businesses which produce and sell the items prepare the following accounts at the end of its accounting year:-

1. The Manufacturing account (to calculate the total cost of production)
2. The Trading and profit & loss account (to find out the net profit or loss)
3. The balance sheet (to show the financial position of the business)

For manufacturing organizations, manufacturing accounts will be needed in addition to trading and profit and loss accounts. This will be for

internal purposes/ use in the company. In place of purchases we will instead have the cost of manufacturing the goods.

For a manufacturing business the manufacturing costs are divided into the following types:

1. **i) Direct material costs**

Direct material costs are those materials used directly in the manufacture of products i.e. materials that can be identified in the final products. E.g. in the manufacture of tables, direct materials consists of timber, nails, glue etc.

1. **ii) Direct labor costs**

These are wages paid to those who are directly involved in the manufacture of a product e.g. in the manufacture of tables; direct labor consists of wage paid to those workers who saw, shape of join the piece of timber into table.

**iii) Direct expenses**

These are expenses that must be incurred in the manufacture of a product. That is, they can be directly allocated a particular unit of a product e.g. live charges for a special equipment used in the process of manufacture, royalties

NB: The sum of all the direct costs is known as **prime costs**

1. **iv) Indirect manufacturing costs / factory overheads**

These are any other expenses (apart from the direct costs) for items being manufactured:

E.g. cleaners' wages, factory rents, depreciation of plant and equipment, factory power and lighting

**NB: prime cost + indirect manufacturing costs = PRODUCTION COSTS**

**Manufacturing Account Format**

Opening stock of raw materials	xxxx	
Add purchase of raw materials	xxxxx	
Add carriage inwards ( if any )	<u>Xxxx</u>	
	Xxxxx	
Less Returns outwards (of raw materials)	<u>xxxx</u>	
	Xxxxx	
Less Goods drawings ( if any )	<u>xxxx</u>	
	xxxxx	
Less Closing stock of raw materials	<u>xxxx</u>	
Cost of Direct Materials		xxxxxxx
Add Direct labour		xxxxxxx
Add Direct expenses (Eg: royalties)		<u>xxxxxxx</u>
Prime Cost		xxxxxxx
<b><u>Add Factory overhead expenses</u></b>		
Factory lighting	xxxxxx	
Factory heating	xxxxxx	
Factory insurance	xxxxxx	
Factory rent	xxxxxx	
Factory maintenance	xxxxxx	
Factory indirect wages	xxxxxx	
Factory supervisor's wages	xxxxxx	( + )

Depreciation on plant & machinery	xxxxxx	
Depreciation on factory building	xxxxxx	
Depreciation on factory furniture	xxxxxx	
Depreciation on factory motor van	xxxxxx	
Depreciation on other factory fixed assets	<u>xxxxxx</u>	<u>XXXXXXXX</u>
		XXXXXXXX
<b>Add Opening stock of work in progress</b>		xxxxxx
		XXXXXXXX
<b>Less Closing stock of work in progress</b>		xxxxxx
<b>Cost of production</b>		XXXXXXXX

In a manufacturing concern, usually there are three kinds of stocks:

*Stock of Raw materials* (the materials which are mainly used for production of the item)

*Stock of Work in progress* (the materials on which some work process have been completed)

*Stock of Finished goods* (The materials on which all the production processes are completed and ready for sale to the customers)

## ASSESSMENT

1. Direct material costs are added into direct manufacturing costs to calculate
  - (a) discuss costs
  - (b) prime costs
  - (c) resale cost
  - (d) merchandise costs

2. Terms used in manufacturing cost systems are
  - (a) manufacturing costs
  - (b) prime costs
  - (c) conversion costs
  - (d) both B and C
3. If total manufacturing cost is \$60000 and total units manufactured is 3000 units, then per unit cost will be
  - (a) \$40
  - (b) \$20
  - (c) \$60
  - (d) \$80
4. Cost computed by dividing total manufacturing cost and total manufactured units is known as
  - (a) per unit cost
  - (b) total cost
  - (c) total indirect cost
  - d) total effective cost
5. What is prime cost?
  - (a) The total of all the direct costs and all of the manufacturing overhead
  - (b) The total of all the direct materials costs and all of the direct labour costs
  - (c) The total of all the direct material costs, all of the direct labour costs and all other direct expenses
  - (d) The total cost of all the most important costs

## ANSWERS

1. b

2. d

3. b

4. a

5. c

## WEEK 13

### The Manufacturing Cost

#### INTRODUCTION

If a firm actually produces the goods that they sell, then there will be no obvious 'purchases' figure to include in the trading account. The costs incurred in the production of goods will appear instead and these will be calculated in a manufacturing account. A manufacturing account therefore shows the cost of producing the goods that are sold during an accounting period. It is split into the following sections:

- **Prime cost** – Direct costs of physically making the products (e.g. raw materials)
- **Overhead cost** – Other indirect costs associated with production but not in a direct manner

The cost of manufacturing the products will be the total of the prime cost and the overhead cost added together. This total factory cost (or production cost) will then be transferred to the trading account where it will appear instead of the 'normal' purchases figure.

#### Prime Cost

The prime cost covers all the costs involved in physically making the products and other costs that are directly related to the level of output. These are usually known as direct costs and common examples would include:

1. Direct materials
2. Direct labour/wages
3. Other direct costs (e.g. packaging, royalties)

## Cost of Raw Materials Consumed

Within the prime cost adjustments will have to be made for opening and closing stocks of raw materials. There may also be carriage inwards charged on the raw materials and returns outwards of materials sent back to their original supplier. The overall charge for materials is referred to as cost of raw materials consumed, this should be highlighted when drawing up a manufacturing account and it is calculated as follows:

–	<b>Opening stock of raw materials</b>
–	<b>Purchases of raw materials</b>
<b>Add</b>	
<b>Carriage inwards on raw materials</b>	<b>Less</b>
<b>Returns outwards of raw materials</b>	
<b>Less</b>	<b>Closing stock of raw materials</b>
<b>Equals</b>	<b>Cost of raw materials consumed</b>

A true direct cost will vary directly with the level of output. If the output level doubles, then we would expect a direct cost to also double. If the cost does not behave in this manner then it may be an indirect cost and not a direct cost.

## **Royalties**

Royalties is sometimes included within the prime cost. These are a cost that is paid to the owner of a copyrighted process. Usually a fee is paid for each product that uses this process and therefore the total royalty cost will be directly proportional to the level of output.

Follow the link below to see an example of a prime cost calculation.

## **Overhead Cost**

This section includes all other expenses concerned with the production of output but not in a direct manner. This means that if the level of production increased, then these expenses may also increase but not by the same proportion. These are sometimes known as indirect costs, factory overheads or indirect manufacturing costs. Common examples of overhead costs would include:

1. Factory rent
2. Indirect labour
3. Depreciation of factory plant and equipment

Depreciation of fixed assets should be included in this section only if it is depreciation on assets included for production. For example, depreciation of machinery would appear as an overhead cost but depreciation of office equipment would appear in the profit and loss account as an expense as would be expected in a non-manufacturing organisation.

Once the overhead costs have been calculated they will need adding to the total of the prime cost. This will give us the production cost of the goods. However, the production cost will need adjusting for goods which are not yet finished.

**Make sure you add the total for factory overheads to the prime cost and don't subtract!**

### **Allocation of Expenses**

Some expenses may be split between two areas of the financial statements. For example, an expense may be split between the prime cost and the overhead costs. Similarly, expenses may be split between the manufacturing account and the profit and loss account. The term office expense is often used to illustrate an expense that will be allocated to the profit and loss account.

If there are prepayments or accruals to adjust for then this should be completed before any split between the sections of the financial statements.

### **Work-in-Progress**

Goods which are not finished are known as work-in-progress. The opening balance of work-in-progress is added on to the production cost and the work-in-progress left at the end of the year will need subtracting to give us the cost of the goods completed during the period we are dealing with.

### **Stocks in Manufacturing Organizations**

There are three types of stock that we deal with in manufacturing accounts. These are as follows:

1. Raw materials – the purchases of these will be adjusted for opening stock and closing stock in the prime cost.

2. Work-in-progress – partly completed goods will be dealt with at the end of the manufacturing account.
3. Finished goods – opening and closing stocks will be dealt with, as is normal, in the trading account

All three types of closing stocks will appear as current assets on the balance sheet.

### **Factory Profits and Unrealized Profit**

One of the main reasons why firms manufacture their own goods, rather than purchasing them from another firm, is that the goods can be manufactured at a lower cost than the purchase price from elsewhere. The difference between the cost of manufacture and the cost of 'bought in' goods is known as factory profit, or profit on manufacturing. Any factory profit will boost the overall profits for the firm but is kept separate from the gross profit until the net profit has been calculated, when they would be added together. Any factory loss incurred should also be kept separate until the net profit is calculated. By keeping the profits separate, this allows the managers of a firm to see how profit had been earned – did it arise out of efficiency in manufacturing, or other areas of the firm?

It is hard to estimate how much a firm would 'save' by manufacturing its own products rather than purchasing them from elsewhere. As a result, factory profit is usually calculated by simply adding on an additional percentage of the production cost to give us the 'transfer price' which will replace the purchases figure in the trading account. This procedure is known as marking-up the production cost.

However, if we mark-up the production cost then the value for the cost of goods sold in the trading account will be higher. This means that the final gross and net profits for the firm would be lower. To cancel out this effect, the factory profit is added on again at the end of the profit and loss account. This time it is added on to the net profit.

<b>Account</b>	<b>Action</b>
<b>Manufacturing</b>	<b>Add factory profit to cost of production</b>
	<b>Deduct factory loss from cost of production</b>
<b>Profit &amp; loss</b>	<b>Add factory profit to net profit</b>
	<b>Deduct factory loss from net profit</b>

### **Example 1**

The following data has been extracted from the books of D Scaife Ltd. At 31 December 2001:

	<b>Dr</b>	<b>Cr</b>
	<b>Naira</b>	<b>Naira</b>
<b>Stocks at 1 January 2001:</b>		
<b>Raw materials</b>		<b>12,500</b>
<b>Work in progress</b>		<b>7,650</b>
<b>Finished goods</b>		<b>18,900</b>
<b>Purchases of raw materials</b>	<b>89,000</b>	
<b>Sales</b>		<b>215,000</b>

<b>Direct labour</b>	<b>32,000</b>	
<b>Rent and rates</b>	<b>18,000</b>	
<b>Electricity</b>	<b>8,000</b>	
<b>Office salaries</b>	<b>43,000</b>	
<b>Depreciation for the year:</b>		
<b>Factory</b>		<b>7,000</b>
<b>Office</b>		<b>3,000</b>

### **Additional Information**

1. Stocks at 31.12.01:

	<b>Naira</b>
<b>Raw materials</b>	<b>11,250</b>
<b>Work in progress</b>	<b>8,420</b>
<b>Finished goods</b>	<b>21,530</b>

2. Rent, rates and electricity are to be apportioned: Factory 75%, Office 25%

3. Finished goods are to be transferred to the trading account at a profit of 20% on factory cost.

### **Unrealized Manufacturing Profit from Unsold Stock**

If we allow for factory profit then this will mean that the value of any closing stock would actually include an amount of factory profit in its valuation. The prudence concept disallows any anticipation of future

profits – how can we say that the value of stock includes profits when we have yet to sell the stock? – and therefore we would need to deduct this profit by making a provision for any profits on unsold stock.

This provision for unrealised profit on unsold stock should be treated in the same way as any other provision. This means that the change in the provision should appear in the profit and loss account as a debit (if it is increased) or as a credit (if it is decreased) which means this would be added on to the gross profit.

<b>Increasing the provision</b>	<b>Increasing the provision</b>
<b>Debit Profit &amp; loss with the increase</b>	<b>Credit Provision account with the increase</b>
<b>Decreasing the provision</b>	<b>Decreasing the provision</b>
<b>Debit Provision account with the decrease</b>	<b>Credit Profit &amp; loss with the decrease</b>

### **Balance Sheet**

Once the factory profit on the closing stock has been calculated then the adjustment would have to be made on the balance sheet. In our previous example, the stock would appear as follows:

<b>Current assets</b>	<b>Naira</b>	<b>Naira</b>
<b>Stock</b>	<b>30000</b>	
<b>Less provision for unrealised profit</b>	<b>6000</b>	<b>24000</b>

### Example 3

The following balances have been extracted from the books of Bohanna Company Ltd as at 30 June 2003.

<b>Stocks at 1 July 2002:</b>	<b>Naira</b>
<b>Raw materials</b>	<b>6,500</b>
<b>Work in progress</b>	<b>7,900</b>
<b>Finished goods</b>	<b>18,430</b>
<b>Factory wages:</b>	<b>–</b>
<b>Direct</b>	<b>143,000</b>
<b>Indirect</b>	<b>54,600</b>
<b>Royalties</b>	<b>1,290</b>
<b>Electricity and power</b>	<b>13,000</b>
<b>General factory expenses</b>	<b>27,000</b>
<b>Maintenance expenses</b>	<b>17,540</b>
<b>General office expenses</b>	<b>28,950</b>
<b>Purchases of raw materials</b>	<b>124,000</b>
<b>Sales</b>	<b>565,000</b>
<b>Depreciation of plant and machinery</b>	<b>9,000</b>
<b>Provision for unrealised profit</b>	<b>4,500</b>

## Additional Information

1. At 30 June 2003 stocks were as follows:

–	<b>Naira</b>
<b>Raw materials</b>	<b>4,980</b>
<b>Work in progress</b>	<b>6,950</b>
<b>Finished goods</b>	<b>21,500</b>

2. Electricity and power and Maintenance expenses are to be apportioned 80% to the factory and 20% to the company's offices.
3. At 30 June 2003 an electricity bill of £800 remained unpaid and maintenance costs paid in advance amounted to N760.
4. The company always transfers finished goods from the factory to the warehouse at factory cost plus 25%.

## ASSESSMENT

1. The total of all direct costs of production is also known as:
  - (a) Production costs
  - (b) Total cost
  - (c) Variable cost
  - (d) Prime cost
2. If a firm experiences an under absorption of overheads then the closing stock should be adjusted in which way?
  - (a) A provision equivalent to amount should be deducted from value
  - (b) Shortfall should be subtracted from closing stock value
  - (c) No adjustment should be made
  - (d) Shortfall should be added to closing stock value

3. The best way of allocating fixed overheads between products is:
  - (a) There is no 'best' way of allocating overheads
  - (b) As a proportion of direct cost incurred by each product
  - (c) Based on number people involved in production of each product
  - (d) Equally between different products
4. Raw materials which are incorporated into goods sold but are not easily identifiable to the goods being made would be known as:
  - (a) Indirect overheads
  - (b) Direct overheads
  - (c) Work in progress
  - (d) Direct materials
5. Wages for staff maintaining machines in factory would be classed as:
  - (a) Direct labour
  - (b) Direct materials
  - (c) Factory indirect expenses
  - (d) Administration expenses

## **ANSWERS**

1. d
2. c
3. a
4. a
5. c

## WEEK 14

### Overview of Partnership Accounting

#### INTRODUCTION

The accounting for a partnership is essentially the same as is used for a sole proprietorship, except that there are more owners. In essence, a separate account tracks each partner's investment, distributions, and share of gains and losses.

A partnership is a type of business organizational structure where the owners have unlimited personal liability for the business. The owners share in the profits (and losses) generated by the business. There may also be limited partners in the business, who do not engage in day-to-day decision making, and whose losses are limited to the amount of their investments in it; in this case, a general partner runs the business on a day-to-day basis.

#### **Accounting for a Partnership**

There are several distinct transactions associated with a partnership that are not found in other types of business organization. These transactions are:

- *Contribution of funds.* When a partner invests funds in a partnership, the transaction involves a debit to the cash account and a credit to a separate capital account. A capital account records the balance of the investments from and distributions to a partner. To avoid the commingling of information, it is customary to have a separate capital account for each partner.

- *Contribution of other than funds.* When a partner invests some other asset in a partnership, the transaction involves a debit to whatever asset account most closely reflects the nature of the contribution, and a credit to the partner's capital account. The valuation assigned to this transaction is the market value of the contributed asset.
- *Withdrawal of funds.* When a partner extracts funds from a business, it involves a credit to the cash account and a debit to the partner's capital account.
- *Withdrawal of assets.* When a partner extracts assets other than cash from a business, it involves a credit to the account in which the asset was recorded, and a debit to the partner's capital account.
- *Allocation of profit or loss.* When a partnership closes its books for an accounting period, the net profit or loss for the period is summarized in a temporary equity account called the income summary. This profit or loss is then allocated to the capital accounts of each partner based on their proportional ownership interests in the business. For example, if there is a profit in the income summary account, then the allocation is a debit to the income summary account and a credit to each capital account. Conversely, if there is a loss in the income summary account, then the allocation is a credit to the income summary account and a debit to each capital account.
- *Tax reporting.* In the United States, a partnership must issue a Schedule K-1 to each of its partners at the end of its tax year. This schedule contains the amount of profit or loss allocated to each partner, and which the partners use in their reporting of personal income earned.

## **Types of Partnership**

1. **Limited partnership:** This is registered and formed under the limited partnership act, it is a form of partnership which there should be at least one ordinary partner who should be responsible for the business if it fails.

Limited partnership is a form of partnership similar to a general partnership, except that where a general partnership must have at least two general partners , a limited partnership must have at least one general partner and at least one limited partner.

## **Features of Limited Partnership**

1. The liability of each partner is limited to the amount invested by each partner
2. It should be registered under limited partnership
3. One ordinary partner should be responsible for the debt of the partnership firm.
4. A limited partner is not permitted to participate in the management of the firm.
5. The limited partners can have access to the account of the partners.

**2. Ordinary partnership:** under this type of partnership all partners have equal responsibilities and power each may participate in the management of the business. They are equally responsible for the partnership liability which is unlimited to all the partners take active part of the day to day running of the business and are liable or responsible for the firm liability.

## Features of Ordinary Partnership

1. They are liable to the full excess of the debt of firm private properties
2. Partners can be sue for the firm liabilities
3. All partners have equal right in decision making
4. Each partner take active part in the management of the firm
5. Every partner are agent of the firm every action of the partner in course of the business is binding on all the partners

## Types of Partners

1. **Active partner**—this is a partner who participate actively in the daily activities of the firm, he will be remunerated acting taken is binding on all the partners.
2. **General partners**—this is a partner who is limited to the share in the administration and management of the firm.
3. **Limited partners**— this is a partner who have contribute to the firm but cannot take active part in the daily running of the firm, the liability of a limited partner is limited to the amount contributed to the business and it will extend to his personal properties.
4. **Dominant (sleeping partner)**—this is a partner who contribute financially to the firm but does not take active part in the administration and management of the firm.
5. **Nominal partners(quasi)**— a nominal partner allow is name to be used by the firm for prestige and reputation purpose, he does not contribute financially nor take active part in the administration and management of the firm.

# **SECOND TERM NOTES ON FINANCIAL ACCOUNTING**

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## WEEK 1

### What is a Partnership Account?

#### INTRODUCTION

A Partnership Account is an account at a brokerage which is typically held by two or more people in which each person is equally liable. The account holders may or may not have a written agreement on the rights and obligations each one has in the partnership account. This is therefore similar to a joint account, but is used mainly for business partnerships rather than for married couples who are investing.

A partnership organisation maintains accounts of its transactions in the same manner as a Sole Trader ship. Since partnership has two or more partners, separate capital account for each partner has to be maintained. Usually every partner contributes something in cash or in kind to provide funds for the running of a business. The amount of contribution is mutually settled and need not necessarily be equal. The sum of the contributions represents the capital of the firm. The partnership deed usually mentions the method of maintaining capital accounts of partners. There are two methods by which capital accounts are maintained i.e., Fixed Capital and Fluctuating Capital.

Meanwhile, a *Partnership* is a form of business organisation in which two individuals combine to own and run a business for the purpose of making profit. It is a form of business in which 2 to 20 people come together, combine resources, contribute their skills, talent etc to run a business with the aim of making profit.

## **Admission of New Partners**

When a new partner joins a partnership the old partnership is dissolved and a new partnership is formed. Accounting for admission of new partner depends on the nature of arrangement between the existing partners and the new partner. Such an arrangement can take any of the following forms:

1. The new partner brings in new assets
2. The new partner purchases interest in partnership from existing partners at book value
3. The new partner pays a bonus for the partnership's goodwill; and
4. The new partner receives a bonus for the partnership's negative goodwill.

Accounting in each of the situation is discussed separately below:

New partner brings additional assets

When the new partner brings in new assets, the assets are debited at the value agreed by the partners for the purpose and the partner's capital account is credited for the total value of those assets.

Example 1

Pluto and Sedna were partners in Kuiper Space Consulting. Their respective capital balance was \$45 million and \$25 million. In 2005 they agreed to admit Eris who agreed to contribute a very specialized telescope worth \$20 million.

The admission through introduction of new assets is recorded by the following

**journal entry:**

<b>Telescope</b>	<b>20,000,000</b>	
<b>Eris Capital Account</b>		<b>20,000,000</b>

The new partner purchases his share from existing partners at book value.

New partner purchases interest in partnership from existing partners at book value

When the new partner purchases interest from existing partners at book value, the transaction is recorded by crediting the capital account of the new partner and debiting the capital account of existing partner(s). The transaction is reported in the books for the partnership at the book value of the share transferred and it has nothing to do with the price which the new partner has paid to the existing partner(s).

**Understanding the Meaning of Goodwill Account**

Goodwill can be defined as an asset, but it cannot be seen or touched, hence it is referred to as an intangible asset. Lord Elton in 1890 opined that goodwill is the probability that the customers will continue to patronize old business even when there is a change of ownership. In the light of this therefore, a goodwill account can be defined as the excess of the purchases considerations over the total value of assets less liabilities. It arises as a result of connection, reputation, and efficiency of a business. It is not a tangible asset and cannot be realized until the business is sold.

## **Reasons for Goodwill**

The following are the reason for goodwill-

- For patent and copy right protection
- The location of a business premises may also induce the purchaser to pay for goodwill.
- Managerial skill: The effectiveness and efficiency of the management of a company can give them the necessary reputation,
- Quality of goods: The quality, durability of the products of a company can bestow good name on it.
- Possession of partial monopoly: when a company is not faced with much competition in the market , then
- it can become a monopolist.

## **Goodwill Valuation**

There is no actual method of valuing goodwill, but the following methods can be used-

1. Number of year
2. Super profit
3. Number of times of the gross annual fee income
4. Excess of value of a business over the realizable value.

## **Characteristics of Goodwill**

1. the value is subjective
2. It cannot be sold separately apart from other assets of the business
3. It may fluctuate from day to day

## **Changes in Partnership**

Changes can occur in partnership when:

1. A partner retires or dies
2. Partnership is dissolved
3. There is a change in the profit or loss sharing ratio
4. A new partner is admitted

## **Valuation of Assets**

This is the process of assessing the value of a company, real property or any other item of worth, in particular assets that produce cash flows.

Valuation of Assets is commonly performed prior to the purchase or sale of an asset or prior to purchasing insurance for an **asset**.

## **Treatment of Goodwill According to Profit Sharing Ratio**

Depending upon the share of profits to be given to the new partner, either a sum of money will be directly paid by him to the old partners (through the firm or privately) or after recording new partner's capital, new partner's capital account will be debited with his share of goodwill, the credit being given to the old partners in the ratio of their sacrifice of future profits. The latter is an indirect method of payment for goodwill by the new partner. The payment is justified because the new partner will take a share of profits which comes out of the shares of other partners. The old partners must be compensated for such a loss.

## ASSESSMENT

1. What is the minimum number of partners required to commence a partnership business?
  - A) 20
  - B) 10
  - C) 2
  - D) 4
2. Partnership type of business is formed by the mutual agreement of partners. What kind of agreement is it?
  - A) Oral agreement
  - B) Written agreement
  - C) Oral or written agreement
  - D) None of them
3. In the general form of partnership, liabilities of partners are:
  - A) limited
  - B) unlimited
  - C) limited to the business capital
4. Is partnership type of business considered as a separate legal entity?
  - A) No
  - B) Yes
5. The written agreement of partnership is most commonly referred to as:
  - A) Agreement
  - B) Partnership deed
  - C) Partnership contract
  - D) Partnership Act

## ANSWERS

1. c

2. c

3. b

4. a

5. b

## WEEK 2

### Understanding Dissolution of Partnership

**Dissolution of Partnership** can be defined as the process of putting an end to the partnership business. It can also be referred to as the “winding up” of business or “cessation of business. It is important to emphasize that the dissolution of partnership results in a complete closure of the business. In other words, the winding up process entails that the book of account will be closed and assets of the business sold while the the proceeds from the sales of the asset is distributed to members after all the creditors had been settled.

#### Reasons for the Dissolution of Partnership

- Low Cash Flow
- Negligent Accounting Practices
- Mismanagement. ...
- Succession-Planning Failure
- Partnership Disagreements
- Noncompliance with Mandates
- Product Liability
- Bankruptcy

#### Entry Requirements for closing a Firm's Books of Accounts

It is important to first note that the way a winding up company decides to close their business is dependent on the nature of the business. A sole proprietorship for instance can be closed down whenever the owner

wishes. However, certain protocols must be followed when winding up a limited liability company. In that case, the company must properly go through what is called a *liquidation process* during which all company assets must be realized. Furthermore, all existing creditors must be paid off before shareholders received their proceeds from the liquidation process. That said, below are the entry requirements for closing a firm's books of accounts-

**Asset Realization:** When you liquidate your company, you must sell any remaining assets. Hire a specialist who can evaluate each asset. If you sell non-current assets such as land, buildings or equipment, debit cash and credit the non-current asset account according to generally accepted accounting principles. Record gains or losses in the profit and loss account. You must dispose of current assets such as inventory or trade receivables such as outstanding amounts from customers. You can sell these to factoring companies for cash, in which case you can debit cash and credit the current asset account in you books.

**Creditors:** As the liquidation process continues, you must discharge of funds to creditors. The category of creditors includes trade-related or suppliers, banks and other financial institutions that provided your company with loans and overdrafts. The accounting entry for paying off trade-related *payables* is a debit to the trade payable account and a credit to the cash account. Record any existing provisions in the profit and loss account. You will need two entries to record loans and overdrafts payments. One entry records your principal payment and the other

records the interest payment. Enter a debit in your long-term liability account and a credit to your cash account to record the principal payment. Finally, debit interest expense and credit cash to record the interest payment.

**Shareholders:** You and your partners, the ordinary shareholders, are the owners of the company, and, therefore, would only have access to the money if any remains after paying off all creditors. To record the distribution of money to shareholders, enter a debit to your equity account and credit cash in your books. Distribute the funds on a pro-rata basis. For example, use the average value for each class of shareholders. Record reserves as income in your profit and loss account by debiting the reserves account and crediting the profit and loss account.

**Other Entries:** You must also account for other transactions that occur as a result of your company's liquidation process. For example, if you hired experts to help you with the process, you must record the expense in your profit and loss account. You might also need to record other payments including employee leave payments or redundancy payments that make as a result of your company closing. You would also record these as expenses in your profit and loss account.

## **ASSESSMENT**

1. Retirement and death of a partner:
  - (a) is dissolution of partnership agreement

- (b) is dissolution of a firm
  - (c) may or may not be a dissolution of partnership agreement
2. Which one of the following double entries is correct regarding the cost of firm or partnership dissolution?
- (a) Credit realization a/c and Debit partners capital a/c
  - (b) Credit realization a/c and Debit bank a/c
  - (c) Debit realization a/c and Credit bank/cash
3. If all the partners, but one are insolvent it is:
- (a) Dissolution of an agreement
  - (b) Dissolution of a firm
  - (c) May or may not cause dissolution
4. If all the partners, but one, are solvent it is:
- (a) Dissolution of partnership agreement
  - (b) dissolution of a firm
  - (c) may or may not cause dissolution
5. Identify the correct double entry for realization profit at time dissolution of partnership
- (a) Debit realization a/c and Credit bank a/c
  - (b) Debit bank a/c and Credit realization account
  - (c) Debit realization account and Credit partners' capital accounts

## **ANSWERS**

- 1. a
- 2. c
- 3. b
- 4. c

5. c

## WEEK 3

### Introduction to Accounting Ratio

#### INTRODUCTION

Accounting ratios are part of financial statement analysis which relate one financial statement amount to another. Take for instance- the inventory turnover ratio divides a company's cost of goods sold for a recent year by the cost of its inventory on hand during that year. For a company with current assets of N300,000 and current liabilities of N150,000, its *current ratio* will be between N300,000 to N150,000; or 2 to 1, or 2:1. This ratio of 2:1 can then be compared to other companies in its industry regardless of size or it can be compared to the company's ratio from an earlier year.

It is therefore important to bear in mind that accounting ratios assist in the measurement of the efficiency and profitability of a company based on its financial reports. Accounting ratios also provide a way of expressing the relationship between one accounting datapoint and another, which is intended to provide a useful comparison. Accounting ratios form the basis of fundamental analysis.

#### Types of Accounting Ratios

**Gross Margin:** This can be defined as sales minus cost of goods sold. If a retailer sells a product for N10 which had a cost of N8, the gross profit *is* N2. The gross profit ratio therefore expresses the gross profit amount as a percentage of sales. In our example the *gross margin ratio* is 20% (N2 divided by N10).

**Markup Ratio:** This is used in several ways. Some retailers use markup to mean the difference between a product's cost and its selling price. Using our above example, the product had a cost of N8 and it had a *markup of N2* resulting in a selling price of N10. The N2 markup is the same as the N2 gross profit. However, the markup percentage is often expressed as a percentage of cost. In our example the N2 markup is divided by the cost of N8 resulting in a markup of 25%. (Some retailers may use the term markup to mean the increase in the original selling. For example, if the N10 selling price was increased to \$11 because of high demand and limited supply, they would say the markup was 1.)

### **Stock Turnover Ratio with working Exercise**

Stock Turnover Ratio or (also called Inventory Turnover) is an efficiency ratio which calculates the number of times per period a business sells and replaces its entire batch of inventories. It is the ratio of cost of goods sold by a business during an accounting period to the average inventories of the business during the period. Dividing the total cost of inventories sold during a period (which equals cost of goods sold) by the cost of average inventories balance maintained by a business gives us dollars of sales made per dollar of cash tied up in inventories.

### **Here is the Formula for Stock Turnover Ratio**

Inventory turnover ratio is calculated using the following formula:

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventories}}$$

Cost of goods sold = Beginning Inventories + Cost of Goods  
Manufactured – Ending Inventories

Cost of goods sold figure is reported on the income statement.

**Average Inventories =** 
$$\frac{\text{Beginning Inventories} + \text{Ending Inventories}}{2}$$

### Example

**Example 1:** Calculate inventory turnover and days inventories outstanding for Shoprite Nigeria based on the information given below:

<b>Opening inventories</b>	<b>N25,000</b>
<b>Closing inventories</b>	<b>N30,000</b>
<b>Cost of goods manufactured</b>	<b>N245,000</b>

### Solution

Cost of goods sold = N25,000 + N245,000 – N30,000 = N240,000

Average inventories = (N25,000 + N30,000) ÷ 2 = N27,500

Inventory turnover ratio = N240,000 ÷ N27,500 = 8.73

Days inventories outstanding = 365 ÷ 8.73 = 41.8

### ASSESSMENT

1. If cost of goods sold is \$8000, gross margin is \$5000 then revenue will be
  - (a) \$13,000
  - (b) -\$13000
  - (c) \$3,000
  - (d) -\$3000

2. Competitiveness can be best measured by
  - (a) Gross margin
  - (b) income margin
  - (c) sales margin
  - (d) cost margin
3. Gross margin is added to cost of sold goods to calculate
  - (a) revenues
  - (b) selling price
  - (c) unit price
  - (d) bundle price
4. Type of distribution, which describes whether events to be occurred are mutually exclusive or collectively exhaustive can be classified as
  - (a) mutual distribution
  - (b) probability distribution
  - (c) collective distribution
  - (d) marginal distribution
5. Fixed cost is divided by break-even revenues to calculate
  - (a) cost margin
  - (b) fixed margin
  - (c) revenue margin
  - (d) contribution margin

## **ANSWERS**

1. a
2. a
3. a

4. b

5. d

## WEEK 4

### Defining the Single Entry/Incomplete Records

#### INTRODUCTION

*Single Entry* is an incomplete form of recording financial transactions. It is the system which does not record two aspects or accounts of all the financial transactions. The Single Entry or Incomplete Records has no fixed set of rules for recording the financial transactions of the business. Single Entry system records only one aspect of transaction. As a result, the Single Entry system is not a proper system of recording financial transactions, which fails to present complete information required by the management. Single entry system mainly maintains cash book and personal accounts of debtors and creditors. Single entry system ignores nominal account and real account except cash account. Hence, it is incomplete form of double entry system, which fails to disclose true profit or loss and financial position of a business organization.

#### Limitations of Single Entry/Incomplete Records

**1. Lack of Mathematical Accuracy :** There are no record of balances of accounts because we do not make ledger. Due to this, we can not make the trial balance for checking mathematical accuracy. In other words, there is big chance of mathematical errors and mistakes in this system.

**2. No Scientific System of Accounting:** Accounting experts think, this is not a scientific system of accounting. Instead of using this, business organisation should use the double entry system of accounting which is fully scientific under accounting standards.

**3. No Use for Finding Financial Position:** Just knowing cash, creditors and debtors balance in this system, we can not find the financial position. So, this system has no use for finding financial position. Without knowing current financial position, doing business is big risk. So, all those who is using single entry system are doing business under big risk of loss of capital.

**4. No Legal Validity:** Accounting records which are made under single entry system is not accepted by law. Because we do not verify these records under scientific rules of accounting.

### **Statement of Affairs**

The Statement of Affair can be defined as the summary of a Company's *assets and liabilities*. It shows the net book value and amount expected to be realised at the date of Insolvency of a business enterprise. In appearance, the Statement of Affairs is similar to a Balance Sheet. Yet, it must be known that the format of the Statement of Affairs is different to a traditional balance sheet and certain calculations and considerations will be required. It is in efforts to show the difference between the Statement of Affairs and Balance Sheet that two comparative statement of affairs are prepared– one at the commencement of the year and other at the end of the year.

The excess of the assets over the liabilities as shown by the statement will represent the capital of the firm. If capital at the end shows an increase as compared to the amount of capital at the start the difference will represent profit and if the capital at the end is less than the capital at the beginning

the difference will be loss. In this calculation, however, two more factors should be taken into account.

To reiterate, the Statement of Affairs provides a useful source of information for both the management and the creditors. Its analysis can be used to establish the following-

- The likely return to creditors
- The extent of the insolvency
- Whether the directors have concealed assets from the administrator
- Whether there are indications of wrongful trading
- Once the administration is complete the actual performance of the administrator.

### **EXAMPLE**

Rasheed and Co. keeps his book on single entry system. His position on January 1st, 1991 was as follows:

Cash in hand N200, cash in bank N3000, stock in trade N20,000, sundry debtors N8,500, furniture N1,800, machinery N15,000 and sundry creditors N22,000.

On 31st December, 1991 the financial position was as follows:

Cash in hand N300, cash in bank N2,000, machinery N27,000, furniture N1,500, sundry debtors N14,000 stock in trade N19,000 sundry creditors N29,000.

During the year Rasheed introduced a new capital of N5,000 and withdrew for his personal expenditure N9,000.

From the above figures, prepare a statement showing the profit or loss made by him during 1991.

## **SOLUTION**

RASHEED & CO.

STATEMENT OF AFFAIRS AS AT 1ST JANUARY, 1991.

<b>Liabilities</b>	<b>Naira</b>	<b>Assets</b>	<b>Naira</b>
<b>Sundry creditors</b>	<b>22,000</b>	<b>Cash in hand</b>	<b>200</b>
<b>Capital (balancing figure*)</b>	<b>26,500</b>	<b>Cash at bank</b>	<b>3,000</b>
		<b>Sundry debtors</b>	<b>8,500</b>
		<b>Stock in trade</b>	<b>20,000</b>
		<b>Furniture</b>	<b>1,800</b>
		<b>Machinery</b>	<b>15,000</b>
	<b>48,500</b>		<b>48,500</b>

\* 48,500 – 22,000

RASHEED & CO.

STATEMENT OF AFFAIRS AS AT 1ST JANUARY, 1991.

<b>Liabilities</b>	<b>Naira</b>	<b>Assets</b>	<b>Naira</b>
<b>Sundry creditors</b>	<b>29,000</b>	<b>Cash in hand</b>	<b>300</b>
<b>Capital (balancing figure*)</b>	<b>34,800</b>	<b>Cash at bank</b>	<b>2,000</b>
		<b>Sundry debtors</b>	<b>14,000</b>
		<b>Stock in trade</b>	<b>19,000</b>
		<b>Furniture</b>	<b>1,500</b>
		<b>Machinery</b>	<b>27,000</b>
	<b>63,800</b>		<b>63,800</b>

\* 63,800 – 29,000

## ASSESSMENT

1. In single entry system of accounting
  - A) Dual aspects of a transaction is recorded
  - B) Single aspect of a transaction is recorded
  - C) Important transactions are recorded
  - D) All of them
2. Statement of financial position produced from incomplete accounting record is commonly known as
  - A) Balance sheet
  - B) Cash flow statement
  - C) Statement of affairs
  - D) Statement of financial operations
3. Which of the following businesses usually maintain incomplete accounting record of the business activities?
  - A) Large businesses
  - B) Companies
  - C) Big partnership firms
  - D) Small businesses
4. In which of the following systems of recording the financial statements reflect true and fair view of an entity and accounting records are considered to be more accurate?
  - A) Single entry system
  - B) Double entry system
  - C) Cash based system
5. Identify the correct formula used to ascertain the closing balance of capital

A)  $\text{Opening capital} + \text{Net income} - \text{Drawing} - \text{Assets} = \text{Closing capital}$

B)  $\text{Closing capital} = \text{Opening Capital} + \text{Net loss} - \text{Drawings}$

C)  $\text{Closing Capital} = \text{Opening capital} + \text{Assets} + \text{Incomes} - \text{Expenses}$

D)  $\text{Closing capital} = \text{Opening capital} + \text{Net income} - \text{Drawings}$

## **ANSWERS**

1. b

2. c

3. d

4. b

5. d

## WEEK 5

### SINGLE ENTRY/INCOMPLETE RECORDS (II)

#### **Introduction**

When companies keep detailed financial records with a single entry system, the final records are an incomplete accounting. When this occurs, the statement of affairs method can be used to determine profit and loss. In order to complete the statement of affairs method, a statement of affairs for the beginning of the period and a statement of affairs for the end of the period are required.

#### **Determination of Profit and Loss from Statement of Affairs**

The statement of affairs method resembles your company's balance sheet in that it shows the company's net worth at a point in time. The statement of affairs method compares transactions at the beginning period to transactions at the ending period to calculate profit and loss. If assets exceed liabilities, this represents a positive capital position for the company, which is a profit. A loss has occurred if liabilities surpass assets when comparing the beginning and ending affairs of the business.

A fresh infusion of capital throws off the calculation of profit and loss using the statement of affairs method. In such a case, subtract the capital injection from the company's assets to obtain an accurate reading of the company's profits. Likewise, drawings from capital distort the profit and loss under the statement of affairs method. Add back the capital withdrawal amount for an accurate reading of the company's profit or loss. Therefore, the formula for determining profit and loss under the statement

of affairs method is capital at the end of the period plus drawings minus new capital contributions less beginning capital.

### **Example**

A company had a beginning capital balance of N12,000 at the beginning of the year. The company's capital increased to N26,000 at the end of the year. During the year, the company received a capital infusion of N9,000 and the owner withdrew N4,000 for personal expenses. Because the owner withdrew capital from the company, add this amount back to the ending capital balance of N26,000 bringing ending capital to N30,000 (N26,000 plus N4,000). Since the company received outside capital of N9,000, subtract this from total capital of N30,000, bringing the total capital to N21,000 (N30,000 minus N9,000). Subtract the beginning capital of N12,000 from N21,000; the company earned a profit of N9,000 for the year.

Trading account for the year ended.....

To opening stock	xxx	By Sales	xxxx	
To purchases	xxxx	Less returns	xx	
Less returns	xxx		-----	xxxx
	-----	By closing stock		xxx
	xxxx	By gross loss ( if loss)		xxx
To Direct expenses:				
Carriage inward	xxx			
Freight	xxx			
Octroi	xxx			
Dock dues	xxx			
Excise duty	xxx			
Royalty	xxx			
Motive power	xx			
Coal, gas, water	xxx			
Factory expenses	xxx			
To Gross Profit (if profit)	xxx			
	xxxxx			xxxxx

Preparation of Trading, Profit and Loss Accounts and and Balance of Balance of Sheet from Incomplete Records

**Trading Account:** Trading Account is one of the financial account prepared to show the gross profit for the period under review, since it contains the result of business over a period of time. Trading Account look at the difference between the sales and the cost of goods sold, it is a revelation account which follows the principle of double entry. On the debit side of a trading account, stocks at the beginning of trading is added with goods purchased and less return outward and then deduct closing stock of goods, the cost of goods sold will be arrived at. i.e opening

stock+purchases-return outward-closing stock=cost of goods sold. On the credit side return inward is deducted from the total sales which is equal net sales.the different between the net sales and the cost of goods sold is the gross profit

### **Format of a Trading Account**

**Profit and Loss Accounts:** The account through which annual net profit or loss of a business is ascertained is called *profit and loss account*. Gross profit or loss of a business is ascertained through trading account, while the net profit is determined by deducting all indirect expenses (otherwise known as the business operating expenses) from the gross profit through profit and loss account. Thus profit and loss account starts with the result provided by trading account.

The following are the features of Profit and Loss Account-

1. This account is prepared on the last day of an account year in order to determine the net result of the business.
2. It is second stage of the final accounts.
3. Only indirect expenses and indirect revenues are shown in this account.
4. It starts with the closing balance of the trading account i.e. gross profit or gross loss.
5. All items of revenue concerning current year – whether received in cash or not – and all items of expenses – whether paid in cash or not – are considered in this account. But no item relating to past or next year is included in it.

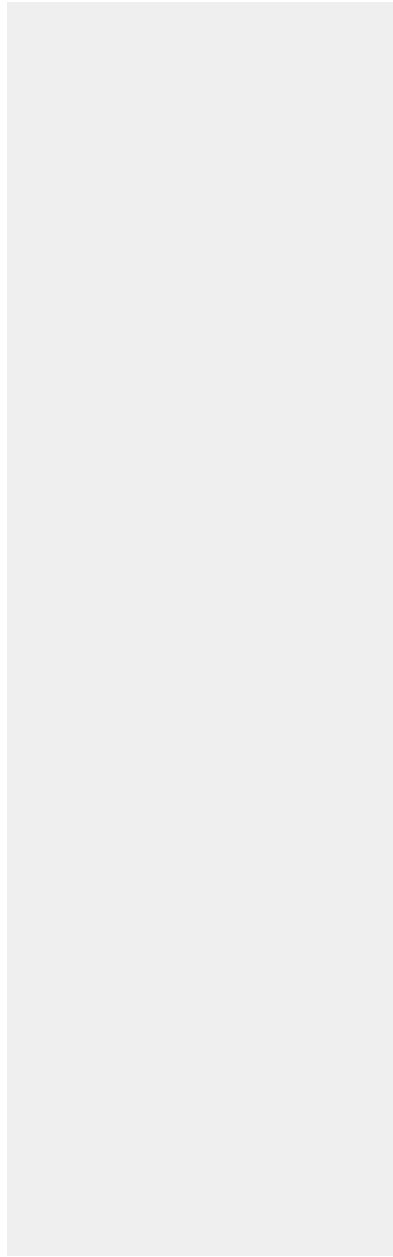
Please see a specimen of the profit and loss account below-

**Name of Business**

**Profit and Loss Account for the year ended**

<b>Naira</b>			<b>Naira</b>	
<b>Trading A/C</b>			<b>Trading A/C</b>	
<b>Gross profit</b>			<b>Gross profit</b>	—
<b>(transferred)</b>	---		<b>(transferred)</b>	-
<b>Office and</b>			<b>Interest</b>	—
<b>Administration</b>	---		<b>received</b>	-
<b>Expenses:</b>				—
<b>Salaries</b>	---		<b>Rent received</b>	-
<b>Rent, rates, taxes</b>	---		<b>Discount</b>	—
<b>Postage &amp; telegrams</b>	---		<b>received</b>	-
<b>Office electric charges</b>	---		<b>Dividend</b>	—
<b>Telephone charges</b>	---		<b>received</b>	-
<b>Printing and stationary</b>	---		<b>Bad debts</b>	—
<b>Selling and</b>			<b>recovered</b>	-
<b>Distribution Expenses:</b>			<b>Provision for</b>	—
			<b>discount on</b>	-
			<b>creditors</b>	-
			<b>Miscellaneous</b>	—
			<b>revenue</b>	-
			<b>Net loss</b>	-
			<b>transferred to</b>	-
			<b>capital A/C</b>	-

Carriage outward	---
Advertisement	---
Salesmen's salaries	---
Commission	---
Insurance	---
Traveling expenses	---
Bad debts	---
Packing expenses	---
Financial and Other	
Expenses:	
Depreciation	---
Repair	---
Audit fee	---
Interest paid	---
Commission paid	---
Bank charges	---
Legal charges	---
Net profit – transferred	---
to capital A/C	



Example

The following is the trial balance of Abang company on 31st December 2005.

Dr.

Cr.

Naira

Naira

1	Opening stock	64,000	
2	Purchases	460,000	
3	Returns inwards	50,000	
4	Carriage inwards	16,000	
5	Salaries	96,000	
6	Carriage outwards	10,000	
7	Rent	72,000	
8	Discount allowed	8,000	
9	Sundry debtors	240,000	
10	Plant and Machinery	360,000	
11	Furniture	60,000	
12	Drawings	18,000	
13	Sundry creditors		350,000
14	Returns outwards		36,000
15	Sales		740,000
16	Capital		328,000
		1,454,000	1,454,000

The closing stock is valued at N126,000.

*Required:*

Prepare a profit and loss account for the year ended 31st December 2005.

**Solution:**

As we have already discussed that profit and loss account starts with the gross profit or gross loss figure produced by trading account, we have to determine the gross profit or gross loss by preparing trading account of Abang company first.

**Trading Account for the year ended 31.12.2005**

Naira		Naira	
Stock 1.1.2005		Sales	740,000
	64,000	Less returns	50,000
Purchases	4,60,000		470,000
Less returns	36,000		
	424,000	Stock (closing)	126,000
Carriage inward	16,000		
Gross profit (transf. to P&L A/C)	312,000		
	816,000		816,000

XYZ co.

**Profit and Loss Account for the year ended 31.12.2005**

	\$		\$
<b>Office and Administration Expenses:</b>		<b>Gross profit</b>	
<b>Salaries</b>	96,000	<b>(transferred from</b>	<b>312,000</b>
<b>Rent, rates, taxes</b>	72,000		
<b>Selling and Distribution Expenses:</b>			
<b>Carriage outwards</b>	10,000		
<b>Discount allowed</b>	8,000		
<b>Net profit – transferred to capital A/C</b>	<b>126,000</b>		
	<hr/> 312,000		<hr/> 312,000

**Balance Sheet from Incomplete Records:** If you are appointed as accountant in any organisation who does not maintain his record on the basis of double entry system, it is your duty to prepare accounts on the basis of double entry system from incomplete record. If you do not know its steps, we are explaining to you its main steps:

{Our Aim to Make Trading and Profit and Loss Account and Balance Sheet on the Basis of Double Entry System }

**First Step: Find Opening Capital:**

Opening capital can be found by making opening balance sheet. It is the excess of assets over liabilities. Just investigate the organisation, you

can find different asset like furniture, vehicle, building and land. From one year ago's all bills of customers and suppliers will be useful for finding opening debtors and creditors.

Opening Balance Sheet

<i>Liabilities</i>	<i>Amount Rs.</i>	<i>Assets</i>	<i>Amount Rs.</i>
Creditors	24,000	Debtors	45,000
		Cash	4,500
Capital in the beginning (Balancing figure)	81,500	Stock	25,000
		Furniture and Fixtures	15,000
		Motor Van	16,000
	1,05,500		1,05,500

Check bills

Check bills

Beginning Balance in bank statement

Calculate the cost at the beginning of the year

### Second Step: Make Cash Book:

It is useful for showing closing balance of cash book as the current asset in the closing balance sheet. It is also helpful for find credit purchase, credit sale and other outstanding expenses and outstanding incomes. We can also find missing cash payments and cash incomes if there will difference between closing cash in our pocket and as per cash book. After making adjusted cash book, we can included all missing items.

### Third Step: Find Credit Purchase:

Finding credit purchase is useful for finding the missing figure of sundry creditor. It will also be included in the cash purchase for making trading account.

### Fourth Step: To Find Credit Sale:

It is to find credit sale because it is useful for finding the missing figure of sundry debtor. It will also be included in the cash sale for making trading account.

### **Fifth Step: To Find Closing Stock:**

Finding closing stock is useful for making trading account. It will also be included in the current assets of balance sheet.

### **ASSESSMENT**

1. If opening capital = \$1000 and closing capital = \$2000. Assuming no drawings during the accounting period, calculate the net income or loss for the period
  - A) \$1000 net income
  - B) \$1000 net loss
  - C) \$2000 net income
  - D) \$2000 net loss
2. Total opening balances of assets and liabilities are \$10,000 and \$5000 respectively. Find out the opening capital of the business
  - A) \$10,000
  - B) \$5000
  - C) \$15000
  - D) \$50,000,000
3. Which one of the following accounts is supposed to be used to get the figure of credit purchases made during the current accounting period?
  - A) Debtor account
  - B) Revenue account
  - C) Creditors account
  - D) Expenses account

4. To obtain the amount of credit sales made during an accounting period, which account is generally used in single entry and incomplete records?
- A) A/c payable account
  - B) Total revenue account
  - C) Debtors account
  - D) Stock account
5. Which of the following is used to work out the balance of cash drawings for an accounting period?
- A) Debtor account
  - B) Credit account
  - C) Cash payments journal
  - D) Cash book

## **ANSWERS**

- 1. a
- 2. b
- 3. c
- 4. c
- 5. d

## WEEK 6

### ACCOUNTS OF NON-PROFIT MAKING ORGANIZATIONS

#### INTRODUCTION

People Join together for a number of reasons in voluntary organization: for mutual entertainment, for protection, or for professional reasons. There are sports clubs, trade unions, consumer societies, political associations, and many more. The degree of richness of any society lies partly in the variety of the voluntary organization it promotes.

#### **Receipts and Payments Account**

A receipt and payment account is a summarized cash book (cash and bank) for a given period". or "This is simply a summary of the cash transactions as in the cash book, analyzed and classified under suitable headings, including the opening and closing balances.

#### **Features of Receipt and payments Account**

1. It is abridged addition of cash book – it is, in effect, a summary of cash book.
2. All cash receipts during the whole year are recorded on its left hand (i.e., debit) side. While all the cash payments during the whole year written on its right hand (i.e., credit) side, arranged in a classified form.
3. Cash receipts and cash payments of both capital and revenue nature are recorded here.
4. Only cash transactions are recorded in this account.

5. It generally shows a debit balance. In case of bank overdraft balance, however, its net balance may be credit. Again, it may also show nil balance but such occasion is rare.
6. Its closing balance indicates closing cash in hand and closing cash at bank.
7. It is not an account within the double entry system – it is a statement only.
8. It is prepared on the last day of the accounting year.

## **ASSESSMENT**

1. Which of the following is generally considered as a non profit oriented organization
  - (a) Charitable organization
  - (b) Corporation
  - (c) Audit firms
  - (d) Insurance companies
2. The receipts and payments account of a non-profit organization is a
  - (a) Nominal account
  - (b) Real account
  - (c) Income statement account
  - (d) Financial statement
3. Non-profit organizations prepare all of the following accounts except the
  - (a) Receipts and payment accounts
  - (b) Income and Expenditure accounts

(c) Balance sheet

(d) Income statement

4. Expenditures greater than incomes of a non-profit organization give rise to a

(a) Loss

(b) Profit

(c) Surplus

(d) Deficit

5. Rent expense of a non-profit organization paid in advance. Which of the following is the correct classification of rent?

(a) Expense

(b) Liability

(c) Equity

(d) Asset

## **ANSWERS**

1. a

2. b

3. d

4. d

5. d

## WEEK 7

### RECEIPT AND PAYMENT ACCOUNTS

#### INTRODUCTION

Receipt and Payment account is a summary of cash receipts and payments during a specific accounting period; usually a year. It records all cash receipts and cash payments, including capital receipts and revenue receipts irrespective of accounting period. All cash receipts are recorded on debit side or receipts side and all cash payments are recorded on credit or payments side of receipts and payments account.

#### Features Of Receipts And Payments Account

1. Summary Of Cash Transactions
2. Cash And Bank Items In One Column
3. No Distinction Between Capital And Revenue
4. Opening And Closing Balance Of Cash
5. Recording Of Cash Receipts And Payments
6. Ignores Non-cash Transactions

#### Preparation of Receipt and Payment Account

In order to prepare the Receipt and Payment account from receipt and payment account, the following steps must be taken-

1. Eliminate all capital receipt like cash receives sales of equipment and capital payment to purchase equipment and capital accounts.

2. Eliminate all item of revenue nature that is item that belong to the accounting period such as subscription for previous year and subscription for the next year collected this year, this is known as subscription paid in advance and it is treated as liability under current liability in the balance sheet
3. If there are members owing subscription pre-credited to the income and expenditure account left the club without paying such subscription will be written off, by debiting the income and expenditure account.
4. Make necessary adjustment for outstanding or accrual of the beginning and the end period e.g subscription in arrears.
5. Debit the income and expenditure account and the depreciation of fixed asset get like of trading concern
6. What is required to known is the gross profit activities like dance or bazaar, the revenue activity is matched with the relevant cost

### **Format for Receipt and Payment Account**

Receipt and Payment Account for the year ended-

<b>Expenditure</b>	<b>xxx</b>	<b>Income</b>	<b>xxx</b>
<b>Rent</b>	<b>xxx</b>	<b>Subscriptions</b>	<b>xxx</b>
<b>Printing</b>	<b>xxx</b>	<b>Interest on investment</b>	<b>xxx</b>
<b>Postage</b>	<b>xxx</b>	<b>Entrance fee</b>	<b>xxx</b>
<b>Honorarium</b>	<b>xxx</b>	<b>Arrival dinner</b>	<b>xxx</b>
<b>Wages</b>	<b>xxx</b>	<b>Donations</b>	<b>xxx</b>

## **Similarities between Receipt and Payment Account and Income and Expenditure account**

- Both account follows the principle of double entry
- They are summarized financial statement
- Both are prepaid by non-profit making concern
- They are prepaid to lower the pare period

## **Difference between Receipt and Payment and Income and Expenditure**

### **Receipt and Payment**

**1 real account**

**2 only actual cash receipt and payment are recorded**

**3 no record of depreciation**

**4 balance represent cash or bank overdraft**

**5 another name for cash book prepared by club**

**6 includes capital and revenue earns**

**7 receipt is debited and payment is credited**

### **Income and Expenditure**

**Nominal account**

**Cash accrual and prepayment are include**

**Give effect to depreciation**

**Balance represent purpose income or expenditure**

**Another name for profit and loss adopted by clubs**

**Only revenue item are recorded**

**Expenditure are debited and income are credited**

## **Test and Exercise**

1. State the differences between income and expenditure account and receipt and payment account
2. Highlight the steps to be taken for the preparation of income and expenditure account
3. State the similarities between income and expenditure and income and receipt account

## WEEK 8

### Introduction to Treatment of Subscription

#### INTRODUCTION

Subscription is a membership fee paid by the member on annual basis. This is the main source of income of such organizations. Subscription paid by the members is shown as receipt in the Receipt and Payment Account and as income in the Income and Expenditure Account. It may be noted that Receipt and Payment Account shows the total amount of subscription actually received during the year while the amount shown in Income and Expenditure Account is confined to the figure related to the current period only irrespective of the fact whether it has been received or not.

#### Accounting Treatment of Over Subscription (Case Study)

When a company receives applications for a large number of shares than offered to public for subscription, it is said that the issue has been over-subscribed. This situation can only be treated using either of the two procedures to be discussed below-

1. **Rejection of Subscription Applications:** When a company cannot deal with the number of applications for shares, the best bet to dealing with such a situation could often be to in such a situation to refund the money received. In this case, the appropriate entry would be- Share Application Account, Dr. (with total amount refunded To Bank Account due to non-allotment.)(Being application money returned, application being rejected)
2. **Acceptance of Application Partially:**

Sometimes the applicants are not allotted the number of shares they have applied for and directors accept the application partially. In such a situation, the applicants are allotted lesser number of shares than they have applied for. In such a situation, the surplus money on application partially accepted will be transferred to share allotment account.

**The journal entry for utilizing the excess application money received towards amount due on allotment is as follows:**

Share application account

To Share allotment account

Dr. (with amount of excess application money to be adjusted towards allotment.)

Where the application money on partially accepted applications is more than the amount necessary for discharging the total obligations towards application and allotment money, then the excess money is returned to the applicants. However the Articles of Association of the company may authorize the company to retain such excess money as calls in advance. The money can be retained towards the calls only if the applicant has agreed to do so. Usually a clause to this effect is incorporated in the prospectus.

**The entry necessary for retaining such excess application money towards the calls in advance is:**

Share application a/c

To Calls in advance a/c

Dr. (with amount with company after adjusting allotment money out of excess application money.)

(Being excess application money transferred to calls in advance account)

**Let us take an example:**

A applies for the purchase of 300 shares of a company in which Rs. 2 is payable on application, and Rs. 3 on allotment. He is allotted 80 shares. A has paid at the time of application  $300 \times 2$ , i.e. Rs. 600 out of which 160 (i.e.  $80 \times 2$ ) will be adjusted towards the amount due on application. The surplus of Rs. 600— Rs 160 i.e. Rs. 440, will be adjusted towards allotment, i.e.,  $(80 \times 3) =$  Rs. 240 and the balance of Rs. 200 will either be retained by the company towards subsequent calls or will be refunded to the applicants. In case the money is retained by the company towards subsequent calls, the necessary entry would be

Share application account Dr. 600  
To Share capital account (80  $\times$  2) 160  
To Share allotment account (80  $\times$  3) 240  
To Calls in advance account (Balance) 200

**On the other hand, if the excess money is not to be utilised towards subsequent calls, and the company decided to refund the amount found its excess of allotment, then the following entry is passed:**

Share application account Dr. 600  
To Share capital account (80  $\times$  2) 160  
To Share allotment account (80  $\times$  3) 240

To Bank Account 200

**SOLUTION :**

Bank a/c (25,000 × 2) To Share application a/c (Being receipt of application money on 25,000 shares @ ₹ 2 per share)	Dr.	50,000	50,000
Share application a/c (20,000 × 2) To Share capital a/c (Being application money of 20,000 shares transferred)	Dr.	40,000	40,000
Share application a/c (5,000 × 2) To Bank a/c (Being application money refunded on rejected applications)	Dr.	10,000	10,000
Share allotment a/c (20,000 × 4) To Share capital a/c (Being allotment money due on 20,000 shares @ ₹ 4 each)	Dr.	80,000	80,000
Bank a/c (20,000 × 4) To Share allotment a/c (Being allotment money received in full)	Dr.	80,000	80,000
Share first call a/c (20,000 × 4) To Share capital a/c (Being first call money due on 20,000 shares @ ₹ 4 each)	Dr.	80,000	80,000
Bank a/c (20,000 × 4) To Share first call a/c (Being first call money received in full)	Dr.	80,000	80,000

**(ii) Case**

Bank a/c To Share application a/c (Being application money received on 25,000 shares @ ₹ 2)	Dr.	50,000	50,000
Share application a/c To Share capital a/c (Being application money of 20,000 shares transferred to share capital account)	Dr.	40,000	40,000
Share application a/c To Share allotment a/c (Being excess application money adjusted towards allotment a/c)	Dr.	10,000	10,000
Share allotment a/c To Share capital a/c (Being allotment money due on 20,000 shares @ ₹ 4)	Dr.	80,000	80,000
Bank a/c (80,000-10,000) To Share allotment a/c (Being allotment money received)	Dr.	70,000	70,000
Share first and final call a/c To Share capital a/c (Being call money due on 20,000 shares @ ₹ 4 per share)	Dr.	80,000	80,000
Bank a/c To Share first and final call a/c (Being call money received in full)	Dr.	80,000	80,000

**Illustration:**

A company issued 20,000 shares of Rs 10 each to the public payable Rs. 2 on application, Rs. 4 on allotment and Rs. 4 on final call. Applications

were received for 25,000 shares. Pass the journal entries in following cases assuming that the amounts due were received;

(i) When applications for 5,000 shares were rejected and application money refunded;

(ii) When surplus of application money is utilised towards allotment.

**Working notes :**

Shares applied	Shares allotted	App. Money received ₹	App. money due ₹	Excess ₹	Adjustment (a) Excess refunded (b) Excess adjusted on allotment
25,000	20,000	(25,000 × 2) 50,000	(20,000 × 2) 40,000	10,000	

**ASSESSMENT**

- \_\_\_\_\_ is a membership fee paid by the members of an organisation on annual basis
  - treatment
  - payment
  - conscription
  - subscription
  
- When cash is received for life membership, which one of the following double entries is passed?
  - Cash Debit and capital Credit
  - Life membership Debit and cash Credit
  - Investment Debit and cash Credit
  - Cash Debit and life membership fund Credit

3. Subscription received but not yet earned is considered as a/an
- A) Asset
  - B) Liability
  - C) Income
  - D) Expenditure
4. A non-profit organization received \$10,000 as the entrance fee of a new member. If 20% of the fee has to be capitalized, what is the amount of fee needs to be shown in the income and expenditure account?
- A) \$2000
  - B) \$8000
  - C) \$9000
  - D) \$10,000
5. \$10,000 received as the annual membership subscription. Out of this, \$2000 is pertaining to the previous accounting period whereas \$1000 is receivable at the end of the current accounting period. Calculate the amount of subscription that will be shown in the income and expenditure account for this accounting
- A) \$10,000
  - B) \$9000
  - C) \$12,000
  - D) \$8000

## **ANSWERS**

1. d

2. d

3. b

4. b

5. b

## WEEK 10

### PREPARATION OF INCOME AND EXPENDITURE ACCOUNTS

#### INTRODUCTION

The necessary information needful for preparing an Income and Expenditure Account are mainly found in the cash book entries which are summarized into the Receipts and Payment Account. A scrutiny of the receipts side will show what items are of revenue nature and also relate to the present period. These will appear on the credit side of the Income and Expenditure Account. The items should be increased by outstanding amounts. The outstanding amounts will also appear in the Balance Sheet. Now supposing the Receipts and Payments Account shows subscriptions to have been received to the extent of N18,300 including N450 for the next year; but subscriptions for the current year not yet received total N1,100, The entries to adjust the subscriptions will be as follows:

(i) Subscriptions Account	Dr.	₹	₹
To Subscriptions Received in Advance Account		450	450
<hr/>			
(ii) Subscriptions Outstandings Account	Dr.	1,100	
To Subscriptions Account			1,100
<hr/>			

The Income and Expenditure Account will be credited in respect of Subscriptions with N18,950.

The Subscriptions Account will appear as follows:

<b>Subscriptions Account</b>			
	₹		₹
To Subscription Received in Advance	450	By Cash	18,300
To Income & Expenditure Account— transfer	18,950	By Subscriptions Outstanding	1,100
	<u>19,400</u>		<u>19,400</u>

The Subscriptions Received in Advance Account will appear in the Balance Sheet on the liabilities side; Subscriptions Outstanding Account will appear on the assets side. Next year, these two accounts will be transferred to the Subscriptions Account.

### Balance Sheet

In the absence of a regular trial balance, a balance sheet can be prepared only by taking each item in the previous year's balance sheet and adjusting it for cash paid or received on capital account (i.e., additions or deductions because of cash transactions) and for loss or depreciation. Outstanding expenses and incomes received in advance and also expenses prepaid and outstanding income must also be shown in the balance sheet. Previous year's General (or Capital) Fund will be adjusted for the current year's surplus (excess of income over expenditure which will be added) or deficit (which will be deducted).

**Illustration: From the following information, calculate the amount of subscriptions received in advance as on 31st March, 2012:**

(i) Subscriptions received during the year 2011-2012 N52,500

(ii) There were 200 members paying subscription at the rate of N250 per annum each.

(iii) Some members have paid their annual subscription in advance during the year.

As on 1st April, 2011 no subscription had been received in advance but subscriptions were outstanding to the extent of 1,000 as on 31st March, 2011.

Subscriptions accrued as on 31st March, 2012 totaled N1,500.

## **ASSESSMENT**

1. Income and expenditure accounts show
  - A) Cash available to an organization
  - B) Closing capital of an organization
  - C) Cash available in the bank account
  - D) Surplus or deficit for the current accounting period
  
2. On what basis the receipts and payments account is prepared?
  - A) Cash basis
  - B) Accrual basis
  - C) Both accrual and cash basis
  
3. In non-profit accounting, the sale of old newspapers is generally considered as a/an
  - A) Expenses
  - B) Expenditure

- C) Income
- D) Capital receipt

4. The Subscriptions Received in Advance Account will appear in the Balance Sheet on the \_\_\_ side

**Solution :**

<i>Dr.</i>	<b>Subscriptions Account</b>		<i>Cr.</i>
	₹		₹
To Subscriptions Accrued as on 1st April, 2011	1,000	By Bank – Subscriptions received during the year	52,500
To Income & Expenditure Account – Transfer of income for the year	50,000	By Subscriptions Accrued as on 31st March, 2012	1,500
To Subscription Received in Advance as on 31st March, 2012 – balancing figure	3,000		
	<b>54,000</b>		<b>54,000</b>

- 5. (a) liabilities
  - (b) debts
  - (c) assets
  - (d) subscription
6. All the necessary information needed to prepare an Income and Expenditure Account are mainly found in the (a) cash book entries
- (b) balance sheet
  - (c) receipt book

## ANSWERS

1. d

2. a

3. c

4. a

5. a

## **WEEK 11**

### **OVERTRADING**

- **Meaning of trading**
- **Signals of overtrading**

#### **Meaning of Overtrading**

Overtrading occurs when a firm is engaged in buying too much and selling too little. This means that the organization accumulates more volume of trade than its financial capacity, which results to piling up to debt in the long run.

Signals of Overtrading

#### **The signals of overtrading include:**

- More capital locked up in stock
- Increase amount of creditors
- Excessive use of bank overdraft
- High ratio of debtor to equity capital and to sales
- Mortgaging the firms properties; in order to obtain loan

#### **Disadvantages of overtrading**

##### **The disadvantages of overtrading include:**

- Too many creditors to be settled
- Difficulty in obtaining loan as a result of shortage of assets
- Shortage of cash for future operation
- Reduced assets are some of them are fully mortgaged

## Components of Trading Account

- Opening stock
- Purchases
- Purchases returns or returns outward
- Carriage inwards
- Cost of goods sold
- Closing stock
- Cost of sales
- Sales returns or returns inward

## The procedure s for preparing profit and loss account

1. The revenue earned is the first item that will be recorded as sales on the credit side less return inwards
2. The statement contains a cost of goods sol section that shows the total cost of inventory that was sold during the period
3. The cost of goods is deducted from sales to get intermediate or gross profit
4. The operating expenses are subtracted from gross profit to determine net income or net profit or loss.

## Test and Exercise

From the following trial balance of Ajayi, draw up a trading, profit and loss account for the year ended 31st December 2013

	Dr	Cr
Capital	3500	24000
Stock		400

Carriage outwards		600
Returns inwards		250
Sales		10,000
Purchases		5,670
Salaries and wages		550
Returns outward		450
Rent		800
Insurance		70
Sundry expense		660
Advertising		220
General expenses		5,000
Motor car		350
Furniture and fitting		1800
Debtor		6000
Bank		10000
Creditors	<u>1840</u>	
drawings		<u>420</u>
	<u>36,290</u>	<u>36,290</u>

**SS 2**

**THIRD TERM NOTES ON  
FINANCIAL ACCOUNTING**

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## **THIRD TERM**

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## WEEK 1

### What is Acquisition of Business?

#### INTRODUCTION

*Business Acquisition* is the process of buying a company to build on strengths or weaknesses of the company making the purchase. It can also be defined as a corporate action in which a company acquires ownership of another company by buying most, if not all of the other company's ownership stakes. This thus enables the acquiring company to assume control of the newly-purchased company. An acquisition occurs when a buying company obtains more than 50% ownership in a target company. As part of the exchange, the acquiring company often purchases the target company's stock and other assets, which allows the acquiring company to make decisions regarding the newly acquired assets without the approval of the target company's shareholders. Acquisitions can be paid for in cash, in the acquiring company's stock or a combination of both. The process begins with defining the type of business that would make a good acquisition. Generally, businesses within the same segment or a highly complementary market segment are targeted. Once defined the target business is approached and if interest is shown due diligence is performed to ascertain the financial and other conditions of the business. When the financial terms are agreed upon, and the contract is signed the merger portion of the acquisition begins. Overlapping processes, personnel and products are evaluated and the better-performing pieces are retained.

## **Purchase Considerations during Acquisition**

Each business acquisition comes with its own unique challenges, some very complex and others routine, involving business, legal and interpersonal relationship issues. To have the greatest likelihood of handling these items properly, and of success in the purchase process and ownership of the business, it is in the best interest of the buyer(s) to fully take a lot of considerations into view by investigating the new business venture as well as consulting the services of professionals such as Lawyers, Accountants etc. Below are some important considerations and steps a buyer should take in making the decision to purchase a business.

1. **Due Diligence:** This is the legal term for carefully evaluating every aspect of the new business enterprise that is about to be acquired. A buyer should therefore hire the services of professional advisors whose function it will be to create a due diligence checklist and a list of questions and issues that need to be answered and resolved to the buyer's satisfaction even as the buyer reviews and gains a better understanding of the business. Some example of questions to be answered include-

- What is the recent financial history of the business?
- Any competition issues?
- Is the price being paid for the business the "right" price?
- Why is the business for sale? Does any other party have a priority right to purchase it?
- What are the cashflow, equipment, personnel and other needs of the business to operate successfully?

- What is actually being purchased: inventory, equipment, raw materials, accounts receivable, contracts, a client list, a customer list, a lease?
  - What is the condition of the assets being purchased? etc
2. **Financing Considerations:** If the purchase is to be financed, then the purchase Contract must provide that the buyer has a reasonable opportunity to apply for and obtain a binding commitment for such financing. The buyer must diligently pursue such financing as obtaining a loan commitment can take some time, and closing on the financing may be a challenging process to the buyer, especially if the financing is being provided through a special governmental program such as an SBA loan, such as the 7(a) or 504 loan programs.
  3. **Management of the Business:** Before purchasing the business, the buyers should have a solid understanding of the choice of entity to operate the business, who will own such entity, who will run the day-to-day affairs of the business (e.g., the officers or managers), how the officers or managers will be compensated and *incentivized*, and how the owners will monitor the officers or managers.
  4. **Carefully set up the Buyer's Acquisition Team:** Buying a business involves many risks and, to be done most successfully, requires an experienced team of professionals and advisers to assist the buyer through the purchase process. Each member of the buyer's acquisition team should bring the right amount of skills, training and expertise to enable buyer to properly work through the purchase process: an attorney experienced in buying businesses to recognize the critical issues and risks and help the buyer navigate through them; a banker, investment banker or a business intermediary / broker to assist in

obtaining acquisition financing and, if desired or needed, equity investment; and an experienced accountant to review the tax returns and financial statements of the business and work with the lender.

## **Goodwill**

Goodwill can be defined as an asset, but it cannot be seen or touched, hence it is referred to as an intangible asset. It can also be defined as the excess of the purchases considerations over the total value of assets less liabilities. It arises as a result of connection, reputation, and efficiency of a business. It is not a tangible asset and cannot be realized until the business is sold.

## **Reasons for Goodwill**

- *For patent and copy right protection*
- *The location of a business premises may also induce the purchaser to pay for goodwill.*
- *Managerial skill: The effectiveness and efficiency of the management of a company can give them the necessary reputation,*
- *Quality of goods: The quality, durability of the products of a company can bestow good name on it.*
- *Possession of partial monopoly: when a company is not faced with much competition in the market , then*
- *it can become a monopolist.*

## **Goodwill Valuation**

There is no actual method of valuing goodwill. Yet, the following methods can be used-

1. Number of year
2. Super profit
3. Number of times of the gross annual fee income
4. Excess of value of a business over the realizable value.

## **Characteristics of Goodwill**

1. The value is subjective
2. It cannot be sold separately apart from other assets of the business
3. It may fluctuate from day to day

## **Reasons for Acquisition**

Companies perform acquisitions for various reasons. They may be seeking to achieve economies of scale, greater market share, increased synergy, cost reductions, or new niche offerings. If they wish to expand their operations to another country, buying an existing company may be the only viable way to enter a foreign market, or at least the easiest way: The purchased business will already have its own personnel (both labor and management), a brand name and other intangible assets, ensuring that the acquiring company will start off with a good customer base.

Acquisitions are often made as part of a company's growth strategy when it is more beneficial to take over an existing firm's operations than it is to expanding on its own. Large companies eventually find it difficult to keep growing without losing efficiency. Whether because the company is

becoming too bureaucratic or it runs into physical or logistical resource constraints, eventually its marginal productivity peaks. To find higher growth and new profits, the large firm may look for promising young companies to acquire and incorporate into its revenue stream.

When an industry attracts too many competitor firms or when the supply from existing firms ramps up too much, companies may look to acquisitions as a way to reduce excess capacity, eliminate the competition, or focus on the most productive providers.

If a new technology emerges that could increase productivity, a company may decide that it is most cost-efficient to purchase a competitor that already has the technology. Research and development may be too difficult or take too much time, so the company offers to buy the existing assets of a company that has already gone through that process.

## **ASSESSMENT**

1. What is business acquisition?
2. What are some reasons for business acquisition?
3. What are the methods for measuring goodwill valuation?
4. What is goodwill?
5. What are the factors to be taken into consideration when making a business acquisition?

## WEEK 2

### **Purchase of Business- Format Preparation of new Business Account**

#### **Introduction**

Purchase of business is the process of acquisition of old business by a company. Promoters can acquire a business and sell it to another company at a profit. The persons who sells the business to another company is called the “vendor”. The money paid by the purchaser is called “purchase price”, the purchase of a business must involve agreement between the parties.

In the purchase of business, the assets, name and connection of the business will be taken over, hence, goodwill must be paid for. A revaluation of assets and liabilities will be required, the amount paid to acquire the business is known as the consideration. The excess of the purchase consideration over the net value of the asset is called “goodwill”, if on the other hand, the purchase consideration is lower than the net assets, the purchaser has gained the advantage of “capital reserve”.

In some cases he may acquire all the assets without cash and leave the vendor to discharge the liabilities of the business. Lastly, the purchase consideration can be paid in cash or shares.

#### **New Business Account (Entries in the book of the purchaser)**

Procedures for purchase of business with cash.

1. Purchase consideration.

Debit: Business purchase account with the purchase consideration

Credit: Vendor Account

1. Agreed valuation of each asset acquired

Debit: Assets Account

Credit: business purchase account

1. Agreed valuation of liabilities

Debit: business purchase account

Credit: liabilities account.

1. Balance of the business purchase account [excess of consideration over assets]

Debit: goodwill account

Credit business purchase account

1. Balance of the business account [excess of assets over consideration]

Credit: capital reserve

Debit: business purchase account.

1. On settlement of the vendors account

Debit: vendor account

Credit: bank account

1. On settlement of the vendors account with shares

Debit: vendor account

Credit: shares capital account

## **ASSESSMENT**

1. What are the steps taken to purchase a business?
2. The persons responsible for the sale of a business are called what?

## WEEK 3

### What is Company Amalgamation?

#### INTRODUCTION

Amalgamation is the blending of two or more existing companies into one company. For example, if two existing companies such as Dangote Flour and Flour Mill Plc go into liquidation to form a new company *Dan Flour Mill*, it will be a perfect example of amalgamation.

Amalgamation can also be defined as the combination of one or more companies into a new entity. An amalgamation is distinct from a merger because neither of the combining companies survives as a legal entity; a completely new entity is formed to house the combined assets and liabilities of both companies. This sense of the term amalgamation has generally fallen out of popular use, and the terms “merger” or “consolidation” are often used instead.

#### Reasons for Amalgamation

The main objective of amalgamation is to achieve synergetic benefits which arise, when two companies can achieve more in combination than when they are individual entities. Besides this however, there are other reasons which shall be found below-

- (i) To reap economies of scale
- (ii) To eliminate competition
- (iii) To build up goodwill
- (iv) To reduce the degree of risk through diversification
- (v) Managerial effectiveness.

## **Process of Amalgamation**

### **The following procedure is followed in an amalgamation-**

1. The terms of amalgamation are finalized by the board of directors of the constituent companies.
2. A scheme of amalgamation is prepared and submitted for approval to the respective High Court.
3. Approval of the shareholders of the constituent companies is obtained.
4. Approval of SEBI is obtained.
5. A new company is formed (where necessary) and issues shares to the shareholders of the transferor company.
6. The transferor company is liquidated and all assets and liabilities are taken over by the transferee company.

## Accounting for Amalgamation

(1) Name	CABIN CO., LTD (Expired Company)	LINK THEORY JAPAN CO., LTD. (Surviving Company)
(2) Business Type	Operation of Specialty Women's Wear Stores	Clothing Sales
(3) Established	March, 1943	December, 2003
(4) HQ Location	717-1 Sayama, Yamaguchi City, Yamaguchi Prefecture, Japan	717-1 Sayama, Yamaguchi City, Yamaguchi Prefecture, Japan
(5) Business Representatives	President Tetsuro Nakashima	President and CEO Chikara Sasaki
(6) Paid in Capital	450 million yen	10 million yen
(7) Outstanding Shares	18 shares	200 shares
(8) Net Assets	10,639 million yen	23,096 million yen
(9) Gross Assets	7,732 million yen	5,147 million yen
(10) Business Year Ending	Last Day in August	Last Day in August
(11) Major Shareholders and Their Holdings	FAST RETAILING CO., LTD. 100%	FAST RETAILING CO., LTD. 100%

## ASSESSMENT

1. What is amalgamation?
2. What are some of the reasons for company amalgamation?
3. What is the process for company amalgamation?

## WEEK 4

### Introduction to Company Formation

#### INTRODUCTION

*Company Formation* is all about the process of founding (i.e., incorporating) a new business enterprise. It is also sometimes called company registration. Company Formation can also be defined as the procedures undertaken to register a business enterprise as a limited company and give it a legal status. In other words, a business becomes a distinct legal entity as soon as it is incorporating. Please note [therefore] that when a business enterprise is incorporated, it becomes an individual 'person' in the eyes of the law. Incorporated businesses are completely separate from their owners in terms of finances, liabilities, contractual agreements, and ownership of property and assets. The constitution of the Federal Republic of Nigeria does not view unincorporated businesses (such as sole traders) as distinct legal entities. Therefore, there is no separation between a sole trader business and its owner in terms of finances, assets and liabilities.

#### **Procedure for the formation of a Company**

During the formation of a Limited Liability Company, the following procedures must be followed-

1. The first step is to get the promoters; they are individuals who conceive the idea of a company and undertake to fulfill all legal requirements of the venture.

2. The following documents will be filled with the registrar of companies. These are memorandum and article of association and statement of nominal capital.
3. The documents are stamped and logged with the registrar of companies for verification
4. When the registrar of companies receives and approves the necessary documents the registrar issues a certificate of incorporation.

### **Memorandum of Association**

The memorandum of association contains the external rules of the company, it refers to the object and power of the company and how it intends to deal and interact with the outside world; it contains the following-

1. The name of the company and the word limited liability at the end.
2. The registered office.
3. The object of the company.
4. The declaration that the liability is limited.
5. The amount of the authorized capital

### **Articles of Association**

This is a document which states the internal regulations of a limited company. It contains the regulations which govern the internal management of the company affairs. The following are found in the article-

1. The right and responsibilities of the shareholder.
2. The duties and power of the directors.

3. How directors may be appointed.
4. The right and duties of the members as between each other and the company.
5. The procedure for accounting and auditing of the company's book etc.

### **Prospectus**

This is a document issued by limited companies inviting the public to subscribe to its shares. the prospectus contains detailed information about the company.it is prepared by only public companies.

### **Certification of Incorporation**

This is a document which gives legal authority to the company to operate as a legal personality.it is issued by the registrar of companies after due consultation with the various documents submitted.

### **Private and Public Companies**

Privately-held companies are are only owned by either solely by their founders, management or a group of private investors. On the other hand, Public companies are companies that have sold portions of their stocks to the public via a process called *initial public offering*. This therefore means that such companies are not owned by a close-knit group anymore as *shareholders* have claim to part of the company's assets and profits.

## **Quoted and Unquoted Companies**

Quoted companies are companies whose shares can be bought and sold on the Stock Exchange. On the other hand, unquoted companies are companies whose securities were previously issued on the stock exchange; but not anymore. In other words, a company is classified as a quoted company if it is traded on the stock exchange. Such a company also has to abide by various rules and regulations such as being audited regularly, publishing its accounts and most especially must make it easy for shareholders to sell easily etc. In the same vein, the unquoted securities have none of the above safety nets, and when you decide to sell, you may not find a buyer easily. The value of the security is hard to determine, as there is no market price. You have to agree a value at arms length with the buyer. And if you need to sell urgently, you may need to accept steep losses.

## **ASSESSMENT**

1. What is company formation?
2. What are the procedures for company formation?
3. What is the Memorandum of association and what does it contain?
4. What is a Certificate of incorporation?
5. What are the things contained in an article of association?

## **WEEK 5**

### **What is Financial System?**

#### **INTRODUCTION**

A financial system is a conglomerate of various markets, instruments, operators, and institutions that interact within an economy to provide financial services such as resource mobilization and allocation, financial inter-mediation and facilitation of foreign exchange transactions to exchange foreign trade. Financial system in a market economy is comprised of both of monetary and non-monetary claims (i.e., served debt and equity). Places, institutions or communication systems that provide a market where financial claims can be bought and sold. Specialists such as brokers and underwriters who aid in the direct transfer of funds from surplus to deficit units.

#### **The Components of the Nigerian Financial System and its Operations**

The Nigerian financial system comprises of the regulatory/supervisory authorities, banks and non-banking financial institutions. The regulatory bodies are the Central Bank of Nigeria (CBN) which is at the apex, the Nigerian Deposit Insurance Corporation (NDIC), Security and Exchange Commission (SEC), the Federal Ministry of Finance (FMF), the Nigerian Supervisory Board (NISB), and the Federal Mortgage Bank of Nigeria (FMBN).

The CBN is a major regulator and supervisor in the money market, with the NDIC playing a complementary role. The CBN exclusively regulates the activities of finance companies and promotes the establishment of development banks. The National Board for Community banks, while the

final granting of licence is the CBN's responsibility. The SEC is the Apex regulator/ supervisor in the capital market, with NSE as self-regulatory institution. The FMF and the CBN share control over Bureaux de change while the NISB is the regulatory authority in the insurance sector. The FMBN regulates mortgage financial business in Nigeria (CBN, 1990). Developmentally, the Nigeria financial system has witnessed a rapid growth in the last two decades. This could be seen from the widespread establishment of many financial institutions. The growth can be claimed to due to the oil boom and the awareness of the importance of money by Nigerians.

### **Features of the Nigerian Financial System**

The major feature of the Nigerian financial system is the dominant role the Federal and State Government play in the financial intermediation; either directly or indirectly. There are a number of government parastatals which the government often lend money to. The state and federal governments also borrow money from the financial system. The governments are also involved in the financial intermediation indirectly through ownership of banks or financial institutions. Other functions of the the Nigerian Financial System can be seen below-

1. A high level of confidence must be in place in the system.
2. An efficient financial system must be able to sustain the intermediation process.
3. An efficient financial system must have in place a large number of intermediaries and participants who must stand ready to engage in healthy competition amongst themselves and within confines and

boundaries specified by law and the various professional standards in place for the participants.

4. There should be a high degree of flexibility in the market. Also, the instruments (financial assets) employed and the methods of operation should be market based, so that the market can respond and adapt to changes in the economic and financial structure, no matter how small the change may be.
5. An efficient financial system must allow for balance in operations of the market. It requires that there should be an optimal mix of various types of financial institutions with respect to both the transfer of current savings and the stock the past savings.

## **Functions of the Money Market and Capital Market in the Nigerian Financial System**

**Money Market:** A well-developed money market is essential for a modern economy. Though, historically, money market has developed as a result of industrial and commercial progress, it also has important role to play in the process of industrialization and economic development of a country. Importance of a developed money market and its various functions are discussed below-

**1. Financing Trade:** Money Market plays crucial role in financing both internal as well as international trade. Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market. The acceptance houses and discount markets help in financing foreign trade.

**2. Financing Industry:** Money market contributes to the growth of industries in two ways:

(a) Money market helps the industries in securing short-term loans to meet their working capital requirements through the system of finance bills, commercial papers, etc.

(b) Industries generally need long-term loans, which are provided in the capital market. However, capital market depends upon the nature of and the conditions in the money market. The short-term interest rates of the money market influence the long-term interest rates of the capital market. Thus, money market indirectly helps the industries through its link with and influence on long-term capital market.

**3. Profitable Investment:** Money market enables the commercial banks to use their excess reserves in profitable investment. The main objective of the commercial banks is to earn income from its reserves as well as maintain liquidity to meet the uncertain cash demand of the depositors. In the money market, the excess reserves of the commercial banks are invested in near-money assets (*e.g.* short-term bills of exchange) which are highly liquid and can be easily converted into cash. Thus, the commercial banks earn profits without losing liquidity.

**4. Self-Sufficiency of Commercial Bank:** Developed money market helps the commercial banks to become self-sufficient. In the situation of emergency, when the commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higher interest rate. On the

other hand, they can meet their requirements by recalling their old short-run loans from the money market.

**5. Help to Central Bank:** Though the central bank can function and influence the banking system in the absence of a money market, the existence of a developed money market smoothens the functioning and increases the efficiency of the central bank.

## **ASSESSMENT**

1. What is Financial system?
2. List 5 features of the Financial system?
3. List the functions of the money market and the capital market in the Nigerian financial system.

## WEEK 6

### Shares

#### Definition of Shares

Shares can be defined as the units of capital or ownership of a limited liability company; it is the division of the company's ownership into numerous equal parts. i.e the interest which a shareholder has in the company. A company cannot commence business until it raises by selling to the public for subscription.

#### Types of Shares

**1. Ordinary shares:** These carry no special rights or restrictions. They rank after preference shares as regards dividends and return of capital but carry voting rights (usually one vote per share) not normally given to holders of preference shares (unless their preferential dividend is in arrears). Some companies create more than one class of ordinary shares – e.g. “A Ordinary Shares”, “B Ordinary shares” etc. This gives flexibility for different dividends to be paid to different shareholders or, for example, for pre-emption rights to apply to some shares but not others.

**2. Deferred ordinary shares:** A company can issue shares which will not pay a dividend until all other classes of shares have received a minimum dividend. Thereafter they will usually be fully participating. On a winding up they will only receive something once every other entitlement has been met.

**3. Non-voting ordinary shares:** Voting rights on ordinary shares may be restricted in some way – e.g. they only carry voting rights if certain conditions are met. Alternatively, they may carry no voting rights at all. They may also preclude the shareholder even attending a General Meeting. In all other respects they will have the same rights as ordinary shares.

**4. Redeemable shares:** The terms of redeemable shares give the company the option to buy them back in the future; occasionally, the shareholder may (also) have the option to sell them back to the company, although that's much less common. The option may arise at or after a specific date, between two dates or be effective at any time the shares are in issue. The redemption price is usually the same as the issue price, but can be set differently. A company can only redeem shares out of profits or the proceeds of a new share issue, which may restrict its ability to redeem shares even if the directors would like to exercise the option. If a company chooses to have redeemable shares, it must also have non-redeemable shares in issue. At no point can all of its share capital be made up of redeemable shares.

**5. Preference shares:** These shares are called preference or preferred since they have a right to receive a fixed amount of dividend every year. This is received ahead of ordinary shareholders. The amount of the dividend is usually expressed as a percentage of the nominal value. So, a N1, 5% preference share will pay an annual dividend of 5 naira. The full entitlement will be paid every year unless the distributable reserves are

insufficient to pay all or even some of it. On a winding up, the holders of preference shares are usually entitled to any arrears of dividends and their capital ahead of ordinary shareholders. Preference shares are usually non-voting (or only have a vote only when their dividend is in arrears).

**6. Cumulative preference shares:** If the dividend is missed or not paid in full then the shortfall will be made good when the company next has sufficient distributable reserves. It follows that ordinary shareholders will not receive any dividends until all the arrears on cumulative preference shares have been paid. By default, preference shares are cumulative but many companies also issue non-cumulative preference shares.

**7. Redeemable preference shares:** Redeemable preference shares combine the features of preference shares and redeemable shares. The shareholder therefore benefits from the preferential right to dividends (which may be cumulative or non-cumulative) while the company retains the ability to redeem the shares on pre-agreed terms in the future.

### **Distinctions between Issues of Shares**

Shares can be issued on the following terms:

- **Shares Issued at a Discount:** This means that the shares are quoted below the nominal value. The issuance of shares at a discount must be stipulated by the provisions of the company's act e.g shares of N3 nominal value would be issued for N2. The difference between the nominal value and issuing value is N1.

- Shares Issued at a Premium: Shares are issued at a premium when the issuing value is more than the nominal value. The difference is called premium. The premium will be regarded as capital reserve and will be posted to share premium account. e.g shares of N3 nominal value was issued at N5. The premium is N2, it occurs as a result of the attractive nature of the shares of the company.
- Shares Issued at a Par: here, shares are not issued at a discount or premium but at the actual price, this means that the nominal price is equal to the issuing price. e.g shares of N2 nominal value was issued at N2.

## **ASSESSMENT**

1. Define Shares
2. List the 6 types of shares
3. What are the terms for which Shares can be issued?
4. What is the difference between the redeemable preference shares and redeemable shares?

## WEEK 7

### Preparation of Accounts for Issue of Shares

#### Introduction

As seen in the previous lecture on shares [Here](#), there are three classes of shares namely- shares issued at par, shares issued at premium and shares issues at discounts. In this lecture, we shall now discuss the procedures for preparing the accounts for these various classes of shares. Read on below-

#### Preparation of Account for Issue of Shares at Par

A company may issue shares at their face value or at a price other than the face value. When shares are issued at a price equal to their face value it is termed as shares issued at par. When issue price of a share is more than its face value, it is known as shares issued at a premium. If issue price of a share is less than its face value, it is called as shares issued at a discount. Below are the accounting entries or procedures for preparing the account for the issue of shares are as follows-

#### 1. On receipt of applications money:

Bank a/c Dr.

To share application a/c

(Being share application money received)

#### 2. On allotment of shares:

(a) Share application a/c Dr.

To share capital a/c

(Being appropriation of application money towards share capital)

(b) Share Allotment a/c Dr.

To share capital a/c

(Being allotment money due on shares @ Rs. per share)

**3. When allotment money is received, the following entry is passed:**

Bank a/c Dr.

To share allotment a/c (Being allotment money received)

**4. (a) If any call is made on the shares, the following entries are passed:**

Share call a/c Dr.

To share capital a/c

**(b) On receipt of call money:**

Bank a/c Dr.

To share call a/c

**Preparation of Account for Issue of Share at Premium (Accounting Entries)**

The following are the entries for issuance of shares at premium-

(a) Bank a/c Dr.

To share application a/c

(Being application money received)

(b) Share application a/c Dr.

To share capital a/c

(Being application appropriated towards capital a/c)

(c) Share Allotment a/c Dr.

To share capital a/c

To securities premium a/c

(Being allotment money and premium money due on share)

Bank a/c Dr.

To share allotment a/c

(Being allotment money received)

Please note that there are no restrictions on the issue of shares at a premium. However, it is only prosperous companies because of their financial strength and high earning capacity which are in a position to offer shares at a premium.

### **Preparation of Account for issue of Shares at Discount**

**Shares can be issued at discount subject to the following conditions:**

(a) The shares must belong to a class already issued.

(b) Discount rate should not be more than 10%.

(c) One year must have passed since the date at which the company was allowed to commence business.

(d) The issue of such shares must take place within two months after the date of court's sanction or within such extended time as the court may allow.

(e) The issue must be authorised by a resolution passed by the company in general meeting and sanctioned by the Company Law Board.

## **Accounting Treatment:**

### **i. Generally, the 'Discount on Shares' is recorded at the Time of Allotment:**

Share Allotment A/c ... Dr. (With the amt., due) Discount on Issue of Shares A/c ... Dr. (With discount)

To Share Capital A/c (Total amount)

(Being the allotment money due)

### **(ii) To Write off 'Discount on Shares'**

Profit & Loss A/c/Securities Premium Reserve A/c .....Dr

To Discount on Issue of Shares A/c

Note. Discount on issue of shares is recorded at the time of allotment made due.

## **Illustration:**

(Shares Issued at discount and calls in arrears. Trendy Shoe Company invited applications for 12,000 equity shares of N100 each at a discount N4 per share (allowed at the time of allotment). The amount was payable as follows: On Application N30, on allotment N36, on first and final call N30.

The public applied for 10,000 shares and these were allotted. All money due was with the exception the first and final call on 400 shares.

**Required:**

Journalese the above transactions in the books of the Company.

**ASSESSMENT**

1. What are the conditions for which Shares can be issued at discount subject?
2. What are the accounting entries or procedures for preparing the account for the issue of shares?

**SOLUTION :****JOURNAL**

<i>Particulars</i>		<i>L.F.</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Bank A/c (10,000 × 30)	Dr.		3,00,000	
To Equity Share Application A/c				3,00,000
(Being the receipt of application money on 10,000 shares @ ₹ 3 per share)				
Equity Share Application A/c	Dr.		3,00,000	
To Equity Share Capital A/c				3,00,000
(Being the transfer of share application money to Share Capital A/c)				
Equity Share Allotment A/c (10,000 × 36)	Dr.		3,60,000	
Discount on Issue of Shares A/c (10,000 × 4)	Dr.		40,000	
To Equity Share Capital A/c (10,000 × 40)				4,00,000
(Being the allotment money due on 10,000 shares @ ₹ 36 per share)				
Bank A/c (10,000 × 36)	Dr.		3,60,000	
To Equity Shares Allotment A/c				3,60,000
(Being the share allotment money received)				
Equity Share First & Final A/c (10,000 × 30)	Dr.		3,00,000	
To Equity Share Capital A/c				3,00,000
(Being the first & final call money due)				
Bank A/c (9,600 × 30)	Dr.		2,88,000	
Calls in Arrears A/c	Dr.		12,000	
To Equity Share First & Final call A/c				3,00,000
(Being the first & final call money received on 9,600 @ ₹ 30 per share)				

## Week 8

### What is Loan Capital?

#### introduction

Loan Capital is the part of a company's capital that is not equity capital but earns a fixed rate of interest instead of dividends, and must be repaid within a specified period; irrespective of the company's financial position. Loan capital may be obtained from a bank or finance company in the forms of long-term loans, or from debt-equity investors in the form of debentures or preferred stock (preference shares). It is usually secured by a fixed and/or floating charge on the company's assets. Unlike debt capital, it does not include short-term loans (such as overdraft).

Loan Capital can also be defined as a long-term capital that is employed from sources other than common stock or savings. That is, loan capital is what a company has borrowed or issued in preferred stock. Loan capital is distinguished by the fact that a company is required to pay coupons or dividends periodically. That is, unlike common stock, loan capital carries a fixed liability for a company. Likewise, it is usually *collateralized* by one or more of the company's assets.

In the same vein, A debenture is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to

secure capital. Like other types of bonds, debentures are documented in an indenture.

### **Types of Debentures**

- Redeemable and Irredeemable (Perpetual) Debentures
- Convertible and Non-Convertible Debentures
- Fully and Partly Convertible Debentures
- Secured (Mortgage) and Unsecured (Naked) Debentures
- First Mortgaged and Second Mortgaged Debentures
- Registered Unregistered Debentures (Bearer) Debenture
- Fixed and Floating Rate Debentures
- Zero Coupon and Specific Rate Debentures
- Callable and Puttable Debentures/Bond

### **Distinction between Shares and Debentures**

#### **Comparison Chart**

<b>BASIS FOR COMPARISON</b>	<b>SHARES</b>	<b>DEBENTURES</b>
<b>Meaning</b>	<b>The shares are the owned funds of the company.</b>	<b>The debentures are the borrowed funds of the company.</b>
<b>What is it?</b>	<b>Shares represent the capital of the company.</b>	<b>Debentures represent the debt of the company.</b>

<b>BASIS FOR COMPARISON</b>	<b>SHARES</b>	<b>DEBENTURES</b>
<b>Holder</b>	The holder of shares is known as shareholder.	The holder of debentures is known as debenture holder.
<b>Status of Holders</b>	<b>Owners</b>	<b>Creditors</b>
<b>Form of Return</b>	Shareholders get the dividend.	Debenture holders get the interest.
<b>Payment of return</b>	Dividend can be paid to shareholders only out of profits.	Interest can be paid to debenture holders even if there is no profit.
<b>Allowable deduction</b>	Dividend is an appropriation of profit and so it is not allowed as deduction.	Interest is a business expense and so it is allowed as deduction from profit.
<b>Security for payment</b>	<b>No</b>	<b>Yes</b>
<b>Voting Rights</b>	The holders of shares have voting rights.	The holders of debentures do not have any voting rights.

<b>BASIS FOR COMPARISON</b>	<b>SHARES</b>	<b>DEBENTURES</b>
<b>Conversion</b>	<b>Shares can never be converted into debentures.</b>	<b>Debentures can be converted into shares.</b>
<b>Repayment in the event of winding up</b>	<b>Shares are repaid after the payment of all the liabilities.</b>	<b>Debentures get priority over shares, and so they are repaid before shares.</b>
<b>Quantum</b>	<b>Dividend on shares is an appropriation of profit.</b>	<b>Interest on debentures is a charge against profit.</b>
<b>Trust Deed</b>	<b>No trust deed is executed in case of shares.</b>	<b>When the debentures are issued to the public, trust deed must be executed.</b>

### **Key Differences Between Shares and Debentures**

The following are the major differences between Shares and Debentures:

1. The holder of shares is known as a shareholder while the holder of debentures is known as debenture holder.
2. Share is the capital of the company, but Debenture is the debt of the company.

3. The shares represent ownership of the shareholders in the company. On the other hand, debentures represent indebtedness of the company.
4. The income earned on shares is the dividend, but the income earned on debentures is interest.
5. The payment of dividend can be made only out of current profits of the business and not otherwise. Unlike the interest on debentures which has to be paid by the company to debenture holders, no matter company has earned profit or not.
6. Dividend is not a business expense and so is not allowed as deduction. On the contrary, interest on debentures is a expense and so allowed as a deduction.
7. In the event of winding up, debentures get priority of repayment over shares.
8. Shares cannot be converted as opposed to debentures are convertible.
9. There is no security charge created for payment of shares. Conversely, security charge is created for the payment of debentures.
10. A trust deed is not executed in case of shares whereas trust deed is executed when the debentures are issued to the public.
11. Unlike debenture holders, shareholders have voting rights.
12. Shares are issued at a discount subject to some legal compliance. Debentures can be issued at a discount without any legal compliance.

## **ASSESSMENT**

1. What is loan capital?

2. What are the key differences between shares and debentures?
3. List the types of debentures

## **WEEK 9**

### **What is a Capital Market?**

#### **INTRODUCTION**

A capital market is any financial market in which long-term debts and equity-backed *securities* are traded (i.e., bought and sold). These securities are typically Capital markets are defined as markets in which money is provided for periods longer than a year. Capital markets channel the wealth of savers to those who can put such wealth to long-term productive use; such as companies or even governments making long-term investments. The capital is typically overseen by financial regulators or monitors such as the Nigerian Securities and Exchange Commission (SEC).

## **The Requirements for enlisting in the Capital Market**

1. Application for Listing will only be entertained if sponsored by a Dealing Member of The Exchange.
2. The company must be a public company, which will issue or has issued an invitation to the public to subscribe for its shares or has satisfied Council that the public is sufficiently interested in the company's shares to warrant Listing.
3. All securities for which listing is sought shall first be registered with the Securities and Exchange Commission.
4. All application and documents to be considered or approved by Council should always be submitted to The Exchange at the earliest possible date. The final prospectus for approval must be forwarded to The Exchange at least seven working days before the date for the completion board meeting.
5. Before the grant of Listing, all applicant companies shall sign a General Undertaking that they will provide promptly certain information about their operations and that they will follow certain administrative procedures.
6. Where it is desired to increase the authorized share capital, the directors shall state, in the explanatory circular or other documents accompanying the notice of meeting, whether or not they presently have any intention of issuing all or any part thereof.
7. A company which applies for Listing shall comply with the minimum public float requirement prescribed by the Listing standard criteria chosen by the Issuer.

8. Subscriptions list must remain open for a maximum period of 28 working days.
9. A maximum of 10% of an offering will be allowed to staff of a company (or its subsidiaries or associated companies) on special application forms. Such offerings may be placed in Trust for the employees. Where a proportion of the shares in a placement or public offer is reserved for employees, the company shall provide The Exchange along with the General Undertaking a list of members of staff who have been allotted shares, the number of such shares, the capacity in which they work for the company and the number of years of service with the company.
10. All companies admitted to Listing on The Exchange shall pay a listing fee as laid down in Appendix iv and these fees are subject to review from time to time.
11. All clauses in the company's Memorandum & Articles of Association that restrict the transfer of fully paid-up shares must be expunged.
12. All Listed companies shall advertise the Notice of their annual general meetings in at least two widely read newspapers at least 21 days before the annual general meeting and such advertisement must be conspicuously placed to cover a reasonable portion of a page.
13. The subscription monies pending allotment and return of funds to subscribers shall be deposited in a designated bank account appointed by the Issuing House and the company. All accrued interests in respect of cleared allotments shall be paid to the company to offset part of the cost of the Issue.

14. Return monies arising from an unsuccessful application or abortion of an offer/issue shall attract interest at the rate determined by the Commission.
15. These general requirements are not exhaustive and Council may add thereto or subtract therefrom as considered necessary subject to the approval of the Securities and Exchange Commission.

## **ASSESSMENT**

1. What is capital market?
2. List 7 requirements for enlisting on the capital market?

## **WEEK 10**

### **Procedure for the formation of a Company**

#### **INTRODUCTION**

During the formation of a Limited Liability Company, the following procedures must be followed-

1. The first step is to get the promoters; they are individuals who conceive the idea of a company and undertake to fulfill all legal requirements of the venture.
2. The following documents will be filled with the registrar of companies. These are memorandum and article of association and statement of nominal capital.
3. The documents are stamped and logged with the registrar of companies for verification.
4. When the registrar of companies receives and approves the necessary documents the registrar issues a certificate of incorporation.

#### **Memorandum of association**

The memorandum of association contains the external rules of the company, it refers to the object and power of the company and how it intends to deal and interact with the outside world; it contains the following

1. The name of the company and the word limited liability at the end.
2. The registered office.
3. The object of the company.

4. The declaration that the liability is limited.
5. The amount of the authorized capital

### **Articles of association**

This is a document which states the internal regulations of a limited company. It contains the regulations which govern the internal management of the company affairs. The following are found in the article;

1. The right and responsibilities of the shareholder.
2. The duties and power of the directors.
3. How directors may be appointed.
4. The right and duties of the members as between each other and the company.
5. The procedure for accounting and auditing of the company's book etc.

### **Prospectus**

This is a document issued by limited companies inviting the public to subscribe to its shares. The prospectus contains detailed information about the company. It is prepared by only public companies.

### **Certification of incorporation**

This is a document which gives legal authority to the company to operate as a legal personality. It is issued by the registrar of companies after due consultation with the various documents submitted.

## **Share capital**

There are various terms used in connection with the share capital

1. Authorized or registered capital or nominal capital: this is the total amount stated in the memorandum of association and approved by the registrar of companies which a company can issue out.
2. Issued capital: this is the total amount that the directors decide to issue to the public for subscription.
3. Called up capital: this is the total amount asked for on all shares.
4. Paid up capital: this is the total amount of shares paid for on the issued capital.
5. Uncalled-up capital: the total amount which has not been called up on the issued share capital.
6. Calls in arrears: this relates to amount called for but not yet received.
7. Calls in advance: this relates to money received prior to payment being requested.

## **Test and Exercise**

Explain the procedures for formation of company.