

**School:** RATU NAVULA COLLEGE **Level:** Year 11

**Subject :** Accounting

**Week:** 1

Lesson 62 - 64

Strand 4: Accounting Reports

Strand 4.1 : Balance Day Adjustments

**Learning Outcome:** Explain the meaning and purpose of balance day adjustments and discuss the different types of adjustments.

Prepare general journal entries for balance day adjustments.

#### 4.1 → **Balance Day Adjustments**

Balance day adjustments are adjustments that need to be made on some accounts at the end of the financial year, so that they accurately reflect the performance of the business.

- ➔ These are only required when a company is using an accrual accounting system, as income or expenses may be recognized and paid or received at different times.

##### **Purpose of Balance Day Adjustments**

- o is to match costs against related income and also to up – date the accounts at the end of the financial period.

##### ✚ **Cash Basis Accounting**

- o means that revenues and expenses are not recognized until the cash is received or paid.

##### ✚ **Accrual Basis Accounting**

- o means that revenue is recognized when earned and expenses when incurred, irrespective of whether they are cash or credit transaction.
- o it takes into account all the revenues and expenses during the period to measure profit and loss .
- o Accrual basis is better than cash basis because revenue is matched against expenses incurred in earning them.

#### 1. **Prepayments**

- ➔ They represent expenses which are paid during the year but relates to next accounting period. They are also termed as Unexpired Cost, Expenses paid in advance or Prepaid Expenses.

##### **Rules for Posting**

Date	Particulars	Debit \$	Credit \$
	Prepaid Expense	Xx	
	Related Expense Account		xx

- Deduct the amount of prepayment from the related expense figure on the **debit side** of profit and loss account/Statement of Financial Performance.
- Record the amount of prepayment under **current assets** in the balance sheet.

For example: Trial Balance (extract)

	\$		\$
<u>Insurance</u>	<u>550</u>		

Additional Information:

1. Insurance paid in advance/ unexpired \$100

Solution

General Journal Entry

Date	Particulars	\$	\$
	Insurance Prepaid Insurance (To record insurance prepaid)	100	100

Profit and Loss (extract)

Expenses	\$		\$
<u>Insurance (550 – 100)</u>	<u>450</u>		

Balance Sheet (extract)

	\$		\$
<u>Current Assets</u>			
<u>Insurance Prepaid</u>	<u>100</u>		

## 2. Accrued Expenses

- ➡ Are expenses which has been incurred but not yet paid.
- ➡ Also known as expenses due, unpaid expense, expired cost.

Rules for Posting

Date	Particulars	Debit	Credit
	Related Expense Account	xx	
	Expense Due		xx

- Add the unpaid amount to the related expense figure on the **debit** side of profit and loss account.
- Record the amount of expense due under **current liabilities** in the balance sheet.

For example: Trial Balance (extract)

	\$		\$
<u>Interest</u>	<u>325</u>		

Additional Information:

2. Interest paid on balance day amounted to \$75

Solution

General Journal Entry

Date	Particulars	\$	\$
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	Interest Interest due (To record interest due but not paid)	75	75
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## Profit and Loss (extract)

<u>Expenses</u>	<u>\$</u>		<u>\$</u>
<u>Interest (325+75)</u>	<u>400</u>		

## Balance Sheet (extract)

	<u>\$</u>		<u>\$</u>
		<u>Current Liability</u>	
	<u>100</u>	<u>Interest due</u>	<u>75</u>

3. **Income Accrued**

It is the income that is earned during the accounting period but not received on balance day.

It is also known as income in arrears, income due, income receivable, etc.

Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Income Due	xx	
	Related Income Account		xx

- **Add** the amount to the income due to the related income account on the credit side of profit and loss account.

For example: Trial Balance (extract)

	<u>\$</u>		<u>\$</u>
		<u>Interest on Deposit</u>	<u>300</u>

Additional Information:

- Interest on deposit due on balance day \$30

Solution

General Journal Entry

Date	Particulars	\$	\$
	Interest on deposit due Interest on deposit (To record interest due but not received)	30	30

## Profit and Loss (extract)

	<u>\$</u>	<u>Revenues</u>	<u>\$</u>
		Interest on deposit <u>(300+30)</u>	330

## Balance Sheet (extract)

	<u>\$</u>		<u>\$</u>
<u>Current Assets</u>			

<u>Interest on deposit due</u>	<u>30</u>		
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4. Income Received in Advance: Record the amount of income due under **current assets** in the balance sheet.
  5. This represents the income that is not earned but received in advance on the balance day.
- ➔ It is also known as income in advance, unearned revenue or pre-received revenue.

### Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Related Income Account	xx	
	Income Received in Advance		xx

- Deduct the amount of the income received in advance from the related income account on the **credit** side of profit and loss account.
- Record the amount of income received in advance under **current liabilities** in the balance sheet.

For example: Trial Balance (extract)

	\$		\$
		<u>Commission</u>	<u>600</u>

Additional Information:

4. Commission received in advance \$200

### Solution

#### General Journal Entry

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	Commission	200	
	Commission received in advance (To record commission received in advance)		200

Profit and Loss (extract)

	\$	<u>Revenues</u>	\$
		<u>Commission (600-200)</u>	400

Balance Sheet (extract)

	\$		\$
		<u>Current Liability</u>	
		Commission received in advance	200

### Activities

1. State the purpose of balance day adjustments.
2. Explain the meaning of the following terms.
  - A. Accrual Basis:

B. Unexpired Cost:

3.

**Trial Balance of Meres Enterprise (extract) as at 30<sup>th</sup> June 2017**

	<u>\$</u>		<u>\$</u>
<u>Insurance</u>	<u>1230</u>	<u>Rent</u>	<u>1100</u>
<u>Vehicles</u>	<u>8100</u>	Interest on Investment	2500
<u>Wages</u>	<u>190</u>		

**Balance Day Adjustments**

1. Wages due \$48
2. Insurance prepaid \$87
3. Rent accrued \$158
4. Interest on investment received in advance \$500

**Required:**

- a. Prepare the General Journal entries for the above.

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	(To record wages due)		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	(To record prepaid insurance)		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	(To record rent accrued)		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	(To record interest on investment received in advance)		

- b. Prepare the Profit and Loss Extract.

Profit and Loss (extract)

	<u>\$</u>	<u>Revenues</u>	<u>\$</u>


**c. Prepare the Balance Sheet extract**

Balance Sheet (extract)

	\$		\$
<u>Current Asset</u>		<u>Current Liability</u>	

Lesson 65-66

Strand 4: Accounting Reports

Strand 4.1 : Balance Day Adjustments

Learning Outcome:

Prepare general journal entries for balance day adjustments.

Show profit and loss and balance sheet extract

**Depreciation**

✚ refers to the writing off the cost of a fixed asset over its useful life .

**Straight Line Method/ Fixed Instalment Method**

- The depreciation expense remains the same irrespective of the year.
- The book value of the asset decreases at a constant amount.

**Formula**

$\text{Depreciation per Annum/ Year} = \frac{\text{Original cost} - \text{Scrap value}}{\text{Estimated useful life}}$ <p style="text-align: center;"><b>OR</b></p> $\text{Depreciation per Annum/ Year} = \text{Original Cost} \times \text{Rate}$
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**Example**

On 1 January 2011 a business purchased Equipment for \$6000 cash. Its estimated life was considered to be 5 years with a residual value of \$2000. The financial year ends on 31 December each year.

**Required:**

a) Calculate Depreciation per annum for equipment Depreciation per

annum =  $\frac{\text{Original Cost} - \text{Scrap value}}{\text{Estimated Useful Life}}$

$$\text{\$800/ annum} = \frac{\text{\$6000} - \text{\$2000}}{5 \text{ Years}}$$

### ➡ General Journal Entry for Recording Depreciation

Date	Particulars	Debit \$	Credit \$
	Depreciation on (name of the asset)	800	
	Provision for depreciation (name of the asset)		800

### Balance Sheet (extract)(31/12/13)

<b><u>Fixed Asset</u></b>	\$
Name of the Asset (Original Cost)	6000
Less Accumulated Depreciation	<u>2400</u>
Book value	<u>3600</u>

### Another name for Provision for Depreciation is Accumulated Depreciation

**Provision for Depreciation** means the total amount of depreciation that has accumulated for a particular asset

### Bad Debts

➡ A **bad debt** is the loss arising from the debtor that is unlikely to pay his/her debt.

➡ Bad Debt arises when:

- o The debtor has gone bankrupt
- o The debtor has migrated
- o It is too costly to take legal action to collect a small amount of debt

### Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Bad Debts	xx	
	Debtors		xx

- The amount of bad debts from the adjustment is added to the related bad debts expense on the debit side of the profit and loss account
- The debtor is decreased by the amount of bad debts from the adjustment in the balance sheet under current assets

For example:

#### Trial Balance

	\$		\$
Debtors	1600		
Bad debts	340		

Additional Information:

5. Provide bad debts on debtors at 10%

Solution

General Journal Entry

Date	Particulars	\$	\$
	Bad debts (10/100 x 1600)	160	
	Debtors		160
	(To record bad debts written off)		

#### Profit and Loss (extract)

	\$		\$
Bad debts (340+160)	500		

#### Balance Sheet (extract)

	\$		\$
Current Asset			
Debtors (1600-160)	1 440		

### ➔ Doubtful Debts

- ➔ Doubtful debts are those debts which a business or individual is unlikely to be able to collect. The reasons for potential non-payment can include disputes over supply, delivery, and the condition of item or the financial stress within a customer's operations. When such a dispute occurs it is prudent to add this debt to the doubtful debt account.



## Rules for Posting

### 1. To Create Provision for Doubtful Debts

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	xx	
	Provision for Doubtful Debts		xx

### 2. To Increase Provision for Doubtful debts

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	xx	
	Provision for Doubtful Debts		xx

### 3. To Decrease Provision for Doubtful debts

Date	Particulars	Debit \$	Credit \$
	Provision for Doubtful Debts	xx	
	Doubtful Debts		xx

### **Formula for Calculating**

$$\text{Doubtful Debt} = (\text{Debtors} - \text{Additional Bad Debts}) \times \text{Rate} / 100$$

- Actual amount of provision for doubtful debts is calculated by using the above formula.

### Rules to follow

Estimated amount for doubtful debts is given in the trial balance on the **credit side**

Actual amount > Estimated amount = increase in provision for doubtful debts

Actual amount < Estimated amount = decrease in provision for doubtful debts

Actual amount is deducted from the Debtors in the balance sheet under current assets

**Activities**

Kristina operates a tailoring business in her hometown as Kristina's Tailoring. Given below is a Trial Balance extract and additional information for the business as at 30<sup>th</sup> June, 2018.

**Kristina's Tailoring  
Trial Balance (extract) as at 30<sup>th</sup> June, 2018**

	\$		\$
Interest on Loan	1 300	Loan (8% p.a. due 2022)	20 000
Rent	4 200	Accumulated Depreciation on Equipment	3 750
Equipment	15 000	Provision for Doubtful Debts	90
Bad Debts	60	Commission	1 040
Insurance	650		
Accounts Receivable	2 500		

**Additional information as at 30<sup>th</sup> June, 2018**

1. Rent per month is \$300.
2. Interest on loan is due \$300.
3. Depreciation on equipment is yet to be provided \$1 500.
4. Commission received in advance \$80.

**Prepare Journal entries for the balance day adjustments 1-4**

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	( )		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	( )		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	( )		

<u>Date</u>	<u>Particulars</u>	<u>\$</u>	<u>\$</u>
	( )		

**The End**

**KL**