Accounting for incomplete records flashcard

These consist of medium sized business entities like; drycleaner, motor car dealers, house building contractors, schools etc. etc. 1. 3 Large scale business entities These consist of large sized business entities like; importers/exporters, motor car manufactures, transporters etc. tc. Here it must be made clear that large scale business entities have these much resources with them that these can easily afford a systematic accounts department where they will be following the double entry book keeping system. Moreover, most of these concerns are incorporated bodies and these have to maintain systematic accounting records in order to fulfill requirements of the Companies Ordinance 1984 and International Financial Reporting Standards (IFRS). . Accounting for Small scale business entities Small scale business entities are often single owner organizations (Sole proprietorship). These are very small in size and can not really run an accountants department in their organizations. They have a very little setup in which a sole trader is acting so many rolls; he/she is the sales manager, and also the purchase manager, also responsible for marketing and accounts matters as well.

A sole proprietor is also concerned about financial performance (profitability) and financial position of the organization, which can make him/her able to take certain future decisions. Certain government agencies, like taxation department, also require knowing profits of the organization. But as the size of the organizations are very little and these can hardly afford an accountant therefore a very simple accounting system is proposed for such organizations. 2. 1 Accounting Records These rganizations do not have to keep any complex accounting records, these are directed by their accounts consultant (Qualified Accountants) to keep certain information relating to cash receipts (introduction of fresh capital) and payments (drawings) and also relating to the period end balances of assets and liabilities. As size of the transactions are very little therefore one can remember very easily what are the (C) Copyright Virtual University of Pakistan 1 Advance Financial Accounting (FIN-611) VU ear end balances of loan taken or was there any addition or disposal of assets during the year. Finally the consultants prepare a statement of profit or loss for the period and also a balance sheet as on the closing date of such period. 2. 2 Statement of Profit or Loss As you have studied in your earlier courses that profit is an out come of the Income Statement that is prepared in a systematic way with the help of a trial balance extracted from the ledger. But over here in the absence of a trial balance we are not able to prepare an Income Statement.

Here we will see that where that profit goes within the financial statements, we finally find that the profit is added up in the Owner’s Equity, which appears like this: Rs. Owner’s Equity (opening balance) *** Add Fresh capital (introduced during the year) *** Net profit (for the year) *** Less Drawings (during the year) (**) Owner’s Equity (closing balance) *** For small scale business entities, which are not preparing proper books of accounts and cannot extract a trial balance, the technique to calculate Net Profit will be to come other way round.

To calculate Net Profit figure from the above equation one must know the all other information that has to be put into it. Now the above equation will be reversed and Net Profit figure will be its out come and this equation is then named as the “ Statement of Profit or Loss”. Name of the Organization

Statement of Profit or Loss For the year ended December 31, 20×7 Rs. Owner's Equity (closing balance) *** Add Drawings (during the year) *** Less Owner's Equity (opening balance) (**) Fresh Capital (introduced during the year) (**) Net profit (for the year) [balancing figure] *** 2. Statement of Affairs From examination stand point, Drawings and Fresh capital will be given in the questions but often the students will be required to calculate the opening and closing balances of Owner's Equity as these will not be given in the question as a single amount. (C) Copyright Virtual University of Pakistan 2 Advance Financial Accounting (FIN-611) VU If you have not yet forgotten the basic accounting equation then Statement of Affairs is very simple to understand.

Unfortunately he did not keep proper books of account. He is forced to submit a calculation of profit for the year ended 31 December 2005 he had stock valued at cost Rs. 3, 950, a van which had cost Rs. 2, 800 during the year and which had depreciated by Rs. 550, debtors of Rs. 4, 970, expenses prepaid of Rs. 170, bank balance Rs. 2, 564, cash balance Rs. 55, trade creditors Rs. 1, 030, and expenses owing Rs. 470. His drawings were: cash Rs. 100 per week for 50 weeks, Cheque payments Rs. 673. Draw up statements to show the profit or loss for the year.

Jehan Zeb is a dealer who has not kept proper books of account. At 31 August 2006 his state of affairs was as follows: Rs Cash 115 Bank Balance 2, 209 Fixtures 4, 000 Stock 16, 740 Debtors 11, 890 Creditors 9, 052 Van (at valuation) 3, 000 During the year to 31 August 2007 his drawings amounted to Rs. 7, 560. Winnings from a football pool Rs. 2, 800 were put into the business Extra fixtures were bought for Rs. 2,. 000. At 31 August 2007 his assets and liabilities were: Cash Rs. 84; Bank overdraft Rs. 165; stock Rs. 21, 491; Creditors for goods Rs. , 002; Creditors for expenses Rs. 236; Fixtures to be depreciated Rs. 600; Van to valued at Rs. 2, 500; Debtors Rs. 15, 821; prepaid expenses Rs. 72 Draw up a statement showing the profit and loss made by Jehan Zeb for the year ended 31 August 2007. 3 (C) Copyright Virtual University of Pakistan 4 Advance Financial Accounting (FIN-611) VU LESSON # 2 PRACTICING ACCOUNTING FOR INCOMPLETE RECORDS Following question illustrates how adjustments are incorporated in the closing statement of affairs and what is the difference in a Balance Sheet and a Statement of Affairs.

By solving this question students will learn that the only items of Statement of Profit or loss are four i. e. , opening balance of owners' equity, closing balance of owners' equity, fresh capital and drawings the result after adjusting these items accordingly will be Net profit for the year. Remember one thing the adjustments like depreciations, provision for doubtful debts, accruals etc are not accounted for in the statement of profit or loss. Question Ali and Bilal are partners in a firm sharing profits and losses in the proportion of 3: 2.

They keep their books on the single entry system. On 31 December, 2006, the following Statement of Affairs was extracted from their books: Liabilities Capital Accounts Ali Bilal Loan- Bilal Sundry Creditors Rs 25, 000 20, 000 25, 000 30, 000 1, 00, 000 Assets Plant & Machinery Stock Sundry Debtors Cash at Bank Rs 30, 000 20, 000 35, 000 15, 000 1, 00, 000 On 31st December, 2007, their assets and liabilities were: Sundry Debtors Rs 40, 000; Sundry

Creditors Rs 25, 000 Plant & Machinery Rs 50, 000; Stock Rs 30, 000; Bills Receivable Rs 5, 000; Cash at Bank Rs 25, 000; Loan- Bilal Rs 25, 000.

You are required to prepare a Profit and Loss Statement for the year ended 31st December, 2007 and a Statement of Affairs as at that date after taking into consideration the following: a) Plant and machinery is to be depreciated by 10% p. a. b) Stock is to be reduced to Rs 25, 000. c) A provision for bad debts to be raised at 5% on Sundry Debtors d) Interest on loan is to be allowed at 6% p. a. e) During the period Ali and Bilal draw Rs 5, 000 and Rs 3, 000 respectively.

Solution Statement of Affairs Ascertainment of Combined Closing Capital as on December 31, 2007 Liabilities Rs Rs Assets Rs Rs Loan- Bilal 25, 000 Plant & Machinery 50, 000 Add: Outstanding 1, 500 26, 500 Less: Depreciation 4, 000 46, 000 Interest Stock 25, 000 25, 000 Sundry Debtors 40, 000 Creditors Less: Provision for 2, 000 Doubtful debts 38, 000 87, 500 Bills Receivable 5, 000 (C) Copyright Virtual University of Pakistan 5 Advance Financial Accounting (FIN-611) Combined Capital (balancing figure) 1, 39, 000 Ali & Bilal Statement of Profit and Loss for the year ended 31. 2. 2007 Combined closing Capital (as above) Add: Combined Drawings during the year (Rs 5, 000+Rs 3, 000) Less: Combined Opening Capital (Rs 25, 000 + Rs 20, 000) Profit before adjustments Rs 87, 500 8, 000 95, 500 45, 000 50, 500 Divisible profit: Ali-3/5th of Rs. 50, 500 Bilal 2/5th of Rs. 50, 500 30, 300 20, 200 Cash at bank 25, 000 VU 1, 39, 000 50, 500 Liabilities Capital–Ali Opening balance Add: Profit Less: Drawings Capital- Bilal Opening Balance Add: Profit Less: Drawing Loan- Bilal Outstanding Interest Sundry Creditors

Ali & Bilal Balance Sheet as at 31. 12. 2007 Rs Rs Assets Rs Plant & Machinery 50, 000 Less: Depreciation 4, 000 25, 000 Stock 30, 000 Sundry Debtors 40, 000 55, 300 50, 300 Less: Provision for 2, 000 5, 000 Doubtful debts Bills Receivable 20, 000 Cash at bank 20, 200 40, 200 3, 000 37, 200 25, 000 1, 500 25, 000 Rs 46, 000 25, 000 38, 000 5, 000 25, 000 1, 39, 000 1, 39, 000 Following question illustrates how changes in the balances of assets and liabilities affect the in crease or decrease in the balances of owner's equity.

Important tips: • Increase in the balance of asset will cause an increase in the owner's equity • Increase in the balance of liabilities will cause a decrease in the owner's equity • Decrease in the balance of asset will cause a decrease in the owner's equity (C) Copyright Virtual University of Pakistan 6 Advance Financial Accounting (FIN-611) • • VU Decrease in the balance of liabilities will cause an increase in the owner's equity Increase in balance means that closing balance is greater than the opening balance and vice versa.

Question Calculate net profit for the year ending on December 31, 2007 from the information regarding changes occurred at the end of the year in following balances: Rupees Increase in Machinery 14, 000 Increase in Stocks 6, 000 Decrease in Debtors 2, 000 Decrease in Cash 1, 000 Increase in Creditors 1, 500 Decrease in Accrued expenses 300 Drawings during the year 2007 10, 000 Fresh capital introduced during the year 2007 4, 000 Solution Working: Increase/decrease in owner's equity (net assets) Increase in Machinery Increase in Stocks Decrease in Debtors Decrease in Cash Increase in Creditors Decrease in Accrued expenses