Week 25

Penang Sangam High School

Accounting-Year 11

Strand 5: Systems for Implementing the Accounting Process

Sub-strand: SUB SYSTEM CASH

Internal Controls over Cash

Significance of Cash as a Liquid Asset

- most business transactions involves receiving and paying cash
- Since cash can be easily stolen and is tempting, adequate control must be implemented to ensure that people with dishonest intentions are detected.

Internal Control over Cash Reciepts

- All money received should be evidenced by a document or other proof.
- All cash received should be **banked intact** at the end of the business day. **Intact** means no payment to be made out of the daily takings. Banking daily ensures that no cash is left in the premises overnight.
- Provide a receipt. Ideally receipts should be pre-numbered and two-part. One copy should be provided to the payer while the other copy is kept on file. All copies of cancelled or mutilated receipts should be retained in the receipt book for auditing purpose. Unused receipts to be locked away.
- Employees who receive or handle cash should not be making entries in the accounting records.
- Keep cash/cheques in a locked and secure area until they can be deposited.
- Duties should be segregated, meaning that the person recording the receipt should not be the same as that making the deposit. If there are only 2 people in the department, the reconciliation should be performed by the person collecting the receipts.
- Any refund of cash should be approved by an authorized person.
- If cash or cheques are received regularly in the mail, two persons should be present when the mail is opened.
- Cash registers and credit card machines should be balanced daily. Over/short amounts should be monitored.

Internal Control Over Cash Payments

Cash is disbursed to pay expenses and liabilities or to purchase assets.

- All payments except petty cash should be made by cheque supported by proper invoice/statements received. The paid cheque provides proof of payment.
- All unused cheques books or forms should be kept in the safe place.

- Cheques should be prenumbered (easy for reference and identifying lost
- cheques) To make cheques safer, they should be crossed "Not Negotiable".
- all cheques should be properly authorized before the payment is made and preferberly two signatories.
- A regular bank reconciliation should be prepared by a person other than the person receiving or making payments

Source document for cash receipts	Source document for cash payments
cash register tape cash sales docket receipt credit side of bank the Statement	cheque butt debit side of the bank statement

PETTY CASH IMPREST SYSTEM

Petty cash procedures represent the use of business cash for minor purchases. Petty cash procedures include setting a fixed petty cash amount for each month, requiring approval prior to spending cash and reconciling the petty cash at least once a month.

Controls over Petty Cash

- The following are the controls over Petty Cash:
  - Petty cash fund should be kept in a safe locker.
  - Petty cash vouchers must be used to record all petty cash expenses, signed by an employee and authorized by a responsible officer.
  - All petty cash vouchers must be numbered and recorded in a sequence
  - order. When reimbursing, all paid vouchers should be submitted to the reimbursing cashier for auditing purpose.
  - Establish a rule to maintain a certain sum for payment only for example a maximum of $4.00.
  - An accurate petty cash book should be prepared and checked by a senior officer.
- It is important that the Petty Cash is used only for the purpose for which it was set up and the following should be avoided:
  - Cash advances for payments. If this is necessary, the advance should be authorized.
  - Borrowing cash from the petty cash.
  - Paying wages out of petty cash.
  - Cash expenditure exceeding the limit set by the Board. For any larger items of expenditure either pay by cheque or draw the cash out of the bank separately. Keep these items separate from the petty cash system.
  - Open access to the petty cash box. Access to the petty cash box should be restricted, with responsibility for the money being clearly assigned. This is to

minimize the risk of errors or unauthorized expenditure occurring

Accounting for Petty Cash Imprest System

Petty cash system is used to make small payments. An original cheque is drawn, cashed and given to the **petty cashier** who handles payments for small expenses using petty cash voucher.

Cash Payment Journal entry is made for the cheque and debited to the petty cash imprest Account.

Petty cash voucher is written by the cashier. The **petty cash book** is prepared from the voucher and balanced. A reimbursement cheque is drawn when the funds in the petty cash becomes low. The reimbursement cheque is the amount of fund used up for expenses.

NB: Petty cash imprest is classified as a current asset in the balance sheet. **Example of a Petty Cash**

Voucher

Petty Cash Voucher			
		Number	
Department		**Date**	
Amount Requested			
Description of Need			
Requested By			
Approved By		**Signature**	

The following has been extracted from Shelly's Books. It shows the amount paid to the vouchers during the month of October, 2014

Date	Transactions	*Voucher No.*	Amount $
01/10	Advance to Petty Cashier Cheque 502		245.00
01/10	Papers	*1*	10.00
	Referees	*2*	30.00
01/10	Postage	*3*	58.00
02/10	Cakes	*4*	10.00
03/10	Book M Brown	*5*	15.00
04/10	Hardware	*6*	22.00
05/10	Petrol	*7*	5.00
06/10	Stamps	*8*	10.00
07/10	Referees	*9*	30.00
08/10	Milk	*10*	15.25
31/10	Reimbursement Chq 503		205.25

Example of a Petty Cash Book

Date	Description	Voucher	Receip ts	Payments	Games	Postage	Papers	Sundry
01/10	Petty Cash Fund	Chq 502	45.00					
01/10	Papers	1		10.00			10.00	
	Referees	2		30.00	30.00			
01/10	Postage	3		58.00		58.00		
02/10	Cakes	4		10.00				10.00
03/10	Book M Brown	5		15.00				15.00
04/10	Hardware	6		22.00				22.00
05/10	Petrol	7		5.00				5.00
06/10	Stamps	8		10.00		10.00		
07/10	referees	9		30.00	30.00			
08/10	Milk	10		15.25				15.25
	Total			205.25	60.00	68.00	10.00	67.25
	Balance c/f			39.75				
			245.00	245.00				
31/10	Balance b/f		39.75					
	Reimbursement Chq.No 503		205.25					

Cash Payments Journal

		Chq No.	Details	Bank
Oct 1	Petty Cash Imprest			245.00
31	Petty Cash Expenses			205.25

Petty Cash Imprest

Oct 1 Cash 245.00

Petty Cash Expenses

Oct 31 Cash 205.

BANK RECONCILIATION

Purpose of Bank Reconciliation

- is to check the bank account and the bank statement and reconcile the difference between the two balances.

Reasons for Difference in the Bank Account (cash book) and Bank Statement

1. **Unpresented cheques**- are cheques which are not yet presented to the bank.
2. **Outstanding deposits (Lodgements)** – deposits not recorded in the bank statement but present in the business records.
3. **Standing orders**(means payments made by the bank on behalf of the firm)
4. Direct deposits (deposits received on behalf of the firm by the bank)
5. Errors
6. Service charges (bank fees, interest on overdraft, cheque book fees etc).
7. **Dishonored cheques** – a cheque for which the bank refuses to pay for.

Steps of doing the Bank Reconciliation Statement

1 a) Compare the **cash receipts journal** with the **Credit side of the Bank Statement** and tick the like items

b) Compare the ***cash payments journal*** with the ***Debit side of the Bank Statement*** and tick the like items

2. a) Any amount unticked on the **Credit side of the Bank Statement** apart from **the error** add to the **cash receipts journal** or *Debit side of the Bank Account*

b) Any amount unticked on the **Dedit side of the Bank Statement** apart from **the error** add to the **cash payments journal** or *Credit side of the Bank Account*

3. a) Any item **unticked in the cash receipts journal apart from the error** is known as ***Lodgments,*** which will ***appear in the Bank Reconciliation statement.***

b) Any item **unticked in the cash payments journal apart from the error** is known as ***Unpresented Cheque*** which will ***appear in the Bank Reconciliation statement***

4. Complete the cash receipts journal and cash payments journal or the bank account

5. Prepare the Bank Reconciliation Statement

Formulas for preparing **Bank Reconciliation Statements**

B + L – U

O + U - L

B means Bank statement balance (credit or favourable)

O means Bank Statement balance (Debit, overdraft or unfavourable)

L means Lodgements

U means Unpresented Cheques

NB: Situations where a previous months Bank Reconciliation statement is provided in the question – Check the lodgements with the current Bank Statement Cr side and (Tick). Check the Unpresented cheques with the current Bank Statement Dr side and (tick). If the amounts do not match then the lodgements and unpresented cheques will reappear in the current months BRS.

Correction of Errors Over addition and Under addition Cash payments Journal

1. If the cash payments journal is **over added** the adjustment of the error is adjusted in the **cash Receipts journal or debit side of the Bank Account**
2. If the cash payments journal is **under added** the adjustment of the error is adjusted in the **cash Payments journal or credit side of the Bank Account**

Cash Receipts Journal

1. If the cash receipts journal is **over added** the adjustment of the error is adjusted in **the cash Payments journal or credit side of the Bank Account**
2. If the cash receipts journal is **under added** the adjustment of the error is adjusted in the cash Receipts journal or debit side of the Bank Account

Errors made by the Bank

If errors are made by the bank all adjustments will be made in the bank reconciliation statement.

Errors in deposits made by the Bank

Cash Book

Sales	$220	
Sales		

Bank Statement Errors

Particulars	Debit	Credit	Balance
Deposit		240 E1	
Deposit		58 E2	
			Errors

Procedure

a) If BLU is used in Bank Reconciliation Statement **Less** the Bank Error amount $20 for E1 and **add** the bank error amount $6 for E2.
b) If OUL is used in Bank Reconciliation Statement **add** the Bank Error amount $20 for E1 and **Less** the bank error amount $6 for E2.

Errors in payments made by the Bank

Cash Book

Chq 101	$72
Chq 104	$87

Bank Statement Errors

Particulars	Debit	Credit	Balance
Chq 101	82 E3		
Chq 104	80 E4		
			Errors

a) If BLU is used in Bank Reconciliation Statement **Add** the Bank Error amount $10 for E1 and **less** the bank error amount $7 for E2.
b) If OUL is used in Bank Reconciliation Statement **less** the Bank Error amount $10 for E1 and **add** the bank error amount $7 for E2.

Activity 1

The following information relates to Riha Patel's cash book for the month of May 2014.

Cash at bank balance – 1/5/14 is $500Dr

Cash Payments Journal				**Cash Receipts Journal**		
Date	Particulars	Cheque Number	Amount $	Date	Particulars	Amount $
May 16	Wages	318	200	May 20	Fees	200
20	A. Brown A. Reena	319 320	175 145	22	W. Wah	490
21	Electricity	321	200	25	Fees	225
30	Purchases materials	322	150	28	K.Roneel	220
31	C. Maxwell Ltd	323	140	31	Fees	445

Assume : Bank has correct records

Bank Statement

Date	Particulars	Debit	Credit	Balance
May 26	Balance			$500 Cr
27	Deposit		200	700 Cr
28	Deposit		490	1190 Cr
28	Chq 318	200		990 Cr
28	Chq 319	170		820 Cr
29	Deposit		225	1045 Cr
30	Bank fees	2.00		1043 Cr
30	Deposit		220	1263 Cr
31	Chq 322	150		1113 Cr
31	Dish Chq	490		623 Cr
31	Direct Dep -Jess		300	923 Cr

Required:

a) Prepare the cash journals
b) Prepare the bank account
c) Prepare the bank Reconciliation Statement

Week 26

Penang Sangam High School

Accounting-Year 11

Strand 5: Systems for Implementing the Accounting Process

Sub-strand: SUB- SYSTEM - INVENTORY

Inventory

- **Inventory** or **stock, merchandise** refers to the goods and materials that a business holds for the ultimate purpose of resale.

- Inventory is often the largest item in the current assets category, and must be accurately counted and valued at the end of each accounting period to determine a business's profit or loss.

Classification of Inventories by Different Businesses

Business	Inventories
Retail store	Foodstuffs, clothing, hardware, electrical, sporting goods, groceries
Furniture wholesaler	Furniture
Electrical retailer	Electrical goods
Car dealer	Motor vehicles
Animal Farmer	Sheep , cattle, horses, pigs, goats, chickens
Mining company	Coal , iron, ore, silver

Importance of Inventories

- Assists in profit determination (calculation of gross profit).

  - Closing stock has to be identified for the preparation of the Final Accounts.
  - Large amounts of money are invested in inventories therefore sufficient control is required. (CCTV cameras, inspection of shopping bags, curved mirrors, store detectives).

Drawbacks of overstocking (too much stock)

- Inventories can become out dated.

- Excessive stock requires a large storage area (additional cost e.g rent, storage space, insurance etc).
- It may cause the problems of converting stocks into cash.

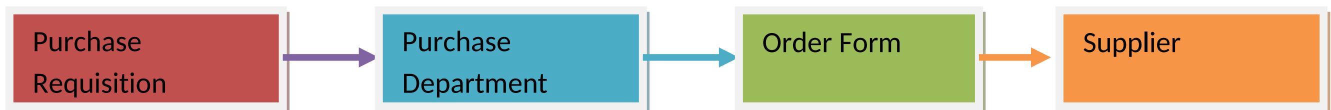
Drawbacks of understocking inventory

- Sales will be lost to competitors.
- Goodwill will diminish (reputation of the business will go down).

Control over the Purchase of Inventories

1. **Ordering inventories** (each department keeps a record of stock sold. When the stock comes at a minimum level it is ordered again).

Purchase Requisition is an internal document used to order the goods required by that department and is sent to the purchases department.



Purchase department is responsible for buying goods irrespective of which department has ordered it.

Order Form is sent to the supplier ordering the goods.

Control over the Purchase of Inventories

2. **Ordering inventories** (each department keeps a record of stock sold. When the stock comes at a minimum level it is ordered again).

2.Receiving inventories (all inventories should be received by the receiving department).

All inventories should be checked against order slip or the packaging slip.

Functions of Department in purchasing Inventories

Purchasing Department	***Receiving Department***	***Inventory Storage Department***	***Accounting Department***
- contacts suppliers	- physically handles the receiving of inventories	- physically stores all inventories	- checks suppliers invoice with order forms and goods
- completes order form for the purchase of inventories	- checks incoming inventories with order forms	- receives inventories accompanied by a goods received slip	- checks suppliers credit notes with the debit notes
- receive slip from receiving department	- completes goods received slip and notifies purchasing dept that inventories have arrived		- prepares purchases journal and purchase returns journals
- notifies the selling department that goods have been received	- forwards invoices to accounting departments		
- authorizes debit notes and forwards it to the supplier when inventories are to be returned	- sends goods to inventory storage department ready for distribution. -Returns goods to the supplier when needed.		

<u>**Control over sale of inventories**</u>

Standardised order form (when order is received in writing or over phone it is written in internal order form).

Inventory Requisition (a form used for requesting inventories from the storage department).

Despatch or Delivery docket (document signed by the customer to certify the receipt of the inventories).

Invoice (document usually accompanies the inventories and is the customers record of goods received).

Credit note (document used when customers return goods).

Sales Department	**Credit Department**	**Inventory Storage Dept**	**Despatch Department**	**Accounting Department**
- receives orders from the customers	- checks the customer's creditworthine ss	- physically stores all inventories	- delivers inventories to customers	- receives duplicate invoices and credit notes
- completes standard order forms	- advises selling dept if credit is granted or refused	- releases inventories only on the basis of an inventories requisition	- receives despatch docket with all inventories	- prepares sales journal and sales returns journal
- prepares invoice, inventory requisition and dispatch docket - checks with credit dept as to customers credit worthiness		-receives returned inventories via the receiving dept, accompanied by goods received slip	- retains despatch docket signed by customer as proof of delivery	

Control over stored inventories

Location -stored where they are easily accessible by those authoriesd.

Security -ensure adequate security is maintained.

Turnover -should be sold as fast as possible.

Stocktaking

is the process of listing, counting and valuing unsold inventories on hand.

Importance of Stocktaking

Determine the value of inventories on hand at a particular date.

the only way of determining actual inventory on hand, see whether stock has been lost through theft or spoilage.

Source Documents associated Purchase and Sales of Inventories

Transaction	**Source Document**
Credit purchase of inventories	Tax invoice received
Credit sales of inventories	Tax invoice issued
Purchase returns	Credit note received
Sales returns	Credit note issued

System used to account for Inventories Physical/Periodic Inventory System

- Where stock is physically counted, listed and valued at the end of each year. (Stocktaking).
- Is adopted by business which finds it impossible to keep a record of the cost price of all inventories sold.
- It does not require a continuous record of inventory balances after each transaction.
- In this case everything that is not on hand at the end of the period is assumed to be sold whereas in reality it may be not because of theft, pilferage, breakage or theft.

Advantages of Periodic Inventory system

- provides full check against the perpetual inventory system to verify discrepancies and value stock more accurately
- is simple and easy to adopt
- used for low value and high turnover items

Disadvantages of Periodic Inventory system

Is time- consuming and brings disturbances to normal business work. When closing stock figure is obtained by physical count, there is danger of discrepancies arising from pilferage, waste, deterioration, theft and clerical errors are not detected.

Short term interim reports cannot be prepared frequently because the amount of closing stock are not available at all times.

Perpetual Inventory System

Provides continuous record of purchase and sales showing current balances of cost of goods sold and stock on hand.

Advantages of Perpetual Inventory System

Stock on hand can be determined at any point in time without actual stock taking.

Is most useful for interim reporting purposes and stock control.

stock loss can be identified when used in conjunction with the physical method Is used for high value and low turnover items.

Allows much greater control over inventories

Disadvantages of Perpetual Inventory System

May be costly to maintain especially when the inventory includes numerous items of small value.

Involves too much clerical work and is time consuming.

May not reveal inconsistencies unless compared with physical stock take.

<u>Difference between Periodic and Perpetual Inventory System</u>

	Perpetual Inventory System	**Periodic Inventory System**
1	Stock on hand can be identified from stock ledger cards	Stock on hand can be determined by stock- take
2	Purchase of inventory is treated as asset	Purchase of inventory is treated as expense
3	Stock loss is identified when compared with periodic system	Stock loss cannot be identified under this system
4	Interim and profit report can be prepared regularly because stock on hand and COGS can be found anytime	The reports cannot be prepared regularly because required data is not available
5	Used for high unit cost and low turnover items e.g. cars, televisions, jewelleries, sofa set, furniture	Used for low unit cost and high turnover items groceries, food items, vegetables

Effect of Incorrect stock valuation

Closing Stock Overstated

Details	***Effect on Year 1***	***Effect on Year 2***
Cost of goods sold	Understated	**Overstated**
Gross and Net Profit	Overstated	**Understated**
Current Assets	Overstated	**No Effect**
Owner's Equity	Overstated	No effect

Closing Stock Understated

Details	***Effect on Year 1***	***Effect on Year 2***
Cost of goods sold	Overstated	Understated
Gross and Net Profit	Understated	Overstated
Current Assets	Understated	No Effect
Owner's Equity	Understated	No effect

Methods of Inventory Valuation

FIFO (First In First Out) Method

- assumes that goods purchased first are the goods sold first.
- Closing stock is always valued at the most recent price.
- in times of rising prices FIFO over values closing stock, undervalues cost of goods sold and overvaluing profits.
- used for items which are perishable or have frequent style changes or technology changes .

Advantages	**Disadvantages**
Is acceptable to Fiji Revenue and Customs Authority (FRCA).	Not suitable in times of rising prices because businesses have to pay more tax.
Closing stock in the balance sheet is valued nearest to market price.	In times of rising prices it fails to give realistic values of cost of goods sold.
The oldest items are sold first.	
Permitted by Accounting standards as an acceptable approach to inventory valuation.	

Activity 2

Daven and Company sells saffron dresses. The following transactions took place during the month.

June 1 Balance 10 dress at $20 each 8 Purchases 15 dress at $8 each 10 Sold 12 dresses

19 Purchased 25 dresses at $10 each 22 Sold 15 dresses

26 Purchased 35 dresses at $9 each 30 Sold 20 dresses

Required

a) Prepare the Stock Leger card using the FIFO method under perpetual system.

b) Calculate the total amount of purchases.

c) Calculate the cost of goods sold.

d) Calculate the gross profit or loss made if the selling price of the dress is $15 each.

e) Calculate the amount of closing stock .

f) If the physical ending inventory count revealed $258, calculate the amount of theft.

2. LIFO (Last in First Out) Method

- assumes that goods bought at the end will be sold first (most recently acquired goods are sold first).

- it leaves the oldest items in closing stock.

- in times of rising prices it tends to under value closing stock, over- value cost of goods sold, under value profits.

Advantages	Disadvantages
in times of rising prices it shows a smaller profit, resulting in less income tax paid.	Not permitted as a stock valuation method under financial reporting standard.
is best suited for the income statement because it matches current cost against current sales .	the stock in the balance sheet is recorded at the outdated price therefore unrealistic.

	during inflation stock on hand is undervalued in real terms resulting in working capital and current ratio to be understated.

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	during inflation stock on hand is undervalued in real terms resulting in working capital and current ratio to be understated.

Example : Daven and Company sells saffron dresses. The following transactions took place during the month.

June 1 Balance 10 dress at $20 each

8 Purchases 15 dress at $8 each

10 Sold 12 dresses

19 Purchased 25 dresses at $10 each

22 Sold 15 dresses

26 Purchased 35 dresses at $9 each

30 Sold 20 dresses

Required :

a) Prepare the Stock Ledger card using the LIFO method under perpetual system.

b) Calculate the total amount of purchases.

c) Calculate the cost of goods sold.

d) Calculate the gross profit or loss made if the selling price of the dress is $15 each.

e) Calculate the amount of closing stock.

If the physical ending inventory count revealed $440, calculate the amount of theft.

a)

Item : Dress		Method: LIFO								
		Receipt/ In			Issued/ Out			Balance		
Date	*Particulars*	*Qty*	*Price*	*Total*	*Qty*	*Price*	*Total*	*Qty*	*Price*	*Total*
1	**Balance**							**10**	**20**	**200**
8	**Purchases**	**15**	**8**	**120**				**15**	**8**	**120**
10	**Sales**				**12**	**8**	**96**	**10**	**20**	**200**
								3	**8**	**24**
19	**Purchases**	**25**	**10**	**250**				**25**	**10**	**250**
22	**Sales**				**15**	**10**	**150**	**10**	**20**	**200**
								3	**8**	**24**
								10	**10**	**100**
26	**Purchases**	**35**	**9**	**315**				**35**	**9**	**315**
30	**Sales**				**20**	**9**	**180**	**10**	**20**	**200**
								3	**8**	**24**
								10	**10**	**100**
								15	**9**	**135**

b) Total Purchases = 120 +250 +315

= **$685**

c) Cost of goods sold = 96+ 150+180

= $**426**

d) Gross profit = ($15 x 47) - 426

= **$279**

e) Closing stock = $200 +24 + 100+ 135

= $**459**

f) Stock loss/ theft/ shoplifting = $459 – 440

= **$19**

3. WAC (Weighted Average Cost)

- It calculates a new average cost every time inventory is bought.
- It is suitable for manufacturing enterprises where several steps are involved e.g. petrol.

Formula:

$$\text{Weighted Average Cost Per Unit} = \frac{\text{Cost of Goods Available for Sale}}{\text{No. of Units Available for sale.}}$$

Advantages	Disadvantages
It evens out price fluctuations where there are constant changes in price prices therefore giving better results than LIFO and FIFO.	A calculation in this method becomes complicated when there are numerous purchases.
Is less complicated than LIFO and FIFO.	
Is acceptable by FRCA.	
Permitted as a stock valuation method under financial reporting standards.	

Example: Daven and Company sells saffron dresses. The following transactions took place during the month.

June 1 Balance 10 dress at $20 each

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10 Sold 12 dresses

19 Purchased 25 dresses at $10 each

22 Sold 15 dresses

26 Purchased 35 dresses at $9 each

30 Sold 20 dresses

Required

a) Prepare the Stock Ledger card using the WAC method under perpetual system.

b) Calculate the total amount of purchases.

c) Calculate the cost of goods sold.

d) Calculate the gross profit or loss made if the selling price of the dress is $15 each.

e) Calculate the amount of closing stock.

Solution

Item : Dress					Method: WAC					
		Receipt/ In			Issued/ Out			Balance		
Date	*Particulars*	*Qty*	*Price*	*Total*	*Qty*	*Price*	*Total*	*Qty*	*Price*	*Total*
June 1	Balance							10	20	200
8	Purchases	15	8	120				25	12.8	320
10	Sales				12	12.8	153.6	13	12.8	166.4
19	Purchases	25	10	250				38	10.96	416.48
22	Sales				15	10.96	164.40	23	10.96	252.08
26	Purchases	35	9	315				58	9.78	567.08
30	Sales				20	9.78	195.60	38	9.78	371.64

b) Total purchases = ($120+ 250 +315)

= **$685**

c) COGS = 153.6 + 164.40 + 195.60 = **$ 513.6**

d) Gross profit = sales – Cost of goods sold

= $705 - $513.6

= **$191.40**

e) Closing stock = the amount remaining in the total of out column after the last sale

= $**371.64**

SI (Standard Identification/Cost)

- requires the actual cost of each item from specific purchases which is used to determine the value of stock on hand.
- is used for items that are rare, expensive or unique e.g. antiques, automobiles, real estates.

Advantages	Disadvantages
- Is used in the purchase and sale of high-priced articles, which is readily identifiable.	-management is able to manipulate by selling at different prices at different points of time.
	Cannot be used for inventory items which are large in quantity with low value such as grocery, kerosene.

Example

Jaya owns and operates a Shop dealing with the sales of Gold Bracelets. On 1 July she had the following stock:

10 Bracelets at $1000 each

7 Bracelets at $1200 each

During the month the following transactions took place:

July 2 Sold two Bracelets cost price $1000 for $1600 cash.

4 Purchased four Bracelets for $1200 on credit.

11 Jaya took one Bracelets cost price $1200 for her own use.

20 Sold three Bracelets cost price $1000 to $2400.

25 Sold one Bracelet cost price $1000 for cash $1800.

Required

Use the information given above to prepare the stock ledger card using Standard Identification cost method

Item : Watches Method : Standard Identification										
		Receipt/ In			Issued/ Out			Balance		
Date	Particulars	Qty	Price	Total	Qty	Price	Total	Qty	Price	Total
July 1	Balance							10	1000	10000
								7	1200	8400
2	Sales				2	1000	2000	8	1000	8000
								7	1200	8400
4	Purchases	4	1200	4800				8	1000	8000
								11	1200	13200
11	Drawings				1	1200	1200	8	1000	8000
								10	1200	12000
20	Sales				3	1000	3000	5	1000	5000
								10	1200	12000
					1	1000	1000	4	1000	4000
								10	1200	12000

Week 27

Penang Sangam High School

Accounting-Year 11

Strand 5: Systems for Implementing the Accounting Process

Sub –strand :SUB- SYSTEM – FIXED ASSETS

Control over Fixed Assets

Fixed Assets – Those that are bought by the business in order to generate revenue.

Internal control procedures relating to the purchase of Fixed Assets

1. Authorization

- higher level management must authorize the purchase of fixed assets.

2. Selection

- it is important to know all the facts about the fixed assets before it is purchased.

3. Proof of Ownership

- Purchase should include proof of ownership e.g. title, copyrights and patent documents.

- It is valuable so it should be kept in the safe or bank safety deposits.

4. Payment of cash

- Proper procedures for payments of the purchase should be maintained.

Internal control procedures relating to the Disposal of Fixed Assets

1. Authorization

- Higher level authorization should be maintained e.g. management.

- This is to prevent an unauthorized employee selling valuable assets.

2. Physical Disposal

- This could take place in form of outright sale, tender, trade- in or scrapping.

- An authorized person must be in charge of the physical disposal.

3. Receipt of cash

- Proper control should be maintained over receipt of cash.

Internal control procedures relating to the Storage of Fixed Assets

1. Location

- All assets should be identified by some means.

Regular checks should be made to ensure that the fixed assets are situated in their correct place.

2. Maintenance

- Assets be kept in good working order.

3. Protection

- must be protected against theft or damage.

- Adequate insurance cover should be kept against unforeseen circumstances.

Fixed Asset register

- keeps detailed information about the fixed assets of the business.

Purpose of Fixed asset Register

- maintains proper control over the fixed assets through the use of control accounts and subsidiary ledgers.
- To have accurate accounting for fixed assets.

Details kept in the fixed Asset Register	
Name of the asset	Original cost
Depreciation rate	Annual depreciation
Date of purchase	Accumulated depreciation
Supplier	Repairs and maintenance
Estimated life	Method of disposal
Method of depreciation	Proceeds from disposal
Insurance for the asset	

A fixed asset is also categorized as **Property, Plant, and Equipment**in the Statement of financial position of the business.

Control over fixed assets

The internal controls over the acquisition of fixed assets are including the following:

- Issuance and approval of a purchase order.
- Receipt of assets and preparation of a receiving report.
- Receipt of an invoice from a vendor.
- Reconciliation of the vendor invoice to the related receiving report and purchase order.
- Authorization of the payment of the vendor invoice.

- Issuance of a check for payment of the vendor invoice.
- Posting of the entry in the equipment sub ledger.
- Posting of the equipment sub ledger activity to the related general ledger control accounts.
- Reconciliation of the general ledger control accounts to the equipment sub ledger.
- Assignment of reasonable lives for depreciation calculations.

- **Depreciation** is a non-cash expense that reduces the value of the fixed asset over time. It refers to the allocating of the original cost of the fixed asset over its useful life.

Business assets that can be depreciated include equipment, machinery, technology and computers, office furniture, buildings and improvements to buildings, leasehold improvements, and business vehicles. Land cannot be depreciated because it appreciates in value.

Causes of depreciation

- **Wear and tear.** For example, an auto will decrease in value because of the mileage, wear on tires, and other factors related to the use of the vehicle.
- **Obsolescence.** Assets also decrease in value as they are replaced by newer models. Last year's car model is less valuable because there is a newer model in the marketplace.
- **Physical Deterioration**
  Value decreases due to flood, excessive heat etc.
- **Passage of time**
  As the time passes the value of fixed assets decreases.

Cost Allocation Concept of depreciation on fixed assets

- it is important to know depreciation is a cost allocation process.
- charging of depreciation each year decreases the book value of the asset.
- the value shown in the balance sheet does not represent the realizable value (market value) the asset could be sold for.
- it represents the written down cost of the asset.
- charging of depreciation is a book entry and it does not involve cash.
- allocating the cost over its useful life does not mean setting cash aside to replace the asset.

Factors Affecting Depreciation

1. Cost of the asset

- are all cost incurred to bring the asset into working order with that of the purchase price.

2. Useful life of the asset

- is the period it is expected to be used in the business.

3. Residual value, scrap value, trade- in value, salvage value, disposal value

- is the value of the asset at the end of its life .

Formulas to Remember on Accounting for Depreciation

1. Original cost = Purchase price + other cost associated in bringing the asset into location or condition ready for use e.g. Instalment cost

2. Depreciable Cost = Original Cost – Scrap value

3. Accumulated Depreciation = Depreciation of the current year + Sum of depreciation for previous years

Another name is Provision for depreciation

4. Book Value = Original Cost – Accumulated Depreciation

5. Rate or % of Depreciation = $\frac{\text{Depreciation per annum}}{\text{Depreciable Cost}}$

6. Gain on Sale = Difference of (Selling Price > Cost Price)

7. Loss on Sale = Difference of (Selling Price < Cost Price)

Methods of Depreciation

1. **Straight Line Method** – **where same amount of depreciation is charged every year.**

Advantages	Disadvantages
Easy and convenient to use	May not reflect the true pattern of asset's economic benefits
Suitable for depreciating assets that provide similar level of economic benefits throughout their useful life (e.g. buildings).	

Formula

Depreciation per Annum/ Year = Original cost - Scrap value / Estimated useful life

OR

Depreciation per Annum/ Year = Original Cost X Rate

NB: Either the formula or rate can be used for calculating depreciation depending on the question.

Example

On 1 January 2010 a business purchased Equipment for $6400 cash and installation charges amounted to $600. Its estimated life was considered to be 5 years with a residual value of $2000.

Required:

- **Calculate the Original Cost, Purchase Price or Acquisition cost of the Equipment**

Original Cost = Purchase Price + Any other cost

$7000 = $6400 + $600

- **Calculate the Depreciable Cost of the Equipment**

Depreciable Cost = Original Cost – Scrap value

$5000 = $7000 - $2000

- **Calculate Depreciation per annum for equipment**

Depreciation per annum = Original Cost – Scrap value / Estimated Useful Life

$1000/ annum = $7000 - $2000 / 5 Years

- Show the calculation in a table

Year	Cost	Depreciation	Accumulated Depreciation	Book Value
2010	$7000	$1000	$1000	**$6000**
2011	$7000	$1000	$2000	**$5000**
2012	$7000	$1000	$3000	**$4000**
2013	$7000	$1000	$4000	**$3000**
2014	**$7000**	**$1000**	**$5000**	**$2000**

Prepare the General Journal Entry of depreciation for the year 2011

Date	Particulars	Debit $	Credit $
31 Dec 2011	Depreciation on Equipment Provision for depreciation on Equipment (To record depreciation expense for the year)	1000	 1000

- Calculate Accumulated Depreciation at the end of the year 2012

Accumulated Depreciation = $1000 x 3

= $3000

- Compute the Book Value of the Equipment at the end of Year 2013

Book Value = Original Cost – Accumulated Depreciation

$3000 = $7000 - ($1000 + $3000)

- What would be the **Gain or Loss on sale** if the Equipment was sold for $6000 at the end of year 2014

Gain or Loss on Sale = Selling Price – Book Value

$4000gain on sale = $6000 - ($7000- $5000)

Gain on sale because selling price is more than book value

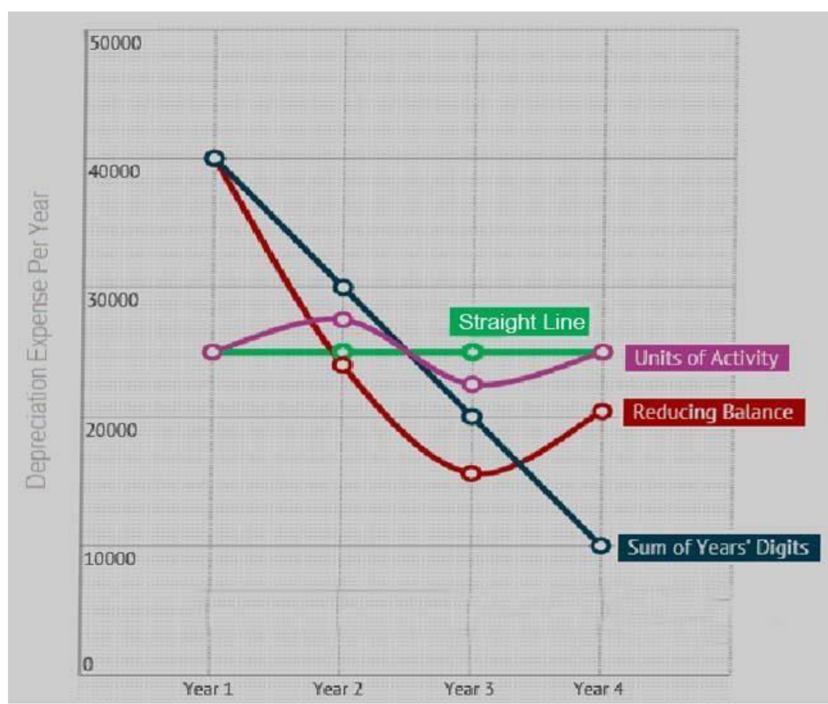
- Show the ledger account for Depreciation on equipment for Years 2010 -2012 Depreciation on Equipment

Year 1 Accumulated Depreciation $1000

Year 2 Accumulated Depreciation $1000

Year 3 Accumulated Depreciation $1000

- Show the ledger account for Provision for Depreciation Year 2010 -2012



Provision for Depreciation

	Year 1 Depreciation $1000
	Year 2 Depreciation $2000
	Year 3 Depreciation $3000

- Show the Balance Sheet (extract) of Equipment at the end of year 2011

Balance Sheet (extract)

Fixed Assets		
Equipment	$7000	
Less Accumulated depreciation	2000	

Diminishing Value Method

- The depreciation charge is larger in the early years but decreases as the asset becomes mature.

Advantages	Disadvantages
As the asset gets older, repairs and maintenance increases but these cost are offset by lower depreciation in later years	is not appropriate for lease because it does not provide equal amount of depreciation each year
Is appropriate where the risk of obsolescence is high e.g. motor vehicles and machinery	not possible to write the total cost at the end of the life because some balances remain

Units of Production Method

- Calculates depreciation on the basis of expected output or usage of the fixed asset.
- life is expressed in number of units, mileage, number of hours rather than

number of years.

- known as Units of Activity, Units of Usage and Unit of Use method.
- generally used for airplanes, plants, machines.
- deprecation and book value under this method fluctuates depending on the usage in each year.

Advantages	Disadvantages
Suitable in case of fixed assets that depreciate in proportion to units of activity rather than just the passage of time.	Is limited to only certain types of assets. Not suitable for furniture or buildings
Most accurately reflects the pattern of consumption of economic benefits.	is solely based on usage, does not take into account assets life.

Formula Depreciation per Unit = **Original Cost – Scrap value** / **Estimated Total Production**

Depreciation per Annum = **Depreciation per unit** **x Number of units in each year**

Depreciation per Annum = **Original Cost – Scrap value** / **Estimated Total Production** **x No. of Units p.a**

Example

Edward purchased a new Toyota Corolla vehicle from Cars Motors Ltd for $46000. The life of the vehicle is estimated at 300000 kilometers and its residual value at that time will be $16000. The distance travelled by the Toyota Vehicle was as follows:

Years	Kilometers
1	90000
2	75000
3	80000
4	92000

Required:

- Calculate the depreciation per kilometer

Depreciation per Unit = Original Cost – Scrap value / Estimated Total Production

$$\text{Depreciation per Unit} = \frac{\text{Original Cost} - \text{Scrap value}}{\text{Estimated Total Production}}$$

$0.10 per kilometer = $46000 - $16000 / 300000 kilometers

$$\$0.10 \text{ per kilometer} = \frac{\$46000 - \$16000}{300000 \text{ kilometers}}$$

- Compute the amount of depreciation for each of the years and complete the table

Year	Original Cost	Working	Annual Depreciation	Accumulated Depreciation	Book Value
1	46000	$.10/km x 90000	9000	9000	37000
2	46000	$.10/km x 75000	7500	16500	29500
3	46000	$.10/km x 80000	8000	24500	21500
4	46000	$.10/km x 92000	9200	33700	12300

- Calculate the profit or loss on sale if the Toyota Vehicle was sold at the end of the second year for $23000.

Loss on sale = Selling Price – Book Value

$**6500** = $23000 - 29500

**************THE END*************