Accounting period

Companies adopt a 12-month period for measuring the income/ profit of the company. This is called an accounting period. At the end of each accounting period all nominal accounts are closed off to the Trading account and the Profit and Loss account in order to calculate the net profit for that specific accounting period. This way, the results of one accounting period can be compared to the next.

GAAP

Generally Accepted Accounting Practice is a collection of published principles, procedures and guidelines that govern how the financial events of a business are recognized, measured and reported.

The application of GAAP ensures that financial statements are:

- understandable
- useful
- relevant
- reliable
- timely
- verifiable
- neutral
- comparable and consistent

GAAP principles/concepts

The Business Entity principle/concept

The financial affairs of a business are kept entirely separate from the financial affairs of the owner.	**Example** An owner owes his sister R5 000 for costs incurred on holiday. This is not reflected in the financial statements of the business.

The Historical Cost principle/concept

This concept is based on the rule that assets will be valued at the historical cost, thus the amount which was originally paid for them (cost price).	**Example** Land and buildings are shown in the financial statements as R400 000, even though an estate agent says the property is worth twice that amount.

The Going-concern Cost principle/concept

Financial Statements are prepared on the assumption that a business will continue operating for the foreseeable future.	**Example** Trading stock is still shown at the cost price of R20 000, even though it would be sold for R15 000 on a flea market or auction immediately.

The Matching principle/concept

This concept has a two-sided effect: - expenses and income must be recorded in the correct time period, and - if an expense has been incurred with the effect of producing income, then these two items must be matched against each other in the same set of financial statements.	**Example** The interest on the loan for the current year amounted to R5 000. Only R3 000 was paid. The Income Statement for the current year reflected an amount of R5 000 in respect of the interest – an adjustment for accrued expenses of R2 000 must be done.

The Prudence principle/concept

This concept is based on the assumption that financial results are presented in a conservative manner, possibly even in a pessimistic manner. An accountant will not consider any expected income but will make provision for anticipated losses even if he is not entirely certain of the exact amount.	**Example** Damages payable to a client will be finalized next year. An estimated amount of R9 000 is recorded this year.

The principle/concept of Materiality

This concept covers the disclosure of items which are of importance to readers of financial statements. Only material (relevant) items are shown in the financial statements. The other details are usually shown separately as a note to the financial statements.	**Example** Interest on overdraft is shown as a separate amount to Interest on loan.

<u>IFRS</u>

The **international Financial Reporting Standards** is a set of high-quality financial reporting standards that could be used by all countries. This set of accounting standards is fast becoming the global standard for the preparation of public company financial statements.

<u>Final accounts</u>

Final accounts are the means of conveying to the management, directors, shareholders and interested outsiders a concise picture of profitability and results of the accounting period, after the accounting period is over.

Trading account

→ to calculate the Gross profit (Sales <u>minus</u> Cost of sales).

Profit and Loss account

→ to calculate the Net profit (Gross profit <u>plus</u> other income <u>minus</u> expenses).

Appropriation account

→ indicates how much of the profit is distributed towards income tax, dividends for shareholders and to increase/decrease reserves.

<u>Year-end adjustments</u>

Adjustments are made to ensure that the matching principle is complied with. Expenses and income are matched in the same time-frame. The double entry principle applies to adjustments → for every debit there is a credit of the same value. Adjustments are recorded by means of journal entries in the General Journal.

1. Trading stock deficit
2. Trading stock surplus
3. Consumable stores on hand
4. Depreciation on the cost price
5. Depreciation on the diminishing balance method
6. Bad debts
7. Bad debts recovered
8. Correction of errors & Omissions
9. Accrued income / Income receivable
10. Deferred income / Income received in advance
11. Accrued expenses / Expenses payable
12. Prepaid expenses
13. Provision for bad debts – expense
14. Provision for bad debts – income
15. Interest on loan capitalized
16. Interest on fixed deposit capitalized
17. Loan payable in the next financial year
18. Fixed deposit that will mature in the next financial year
19. Adjustment for Income tax
20. Adjustment for Dividends

In the books of LE ROUX TRADERS LTD
Accounting period: *1 March 2020 – 28 February 2021*
Given: Pre-Adjustment Trial Balance and Adjustments

1. TRADING STOCK DEFICIT → an expense for the business

→ The value of the stock, according to a physical stocktaking, is less than the value of the stock in the books of the business.

According to the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year, the balance of the Trading stock account is R52 300.

Adjustment: A physical stock take on 28 February 2021 revealed that trading stock worth R49 800 was on hand → **R2 500 less than the value of the stock in the books of the business**.

GJ: Dr Trading stock deficit, R2 500
Cr Trading stock, R2 500

Assets	Owner's equity	Liabilities
– 2 500 Trading stock -	– 2 500 Trading stock deficit +	0

Reasons for the deficit: Theft, incorrect bookkeeping, incorrect calculation of selling price or cost price, errors and omissions.

2. TRADING STOCK SURPLUS → an income for the business

→ The value of the stock, according to a physical stocktaking, is more than the value of the stock in the books of the business.

According to the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year, the balance of the Trading stock account is R52 300.

Adjustment: A physical stock take on 28 February 2021 revealed that trading stock worth R53 100 was on hand → **R800 more than the value of the stock in the books of the business**.

GJ: Dr Trading stock, R800
Cr Trading stock surplus, R800

Assets	Owner's equity	Liabilities
+ 800 Trading stock +	+ 800 Trading stock surplus +	0

Reasons for the surplus: Stock purchased was not recorded in the books, incorrect bookkeeping, incorrect calculation of selling price or cost price, errors and omissions.

3. CONSUMABLE STORES ON HAND → an <u>asset</u> for the business

→ **Stationery**, **Packing material** and **Consumable stores** not used, thus remaining in the business at the end of the year.

According to the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year, stationery to the amount of R3 100 was purchased during the year.

Adjustment: A physical stock take on 28 February 2021 revealed that stationery to the value of R600 was on hand → **thus, not used during the year.**

GJ: Dr Consumable stores on hand, R600
Cr Stationery, R600

Assets	Owner's equity	Liabilities
+ 600 Consumable stores on hand +	+ 600 Stationery -	0

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4. DEPRECIATION ON THE COST PRICE → an <u>expense</u> for the business

→ The value of vehicles and equipment decrease because of wear and tear.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

Equipment	R56 000
Accumulated depreciation on equipment	R22 470

Adjustment: Depreciation on equipment must be taken into account at 10% p.a. on the cost price.

Calculation: 10/100 x 56 000 = R5 600

GJ: Dr Depreciation, R5 600
Cr Accumulated depreciation on equipment, R5 600

Assets	Owner's equity	Liabilities
– 5 600 Accumulated depreciation on equipment +	– 5 600 Depreciation +	0

→ **Accumulated depreciation on vehicles/equipment** is a negative asset because it makes the value of the asset less.

5. DEPRECIATION ON THE DIMINISHING BALANCE → an <u>expense</u> for the business

→ The value of vehicles and equipment decrease because of wear and tear.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:
Vehicles R120 000
Accumulated depreciation on vehicles R33 500

Adjustment: Depreciation on vehicles must be taken into account at 15% p.a. on the diminishing balance method.

Diminishing balance = Cost price – Accumulated depreciation
Diminishing balance = Carrying value = Book value

Calculation: 15/100 x (120 000 – 33 500) = R12 975

GJ: Dr Depreciation, R12 975
Cr Accumulated depreciation on vehicles, R12 975

Assets	Owner's equity	Liabilities
– 12 975 Accumulated depreciation on vehicles +	– 12 975 Depreciation +	0

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6. BAD DEBTS → an <u>expense</u> for the business

→ Debtors that cannot pay their debts, must be written off as irrecoverable and taken out of the books of the business.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:
Debtors control R8 600

Adjustment: On 28 February 2021, debtor M Franken owes the business R4 800. She was declared insolvent and her insolvent estate pays out 40 cents in the rand. This was not recorded yet. The remainder should be written off.

Calculation: 40 c x R4 800 = R1 920 → CRJ
60 c x R4 800 = R2 880 → GJ

CRJ: Dr Bank, R1 920
Cr Debtors control, R1 920

GJ: Dr Bad debts, R2 880
Cr Debtors control, R2 880

Assets	Owner's equity	Liabilities
+ 1 920 Bank + – 4 800 Debtors control –	– 2 880 Bad debts +	0

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7. BAD DEBTS RECOVERED → an income for the business

→ Debtors that were previously written off as bad (Bad debts), can still pay the amount they owe. This person is not a debtor in your books anymore and was already removed from the Debtors list when he was written off as bad.

Adjustment: Debtor A Lawrence, whose debt had been written off as bad in the previous month, paid R300 directly into the bank account of the business.

CRJ: Dr Bank, R300
Cr Bad debts recovered, R300

Assets	Owner's equity	Liabilities
+ 300 Bank +	+ 300 Bad debts recovered +	0

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8. CORRECTION OF ERRORS & OMISSIONS

→ Errors made in the books of the business must be corrected by a double entry in the General Journal.

Adjustment: Stationery purchased on credit for R400, was entered in the CJ as Trading stock.

GJ: Dr Stationery, R400
Cr Trading stock, R400

Assets	Owner's equity	Liabilities
– 400 Trading stock –	– 400 Stationery +	0

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OMISSIONS

→ Information that was left out from the books of the business must be recorded in the General Journal.

Adjustment: Trading stock of R600, returned to creditor Wilson & Co, has not been entered in the books.

GJ: Dr Creditors control (Wilson & Co.), R600
Cr Trading stock, R600

Assets	Owner's equity	Liabilities
– 600 Trading stock –	0	– 600 Creditors control –

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9. ACCRUED INCOME → an asset for the business (money owed to the business).

→ **Income for this financial year not received yet**
Are you going to Add or Subtract the amount? ADD

Adjustment: The rent income for February 2021, the last month of the financial year, was not received yet, R2 300.

GJ: Dr Accrued income, R2 300
Cr Rent income, R2 300

Assets	Owner's equity	Liabilities
+ 2 300 Accrued income +	+ 2 300 Rent income +	0

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10. DEFERRED INCOME → a <u>liability</u> for the business (a service owed by the business to the tenant).

→ **Income already received for the next financial year**
Are you going to Add or Subtract the amount? SUBTRACT

Adjustment: Received R3 400 from the tenant during February 2021. It was for the rent for March 2021.

GJ: Dr Rent income, R3 400
Cr Deferred income, R3 400

Assets	Owner's equity	Liabilities
0	– 3 400 Rent income –	+ 3 400 Deferred income +

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11. ACCRUED EXPENSES → a <u>liability</u> for the business (money owed by the business).

→ **Expenses for this financial year not paid yet**
Are you going to Add or Subtract the amount? ADD

Adjustment: Directors fees of R23 400 is still payable on 28 February 2021, die last day of the financial year.

GJ: Dr Directors fees, R23 400
Cr Accrued expenses, R23 400

Assets	Owner's equity	Liabilities
0	– 23 400 Directors fees +	+ 23 400 Accrued expenses +

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12. PREPAID EXPENSES → an <u>asset</u> for the business (a service owed to the business).

→ **Expenses already paid for the next financial year**
Are you going to Add or Subtract the amount? SUBTRACT

Adjustment: Paid R7 800 for an advertisement contract of 6 months on 1 January 2021. *(Remember your financial year is 1 March 2020 – 28 February 2021)*

Calculation: R7 800/6 = R1 300 per month **x 4 = R5 200**
2 months (Jan, Feb) were paid for this year
4 months (Mar, Apr, May, Jun) were paid in advance

GJ: Dr Prepaid expenses, R5 200
Cr Advertising, R5 200

Assets	Owner's equity	Liabilities
+ 5 200 Prepaid expenses +	+ 5 200 Advertising –	0

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13. PROVISION FOR BAD DEBTS ADJUSTMENT → an <u>expense</u> for the business

→ **Provision for bad debts (expense) is the prediction that debtors that can become bad in the future, will be MORE than the previous year**

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:
Debtors control R19 860
Provision for bad debts R 903

Adjustment: Provision for bad debts must be adjusted to 5% of the outstanding debtors.

Calculation: 5/100 x R19 860 = R993

→ The Provision for bad debts was only R903 which is less than the R993, so it must become **MORE with R90** (R993 – R903).

GJ: Dr Provision for bad debts **<u>adjustment</u>**, R90
Cr Provision for bad debts, R90

Assets	Owner's equity	Liabilities
– 90 Provision for bad debts +	– 90 Provision for bad debts adjustment (expense) +	0

→ **Provision for bad debts** is a negative asset, because it makes the Debtors control less.

14. PROVISION FOR BAD DEBTS ADJUSTMENT → an <u>income</u> for the business

→ **Provision for bad debts (income) is the prediction that debtors that can become bad in the future, will be LESS than the previous year**

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:
Debtors control R17 460
Provision for bad debts R 993

Adjustment: Provision for bad debts must be adjusted to 5% of the outstanding debtors.

Calculation: 5/100 x R17 460 = R873

→ The Provision for bad debts was R993 which is more than the R873, so it must become **LESS with R120** (R993 – R873).

GJ: Dr Provision for bad debts, R120
Cr Provision for bad debts **<u>adjustment</u>**, R120

Assets	Owner's equity	Liabilities
+ 120 Provision for bad debts –	+ 120 Provision for bad debts adjustment (income) +	0

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15. INTEREST ON LOAN CAPITALISED → an <u>expense</u> for the business

→ Interest on loan that is capitalised means that you add the amount of the interest to the loan account. *You must still pay the interest on loan amount during the financial year.*

Adjustment: Interest on the loan from QT Bank must be capitalised.

The following loan statement was received from QT Bank on 28 February 2021, the last day of the financial year.

Balance on 1 March 2020	200 000
Interest capitalised	21 000
Payments for the year include interest and capital payments (R2 500 x 12)	(30 000)
Balance on 28 February 2021	**R191 000**

GJ: Dr Interest on loan, R21 000
Cr Loan: QT Bank, R21 000

Assets	Owner's equity	Liabilities
0	– 21 000 Interest on loan +	+ 21 000 Loan +

Remember, you must first pay the interest on the loan before you can pay off a part of the loan.

In the example, the R30 000 consists of R21 000 paid for the interest and R9 000 paid off on the loan. Therefor **the loan only decrease with <u>R9 000</u> from R200 000 to R191 000**.

16. INTEREST ON FIXED DEPOSIT CAPITALISED → an <u>income</u> for the business

→ Interest on fixed deposit that is capitalised means that you add the amount of the interest to the fixed deposit account.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

Fixed deposit: Disa Bank R30 600

Adjustment: The interest on the fixed deposit with Disa Bank for the financial year amounted to R2 400. It must be capitalised.

GJ: Dr Fixed deposit: Disa Bank, R2 400
Cr Interest on fixed deposit, R2 400

Assets	Owner's equity	Liabilities
+ 2 400 Fixed deposit +	+ 2 400 Interest on fixed deposit +	0

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17. LOAN PAYABLE IN THE NEXT FINANCIAL YEAR

→ The part of the loan that is payable in the next financial year must be removed from the Non-current liabilities (Loan: QT Bank) to the Current liabilities as a **Short term loan**. This is a reminder of the amount payable by the business in the nearby future.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

Loan: QT Bank R191 000

Adjustment: R10 000 is payable on the loan on 1 July 2021. This amount will not include interest on the loan because it is the amount that the loan will become less.

BALANCE SHEET:

Non-current Liabilities → Liabilities payable within any period longer than 12 months from the end of the financial year.

Loan: QT Bank (191 000 **– 10 000**) R181 000

Current Liabilities → A liability/an amount that needs to be settled within 12 months of financial year-end becomes a Current Liability.

Short term loan **R10 000**

18. FIXED DEPOSIT THAT WILL MATURE IN THE NEXT FINANCIAL YEAR

→ The part of the fixed deposit that will mature (pay out) in the next financial year must be removed from the Non-current assets (Fixed deposit: Disa Bank) to the Note for Cash and Cash equivalents as **Fixed deposit mature**. This is an indication of money that will be paid out to the business in the nearby future.

The following balances appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

Fixed deposit: Disa Bank R33 000 (after the interest was capitalised)

Adjustment: One third of the fixed deposit will mature on 31 May 2021.

BALANCE SHEET:

Non-current Assets → Assets that will be part of the business for a period longer than 12 months from the end of the financial year.

Fixed deposit: Disa Bank (33 000 **– 11 000**) R22 000

Note for Cash and Cash equivalents

Bank	xxx
Cash float	xx
Petty cash	xx
Fixed deposit mature	**11 000**

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19. ADJUSTMENT FOR INCOME TAX

1st provisional payment half-way through the year, R65 000
CPJ → Dr SARS (Income tax)
Cr Bank

2nd provisional payment at the end of the year, R60 000
CPJ → Dr SARS (Income tax)
Cr Bank

→ The **SARS (Income tax)** account is a **liability** because the business owes money to SARS for tax. It can become an asset when, for a specific year, the business paid more than the tax assessment.

Assets	Owner's equity	Liabilities
– 125 000 Bank –	0	– 125 000 SARS (Income tax) –

A third payment will be made to SARS in the beginning of the next financial year, if the business owes money to SARS.

→ The **SARS (Income tax)** (Balance sheet account) will always have a **debit balance in the Pre-Adjustment Trial Balance** at the end of the financial year, because of the provisional tax payments that were already made.

After the **tax return form** was submitted, SARS will issue the business with the **tax assessment form**, showing how much income tax is payable for the financial year.

What to do with the **tax assessment**?

GJ: Dr Income tax
Cr SARS (Income tax)

→ Should the provisional tax paid be LESS than the total tax due (assessment), the SARS (income tax) account will have a credit balance. Meaning the business owes money to SARS
↓
SARS (Income tax) is a **liability for the business**
↓
Show it in the note for **Trade and other payables**

→ Should the provisional tax paid be MORE than the total tax due (assessment), the SARS (income tax) account will have a debit balance. Meaning that SARS owes the business money.
↓
SARS (Income tax) is an **asset for the business**
↓
Show it in the note for **Trade and other receivables**

NOTE! Income tax (Nominal account) is not an operating expense, it is part of the **distribution of the net profit**.

Example 1:

The following balance appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

SARS (Income tax) R125 000 **Dr**

Adjustment: After completion of the audit, the income tax assessment for the year was calculated at R142 000.

GJ: Dr Income tax, R142 000
Cr SARS (Income tax), R142 000

Assets	Owner's equity	Liabilities
0	– 142 000 Income tax +	+ 142 000 SARS (Income tax) +

The business **will owe SARS R17 000** because the **provisional tax payments were too little/less than the tax assessment** (R142 000 – R125 000).

Example 2:

The following balance appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

SARS (Income tax) R125 000 **Dr**

Adjustment: After completion of the audit, the income tax assessment for the year was calculated at R120 000.

GJ: Dr Income tax, R120 000
Cr SARS (Income tax), R120 000

Assets	Owner's equity	Liabilities
0	– 120 000 Income tax +	+ 120 000 SARS (Income tax) +

SARS will owe the business **R5 000** because the **provisional tax payments were too much/more than the tax assessment** (R125 000 – R120 000).

20. ADJUSTMENT FOR DIVIDENDS

INTERIM DIVIDENDS

An interim dividend was declared and paid half-way through the financial year.

Adjustment: Interim dividends of 18 c per share was declared and paid on 31 August 2020 (80 000 shares were issued).

CPJ: Dr Dividends on ordinary shares, R14 400
Cr Bank, R14 400

Assets	Owner's equity	Liabilities
– 14 400 Bank –	– 14 400 Dividends on ordinary shares +	0

FINAL DIVIDENDS

A final dividend was only declared at the end of the financial year.

GJ: Dr Dividends on ordinary shares
Cr Shareholders for dividends

A payment will be made to the Shareholders in the beginning of the next financial year, to pay the **FINAL DIVIDENDS** declared on the last day of the previous financial year.

The **Dividends on ordinary shares** (Nominal account) will always have a **debit total in the Pre-Adjustment Trial Balance** at the end of the financial year, because of the interim dividends that were already paid.

As final dividends are only declared at the end of the financial year, the business owe money to the shareholders. Thus, the **Shareholders for dividends** (Balance Sheet account) is a **liability** for the business

↓

Note in the Balance Sheet for **Trade and other payables**

NOTE! Dividends on ordinary shares (Nominal account) is not an operating expense, it is part of the **distribution of the net profit**.

<u>Example</u>:

The following total appeared in the Pre-Adjustment Trial Balance on 28 February 2021, the last day of the financial year:

Dividends on ordinary shares R14 400 **Dr**

Adjustment: Declared final dividends of 22 c per share on 28 February 2021 (80 000 shares were issued).

GJ: Dr Dividends on ordinary shares, R17 600
Cr Shareholders for dividends, R17 600

Assets	Owner's equity	Liabilities
0	– 17 600 Dividends on ordinary shares +	+ 17 600 Shareholders for dividends +

The business will **always owe the Shareholders for dividends** the amount of the final dividends on the last day of the financial year, because the **final dividend was only declared and NOT PAID**.