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Ministry of Labor and Skills

ACCOUNTING AND FINANCE

LEVEL - IV

Based on November, 2023, curriculum V – II

Module title: Preparing Financial Reports based international financial report standard (IFRS)

Module code: LSA ACF4 M04 1123

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Prepared by: Ministry of Labor and Skills

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Table of Contents

Acronym

IFRS -------------- International Financial reporting standard

GAAP ------------- Generally accepted accounting principles

IAS------------------International accounting standard

IASB---------------- International accounting standard Board

PP&E---------------- property, plant and Equipment

NPPE----------------- net property, plant and equipment

GPPE------------------ Gross property, plant and equipment

DDR -------------------double decline rate

BV---------------------- book value

SLP --------------------- straight line percentage

Introduction to the Module

In accounting and finance field, Preparing Financial Reports based international financial report standard is very important for the overall organizational operation. It helps to know Basics of IFRS for SME, Asset register, Record and Post Balance Day entries and End of period financial report preparation

This module is designed to meet the industry requirement under the Accounting and finance occupational standard, particularly for the unit of competency: Preparing Financial Reports based international financial report standard.

This module covers the units:

- Basics of IFRS for SME
- Asset register
- Record and Post Balance Day entries
- End of period financial report preparation

Learning Objective of the Module

At the end of the session, the students will able to:

- Explain Basics of IFRS for SME
- Maintain asset register
- Record and Post Balance Day entries
- Prepare end of period financial reports

Module Instruction

For effective use this modules trainees are expected to follow the following module instruction:

1. Read the information written in each unit
2. Accomplish the Self-checks at the end of each unit
3. Perform Operation Sheets which were provided at the end of units
4. Do the “LAP test” giver at the end of each unit and
5. Red the identified reference book for examples and exercise

Unit One: Basics of IFRS for SME

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Introduction to IFRS
- Adoption of IFRS
- Standards of IFRS/IAS for SME
- Principles of IFRS

This guide will also assist to you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Explain IFRS
- Prepare first time adoption of IFRS
- Apply IFRS/IAS Standards for SME
- Apply IFRS principles

1.1. Introduction to IFRS

International **F**inancial **R**eporting **S**tandards (**IFRS)** is a set of accounting standards developed and maintained by the International Accounting Standards Board (IASB) to provide a globally recognized framework for financial reporting by companies. IFRS aims to enhance transparency, comparability, and consistency in financial statements across different countries and industries. These standards are used by companies listed on stock exchanges worldwide, as well as by many private companies.

IFRS is a globally recognized set of Standards for the preparation of financial statements by business entities.

Some of the key differences between GAAP and IFRS:

GAAP stands for Generally Accepted Accounting Principles, which are the generally accepted standards for financial reporting in the United States. IFRS stands for International Financial Reporting Standards, which are a set of internationally accepted accounting standards used by most of the world's countries. IFRS is a globally accepted standard for accounting, and is used in more than 120 countries while GAAP is exclusively used within the United States and has a different set of rules for accounting than most of the world.

- **Approach**

GAAP is generally more rules-based, with specific guidelines and procedures to follow in numerous scenarios. On the other hand, IFRS is more principles-based and allows for more interpretation, relying on the substance of the transaction rather than strict definitions.

- **Inventory costing**

GAAP allows for two methods of accounting for inventory costs: Last-In, First-Out (LIFO) and First-In, First-Out (FIFO). Conversely, IFRS only permits the FIFO method.

Based on Revenue recognition

While both GAAP and IFRS have converged significantly on revenue recognition principles in recent years, differences still exist. For instance, GAAP provides more industry-specific guidance.

- **Write-downs and reversals**

Under GAAP, once inventory has been written down, it cannot be reversed. IFRS, however, allows for the reversal of an inventory write-down if specific criteria are met.

- **Development costs**

GAAP mandates that costs associated with research and development are expensed as incurred. However, under IFRS, certain development costs can be capitalized and amortized over multiple periods.

- **Fixed assets revaluation**

IFRS allows fixed assets to be reported at fair value, while GAAP allows only for the reporting of historical costs.

- **Intangible assets**

IFRS has a more stringent approach to intangible asset recognition and allows for the revaluation of certain intangibles. GAAP, on the other hand, has more specific rules and does not allow for revaluation.

- **Presentation of financial statements**

There are some differences in the order of specific items on the balance sheet and income statement. For example, under GAAP, the balance sheet order is: assets, liabilities, and equity. Under IFRS, it is: assets, equity, and liabilities.

- **Consolidation**

GAAP and IFRS use different models for determining when an entity should be consolidated. GAAP uses a variable-interest entity model, which is more focused on control, while IFRS uses a voting-interest model, which considers voting rights and potential voting rights.

- **Leases**

GAAP distinguishes between operating leases and capital leases, while IFRS classifies all leases with a lease term of more than 12 months as finance leases unless the asset is of low value.

1.2. Adoption of IFRS

Preparing for the first-time adoption of International Financial Reporting Standards (IFRS) involves several steps. Here is a general outline of the process:

1. **Understand IFRS:** Familiarize yourself with the key concepts, principles, and requirements of IFRS by studying the standards and related guidance provided by the International Accounting Standards Board (IASB).

2. **Assess impact:** Evaluate the impact of adopting IFRS on your financial statements, accounting policies, processes, and systems. Identify key differences between IFRS and your current Generally Accepted Accounting Principles (GAAP) to determine areas requiring significant changes.
3. **Develop an implementation plan:** Create a detailed plan that outlines the tasks, timelines, and resources needed to transition to IFRS. This plan should cover various areas such as training, communication, system upgrades, and data migration.
4. **Gather and analyze data:** Collect relevant financial and non-financial data under IFRS. Analyze the differences in measurement, recognition, and presentation of items between your current GAAP and IFRS to ensure accurate reporting.
5. **Identify accounting policy choices:** Determine the accounting policy choices available under IFRS and assess their impact on your financial statements. Consider engaging external experts or consultants to help with complex issues if necessary.
6. **Update accounting policies and systems:** Revise your accounting policies to align with IFRS requirements. Update your financial reporting systems, internal controls, and processes to capture information required for IFRS reporting accurately.
7. **Training and communication:** Train your finance team and key stakeholders on IFRS requirements, changes, and impacts. Ensure effective communication channels are established to address any queries or concerns during the transition period.
8. **Perform an impact assessment:** Conduct a comprehensive impact assessment to determine the effect of IFRS adoption on your financial statements and disclosure notes. Compare the financial results under IFRS with your previous GAAP-based financial statements.
9. **Prepare financial statements:** Develop the first set of IFRS-compliant financial statements, including balance sheets, income statements, and cash flow statements. Ensure compliance with all applicable disclosure requirements.
10. **External audit and reporting:** Engage your external auditors for a review or an audit of your first set of IFRS financial statements. Prepare your financial statements and related disclosures in accordance with IFRS requirements.

1.3. Standards of IFRS/IAS for SME

The IFRS for SMEs (Small and Medium-sized Enterprises) was published in July 2009. It is a matter for authorities in each territory to decide which entities are permitted or even required to apply IFRS for SMEs. One aim of the IFRS for SMEs is to provide a standard for entities in countries that have no national GAAP. IFRS for SMEs will provide an accounting framework in such countries for entities that are not of the size nor have the resources to adopt full IFRS.

IFRS for SMEs is a simplified version of full IFRS standards, tailored specifically for smaller businesses. It provides a comprehensive framework for preparing and presenting financial statements in conformity with IFRS but with reduced disclosure requirements.

To apply IFRS/IAS standards for SMEs, here are some key steps:

1. **Understand the scope:** Determine if your entity qualifies as an SME according to the relevant guidelines. Most countries have specific criteria such as turnover, total assets, or number of employees.
2. **Adopt the standards:** Familiarize yourself with the IFRS for SMEs standard, which provides accounting policies and principles for SMEs. The standard covers various topics such as presentation of financial statements, recognition and measurement of assets, liabilities, income, and expenses.
3. **Apply the standards consistently:** Ensure that you apply the standards consistently across all relevant areas of your financial reporting. This includes recognizing and measuring assets and liabilities, determining fair values, and applying specific guidance for various transactions.
4. **Make necessary adjustments:** Review your existing accounting policies and procedures and make any necessary adjustments to align them with the requirements of IFRS for SMEs. This may involve changes in revenue recognition, lease accounting, impairment testing, and other areas.
5. **Prepare financial statements:** Based on the adapted standards, prepare financial statements including the statement of financial position (balance sheet), statement of comprehensive income (income statement), statement of changes in equity, and cash flow statement. Ensure proper presentation and disclosure as per the IFRS for SMEs standard.
6. **Disclosure requirements:** While IFRS for SMEs has reduced disclosure requirements compared to full IFRS, make sure you provide all the necessary

disclosures required by the standard. These include information about significant accounting policies, contingencies, related parties, and other relevant information.

7. **Stay updated:** Keep yourself updated with any amendments or changes to the IFRS for SMEs standards, as issued by the International Accounting Standards Board (IASB) or any applicable local regulatory bodies.

1.4. Principles of IFRS

Applying International Financial Reporting Standards (IFRS) involves following a set of accounting principles and guidelines issued by the International Accounting Standards Board (IASB).

The key principles of IFRS include:

- **Fair Presentation:** Financial statements should present a true and fair view of an entity's financial position, performance, and cash flows.
- **Going Concern:** Unless there is evidence to the contrary, financial statements are prepared on the assumption that the entity will continue its operations for the foreseeable future.
- **Accrual Basis:** Transactions and events are recorded in the financial statements when they occur, rather than when the cash is received or paid.
- **Consistency:** Entities are expected to apply consistent accounting policies within each reporting period and across different periods, unless a change is required by a standard or it provides more relevant and reliable information
- **Materiality**: Financial information should be disclosed if its omission or misstatement could influence users' economic decisions.
- **Prudence:** When there is uncertainty about the realization or measurement of assets or income, caution should be exercised. Assets and income should not be overstated, and liabilities and expenses should not be understated.
- **Substance over Form:** The economic substance of transactions and events should be accounted for, rather than just their legal form.
- **Comparability:** Financial statements should be prepared in a manner that enables users to compare them with those of other entities, either over time or across different entities.

Self Check 1

I. Write True for correct statement and False for incorrect statement

1. IFRS for SMEs is a set of accounting standards specifically designed for large, multinational corporations. __________
2. GAAP and IFRS are essentially the same, with no significant differences in their approach to financial reporting. ________
3. Under IFRS, fixed assets can be reported at fair value, while GAAP allows only reporting of historical costs. ___________
4. IFRS for SMEs requires the same level of disclosure as the full IFRS standards. ___
5. The key principle of consistency in IFRS means that entities should apply different accounting policies within the same reporting period. ________

II. Choose appropriate answer from the given alternatives

1. What is the primary objective of IFRS?
   a) Increase complexity in financial reporting
   b) Enhance transparency, comparability, and consistency
   c) Provide guidelines for national GAAP
   d) Apply only to publicly traded companies
2. Which method of accounting for inventory costs is permitted under both GAAP and IFRS?
   a) LIFO
   b) FIFO
   c) Weighted Average
   d) Specific Identification
3. What is the primary focus of IFRS principles in comparison to GAAP?
   a) Strict adherence to rules
   b) Substance of the transaction
   c) Industry-specific guidance
   d) Conservative accounting practices
4. What is the primary purpose of preparing for the first-time adoption of IFRS?
   a) Introduce new accounting principles
   b) Align with local regulatory requirements
   c) Evaluate the impact on financial statements
   d) Increase disclosure requirements

5. Which IFRS principle emphasizes caution when there is uncertainty about the realization or measurement of assets or income?
   a) Fair Presentation
   b) Prudence
   c) Going Concern
   d) Substance over Form
6. What is the basis for recording transactions and events in financial statements under the accrual basis principle?
   a) When the cash is received or paid
   b) When they occur
   c) Only at the end of the financial year
   d) As per the legal form of the transaction
7. Which of the following is a key characteristic of IFRS for SMEs?
   a) High level of complexity
   b) Exclusively for large corporations
   c) Streamlined and tailored for smaller businesses
   d) Applicable only in the United States
8. What does the materiality principle in IFRS emphasize?
   a. The need for detailed disclosure in financial statements
   b. The significance of financial information for decision-making
   c. The strict adherence to accounting rules
   d. The use of fair value in reporting assets
9. Which financial statement is not typically included in the preparation of end-of-period financial reports?
   a) Statement of Comprehensive Income
   b) Statement of Changes in Equity
   c) Statement of Cash Flows
   d) Statement of Budgetary Control

III. Write appropriate answer on the given space

1. GAAP and IFRS differ in their approach to accounting principles. While GAAP is more _________________, IFRS is _________________, focusing on the substance of transactions rather than strict definitions.
2. One significant difference between GAAP and IFRS lies in inventory costing methods. GAAP allows for both Last-In, First-Out (LIFO) and First-In, First-Out (FIFO), whereas IFRS only permits the _________________ method.
3. Under GAAP, the treatment of inventory write-downs differs from IFRS. While GAAP does not allow for the reversal of inventory write-downs, IFRS permits reversal under specific _________________.
4. Regarding development costs, GAAP requires immediate expense, whereas IFRS allows for the capitalization and _________________ of certain development costs over multiple periods.
5. In terms of fixed assets, IFRS allows reporting at fair value, whereas GAAP permits reporting only at _________________.

Unit Two: Asset Register

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Registration of property, plant and equipment
- Method of calculating depreciation
- Maintaining asset register

This guide will also assist to you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Prepare a register of property, plant and equipment
- Determine method of calculating depreciation
- Maintain asset register and depreciation schedule

2.1. Registration of Property, Plant and Equipment

International accounting standard 16(IAS 16) Define and establishes principles for recognizing property, plant and equipment as assets, measuring their carrying amounts, and measuring the depreciation charges and impairment losses to be recognized in relation to them.

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than one period.

The cost of an item of property, plant and equipment is recognized as an asset if, and only if:

- It is probable that future economic benefits associated with the item will flow to the entity; and
- The cost of the item can be measured reliably.

An item of property, plant and equipment is initially measured at its cost. The Cost includes:

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- The estimated costs of dismantling and removing the item and restoring the site on which it is located, unless those costs relate to inventories produced during that period.

Property, plant, and equipment basically include any of a company's long-term, fixed assets. PP&E assets are tangible, identifiable, and expected to generate an economic return for the company for more than one year or one operating cycle (whichever is longer).

The account can include machinery, equipment, vehicles, buildings, land, office equipment, and furnishings, among other things. Note that, of all these asset classes, land is one of the only assets that do not depreciate over time.

If a company produces machinery for sale, that machinery is not classified as property, plant, and equipment, but rather is classified as inventory. The same goes for real estate companies that hold buildings and land under their assets. Their office buildings and land are PP&E, but the houses or land they sell are inventory.

Property, plant and equipment can be recorded manually on a book or digitally by using different software (i.e excel spread sheet, Peachtree accounting software, quick book etc). Recording of Property, plant and equipment includes the following detailed information.

- Identification or serial number
- Acquisition cost
- Acquisition date
- Depreciation rate and method
- Accumulated depreciation
- Net book value
- Location and class of asset

At the end of every month, the accountant should prepare a depreciation schedule for each of the item using depreciation rates.

Determining net property, plant and Equipment

The following formula is used to determine net property, plant and equipment

NPPE = GPPE + Capital Expenditures – Accumulated Depreciation

Where:

NPPE = net property, plant and equipment

GPPE=Gross property, plant and equipment

Illustration

In May 2022, Addis Factory owned Property, plant and equipment with a gross value of birr 5,000,000. Accumulated depreciation for the same Assets was birr 2,100,000. Due to the wear and tear of the machinery, the company decided to purchase new equipment in birr 1,000,000. For this period, the depreciation expense for all old and new equipment is birr 150,000. Determine ending balance or net of Property, plant and equipment

NPPE = GPPE + Capital Expenditures – Accumulated Depreciation

NPPE=5,000,000 + 1,000,000 –(2100000+150000) =3,750,000 birr

Thus, the ending balance is birr 3,750,000.

2.2. Method of Calculating Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Calculating depreciation includes the following items

- **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.
- **Useful life is**:
  - ➢ The period over which an asset is expected to be available for use by an entity; or
  - ➢ The number of production or similar units expected to be obtained from the asset by an entity.
- **The residual value of an asset** is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation can be determined by using different methods. Quite often tax authorities dictate the type of depreciation method to be applied to assets. The four most popular depreciation methods are:

I. Straight-Line
II. Double Declining Balance
III. Units of Production
IV. Sum of Years digits

I. Straight-line depreciation method

This is the simplest method of all. It involves the simple allocation of an even rate of depreciation every year over the useful life of the asset. This means depreciable value of the asset is equally distributed to its useful life.

The formula for straight-line depreciation is:

$$\textbf{Annual depreciation expense} = \frac{\textbf{Asset cost} - \textbf{Residual value}}{\textbf{useful life of the asset}} \text{ ---------------------------- (1)}$$

Depreciable cost= Asset cost – Residual Value --- (2)

Straight line percentage (SLP) = (1/useful life) *100% ------------------------------- (3)

$$\textbf{Annual depreciation expense} = \frac{\textbf{Depreciable cost}}{\textbf{useful life of the asset}} \text{ ------------------1 \&2-------- (4)}$$

Annual Depreciation expense = SLP*depreciable cost from 2&3------------------ (5)

Annual depreciation expense can be determine by using formulas 1,4 and 5 Depending on the given variables.

Example

Suppose manufacturing company purchases machinery for br. 2,500,000 and the useful life of the machinery are 25 years and the residual value of the machinery is br. 20,000

Determine

A. Annual Depreciation expense= (2,500,000-20,000) / 25 = br. 99200
B. Straight line percentage=1/25*100%= 4%
C. Depreciable cost=2500000-20000= 24800000 birr

Accumulated depreciation and Book value

Accumulated depreciation is the total depreciation of the fixed asset accumulated up to a specified time.

$$\text{Accumulated depreciation} = \sum_{k=1}^{n} \text{Depreciation expenses}$$

Accu. Dep= Dep. Exp1+ Dep. Exp2 + Dep. Exp3 ….+ Dep. Expn

Book value is the difference between cost of the asset and accumulated depreciation

BV=cost – Accu. Dep

Example

Gochu Company purchased truck at cost of 2,500,000 birr with an estimated useful life of 10 years and 250,000 birr salvage value.

A. Determine annual depreciation expense of the truck
   Annual Dep=(2500000-250000)/10= 225,000 birr
B. Show each year depreciation, accumulated depreciation and book value of the truck

Table 2. 1Schedule of depreciation, accumulated depreciation and book value

Year	Beginning book value	Annual Depreciation	Accumulated depreciation	Ending book value
1	2,500,000	225,000	225,000	2,275,000
2	2,275,000	225,000	450,000	2,050,000
3	2,050,000	225,000	675,000	1,825,000
4	1,825,000	225,000	900,000	1,600,000
5	1,600,000	225,000	1,125,000	1,375,000
6	1,375,000	225,000	1,350,000	1,150,000
7	1,150,000	225,000	1,575,000	925,000
8	925,000	225,000	1,800,000	700,000
9	700,000	225,000	2,025,000	475,000
10	475,000	225,000	2,250,000	250,000

II. Double declining method

This is one of the two common methods a company uses to account for the expenses of a fixed asset. This is an accelerated depreciation method. As the name suggests, it counts expense twice as much as the book value of the asset every year.

Double declining method is applied in three steps

1. Determine the straight line percentage
2. Determine the double declining balance rate by multiplying the SLP by two.
   DDR=2*SLP
3. Compute the depreciation expense by multiplying the DDR with book value of the asset
   Depreciation expense= DDR*BV

Where

DDR = double decline rate

BV= book value

SLP= straight line percentage

Note in double declining method the last year depreciation expense is computed by subtracting salvage value from book value

Example

On April 1, 2012, company XYZ purchased a piece of equipment for br. 100,000. This is expected to have 5 useful life years. The salvage value is birr 14,000. Company XYZ considers depreciation expenses for the nearest whole month. Calculate the depreciation expenses for 2012, 2013, 2014, 2015, and 2016 using a declining balance method.

Solution

- Useful life = 5
- Straight line depreciation percent = 1/5 = 0.2 or 20% per year
- Depreciation rate = 20% * 2 = 40% per year
- Depreciation for the year 2012 = br. 100,000 * 40% * 9/12 = br. 30,000
- Depreciation for the year 2013 = (br. 100,000- br.30,000) * 40% * 12/12 br.= 28,000
- Depreciation for the year 2014 = (br 100,000 – br. 30,000 – br. 28,000) * 40% * 9/12 = br16,800
- Depreciation for 2016 is br. 1,120 to keep the book value same as salvage value.
- br 15,120 – br. 14,000 = br. 1,120 (At this point the depreciation should be stop).

III. Unit of Production method

This is a two-step process, unlike the straight-line method. It is very useful method in assembly for production lines. Hence, the calculation is based on the output capability of the asset rather than the number of years.

Unit of production method is a two-step process,

Step 1: Calculate per unit depreciation

Per unit Depreciation = (Asset cost – Residual value) / Useful life in units of production

Step 2: Calculate the total depreciation of actual units produced:

Total Depreciation Expense = Per Unit Depreciation * Units Produced

Example: ABC /Company purchase a printing press to print flyers for br. 40,000 with a useful life of 180,000 units and a residual value of br. 4000.

Required

a) Determine depreciation expense if It prints 4000 flyers in 2015.

Step 1: Per unit Depreciation = (40,000-4000)/180,000 = br. 0.2

Step 2: Total Depreciation expense = br. 0.2 * 4000 flyers = br. 800

So the total Depreciation expense is br. 800 which is accounted for.

Once the per-unit depreciation is found out, it can be applied to future output runs

b) Determine depreciation expense if It prints 9000 flyers in 2016.

c) Determine accumulated depreciation at the end of 2016.

d) Calculate book value of the printer at the end of 2016.

IV. Sum-of-the-years' digits method

Sum of years Digits Methods or the sum of year depreciation method is an accelerated depreciation method whereby the method declines the asset's value at an accelerated rate. Most of the depreciation of an asset is recognized in the first few years of its useful life. Therefore greater deductions are allowed in the starting life of the assets than in subsequent years, mainly in the case of those assets which are heavily used when they are new.

Although, the amount of depreciation remains the same whether the Company uses the straight-line depreciation method, double declining balance method, or the sum of year digits method. It is just that the amount of timing of the depreciation differs in all three approaches.

- The sum of the year's digits method causes the Company's net income variability. The assets are depreciated at a higher rate in the early years, and thus, the net income is lower in the early life of the asset. But as the useful life of the asset increases, the reported net income increases.
- However, using this method can indirectly impact the company's cash flow. Since the depreciation amount is higher in the initial years, the reported net income is lower; hence, the tax implication is lower.

Steps to Sum of Years Digits Method

Below are the steps to the sum of Years digits method –

1. First, calculate the depreciable amount, which is equal to the asset's total cost of acquisition minus the salvage value.

   Depreciable amount = Total acquisition cost – Salvage Amount.

2. Calculate the Sum of Useful Years of the Asset.
3. Determine depreciation factor. It is the asset's useful life divided by the sum of the good years of the asset.
4. Determining depreciation by multiplying depreciable amount with depreciation factor each year.

The Sum of years depreciation = Number of useful years/sum of useful years * (Depreciable amount)

For example Let say Company YTH purchased plant equipment for 50000 birr and it salvage value after three years useful life is 5000 birr.

Depreciable value =500000-5000=45000birr

Then, the sum of useful years = 3 + 2 + 1 = 6.

The factors for each year will be 3/6, 2/6, and 1/6, respectively, for the 1st, 2nd, and 3rd year

1st year depreciation = 45000*3/6 = 22,500

2nd year depreciation= 45000*2/6 =15,000

3rd year depreciation= 45000*1/6 = 7,500

2.3. Maintaining Asset Register

An asset register is a list of all the assets owned by a company. It includes the asset's name, description, location, purchase date, cost, and depreciation schedule. The depreciation schedule is a table that shows how the asset's value will decrease over time.

There are several reasons why it is important to maintain an asset register and associated depreciation schedule. First, it helps to keep track of the company's assets. This is important for financial reporting purposes, as well as for tax purposes. Second, it helps to ensure that the company is depreciating its assets correctly. This is important to avoid overstating the company's assets on its financial statements. Third, it helps to track the location of assets. This is important for security and insurance purposes.

There are several ways to maintain an asset register and associated depreciation schedule. One way is to use a spreadsheet. Another way is to use a software program designed for asset management. Whichever method you choose, it is important to keep the information up-to-date.

Here are some tips for maintaining an asset register and associated depreciation schedule:

- Keep the asset register in a secure location.
- Update the asset register regularly.
- Reconcile the asset register with the company's financial statements.
- Keep the depreciation schedule up-to-date.
- Track the location of assets.
- Back up the asset register and depreciation schedule regularly.

By following these tips, you can ensure that your company's asset register and depreciation schedule are accurate and up-to-date.

Self- check 2

I. Choose the best answer from the given alternatives

1. What is property, plant, and equipment?
   A. Fixed assets with useful lives that extend beyond one year
   B. Fixed assets with useful lives of one year or less
   C. Tangible current assets
   D. Long-term intangible assets
2. Which of the following costs should be capitalized as a part of fixed assets?
   A. Installation costs
   B. Repairs
   C. Maintenance
   D. Production salaries
3. The net balance for fixed assets is equal to the gross balance less _____ and _____.
   A. Accumulated depreciation, impairment
   B. Current year depreciation, repairs expense
   C. Expensed repairs, impairment
   D. Shipping charges, accumulated depreciation
4. The calculation of depreciation using the declining-balance method
   A. Ignores salvage value in determining the amount to which a constant rate is applied.
   B. Multiplies a constant percentage times the previous year's depreciation expense.
   C. Yields an increasing depreciation expense each period.
   D. Multiplies a declining percentage times a constant book value.
5. A plant asset with a cost of $900,000 and accumulated depreciation of $800,000 is sold for $80,000. What is the amount of the gain or loss on disposal of the plant asset?
   A. $20,000 loss.
   B. $80,000 loss.
   C. $80,000 gain.
   D. $20,000 gain.

II. Record appropriate journal entries for the following economic activities

1. Faster Company purchased equipment in 2010 for $104,000 with an estimated salvage value of $8,000 and a 10-year useful life. At December 31, 2016, there was $67,200 in the Accumulated Depreciation account for this equipment using the straight-line method of depreciation. On March 31, 2017, the equipment was sold for $21,000.
2. Lewis Company sold equipment for $11,000 on September 1. The equipment originally cost $25,000 in 2014 and $6,000 was spent on a major overhaul in 2017 (charged to the Equipment account). Accumulated Depreciation on the equipment to the date of disposal was $20,000.
3. Selby Company sold equipment that had a book value of $13,500 for $15,000 on July 5. The equipment originally cost $45,000 and it is estimated that it would cost $57,000 to replace the equipment.

III. Write True if the given statement is correct and False if the statement is incorrect

1. Property, plant, and equipment (PP&E) assets include tangible items expected to generate economic returns for a company for less than one year.
2. Under the International Accounting Standard 16 (IAS 16), an item of property, plant, and equipment is initially measured at its fair value.
3. The Net Property, Plant, and Equipment (NPPE) formula include Gross Property, Plant, and Equipment (GPPE), capital expenditures, and accumulated depreciation.
4. The Straight-Line Depreciation Method allocates an even rate of depreciation every year over the useful life of the asset.
5. Accumulated Depreciation is the total depreciation of a fixed asset accumulated up to a specified time, and the book value is the difference between the cost of the asset and accumulated depreciation.

Operation Sheet 2.1: Asset Register and Depreciation Schedule Maintenance

Operation Title: Managing Asset Register and Depreciation Schedule

Purpose: To accurately track and account for company assets, as well as maintain an up-to-date depreciation schedule.

Conditions or Situations for the Operation:

- ✓ Access to a secure and confidential working area.
- ✓ Adequate knowledge of asset management procedures.
- ✓ Properly operated computer or manual asset management tools.
- ✓ Compliance with company policies and accounting standards.

Equipment, Tools, and Materials:

- Computer or physical ledger for manual recording.
- Asset identification tags or labels.
- Relevant accounting software (if applicable).
- Documentation related to asset acquisition.

Steps in Doing the Task:

1. Secure Working Environment: Ensure that the workspace is secure and confidential to prevent unauthorized access to asset information.
2. Gather Necessary Tools: Collect the required tools, including a computer or manual ledger, asset identification tags, and any relevant documentation.
3. Access Asset Register: Log in to the asset management system or open the manual asset register.
4. Update Asset Information: Record any new asset acquisitions, disposals, or changes in the asset register. Include details such as identification numbers, acquisition dates, and costs.
5. Verify Asset Details: Cross-verify the recorded information with physical inspections to ensure accuracy.
6. Assign Depreciation: Based on the chosen depreciation method, calculate and record the depreciation for each asset.

7. Accumulated Depreciation: Maintain a running total of accumulated depreciation for each asset.
8. Net Book Value Calculation: Calculate the net book value of each asset (Acquisition Cost - Accumulated Depreciation).
9. Review and Reconcile: Periodically review the asset register to identify discrepancies and reconcile with financial records.
10. Backup Data: If using computerized systems, regularly back up asset register data to prevent loss.
11. Documentation: Keep proper documentation for asset acquisitions, disposals, and any changes for audit purposes.

Note: This operation sheet provides a general guideline for maintaining the asset register and depreciation schedule. The specific steps may vary based on the company's policies, the chosen depreciation method, and the nature of the assets being managed. Regular updates and accurate recording are essential for effective asset management and financial reporting

LAP T Test

Instructions: Given necessary templates, tools and materials you are required to perform the following tasks accordingly.

Task 1: Register at least three fixed asset in your college

Task2: Prepare depreciation schedule of the fixed assets

Unit Three: Record and Post Balance Day entries

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Depreciation and Disposal of Fixed Assets
- Adjusting expense and revenue accounts
- Recording bad and doubtful debts
- Inventory Adjustment
- Final General Ledger preparation

This guide will also assist to you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Record depreciation and disposal of fixed assets
- Adjust expenses and revenue accounts for prepayment and accruals
- Record bad and doubtful debts
- Adjust ledger accounts for inventories and transfer to final accounts
- Prepare final general ledger

3.1. Depreciation and Disposal of Fixed Assets

Under IFRS (International Financial Reporting Standards), the disposal of fixed assets is treated based on the principles outlined in IAS 16 "Property, Plant and Equipment." When disposing of a fixed asset, there are several steps involved in recording the transaction:

The accounting for depreciation requires an ongoing series of entries to charge a fixed asset to expense, and eventually to derecognize it. These entries are designed to reflect the ongoing usage of fixed assets over time.

Depreciation is the gradual charging to expense of a fixed asset's cost over its expected useful life. Tangible fixed assets, such as buildings, equipment, vehicles and so on except land values' decreases over time after their purchase because of wear, tear and obsolescence. Depreciation represents the estimate for how much this value has declined in a given fiscal period.

So depreciation expense is debited and accumulated depreciation is credited on balance date adjusting entry.

Depreciation expense---------------------**

Accumulated depreciation ------------------**

Fixed assets must be removed from the balance sheet when the asset is disposed of, such as sold, exchanged, or retired from operations. The journal entry to dispose of fixed assets affects several balance sheet accounts and one income statement account for the gain or loss from disposal. Removing disposed-of fixed assets from the balance sheet is an important bookkeeping task to keep the balance sheet accurate and useful.

Below are the five steps in recording the disposal of fixed assets:

Step 1: Record the partial-year depreciation expense through the date of disposal.

Step 2: Debit the Accumulated Depreciation account for the amount of depreciation claimed over the life of the asset

Step 3: Credit the Fixed Asset account for the original cost of the asset.

Step 4: Debit the Cash account for the proceeds from the sale. If there's a promissory note, debit Notes Receivable instead.

Step 5: Recognize any gain (credit) or loss (debit) resulting from the disposal. This amount can be determined by whatever is necessary to make the journal entry balance.

There are four accounts (cash, accumulated depreciation, loss or gain on sales and fixed asset) affected when writing off a fixed asset at disposal. When you write something off the books, accounts with normal debit balances are credited and accounts with normal credit balances are debited.

When loss on sales of fixed asset the journal entry will be:

Cash --**

Accumulated depreciation------------------------**

Loss on sale of fixed asset------------------------**

Fixed asset--**

When gain on sales of fixed asset the journal entry will be:

Cash --**

Accumulated depreciation------------------------**

Gain on sale of fixed asset-----------------------------**

Fixed asset--**

Illustration

Let's assume that the LY company have a fixed asset with an original cost of birr 50,000 and accumulated depreciation of birr 30,000 as of the beginning of the accounting year. The fixed asset has no salvage value and it has a useful life of five years. The company uses the straight-line method of depreciation.

A. If the company sold the fixed asset for birr 20,000 on Tahsas 30 of the same year. The journal entries would be:

To update the accumulated depreciation as of Tahsas 30

Tahsas 30 Depreciation expense-----------------5000

Accumulated depreciation----------------------5000

To record the disposal and gain on sale of fixed asset

The book value of our asset is birr 15,000 (birr50,000 to birr35,000). We sold it for birr20,000, resulting in a birr5,000 gain. Gains happen when you dispose the fixed asset at a price higher than its book value.

Cash---------------------------------------20000

Accumulated depreciation-------------35000

Fixed asset-------------------------------50000

Gain on sale of fixed asset--------------5000

B. If the company sold the fixed asset for birr 12,000 on Tahsas 30 of the same year. The journal entries would be:

To update the accumulated depreciation as of Tahsas 30

Tahsas 30 Depreciation expense-----------------5000

Accumulated depreciation-----------------------5000

To record the disposal and loss on sale of fixed asset

The book value of our asset is birr 15,000 (birr50,000 to birr35,000). We sold it for birr12,000, resulting in a birr3,000 loss. Loss happens when you dispose the fixed asset at a price less than its book value.

Cash--------------------------------------12000

Accumulated depreciation--------------35000

Loss on sale of fixed asset--------------3000

Fixed asset-------------------------------50000

Disposal of Asset for no Proceeds at a Loss

Disposal of a fixed asset doesn't necessarily mean selling it. You can also discontinue the use of an asset by retiring it completely. Let's assume that on Tahsas 30, a fire destroyed the fixed asset. Upon inspection of the asset, it was deemed inoperable and totally destroyed. Our entries would be:

To update the accumulated depreciation as of Tahsas 30

Tahsas 30 Depreciation expense -------------------5000

Accumulated depreciation-------------------5000

To record the disposal and loss due to fire

In this case, we recognize the entire book value of the asset as a loss of birr 15,000.

Accumulated depreciation--------------------35000

Loss of fixed asset due to fire------------------15000

Fixed asset---50000

Disposal of a Fully Depreciated Fixed Asset for No Proceeds

Now let's assume we keep the fixed asset until the end of its useful life, at which time it's fully depreciated.

To record the disposal of fully depreciated asset

Accumulated depreciation-----------------------**

Fixed asset---**

Illustration

Let's assume that the LY company have a fixed asset with an original cost of birr 50,000 and the fixed asset has no salvage value and it has a useful life of five years. The company uses the straight-line method of depreciation. At the end of 5th year the company disposes the asset and record journal entry as:

Accumulated depreciation-----------------------50000

Fixed asset---50000

Under International Financial Reporting Standards (IFRS), the disposal of fixed assets is recorded using several accounting entries. Here are the steps involved, along with a numeric example:

1. Determine the carrying amount: Calculate the carrying amount of the fixed asset being disposed of. This is the original cost of the asset less any accumulated depreciation or impairment losses.
2. Recognize any gain or loss on disposal: If the fair value of the fixed asset at the time of disposal differs from its carrying amount, a gain or loss on disposal is recognized. The gain or loss is calculated as the difference between the fair value and the carrying amount.
3. Update accumulated depreciation: Remove the accumulated depreciation related to the fixed asset being disposed of. This adjusts the depreciation expense that has been recorded over the useful life of the asset.
4. Remove the fixed asset from the books: Remove the fixed asset and its related accumulated depreciation from the balance sheet.

Illustration

Suppose a company has a computer with an original cost of $5,000, accumulated depreciation of $3,000, and a remaining useful life of 2 years. The fair value of the computer at the time of disposal is $2,500.

1. Carrying amount: Original cost - Accumulated depreciation
   Carrying amount = $5,000 - $3,000 = $2,000
2. Gain or loss on disposal: Fair value - Carrying amount
   Gain or loss = $2,500 - $2,000 = $500 (Gain)
3. Update accumulated depreciation: Remove the accumulated depreciation of $3,000 associated with the computer.
4. Remove the fixed asset: Remove the computer and its associated accumulated depreciation from the balance sheet.

When disposing of fixed assets under IFRS (International Financial Reporting Standards), there are a few key steps to follow. Let's go through an example to illustrate the journal entries involved.

Let's say the company ABC Ltd. decides to sell a piece of equipment for $10,000. The original cost of the equipment was $15,000, and its accumulated depreciation is $5,000.

Step 1: Calculate the carrying amount:

Carrying Amount = Original Cost - Accumulated Depreciation

Carrying Amount = $15,000 - $5,000

Carrying Amount = $10,000

Step 2: Recognize the disposal:

The disposal of the asset should be recognized in the financial statements. This involves removing both the asset and its accumulated depreciation from the books. Here are the journal entries:

Accumulated Depreciation - Equipment	$5,000	
Loss on Disposal	$X (if any)	
Cash (or Accounts Receivable)	$10,000	
Equipment		$15,000

Note: If the sale price ($10,000 in this example) is greater than the carrying amount ($10,000 in this example), a gain on disposal will be recognized instead of a loss. In that case, the "Loss on Disposal" entry would be replaced with "Gain on Disposal."

The "Accumulated Depreciation - Equipment" account is debited to remove the accumulated depreciation associated with the asset.

The "Loss on Disposal" account is debited if there is any loss on the disposal. The amount depends on the carrying amount and the sale price.

The "Cash" (or "Accounts Receivable" if it's on credit) account is debited with the sale price of the asset.

The "Equipment" account is credited to remove the original cost of the asset.

Step 3: Update the depreciation expense:

After the disposal, the depreciation expense should be adjusted accordingly. In this example, assume the equipment was being depreciated on a straight-line basis over 5 years.

Depreciation Expense	$1,000	
Accumulated Depreciation - Equipment		$1,000

This entry reflects the adjustment of depreciation expense for the period based on the new carrying amount after the disposal.

It's worth mentioning that the specific circumstances and requirements of each company may vary, so it's always recommended to consult with a qualified accountant or financial professional who can provide guidance based on the specific situation.

Please note that my responses are based on general accounting principles, and it's always advisable to consult financial experts or refer to the applicable accounting standards for specific scenarios.

3.2. Adjusting Expense and Revenue Accounts

There are two types of adjusting entries—deferrals and accruals**.** Deferrals may be either deferred expenses or deferred revenue. Accruals may be either accrued expenses or accrued revenue.

I. Deferred expenses
II. Deferred revenue
III. Accrued expenses
IV. Accrued revenue

I. Deferred expenses

A Deferred Expense, also known as a prepaid expense, is an accounting concept that refers to an expenditure that has been paid in advance but has not yet been incurred. This occurs when a company makes a payment for goods or services that will benefit the business over multiple accounting periods.

Examples of Deferred Expenses:

- Prepaid Rent: If a company pays rent for several months in advance, the payment is initially recorded as a deferred expense. Each month, a portion of the prepaid rent is recognized as an expense.
- Insurance Premiums: Payments made for insurance coverage for future periods are treated as deferred expenses. The expense is recognized as the coverage period progresses.
- Subscription Services: Businesses that subscribe to services or publications and pay in advance treat the subscription cost as a deferred expense, recognizing it over the subscription period.

Accounting Treatment:

- **Initial Recordation:** The initial payment is recorded as a debit to a prepaid (asset) account and a credit to the cash or accounts payable account.
- **Expense Recognition:** As time passes or as the related goods or services are consumed, a portion of the prepaid amount is transferred from the prepaid (asset) account to the appropriate expense (income statement) account.
- **Adjustments:** Regular adjustments are made to accurately reflect the reduction in the prepaid asset account and the recognition of the corresponding expense.

Illustration

1. Assume a company purchases birr12000 worth of insurance that will be used up within one year. On date of purchase

   Prepaid insurance------------------------12000

   Cash--12000

At the end of the month adjusting entry will be:-

   Insurance expense -----------------------1000

   Prepaid insurance -----------------------1000

2. let the company prepaid a one-year shop rent 24000 birr during the month and initially recorded it as an asset because it would last for more than one month. By the end of the month some of the prepaid rent 2000birr expired, so you reduced the value of this asset to reflect what you actually had on hand at the end of the month (birr22000). What was expired (birr2000) became an expense. At the end of the month adjusting entry will be:-

   Rent expense---------------------2000

   Prepaid rent -----------------------2000

II. **Deferred revenue: -** Deferred revenue, also known as unearned revenue or deferred income, is an accounting concept that refers to money received by a business in advance of earning it. In other words, it represents payments received for goods or services that the company has not yet delivered or performed. Deferred revenue is a liability on the balance sheet until the goods or services are provided, at which point it is recognized as revenue.

Examples of Deferred Revenue:

- **Subscription Services:** If a company sells annual subscriptions, the payment received upfront is considered deferred revenue until the subscription period is completed.
- **Software Licenses:** Businesses that sell software licenses may receive payment in advance for a specific period. The unearned portion is treated as deferred revenue.
- **Magazine Subscriptions:** Publishers often receive payments for future magazine deliveries, and the unearned revenue is recognized as deferred until each issue is provided.

Accounting Treatment:

- **Initial Recordation:** The upfront payment is recorded as a liability (deferred revenue) on the balance sheet, with a corresponding debit to cash or a liability account.
- **Revenue Recognition:** As goods or services are delivered, a portion of the deferred revenue is recognized as earned revenue on the income statement. The liability is decreased accordingly.

- **Adjustments:** Regular adjustments are made to accurately reflect the reduction in the deferred revenue liability and the recognition of the corresponding revenue.

Illustration

Fast company client paid 3000 birr 60-day fee in advance covering the period from 27/12 – 24/2 and recorded a debit to cash and a credit to unearned consulting revenue, a liability account.

Step 1: Current balance equals $3,000.

Step 2: Fast earns payment as time passes. At 31/12, 5 days' service is earned or 5/60 x $3,000 = $250.

Step 3: Adjusting entry reduces liability, Unearned Consulting Revenue, by $250 or 5 days' worth of revenue. Also, Consulting Revenue of $250 is earned.

On 27/12 cash---------------------------3000

Unearned revenue------------------3000

On 31/12. Unearned revenue------------------250

Revenue ------------------------------250

III. Accrued expenses

Accrued expenses require adjusting entries. In this case someone is already performing a service for you but you have not paid them or recorded any journal entry yet. The transaction is in progress, and the expense is building up, but nothing has been written down yet. This may occur with employee wages, property taxes, and interest. If the end of an accounting period arrives before you record any of these growing expenses, you will make an adjusting entry to include the part of the expense that belongs in that period and on that period's financial statements. For the adjusting entry, you debit the appropriate expense account for the amount you owe through the end of the accounting period so this expense appears on your income statement. You credit an appropriate payable, or liability account, to indicate on your balance sheet that you owe this amount.

A. For salaries and wage accrued expenses

Wage expense--------------------**

Wage payable----------------------**

B. For taxes accrued expenses

Taxes expense -------------------**

Taxes payable ----------------------**

C. For Interest accrued expenses

Interest expense -------------------**

Interest payable ---------------------**

V. **Accrued revenue**: - Accrued revenues require adjusting entries. “Accrued” means “accumulated over time.” In this case a customer will only pay you well after you complete a job that extends more than one accounting period. At the end of each accounting period, you record the part of the job that you did complete as a sale. This involves a debit to *Accounts Receivable* to acknowledge that the customer owes you for what you have completed and a credit to *Fees Earned* to record the revenue earned thus far.

Revenue is earned as a job is performed. Sometimes an entire job is not completed within the accounting period, and the company will not bill the customer until the job is completed. The earnings from the part of the job that has been completed must be reported on the month’s income statement for this accrued revenue, and an adjusting entry is required.

Example:-Assume that a company begins a job for a customer on June 1. It will take two full months to complete the job. When it is complete, the company will then bill the customer for the full price of $4,000. No journal entry is made at the beginning of June when the job is started. At the end of each month, the amount that has been earned during the month must be reported on the income statement. If the company earned $2,500 of the $4,000 in June, it must journalize this amount in an adjusting entry as:-

Account receivable -------------------2500

Fees earned-----------------------------2500

Some other adjusting entries

a. **Supply:-** Supplies are relatively inexpensive operating items used to run your business. Suppose a company purchases birr1100 worth of supplies that will be used for two months.

Supplies------------------------------1100

Cash---------------------------------------1100

If the company used birr550 in the month adjusting entry at the end of the month will be:

Supplies expense-------------------------550

Supplies ------------------------------------550

The company had purchased supplies during the month and initially recorded them as an asset because they would last for more than one month. By the end of the month it used up some of these supplies, so the company reduced the value of this asset to reflect what it actually had on hand at the end of the month. What was used up became an expense, or cost of doing business, for the month. To transfer what was used, Supplies Expense was debited for the amount *used* and Supplies was credited to reduce the asset by the same amount. Any remaining balance in the Supplies account is what you have left to use in the future; it continues to be an asset since it is still available.

b. **Depreciation: -** A fixed asset is a **t**angible/physical item owned by a business that is relatively expensive and has a permanent or long life of more than one year. Some examples are equipment, furnishings, vehicles, buildings, and land. Each of these is recorded as an asset at the time it is purchased. Its initial value, and the amount in the journal entry for the purchase, is what it costs.

Although fixed assets cost company money, they are not initially recorded as expenses. It is recorded as debit account "Equipment," NOT "Equipment Expense"). Fixed assets are first recorded as assets that later are gradually "expensed off," or claimed as a business expense, over time.

The process of "expensing off" the cost of a fixed asset as it is "used up" over its estimated useful life is **depreciation.** (NOTE: Land is property that does not "get used up;" therefore it is not depreciated.)

Example

Assume that the equipment depreciates at a rate of $100 per month, which is determined by dividing its cost of $6,000 by 60 months (five years). After one month, the equipment is no longer worth $6,000. It has lost $100 of its initial value, so it is now worth only $5,900. An adjusting entry must be made to recognize this loss of value.

Depreciation expense--------------------100

Accumulated depreciation-----------100

3.3. Recording Bad and Doubtful Debts

Regardless of how careful a company is in granting credit, some credit sales or service will be uncollectable. The operating expense recorded from uncollectable receivables is known as bad debt expense, uncollectable accounts expense or doubtful account expense. Some indications that an account may be uncollectable may include:-

a) The receivables past due
b) The customer files for bankruptcy
c) The customer does not respond to the company's attempts to collect
d) The customer closes its business
e) The company cannot locate the customer

There are two methods of accounting for uncollectable receivables are:-

A. Direct write off method
B. Allowance method

A. Direct write off method

Under this method bad debt expense is recorded only when an account is determined to be worthless. It is not recorded until the customer's account is determined to be uncollectable. At that time the customer's account receivable is written off.

Illustration

Assume that on May 10, 2022 a 12,000 birr account receivable from Mr. Abdisa has been determined to be uncollectable. The entry to write off the account is as follow.

May 10 Bad debt expense ----------------------12000

Account receivable Mr. Abdisa--------------12000

B. **Allowance Method**

- Estimate of doubtful debts made at the end of the period an adjusting entry is made at the end of each accounting period.
- Allowance also known as 'provision 'he/she say paid Since the specific customer accounts that will become uncollectible are not yet known when the adjusting entry is made, a contra-asset account named allowance for bad debts,
- Allowance method is sometimes called allowance for doubtful accounts, is subtracted from accounts receivable to show the net realizable value of accounts receivable on the balance sheet.

Estimating bad debts expense

- The allowance method of accounting for bad debts requires an estimate of bad debts expense to prepare the adjusting entry at the end of each accounting period.
- There are two approaches to estimate bad debts expense using the allowance method:

i. **Percentage of Total Receivables method**

The allowance for doubtful accounts is determined based on the percentage of ending accounts receivable that are presumed to be uncollectible. This method is labeled a balance sheet approach because the one figure being estimated (the allowance for doubtful accounts) is found on the balance sheet.

Estimated Amount of Uncollectible = Total Amount of Receivables X All outstanding Estimated Percent

ii. **Percentage of sales method**

This alternative computes doubtful accounts expense by anticipating the percentage of sales (or credit sales) that will eventually fail to be collected. The percentage of sales method is sometimes referred to as an income statement approach because the only number being estimated (bad debt expense) appears on the income statement.

Estimated bad debt expense = (Credit sales for period x Estimated rate of bad debts)

Illustration Assume that ABC Company chooses to use the percentage of sales method. All available evidence is studied by officials who come to believe that 8 percent of credit sales amounted $400,000 made during Year two will prove to be worthless. In applying the percentage of sales method, what adjusting entry is made at the end of the year so that financial statements can be prepared?

Answer: According to the general ledger, the company generated $400,000 in credit sales during Year Two. If uncollectible accounts are expected to be 8 percent of that amount, the expense is reported as $32,000 ($400,000 × 8 percent). Bad debt expense (the figure estimated) must be raised from its present zero balance to $32,000.

Adjusting Entry for Year Two—Bad Accounts Estimated as a Percentage of Sales

Bad debt expense --------------------32000

Allowance for bad debt -------------------32000

iii. **Aging method: -** This method first categorizes all receivable balances by age and then multiplies each of the individual totals by a different percentage. Normally, a higher rate is used for accounts that are older because they are considered more likely to become uncollectible.

Illustration Assume the following age classification as of December 31, 2008 for Hachalu Company.

Age	Amount	Present (%)	Estimated uncollectable
0-30 days	Br. 60,000	1	600
31-60 days	15,000	2	300
61-90	10,000	10	1000
91-120	8000	20	1600
above120	7000	50	3500
	100,000birr		700birr

Table 3. 1 Aging method of depreciation schedule

Dec 31, 2008, Bad debts expense --------------Br7,000

Allowance for uncollectible --------------7,000

(to record estimated bad debts under aging method)

3.4. Inventory Adjustment

The adjusting entry for inventory is made at the end of an accounting period to bring the inventory account balance up-to-date and accurately reflect the actual amount of inventory on hand. If the perpetual inventory system is used, the adjusting entry is typically not needed, as the inventory account balance is updated continuously by the automated system throughout the period with every purchase, sale, or another event that affects the company's inventory. However, if the periodic inventory system is used, an adjusting entry is necessary to adjust the inventory account balance to its correct ending balance.

The adjusting entry for inventory typically involves two accounts; inventory and Cost of Goods Sold (COGS). If the physical inventory count at the end of the period reveals that the actual inventory on hand is less than the amount recorded in the accounting system, the adjusting entry for inventory would be a debit to COGS and a credit to inventory. This entry reduces the Inventory account to its actual ending balance and increases the cost of goods sold account to reflect the cost of the inventory that was sold but not yet recorded. The adjusting entry for inventory reduction will be as follows:

DD/MM/YYYY Cost of Goods Sold (COGS) -------------------**

Inventory---------------------------------**

(Adjusting journal entry for a decrease in inventory)

Conversely, if the physical inventory count at the end of the period reveals that the actual inventory on hand is more than the amount recorded in the accounting system, the adjusting entry for inventory would be a debit to inventory and a credit to the cost of goods sold. This entry increases the Inventory account to its actual ending balance and reduces the Cost of Goods Sold account to reflect the cost of the inventory that was not sold but was already recorded. This adjusting entry for inventory will be as follows:

DD/MM/YYYY Inventory------------------------------**

COGS----------------------------------**

(Adjusting journal entry for an increase in inventory)

IAS 2 provides guidance for determining the cost of inventories and the subsequent recognition of the cost as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories includes all costs of purchase, costs of conversion (direct labor and production overhead) and other costs incurred in bringing the inventories to their present location and condition. The cost of inventories is assigned by:

- specific identification of cost for items of inventory that are not ordinarily interchangeable; and
- The first-in, first-out or weighted average cost formula for items that are ordinarily interchangeable (generally large quantities of individually insignificant items).

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs.

To record the ending inventory in an adjusting entry, you need to calculate the value of the inventory first. The value of the ending inventory can be calculated using different inventory valuation methods, such as First-In, First-Out (FIFO), Last-In, First-Out (LIFO) this method is not applicable under IFRS, or weighted average cost. The ending inventory is the value of inventory items that a company has on hand at the end of an accounting period. The adjusting entry can then be made by either debiting cost of goods sold and crediting inventory or debiting the inventory and crediting the cost of goods sold depending on whether there was a decrease or an increase in inventory respectively.

Illustration

Assuming a dog food retailer has the following information as of March 22, 2023:

Beginning inventory = $10,000

Purchases during the period = $20,000

Sales during the period = $25,000

Assume that this retailer uses the First-In, First-Out (FIFO) inventory valuation method where the first inventory gets sold first and the last inventory gets sold last. To determine the amount that would be recorded in the adjusting entry for inventory, we have to first calculate the ending inventory. To calculate the ending inventory, we need to assume that the most recent inventory items purchased are still on hand, and the oldest items have been sold. Therefore, the ending inventory will consist of the cost of the oldest items in stock.

Using the FIFO method, we can calculate the cost of the ending inventory as Ending inventory = Beginning inventory + Purchases during the period – Sales during the period

Ending inventory = $10,000 + $20,000 – $25,000 = $5,000

To record the ending inventory for this adjusting entry, we would credit the inventory account for $5,000 and debit the cost of goods sold for $5,000 based on the accounting debit and credit rules. By making this entry, we are adjusting the inventory and COGS accounts to reflect the value of the ending inventory and the related cost of goods sold for the period. When recorded in the company's journal, the entry would look like this:

23/3/2023 Cost of Goods Sold (COGS) --------5000

Inventory --------------------------------5000

3.5. Final General Ledger Preparation

A general ledger is an accounting record that compiles every financial transaction of a firm to provide accurate entries for financial statements. The double-entry bookkeeping requires the balance sheet to ensure that the sum of its debit side is equal to the credit side total. A general ledger helps to achieve this goal by compiling journal entries and allowing accounting calculations.

General Ledger is a process of summarizing all the financial transaction of an account for a given period in a prescribed format with the objective to ascertain the closing balance at the end of the given period.

For mat of ledger

The general ledger can be organized and presented in either T-account format or columnar format. Both formats aim to provide a clear representation of financial transactions and their impact on various accounts. Let's explore each format:

I. T-Account Format

T-accounts are a visual representation of individual ledger accounts.

Each T-account resembles the letter 'T,' with the vertical line representing the account title and the horizontal line dividing the account into two sides: the left side (debit) and the right side (credit).

Debits are recorded on the left side, and credits are recorded on the right side.

The account balance is calculated by taking the difference between the total debits and credits.

Example:

Cash account

500	100
300	300
200	200
Balance 400	

II. Columnar Format:

Columnar format involves organizing accounts in columns to record and calculate transaction details. Columns include date, description, reference, debit amount, credit amount, and balance.

Each transaction is recorded in a row, with debits in the debit column and credits in the credit column.

The balance column is updated after each transaction.

Example:

Date	Description	Reference	Debit (ETB)	Credit (ETB)	Balance (ETB)
01/01/2023	Example	ABC123	500		500
01/15/2023	Example	INV-001		200	300
01/20/2023	Example	XYZ456	700		1000
01/31/2023	Example	INV-021		100	900

Both formats serve the purpose of providing a visual representation of financial transactions, and the choice between them depends on the preference of the accountant or the organization's accounting system. Columnar formats are often used in computerized accounting systems for ease of data entry and analysis.

Name of Account

Dr. *Cr.*

Date	Particulars	J.F	Amount	Date	Particulars	J.F	Amount
Year Month Date	To (Name of Credit Account in Journal)			Year Month Date	By (Name of Debit account in Journal)		

Figure 3. 1 columnar form of ledger

Explanation:

i. Each ledger account is divided into two parts. The left hand side is known as the debit side and the right hand side is known as the credit side.

ii. The name of the account is mentioned in the top (middle) of the account.

iii. The date of the transaction is recorded in the date column.

iv. The word 'To' is used before the accounts which appear on the debit side of an account in the particulars column. Similarly, the word 'By' is used before the accounts which appear on the credit side of an account in the particulars column.

v. The name of the other account which is affected by the transaction is written either in the debit side or credit side in the particulars column.

vi. The page number of the Journal or Subsidiary Book from where that particular entry is transferred is entered in the Journal Folio (J.F) column.

vii. The amount pertaining to this account is entered in the amount column.

Process of general ledger preparation

In preparation of final general ledger there are two main processes

A. Posting
B. Balancing an account:

A. Posting

The process of transferring the entries recorded in the journal or subsidiary books to the respective accounts opened in the ledger is called Posting. In other words, posting means grouping of all the transactions related to a particular account at one place. It is necessary to post all the journal entries into various accounts in the ledger because posting helps us to know the net effect of various transactions during a given period on a particular account.

- The following steps show procedure of posting for an Account which has been debited in the journal entry.
  - Step 1. Locate in the ledger, the account to be debited and enter the date of the transaction in the date column on the debit side.
  - Step 2. Record the name of the account credited in the Journal in the particulars column on the debit side as “To..... (Name of the account credited)”.
  - Step 3. Record the page number of the Journal in the J.F column on the debit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.
  - Step 4. Enter the relevant amount in the amount column on the debit side.
- The following steps show procedure of posting for an Account which has been CREDITED in the journal entry.
  - Step 1. Locate in the ledger the account to be credited and enter the date of the transaction in the date column on the credit side.
  - Step 2. Record the name of the account debited in the Journal in the particulars column on the credit side as “By...... (Name of the account debited)”
  - Step 3. Record the page number of the Journal in the J.F column on the credit side and in the Journal, write the page number of the ledger on which a particular account appears in the L.F. column.
  - Step 4. Enter the relevant amount in the amount column on the credit side.

Posting the Opening Entry

The opening entry is passed to open the books of accounts for the new financial year. The debit or credit balance of an account what we get at the end of the accounting period is known as closing balance of that account. This closing balance becomes the opening balance in the next accounting year. The procedure of posting an opening entry is same as in the case of an ordinary journal entry. An account which has a debit balance, the words ‘To balance b/d’ are recorded on the debit side in the particulars column. An account which has a credit balance, the words “By balance b/d” are recorded in the particulars column on the credit side. In fact, opening entry is not actually posted but the accounts are merely incorporated in the ledger, if the ledger is a new one or old.

B. Balancing an account:

Balance is the difference between the total debits and the total credits of an account. When posting is done, many accounts may have entries on their debit side as well as credit side. The net result of such debits and credits in an account is the balance. Balancing means the writing of the difference between the amount columns of the two sides in the lighter (smaller total) side, so that the grand totals of the two sides become equal.

Significance of balancing

There are three possibilities while balancing an account during a given period. It may be a debit balance or a credit balance or a nil balance depending upon the debit total and the credit total.

Procedure for Balancing

While balancing an account, the following steps are involved:

Step 1. Total the amount column of the debit side and the credit side separately and then ascertain the difference of both the columns.

Step 2. If the debit side total exceeds the credit side total, put such difference on the amount column of the credit side, write the date on which balancing is being done in the date column and the words “By Balance c/d” (c/d means carried down) in the particulars column. Or

If the credit side total exceeds the debit side total, put such difference on the amount column of the debit side, write the date on which balancing is being done in the date column and the words “To Balance c/d” in the particulars column.

Step 3 Total again both the amount columns, put the total on both the sides and draw a line above and a line below the totals.

Step 4 Enter the date of the beginning of the next period in the date column and bring down the debit balance on the debit side along with the words “To Balance b/d” (b/d means brought down) in the particulars column and the credit balance on the credit side along with the words “By balance b/d” in the particulars column.

Cash Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2017 Feb.01	To Sales A/c		15,000	2017 Feb.15	By Purchase A/c		8,000
Feb.20	To Farhan's A/c		4,000	Feb.25	By Salary A/c		2,500
				Feb.28	By Balance c/d		8,500
			19,000				19,000
Mar.1	***To Balance b/d***		8,500				

Capital Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2015 Feb.28	To Balance c/d		80,000	2015 Feb.01	By Cash a/c		80,000
			80,000				80,000
				2015 **Mar.1**	***By Balance b/d***		80,000

Figure 3. 2 Balancing of ledger

Self -Check 3

I. Multiple-Choice Questions:

1. What is the purpose of recording depreciation in accounting?
   A. To increase the value of fixed assets
   B. To reflect the ongoing usage of fixed assets over time
   C. To decrease the value of accumulated depreciation
   D. To calculate the original cost of assets
2. Which method calculates depreciation by dividing the original cost of an asset by its useful life?
   A. Units of Production
   B. Double Declining Balance
   C. Straight-Line
   D. Sum-of-Years-Digits
3. In the journal entry for the sale of a fixed asset with a gain, which account is credited?
   A. Cash
   B. Accumulated Depreciation
   C. Loss on Disposal
   D. Gain on Disposal
4. Under IFRS, how is the disposal of fixed assets recorded in the financial statements?
   A. Only in the income statement
   B. Only in the balance sheet
   C. In both the income statement and balance sheet
   D. It is not recorded under IFRS
5. How is the gain or loss on the sale of a fixed asset calculated?
   A. Selling price - Book value
   B. Accumulated depreciation - Original cost
   C. Accumulated depreciation + Original cost
   D. Book value - Selling price
6. What is the purpose of an adjusting entry for prepaid expenses?
   A. To decrease the prepaid expense account
   B. To recognize expenses that have been paid in advance
   C. To increase the prepaid expense account
   D. To adjust the cash account
7. Under the direct write-off method, when is the bad debt expense recorded?
   A. When an account becomes uncollectible
   B. At the end of the accounting period

C. When the sale is made
D. When the cash is received

8. Which method estimates bad debt expense based on the percentage of total receivables?
   A. Direct Write-Off Method
   B. Allowance Method
   C. Aging Method
   D. Percentage of Sales Method
9. How is the ending inventory recorded in an adjusting entry when using FIFO?
   A. Debit Inventory, Credit Cost of Goods Sold
   B. Debit Cost of Goods Sold, Credit Inventory
   C. Debit Inventory, Credit Accounts Payable
   D. Debit Cost of Goods Sold, Credit Accounts Receivable
10. What is the purpose of balance day adjustments in accounting?
    a) To close financial statements
    b) To ensure accurate representation of business transactions
    c) To prepare tax returns
    d) To calculate profits
11. Which of the following is an example of a prepayment adjustment?
    a) Accrued salaries
    b) Depreciation expense
    c) Unearned revenue
    d) Bad debt expense
12. In the Columnar Format of a General Ledger, what does the "Balance" column represent?
    a) Net income
    b) Total debits
    c) Closing balance
    d) Beginning balance
13. What is the purpose of posting in accounting?
    a) To create financial statements
    b) To transfer entries from the journal to the ledger
    c) To calculate depreciation
    d) To record opening balances
14. How is an opening entry recorded in the General Ledger?
    a) "By Balance b/d" on the debit side
    b) "To Balance b/d" on the debit side
    c) "By Balance c/d" on the credit side
    d) "To Balance c/d" on the credit side

15. What does a credit balance in an account indicate?
    a) The account has more credits than debits
    b) The account has a surplus
    c) The account has more debits than credits
    d) The account has a deficit
16. When is a prepayment adjustment made in accounting?
    a) At the end of the accounting period
    b) At the beginning of the accounting period
    c) Throughout the accounting period
    d) Only in case of losses
17. What does "Accumulated Depreciation" represent in the General Ledger?
    a) A liability account
    b) An expense account
    c) An asset account
    d) A revenue account

II. write appropriate answer for the following questions

1. What is general ledger?
2. Write the steps of posting.
3. Show the journal entry of an expense accrual and illustrate the journal by using the given numbers.
4. Explain the meaning and purpose of "By Balance b/d" and "To Balance b/d" in the context of a ledger account, incorporating the provided information.
5. List at least four adjusting entries.

III. Workout Questions:

1.A company purchased a machine for $40,000 with a useful life of 5 years. Calculate the annual depreciation using the straight-line method.

2.ABC Company estimates that 5% of its total credit sales of $200,000 will become uncollectible. Calculate the estimated bad debt expense.

3.XYZ Corp prepaid $12,000 for rent for the entire year. At the end of the first month, $1,000 of rent has been used. Make the adjusting entry.

4.Given the aging schedule, calculate the estimated bad debt expense for the company.

Age	Amount in birr	Percent (%)
0-30 days	70000	1
31-60 days	25000	2
61-90 days	15000	10
91-120 days	9000	20
Above 120 days	10000	50

5. A retailer had a beginning inventory of $10,000, made purchases of $20,000, and recorded sales of $25,000. Calculate the ending inventory using the FIFO method and make the adjusting entry.
6. In a recent transaction, your business incurred $2,000 in utility expenses for the current month but has not yet paid. Explain how you would make the necessary journal entry.
7. Suppose your company pre-paid $1,500 for insurance coverage for the next six months. Detail the adjustment entry and its impact on the T-account Format.

Unit Four: End of Period Financial Reports Preparation

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Adjusted Trial Balance
- Revenue statement
- Balance sheet
- Closing entries
- Post-closing Trial balance
- Accounting errors

This guide will also assist you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Prepare adjusted trial balance
- Prepare revenue statement
- Prepare balance sheet
- Record closing entries
- Prepare post closing trial balance
- Identify and correct errors

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Ministry of Labor and Skills

4.1. Adjusted Trial Balance

The adjusted trial balance is a financial statement that lists all the general ledger accounts and their balances after adjusting entries have been made at the end of an accounting period. Adjusting entries are necessary to ensure that the financial statements accurately reflect the company's financial position and performance by accounting for items such as accruals, deferrals, depreciation, and other adjustments.

In adjusted trial balance accounts are recorded as follow

- Assets (Debits): Cash, Accounts Receivable, Supplies, Prepaid Insurance, Equipment
- Liabilities (Credits): Accounts Payable, unearned revenue, salary payable, tax payable
- Equity (Credits): No direct equity account is shown, but it would include items like owner's equity or retained earnings.
- Expenses (Credits): Salaries Expense, Rent Expense, Interest Expense, Utilities Expense, Depreciation Expense, Insurance Expense
- Revenues (credit): sales revenue, service revenue, rental income

4.2. Revenue Statement

Financial statements are comprehensive records of a company's financial activities and position. They provide a summary of the company's financial performance and financial position over a specific period, offering insights into its ability to generate profits and manage its resources. The primary financial statements include the balance sheet, income statement, cash flow statement, and statement of changes in equity.

Importance of Financial Statements:

a. Performance Evaluation: Financial statements help assess a company's profitability and operational efficiency.
b. Investor Decision-Making: Investors use financial statements to make informed investment decisions.
c. Creditworthiness: Lenders and creditors use financial statements to evaluate a company's ability to repay debts.
d. Management's Assessment: Company management relies on financial statements to gauge the effectiveness of business strategies.

In summary, financial statements are crucial tools for understanding a company's financial health, performance, and overall viability. They play a vital role in decision-making for investors, creditors, and company management.

An income statement also known as a profit and loss is one of the financial statement that shows the income and expenses of a company for a specified time. Investors and business managers use the income statement to determine the company's financial health.

Preparing a revenue statement under International Financial Reporting Standards (IFRS) for small and medium-sized entities (SMEs) involves recognizing and reporting revenue earned by the entity during a particular accounting period. The revenue statement is also referred to as the income statement or profit and loss statement.

Format of Income statement

International Financial Reporting Standards (IFRS) provide a globally recognized framework for financial reporting. The format of an income statement under IFRS is quite similar to the general structure, with some specific terminology and classifications adhering to IFRS principles.

XYZ Company

Profit loss statement

Dec31, 2023

Revenue

Sales revenue ---**

Service revenue --**

Other operating revenue ---**

Total revenue ---**

Cost of sales -- (**)

Gross profit ---**

Operating expenses

Selling expenses --**

General and administrative expenses-----------------**

Research and development expenses-----------------**

Other operating expense -------------------------------**

Total operating expenses----------------------------- (**)

Operating Profit/Loss---**

Finance cost --- (**)

Operating Profit/Loss Before tax--**

Income tax expenses------------------------------------- (**)

Operating Profit/Loss for the period ---**

Earnings per share

Basic Earnings per share --**

Diluted Earnings per share ---**

Explanation:

Revenue: Recognizes income generated from primary business activities.

Cost of Sales: Represents direct costs attributable to the production of goods or services sold.

Gross Profit: Calculated as total revenue minus cost of sales.

Operating Expenses: Includes selling expenses, general and administrative expenses, research and development expenses, and other operating expenses.

Operating Profit (Loss): Obtained by subtracting total operating expenses from gross profit.

Finance Costs: Reflects interest and other costs related to borrowing.

Profit (Loss) Before Tax: The result after deducting finance costs from operating profit.

Income Tax Expense: Represents the tax payable based on applicable tax rates.

Profit (Loss) for the Period: Net income or loss after accounting for taxes.

Earnings per Share (EPS): Indicates the portion of profit attributable to each outstanding share of common stock.

Figure 4. 1Preparation of financial statement manually and digitally

4.3. Balance Sheet

According to IFRS a Balance sheet is referred to as Statement of Financial position. This brings out more clearly the role played by the statement. Financial position is a systematic report consisting of assets, liabilities and capital of the company for a certain period.

The purpose of a balance sheet is to show the financial position of a company over a period, usually at the end of a fiscal year or calendar year.

The balance sheet in financial statements provides a useful basis for:

- Calculating the rate of return
- Assess the company's capital structure
- Establish liquidity and financial flexibility

Financial position contains three main parents

I. Assets
II. Debt/Liabilities
III. Capital

I. Assets are can be tangible and intangible assets owned, including expenses that have not been allocated or costs that will be allocated in the future, and are divided into:

a. Current assets are cash and other assets that can be liquidated or sold within one year.
b. Fixed assets are assets that are physically visible (concrete) and are used in operations, are permanent and cannot be used up in one cycle of activity or one year.
c. Intangible fixed assets are assets that are not physically visible, but have value and are used in company activities.
d. Other assets

II. Debt is the company's obligations to other parties related to unfulfilled finances originating from creditors. Debts or liabilities can be divided into:

a. Current liabilities/short term debts are financial obligations which are repaid within one year from the balance sheet date.
b. Long-term debt is a financial obligation whose repayment period exceeds one year.

III. Capital is the right or property of the owner of the company which is allocated for the sustainability of the company.

As per IFRS/IAS 1 requires that in case of a loan liability, if any condition of the loan agreement which was classified as non -current is breached on or before the reporting date, such loan liability should be classified as current, even if the breach is rectified after the balance sheet date.

Statement of Financial position Format

Based on how the statement of financial position components presented Statement of Financial position is presented in two main formats.

I. Vertical Format
II. Horizontal Format

Your Co. Ltd
Statement of Financial Position
As At 31/12/XXXX

Non-Current Assets	Cost Amt.$	Dep. Amt.$	NBV Amt.$	**Cap. + Lia.**	Amt.$	Amt. $
Motor vehicle	XXX	XX	XXX	Capital	XXX	
Office Equip	XXX	XX	XXX	Net Profit	XX	
Fixtures & Fitting	XXX	XX	XXX	Less Drawings	(XX)	XXX
Current Assets						
Trade Debtors	XXX			**Long Term Liabilities**		
Less prov.- d/debts	(XX)		XXX	Loan		XXX
Cash in Hand			XX	**Current Liabilities**		
Cash at Bank			XX	Accrued Expense.		XX
Prepaid Exp.			XX	Income in Advance		XX
Accrued Income			XX	T/Creditors		XXX
Unused Stationery			XX	Bank O/D		XX
Inventory			XX			
			XXXX			XXXX

Figure 4. 2Vertical Format of statement of financial position

Your Co. Ltd
Statement of Financial Position
As At 31/12/XXXX

NON-CURRENT ASSETS		**COST Amt.$**	**Dep. Amt.$**	**NBV Amt.$**
Motor Vehicle	*(Note-1)*	XXX	XX	XXX
Office Equipment	*(Note-1)*	XXX	XX	XXX
Fixtures & Fittings	*(Note-1)*	XXX	XX	XXX
CURRENT ASSETS				
Trade Debtors	*(Note-2)*	XXX		
Less Prov. for Doubtful Debts		(XX)		XXX
Cash in Hand	*(Note-3)*			XX
Cash at Bank	*(Note-3)*			XXX
Prepaid Expenses	*(Note-4)*			XX
Accrued Income	*(Note-5)*			XX
Unused Stationery	*(Note-6)*			XX
Inventory	*(Note-7)*			XX
TOTAL				XXXX
Capital	*(Note-8)*			XXX
Add/(less) Net Profit/(Loss)	*(Note-9)*			XX(XX)
				XXXX
NON CURRENT LIABILITIES				
Loan	*(note-10)*			XXX
CURRENT LIABILITIES				XXX
Accrued Expenses	*(note-11)*			XX
Income in Advance	*(Note-12)*			XX
Trade Creditors	*(Note-13)*			XX
Bank over draft	*(Note-14)*			XX
TOTALS				XXXX

Figure 4. 3Horizontal Format of statement of financial position

4.4. Closing Entries

All temporary accounts such as Revenues, expenses and drawing /dividend account are used to accumulate effects of some transaction on owner's equity account for a specific period. At the end of the accounting period the balances of revenue and expense accounts are summarized in one another temporary account called the **income summary**. The balance in the income summary is transferred/closed to the capital (owner's equity) account. The balance on the drawing /divided account is directly closed to the capital (retained earnings account).

The process of transferring balances of temporary accounts to the capital account is called closing entry; and these entries should be posted to the respective ledgers after journalizing. This closing of accounts is used to transfer net income or net loss and drawing /dividend to capital/retained earnings, account. Moreover; it is used to reduce the balance of temporary accounts to zero so that they will be ready for the next accounting period.

To illustrate assume a shopping service named by ABG-shopping service, the closing entries are journalized on the journal and posted to the respective ledgers. The entries to close the temporary accounts are summarized as follows:

Income summary…………………………………..xxxx

Expenses (all by name/list) …………………………..xxxxx

This is to close the expenses accounts

Revenue ……………………………………………… xxxx

Income summary……….……………………………xxxx

This is to close the revenue account

Capital ………………………………………………. xxxxxxx

Drawing ……………………………………………..xxxxxx

This is to close the drawing account

Finally, the balance on the income summary account will be closed to the capital account either as debit or credit it depending on its balance.

4.5. Post-closing trial balance:

The post-closing trial balance is a financial statement that lists all the general ledger accounts and their balances after the closing entries have been made. Closing entries are necessary at the end of an accounting period to reset the temporary accounts (revenue, expense, and dividend accounts) to zero and transfer their balances to the permanent accounts (asset, liability, and equity accounts).

The post-closing trial balance reflects only the permanent accounts, as the temporary accounts have been closed out. The closing entries transfer the balances from revenue and expense accounts to Retained Earnings, and these temporary accounts are then reset to zero.

The post-closing trial balance provides a starting point for the next accounting period, with all temporary accounts set to zero and only permanent accounts carrying forward their balances. It ensures that the accounting equation (Assets = Liabilities + Equity) remains in balance.

Post closing trial balance Format

The post-closing trial balance sheet includes a header that lists the company name, name of the trial balance and the dates of the reporting period as well as columns that may include:

- Account numbers
- Account names/descriptions
- Debits and Credits

ABC Company Post-Closing Trial Balance December 31, 2022			
Account number	**Account name**	**Debit**	**Credit**
101	Cash	$30,000	
110	Accounts receivable	$500	
125	Prepaid rent	$1,000	
182	Inventory	$36,800	
201	Leasehold improvements	$100,000	
205	Accumulated depreciation		$1,500
210	Accounts payable		$68,400
230	Accrued expenses		$600
240	Unearned income		$800
280	Long-term liabilities		$70,000
300	Common stock		$15,000
310	Retianed earnings		$12,000
	Totals	**$168,300**	**$168,300**

Figure 4. 4 Post closing trial balance format

4.6. Accounting Errors

An accounting error is an error in an accounting entry that was not intentional. When spotted, the error or mistake is often immediately fixed. If there is no immediate resolution, an investigation into the error is conducted. An accounting error should not be confused with fraud, which is an intentional act to hide or alter entries for the benefit of the firm. Although there are numerous types of errors, the most common accounting errors are either clerical mistakes or errors of accounting principle.

4.6.1. Types of Accounting Errors

There are numerous types of accounting errors, and some of the most common mistakes are listed below.

Error of Original Entry

An error of original entry is when the wrong amount is posted to an account. The error posted for the wrong amount would also be reflected in any of the other accounts related to the transaction. In other words, all of the accounts involved would be in balance but for the wrong amounts.

Error of Duplication

Error of duplication is when an accounting entry is duplicated, meaning it's debited or credited twice for the same entry. For example, an expense was debited twice for the same amount would be an error of duplication.

Error of Omission

An error of omission is when an entry wasn't made even though a transaction had occurred for the period. For example, an account payable, which is the short-term debts that companies owe suppliers and vendors, is not credited when goods were purchased on credit. This is common when there are many invoices from vendors that need to be recorded, and the invoice gets lost or not recorded properly.

An error of omission could also include forgetting to record the sale of a product to a client or revenue received from account receivable. Accounts receivables reflect the money owed by customers to a company for products sold.

Error of Entry Reversal

Error of entry reversal is when the accounting entry is posted in the wrong direction, meaning a debit was recorded as a credit or vice versa. For example, cost of goods sold, which contains raw materials and inventory, is credited instead of debited and finished inventory is debited instead of credited.

Error of Principle

Error of accounting principle occurs when an accounting principle is applied in error. For example, an equipment purchase is posted as an operating expense. The operating expenses are the day-to-day expenses and wouldn't include a fixed-asset purchase. Also, asset purchases should be recorded on the balance sheet while operating expenses should be recorded on the income statement.

Error of Commission

Error of commission is an error that occurs when a bookkeeper or accountant records a debit or credit to the correct account but to the wrong subsidiary account or ledger. For example, money that has been received from a customer is credited properly to the accounts receivable account, but to the wrong customer. The error would show on the accounts receivable subsidiary ledger, which contains all of the customers' invoices and transactions.

A payment to a vendor that's recorded as an accounts payable, but to the wrong invoice or vendor is also an error of commission. The error would show as posted to the wrong vendor on the accounts payable subsidiary ledger.

Compensating Error

Compensating error is when one error has been compensated by an offsetting entry that's also in error. For example, the wrong amount is recorded in inventory and is balanced out by the same wrong amount being recorded in accounts payable to pay for that inventory.

How to Correct Accounting Errors

Often, adding a journal entry (known as a "correcting entry") will fix an accounting error. The journal entry adjusts the retained earnings (profit minus expenses) for a certain accounting period. Correcting entries are part of the accrual accounting system, which uses double-entry bookkeeping.

- For example, $1000 worth of salaries payable wasn't recorded (an error of omission). To make the correction, a journal entry of $1000 must be added under "salary expense" (debit) and $1000 added as "salary payable" (credit).

Errors from the previous year can affect your current books. The way around this is to add backdated correcting entries.

- For example, the mistake in the previous example was made in 2017. To make the correction, add the $1000 debit and credit dated December 31, 2017.

Reconciliations will also reveal many types of errors. You should perform reconciliations on a monthly and yearly basis, depending on the type of reconciliation. Bank reconciliations can be done at month end while fixed asset reconciliations can be done at year end.

To do a bank reconciliation, you need to first balance your cash account—small businesses typically record payments and receipts in a cash book. The debits and credits should balance. Then compare them to your bank statement.

If your cash account and bank statement are showing different figures, it's time to check each transaction on *both* sides. This way, you'll see whether the bank made a mistake or recorded a transaction in a different month (and different monthly statement) than you did. Or you'll realize there's an accounting error on your end.

Self -Check 5

I. Choose the best answer from the given alternatives

1. Henderson Inc. reports the following: assets of $500,000, liabilities of $350,000 and capital stock of $100,000. What is the balance in retained earnings?
   a. $450,000
   b. $50,000
   c. $250,000
   d. $750,000
2. You are considering investing in the stock of Mogul Corporation. On which of the following statements would you find information about what a company has to help it generate revenue in the future and what the company owes to others?
   a. Income statement
   b. Statement of retained earnings
   c. Balance sheet
   d. Statement of cash flows
3. Which of the following is not a correct representation of the accounting equation?
   a. Assets = Liabilities + Capital Stock + Retained Earnings
   b. Assets – Liabilities = Owners' Equity
   c. Assets = Liabilities + Owners' Equity
   d. Assets + Liabilities = Owners' Equity

II. Say true for correct and false for incorrect statements given bellow

1. __ The income statement gives company's revenues and expenses for one particular day of the year.
2. ____ An increase in net assets of a business due to the sale of its inventory is a gain.

3. ____ Retained earnings represents amounts contributed to the business by its owners.
4. ____ Assets and liabilities can be broken down into the categories of current and noncurrent.
5. ____ Income tax expense is typically reported separately from other expenses.
6. ____ Dividends paid are reported on the balance sheet.
7. ____ Sales revenue less cost of goods sold is referred to as net income.
8. ____ A gain is the amount of net income earned by a company over its life less any dividends it has paid.
9. ____ The purpose of the balance sheet is to report the assets and liabilities of a company on a specific date.

III. Give appropriate answers for the following questions

1. The following relate to Farr Corporation for the month of April:

Sales Revenue	$140,000
Gain on the Sale of Land	$20,000
Cost of Goods Sold	$75,000
Tax Expense	$14,000
Advertising Expense	$10,000
Dividends Paid	$7,000
Loss on Lawsuit	$24,000

a. Determine Farr's gross profit for the month of April.

b. Determine Farr's net income for the month of April.

c. If retained earnings at the beginning of April were $1,500,000, what would retained earnings be at the end of April?

Operation Sheet 5.1: Income Statement Preparation

Operation Title: Income Statement Generation

Purpose: To prepare a comprehensive income statement that accurately reflects the financial performance of the company over a specific period.

Conditions or Situations for the Operation:

- Access to financial records and transaction data.
- Adequate knowledge of accounting principles and standards.
- Properly configured and functioning accounting software or manual ledger.
- Compliance with company policies and relevant accounting regulations.

Equipment, Tools, and Materials:

- Computer with accounting software or manual ledger.
- Financial records, including journals and ledgers.
- Relevant documentation for revenue, expenses, and adjustments.

Steps in Doing the Task:

1. Secure Working Environment: Ensure that the workspace is secure and confidential to prevent unauthorized access to financial information.
2. Gather Necessary Tools: Collect the required tools, including a computer with accounting software or a manual ledger, financial records, and relevant documentation.
3. Access Financial Records: Log in to the accounting software or open the manual ledger to access financial records, including journals and ledgers.
4. Compile Revenue Information: Identify and compile all sources of revenue for the specified period. This may include sales revenue, service revenue, interest income, or any other income generated.
5. Deduct Cost of Goods Sold (COGS): If applicable, deduct the cost of goods sold (COGS) from the total revenue to determine the gross profit.
6. Detail Operating Expenses: List and detail all operating expenses, including selling expenses, general and administrative expenses, and any other relevant costs.

7. Calculate Operating Income (Loss): Subtract the total operating expenses from the gross profit to calculate the operating income or loss.
8. Include Other Income (Expenses): Account for any additional income or expenses not included in the operating section. This may include interest income, interest expenses, and gains or losses from non-operating activities.
9. Calculate Income Before Tax: Add the operating income (loss) to the other income (expenses) to find the income before tax.
10. Deduct Income Tax Expense: Subtract the income tax expense from the income before tax. This reflects the portion of the income set aside for taxes.
11. Calculate Net Income: Subtract the income tax expense from the income before tax to determine the net income. This represents the company's profit after all expenses and taxes.
12. Format and Presentation: Organize the income statement in a clear and standardized format, presenting revenue, expenses, and net income prominently.
13. Review and Analysis: Review the income statement for accuracy and completeness. Analyze the figures and trends to gain insights into the financial performance of the business.

Operation Sheet 5.2: Balance Sheet Preparation

Operation Title: Balance Sheet Generation

Purpose: To create a balance sheet that provides a snapshot of a company's financial position at a specific point in time.

Conditions or Situations for the Operation:

- Access to financial records and transaction data.
- Adequate knowledge of accounting principles and standards.
- Properly configured and functioning accounting software or manual ledger.
- Compliance with company policies and relevant accounting regulations.

Equipment, Tools, and Materials:

- Computer with accounting software or manual ledger.
- Financial records, including journals and ledgers.
- Relevant documentation for assets, liabilities, and equity.

Steps in Doing the Task:

1. Secure Working Environment: Ensure that the workspace is secure and confidential to prevent unauthorized access to financial information.
2. Gather Necessary Tools: Collect the required tools, including a computer with accounting software or a manual ledger, financial records, and relevant documentation.
3. Access Financial Records: Log in to the accounting software or open the manual ledger to access financial records, including journals and ledgers.
4. Compile Asset Information: Identify and compile information about the company's assets, including current assets (cash, accounts receivable) and non-current assets (property, equipment).
5. Determine Liabilities: Identify and compile information about the company's liabilities, including current liabilities (accounts payable) and non-current liabilities (long-term debt).
6. Calculate Equity: Determine the equity by subtracting total liabilities from total assets.

7. Organize Asset Section: Present assets on the balance sheet in a structured format, separating current and non-current assets.
8. Organize Liability Section: Present liabilities on the balance sheet in a structured format, separating current and non-current liabilities.
9. Present Equity Section: Present equity on the balance sheet, including details such as common stock, retained earnings, and additional paid-in capital.
10. Ensure Balance: Ensure that the total assets equal the total liabilities and equity, maintaining the accounting equation (Assets = Liabilities + Equity).
11. Format and Presentation: Organize the balance sheet in a clear and standardized format, presenting assets, liabilities, and equity prominently.
12. Review and Analysis: Review the balance sheet for accuracy and completeness. Analyze the figures and trends to gain insights into the financial position of the business.

LAP Test

Instructions: Based on information given bellow you are required to perform the following tasks accordingly.

Task 1: Record journal entries

Task2: prepare general ledger

Task3: Prepare Trial balance

Task 4: prepare income statement

Task 5: prepare balance sheet

Task 6: Record closing entries

Task 7: prepare post closing trial balance

Available information of XYZ Company is as follow:

- Assume XYZ's accounting **period is one month.**
- The transactions are as follows:
  1. Oct 1 XYZ invests Br 10,000 cash in advertising company to be known as yazici advertising company.
  2. On Oct. 1 XYZ advertising purchase office equipment Br 5,000 by signing 3 month agreement ,12 % interest ,Br 5,000 notes payable.
  3. On Oct. 2 a co. receives Br 1,200 in advance from knox client for advertising service that are expected to be completed on Dec 31
  4. On Oct. 3 a company pays office rent for October in cash Br 900
  5. On oct .4 a Co. Pays Br 600 for one year insurance policy that will expire the next year on September 30
  6. On oct. 5 a Co. purchases an estimated 3 –month supply of advertising materials on account from Aero supply for Br. 2,500
  7. On oct. 9, a Co. hires four employees to begin work on oct 15. Each employee is to receive weekly salary of Br. 500 for a 5 day week, payable every 2 weeks fist payment made on October 26.
  8. On cot 20, a Co. BOD declares and pays a Br. 500 cash dividend to shareholders
  9. On oct. 26, a Co. owes employee salaries of Br. 4,000 and pays them in cash
  10. On oct 31 a Co. receives Br. 10,000in cash form Copa company for advertising service performed in October

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Ministry of Labor and Skills

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