Intermediate accounting 1 pdf notes

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 Excerpt COURSE NAME/CODE: INTERMEDIATE ACCOUNTING (BSAF011) Lecture Notes by Professor Olwor Sunday Nicholas PhD, JD, MBA, LLM, PGDPAM, BA Course description; This course will give students an in-depth study of accounting theory and practice for students who require more than introductory coverage both conceptual and application topics are studied . Course objectives; Objectives 1) To prepare accounts and Financial Statements of a business enterprise 2) To record transactions of a manufacturing concern and prepare its accounts 3) To record transactions in royalty, Hire purchase and branch Accounting 4) Prepare royalty accounts, Hire purchase and branch accounts 5) Prepare final accounts with adjustment Course outline; - Preparation of accounts - Presentation of business, partnership and company Accounts - Receipts and payments Accounts - Income and expenditure Accounts - Cash flow statements 10hrs Manufacturing Accounts - Introduction - Elements of costs - Product cost and period cost - Stock in trade of a manufacturing firm - Market value of goods manufactured - Unrealized profit in stock - Consignment Accounts - Insurance Accounts, farm Accounts 14hrs Departmental Accounts Departmental Accounts - Understanding departmentalization - Preparing departmental accounts Royalty Accounts - Definition of royalty - Royalty Accounts & their purpose 8hrs Hire purchase Accounts - Definition of hire purchase transactions - Distinguishing hire purchase transaction from ordinary sales - Accounting treatment for hire purchase transaction 8hrs Branch Accounts - Definition and types of branches - Accounting entries for branch accounts - Principle of markup - Reconciling current accounts - Final accounts for organizations with branches 10hrs Accounting for lease obligations - Definition of Lease Accounting - Disclosure requirements - Accounting entries for lease - Accounting for sale and lease ball transactions. 10hrs Total lecture hours 60 Mode of assessments Course work test 1 20% Course work test 2 20% Final exam 60% PARTNERSHIP ACCOUNTS INTRODU (I ION A partnership is an agreement between two or more people who enter into business with a view of earning profits. A partnership may be established formally by means of a partnership agreement/deed or a partnership may be presumed to exist from the actions of the individuals. A partnership agreement/deed is a written agreement in which the partners among others set out the terms of the partnership. The partnership^ agreement specifies among others; - The names of the partners - Capital to be contributed by each partner - Interest on capital (if any) - Drawings to; be made by the partners - Interest on drawings (if any) Salaries paid to active partners - Nature and kind of business Contractual duties of the partners - Valuation of goodwill in case of changes in the partnership - Preparation and auditing of accounts - Procedure of admission and retirement of partners - Duration of the partnerships business. Where no partnership agreement exists, the Partnership Act guides the partners. Advantages of a Partnership A partnership is regarded to be the second stage in the evolution of business the first stage being sole proprietorship. The main Advantages enjoyed by the partnership over sole trade include; - It has access to more capital since up to 20 members may contribute capital towards the partnership business - It can command a wide range of experience and skills from the partners. The risks are spread across a large number of people - Easy formation of the partnership business - The partnership will have a wider network of contacts. Disadvantages of Partnership On the other hand, partnerships suffer from the following disadvantages; - Profits are spread between a number of people - Dilution of control over the business - There is a limitation on the number of partner such that the number cannot exceed 20 members - Disputes may arise amongst the members on such ma - Risks of implied authority, every partner is liable for the actions of another provided by the principal agency relationship that exists among them - Unlike a limited company, partnerships always have limited resources and may not be able to undertake large-scale operations - The members have unlimited liability. In the event of winding up of business and the proceeds from business assets cannot cover the obligations, partners are called upon to raise cash towards the de.bts from their own private source to cover the debts of the partnership. Characteristics of partnership: From the above analysis, it can be concluded that partnerships are characterized with; - Existence of a business with a major objective of making profits - There must be two or more persons who have mutually agreed to carry on business - There is always a contractual relationship between members. Only people who have contractual capacity can be partners - The main objective of the partnership is the profit motive and there must be an agreement to share the profits and losses made using the agreed profit and loss sharing ratios - The partnership members have unlimited liability that is in the event of the partnership winding up, the partners will be called upon to contribute to the debts incurred (if any) from their own resources. TYPES OF PARTNERS Sleeping/ dormant partners: A sleeping partner is a partner who does not actively participate in the partnership activities. Though he/she doesn't participate in the day to day running of the business he has a right to books of accounts and sharing of profits or losses in the agreed ratios. Nominal partner: Is a person whose name is used as if he/she was a member of the firm, but who in reality is not a partner. He is liable to the third parties who give credit to the firm on the strength of his being a partner. Minor partner: A minor partner can be admitted to the benefits of the existing partnership with the consent of all the partners. A minor is not personally liable for the debts of the firm but he/she shares in the partnership profits and benefits. Sub partners: A partner who gets share of profits of the firm through one of the partners. He/She is not liable against the firm and is not liable to the third parties for the firm's debts. Partners in profits only: Is a partner who shares profits only but doesn't share losses. He does not take part hi the management of the business but is liable to third parties who deal with the partnership on that basis. FINANCIAL STATEMENTS FOR PARTNERSHIPS The income statement prepared by partnership is similar to that parepared by other businesses except the appropriations account. That is , the trading and profit and loss accounts are the same as those of other business enterprise. However, in addition to the trading, profit and loss account, an appropriation account is prepared as shown in this format Structure of the income statement Sales xxx Less cost of sales Opening Inventory xxx Add: Purchase xxx Goods available for sale xxx Less : closing Inventory xxx Cost of sales xxx Gross profit xxx Add other incomes xxx Gross Income xxx Less expenses total xxx Profit for the year xxx Add interest on drawing xxx Xxx Less: Interest on capital A xxx B xxx C xxx Partners salaries-C xxx xxx Profits to be shared xxx Share of profits A XXX B XXX C XXX Note: - Interest on a loan is a business expense and treated as business expenses in the profit and loss account - If a partnership gives out a loan in return for interest, the interest received is treated as a miscellaneous income - If a partner extends a loan to the partnership, interest charges on the loan business expense and charged against the profits. The balance sheet prepared by partnership is also similar to that of other businesses except the owner's equity (capital) component as shown below. Structure of the Balance Sheet Non Current Asset cost acc. Depn. NBV Plant xxx xxx xxx Equipment xxx xxx xxx Xxx xxx xxx Current Assets Inventory xxx Accounts Receivable xxx Bank xxx xxx Total Assets xxx Current Libilities Capital Account X xxx Y xxx Z xxx Current A/cs X xxx Y (xxx) Z xxx xxx Non- current liabilities Loan xxx Current Liabilities xxx Total Capital and Liabilities xxx Note: The negative balance in the current account implies a debit balance whereas a positive balance implies a credit balance. PARTNERSHIP CAPITAL ACCOUNTS The capital accounts of partnerships are maintained in a columnar form following either the fixed capital balance method or the fluctuating capital balance method. Under the fixed capital balance method, the capital account records the partner's capital contribution only and a current account is opened to record the individual partner's dealings with partnership For the fluctuating capital balance method, the capital account record both the individual partner's dealings with the partnership and their capital contributions. A current account is not maintained. The two methods can be illustrated as follows; Fixed capital balance method CAPITAL ACCOUNT illustration not visible in this excerpt Fluctuating capital balance method CAPITAL ACCOUNTS illustration not visible in this excerpt The fixed balance method is preferred since it allows proper and independent monitoring of the capital contribution of the partners and their dealings with the partnership. The Basic Double Entry records under partnership In the preparation of the partner's capital and current accounts, the following double entry procedure should be followed; 1. When additional capital is brought into the business Dr. Bank/Cash/Asset Account Cr. Individual Partner's capital Account 2. When the partners are entitled to interest on capital Dr. Interest on capital account/Income statement. Cr. Individual Partner's current Account 3. In case of drawings Dr. Individual partner Current account Cr. Bank/Cash Account 4. When partners are charged interest on drawings Dr. Individual partners current account Cr. Interest on drawings Account/income statement 5. When partners are entitled to partnership salaries Dr. Partner's Salary Account/ Income statement Cr.Individual Partners Current Account 6. Share of profits made during the year Dr. Income statement Cr. Individual Partners Current Account 7. Share of losses Made/ incurred during the year Dr. Partner's current account Cr, Income Statement Example Paul and John are in partnership sharing profits and losses in the ratios of 6:4 The following is their trial balance for the year ended 30th June 2007 Paul and John Trial balance for the year ended 30th June 2007 Dr. Cr. Office equipment cost 13,000 Motor Vehicle cost 18,400 Provision for depreciation Motor Vehicle 7,360 Office equipment 3,900 Inventory 30.6.2001 49,940 Accounts receivable 41,920 Accounts payable 32,550 Cash at Bank 1,230 Cash at Hand 280 Sales 180,740 Purchases 143,260 Salaries 16,834 Office expenses 2,740 Discounts Allowed 1,126 Current a/c Paul 2,758 John 2422 Capital A/c4 Paul 54,000 Additional information: - Closing inventory was valued at shs. 54, - Office expenses owing was shs - Provide for depreciation on motor vehicle 20% on cost and office equipment 1 at cost - Interest on capital is charged at 10% - Charge interest on drawings Paul shs.360 and John shs. 420 Required Prepare the final set of Accounts including a) the Income statement b) Balance sheet c) Draw up the capital and current accounts of the partners PAUL AND JOHN INCOME STATEMENT FOR THE YEAR ENDED 30th June 2007 Sales 180,740 Less cost of sales Inventory 49,940 Purchases 143,260 193,200 Less closing Inventory 54,680 138,520 Gross profit 42,220 Less operating expenses Salaries 16,834 Office expenses 2,740 Discounts Allowed 1,126 Accrued office expenses 220 Depreciation Motor vehicles 3,680 Equipment 1,300 25,900 Net Profit 16,320 Add interest on drawings Paul 360 John 420 780 17,100 Less interest on Capital Paul 5,400 John 2.400 7,800 Profits to be shared 9,300 CURRENT ACCOUNTS illustration not visible in this excerpt PAUL AND JOHN BALANCE SHEET AS AT 30th June 2001 Non Current Assets Cost Accum. Dep. NBV Motor vehicles 18,400 111,040 7,360 Office equipment 13,000 5,200 7,800 31,400 16,240 15,160 Current assets Inventory 54,680 Accounts Receivables 41,920 Cash at Bank 1,230 Cash at Hand 280 98,110 Total assets 113,270 Capital and Liabilities Capital Account Paul 54,000 John 24,000 78,000 Current Account Paul 2,378 John 122 Liabilities Accounts Payables 32,550 Accrued expenses 220 32,770 Total Capital and Liabilities 113,270 COMPANY ACCOUNTS Introduction A company represents the third stage in the evolution of business organizations the first two being Sole proprietorship and partnership firms. It is an association of persons formed for economic gains of its members who contribute money\s worth to a common stock (ordinary shares). It has a right to act as a natural being granted by law. Essentials Characteristics of a Company - Voluntary Association- cannot compel a person to become a member nor give up its membership - Independent legal entity-a company is a legal entity quite distinct and separate from its members. Can own property, enter into contracts, open bank accounts, sue and be sued by its members as well as outsiders - Perpetual existence- a company has a perpetual succession. The existence of a company can be terminated only by law. Thus members can come and go but the company may go on forever - Common seal- the directors of the company act as its agents and all acts of the company are authorized by its common seal. The common seal is the official signature of the company - Limited liability- the liability of the members of a company is generally limited to the extent of the unpaid value of the shares held by them - Transferability of shares- the shares of a public company are freely transferable. However in the case of private companies they are transferable subject to the restrictions put by the companies Articles of Association. Advantages of companies - There is limited liability - Large capital base because of big membership and their contributions - Professional management- owners trust the running of the business to managers who are professionals in different fields - Higher chances of acquiring more funds from loans and debentures because companies can afford collateral security - They have a legal framework- operate in accordance with the law-Companies Act - There is continuity of business and perpetual succession of the business - Shares are freely transferable, more especially in public limited companies. 3.3 Disadvantages of Companies - Compliance with the companies Act - Having to comply with all Accounting Standards during the preparation of Financial Statement - Formation and annual registration costs. Types of Companies 1. Statutory companies- a company formed by the Act passed either by the central or state legislature. Such companies are governed by their respective Acts and are not required to have ant Articles of Association (AOA) and Memorandum of Association (MO A) 2. Government Companies- a company of which no less than 51% of the paid up capital is held by the central government. 3. Foreign companies- a company which is incorporated outside the country but with a place of business in the country. 4. Registered companies —Companies formed by registration under the companies Act. The working of such companies is regulated by the provisions of the Companies Act, AOA and MOA. Such companies may be limited by share or limited by guarantee or unlimited companies. - Companies limited by guarantee- a guarantee company in which the liability of its members is limited by the memorandum to such amounts as the members may undertake by memorandum to contribute to meet the deficiency of the assets of the company in the event of its being wound up. - Unlimited - a company not having any limit on the liability of its members. 5. Private company- a private company is one which by its AOA, -Restricts the number of members to fifty excluding the past and the present employees of the company who are members of the company. -Prohibits any invitation of the public to subscribe to its shares or debentures. -Required to add the words "private limited" at the end of its name. 6 Public company- a company whose AOA does not contain a requisite restrictions to make it a private company. A public company needs a minimum of seven (7) persons for its registration. Formation of a company The procedure for the formation of a company, from the time of the idea of . forming a company is first conceive until the company is actually formed and commences business may be divided into three stages; - Promotion - Incorporation - Commencement of business Promotion This is the stage of conceiving the idea and its working up. The person involved in this task is termed a promoter. Incorporation This is the stage which brings the company into existence. It involves; - Ascertainment of the availability of the proposed name of the company. - Application for a license - Securities and exchange board / committee approval to draft prospectus (this applies where the company proposes to raise capital by issue of shares or debentures to the general public) - Preparation of the Memorandum of Association. This defines the company's constitution and objectives, lays down the fundamental conditions upon which the company is allowed to be formed. The MOA must have the following clauses. - Name clause - Object clause - Liability clause - Capital Clause - Association clause -Preparation of the Articles of Association-AOA are regulations and bylaws governing the internal affairs of the company. A public limited company may either have its own articles or. may accept to use schedule 1 of the companies Act. In case the company does not file its own articles it is presumed that is has adopted Table A for its articles. -Preparation of the prospectus- a document inviting deposits from the public or offers from the public to subscribe to the shares or debentures of the company. The prospectus contains information about; - The objectives of the company - Past history and future prospects - Managerial personnel - Amount of minimum subscription Fixation of underwriter, brokers, solicitors and auditors. In addition to the above preliminary steps the promoters will have to take the following steps to get the company incorporated - Filling the necessary documents - Payment of the necessary fees - Obtaining of the certificate of incorporation - The promoters should file the following documents with the required fees to the registrar of companies - Memorandum of Association (MOA) - Articles of Association (AO A) - A list of persons who have consented to become directors of the company - A written consent by the directors to act as directors and written undertaking to take up and pay for the shares - Notice of address of the registered office. [...] 

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