

**FINANCIAL ACCOUNTING  
WEEK 7 (LECTURE SEVEN)**

**WEEK 7: PERIODIC MEASUREMENT AND END OF PERIOD ADJUSTMENTS  
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**Learning Objectives**

- Upon completion of this topic you should be able to:
- Explain the reasons for making provision for bad and doubtful debts
- Explain the reasons for making provision for depreciation on fixed assets
- Explain the methods for calculating provision for depreciation
- Distinguish between accrued, revenues and expenses
- Correctly, account for accrued revenues and expenses
- Correctly account for prepaid expenses

**Introduction**

Revenue and costs must be recognized as they are earned or incurred, not as money is received or paid. They must be matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate. Therefore, all incomes and expenses that relate to a particular financial period will be matched together to determine the profit for the year. Following from the previous lessons, after the ledger accounts have been balanced and an entity is approaching the end of year, certain transaction and processes must be carried out before an entity prepares its end of year financial statements. The additions and subtractions in this case are the ones referred to as end of year adjustments because they must happen at the end of the year to ensure that all revenues have been matched with all expenses in the year and also assets and liabilities have been properly valued to reflect the true and fair view of the entity in all aspects of assets, capital and liabilities.

**These adjustments involve:**

- Bad debts written off
- Provision for Bad and doubtful debt
- Depreciation

- Appreciation
- Accrued expenses
- Accrued revenues
- Prepaid expenses
- Prepaid revenues

These points are explained in details below.

### **BAD & DOUBTFUL DEBTS**

Some debtors may not pay up their accounts for various reasons e.g. a credit customer (debtor) may go out of business. When a debtor is not able to pay up his/her account this becomes a bad debt. Therefore, the business/firm should write it off from the accounts and thus it becomes an expense that should be charged in the profit & loss account.

When a debtor is completely unable to pay the amount owing will be written off as a bad debt. A bad debt is treated as an **expense** in the income statement. The treatment of bad debt as follows:

Dr: Income statement	xx
Cr: Debtors account	xx

The amount of the provision will then be deducted from the debtors in the statement of financial position (Balance Sheet). In the subsequent provision only increase or decreases in the provision are considered with an increase in provision being treated as an expense in the income statement while a decrease in provision is treated as an income.

Sometimes a bad debt written off is recovered in future. This is referred to as bad debt recovered. If a debt previously written off is recovered it is treated as an **income** in the income statement and it will be recorded as follows:-

Dr: Cash/bank A/C	xx
Cr: Income statement	xx

In practice a firm may also be unable to collect all the amounts due from credit customers (debtors). This is because a section of the debtors will not honour their obligations. The problem posed by this situation is that it is difficult to identify the debtors who are unlikely to

pay their accounts. Furthermore, the amount that will not be collected may also be difficult to ascertain. These debts that the firm may not collect are called doubtful debts. A firm should therefore provide for such debts by charging the provision in the profit and loss account. Provision for doubtful debts maybe specific or general. Specific relate to a debtor whom we can identify and we are doubtful that he may pay the debt (if one of our debtors goes out of business).

### **DOUBTFUL DEBTS**

A provision for doubtful debts can either be for a specific or a general provision. A specific provision is where a debtor is known and chances of recovering the debt are low. The general provision is where a provision is made on the balance of the total debtors i.e. Debtors less Bad debts and specific provision.

The accounting treatment of provision for doubtful debts depends on the year of trading and the entries will be as follows. If it is the 1st year of trading (1st year of making provision):

- i. Debit P&L a/c.
- ii. Credit provision for doubtful debts (with total amount of the provision).

In the subsequent periods, it will depend on whether if it is an increase or decrease required on the provision.

#### **If it is an increase:**

- i. Debit P&L a/c.
- ii. Credit provision for doubtful debts (with increase only).

#### **If it is a decrease:**

- i. Debit provision for doubtful debts.
- ii. Credit P&L a/c (with the decrease in provision only).

#### **EXAMPLE**

Debtors	x
Bad debts	<u>(x)</u>
	x
Specific Provision	<u>(x)</u>
	x



There are other forms of allowances such as the allowance for discounts among others. But this lesson concentrated on the above sub-topics as given in the objectives. The others will be featured in the income statement constructing and the balance sheet in the subsequent topics.

## **Returns inwards and returns outwards**

### **Returns Inwards**

Return inwards refers to credit sales that have been returned by customers. Return inwards is deducted from the sales in the income statements.

### **Returns Outwards**

Return outwards refers to credit purchases that were returned to suppliers. Return outwards is deducted from purchases in the income statement.

## **Discount allowed and Discount received**

### **Discount allowed**

Discount allowed refers to the rebate or allowance granted to customers. It may be given to customers to encourage them to buy in bulk or to pay their dues promptly. Discount allowed is treated as an *expense* in the income statement. It will be deducted from the gross profit

### **Discount received**

Discount received refers to rebate or allowance received from the suppliers. Discount received is treated as an *income* in the income statement. It will be added to the gross profit.

## **Carriage inwards and carriage outwards**

### **Carriage inwards**

Carriage inward refers to the transport cost or expense on purchases. It will be added to the purchases in the income statement.

### **Carriage outwards**

Carriage outwards refers to transport costs or expenses on sales. It is treated as an expense on the income statement and will be deducted from the gross profit.

## **DEPRECIATION**

It is the loss of value of a non-current asset throughout its period of use by the firm. IAS 16 on property, plant and equipment defines depreciation as the allocation of a depreciable amount of a

non-current asset over its estimated useful life. Under the matching concept, all incomes or revenues and expenses for a particular period should be reported in the financial statements and because depreciation is an expense of the business therefore, it will be charged in the profit and loss account.

### ***Causes of Depreciation***

#### **1. *Physical Factors***

- Wear and tear: Some non-current assets depreciate or lose value due to use overtime e.g. machinery and motor vehicles.
- Rot/decay/rust: This happens on assets that are not well maintained by the firm e.g. some machines.

#### **2. *Economic Factors***

- Inadequacy: Some assets lose value due to them becoming inadequate e.g. when a business grows or expands then some buildings may become inadequate due to space. Also, some machines are unable to manufacture a large number of goods.
- Obsolescence: Some assets become obsolete due to change in technology or different methods of production e.g. computers.

#### **3. *Time Factors***

Some assets have a legal fixed time e.g. properties on lease.

#### **4. *Depletion***

This occurs when some assets have a wasting character due to extraction of raw materials, minerals or oil. Such assets include mines, oil wells, and quarries.

### **Methods of Calculating Depreciation**

These are the methods developed to assist in estimating the amount of depreciation to be charged in the profit and loss account as an expense. The methods chosen by a firm should be in accordance with the agreed accounting practice, accounting standards and suit the firm's non-current assets. There are two main methods of estimating depreciation and five others that will apply in a firm's situation.

#### **The common methods of depreciation include:**

- Sum of the digits methods – uses a formula.
- Revaluation method – applies to a non-current asset of low value.

- Machine-Hour method – depreciation is based on number of hours a machine is expected to operate (manufacturing process).
- Unit of output method – depreciation is based on the number of units a machine is expected to produce.
- Depletion of units – depreciation is based on number of units extracted from the asset.
- Straight line method (on cost method)
- Reducing balance method
- Depreciation fund method
- Repairs Provision method

### Sum of digits method

This method determines the sum of the years (digits) and then allocated depreciation based on the total sum. The sum is determined by  $(n(n+1))/2$ . Where n refers to the number of years of the economic life e.g. for the above example the sum of digits will be  $5(5+1)/2= 15$ . Assume further that the salvage value was sh. 250,000. The total depreciation of sh. 750,000 (1,000,000-250,000) will be allocated as follows using sum of digits

Year	Workings	Depreciation Expense
2017	750,000 x 5/15	250,000
2018	750,000 x 4/15	200,000
2019	750,000 x 3/15	150,000
2020	750,000 x 2/15	100,000
2022	750,000 x 1/15	50,000

### Revaluation method

This method uses professional valuation at the beginning and at the end of the period. Depreciation will be the difference between the valuation at the beginning of the period and that at the end of the period. e.g. the value of the asset at the begging of 2017 is \$. 1,000,000 suppose at the end of December 2017 valuation is done and the value found to be \$ 880,000, depreciation will be sh. 120,000. This will be repeated for all the years.

### *The Straight-Line Method*

This method ensures that a uniform amount of depreciation is charged in the P&L a/c for a particular asset and is based on the following formula:

$$\text{Depreciation for year} = \frac{\text{Cost of asset} - \text{Residual Value}}{\text{Estimated useful life}} = \frac{\$100,000 - \$20,000}{8}$$

$$= \$10,000 \text{ per year}$$

**Cost of Asset – Residual Value**

Estimated useful life of asset.

**Residual Value**

The amount the firm expects to sell the asset after the period of use in the firm, also called Sales Value / Scrap Value.

**Estimated Useful Life**

The period the asset is expected to be used in the firm.

**Example 1**

A firm buys a machine for \$.100, 000 which it expects to use in the firm for eight years. After the eight years the machine will be sold for\$.20, 000. Under the straight-line method, the depreciation amount will be computed as follows:

This means for this asset \$10, 000 will be charged in the profit and loss account as depreciation expense on the machine.

The straight-line method assumes that benefits accruing on use of a non-current asset are spread out evenly over the life of the asset e.g. buildings use straight-line method.

Percentage rate based on cost as opposed to number of years can also be used to calculate the depreciation.

**Reducing Balance Method**

The firm determines a fixed percentage rate that is applied on the cost of the asset during the first period of use. The same rate is applied in the subsequent financial periods but the rate is applied on the reduced value of the asset. (Cost of asset – total depreciation provided to date).

This method ensures that higher amount of depreciation are charged in the P&L account in the earlier periods of use and lower amounts in the latter periods of use as shown in the following example:

**Example 2**

Assume a firm buys machinery for \$.100, 000 and provides depreciation on machines at 20% p.a. on reducing balance method. The depreciation charged to the P&L will be as follows for the next 3 years.

<b>Year 1</b>	\$	\$	
<b>Cost</b>		100,000	
Depreciation 20% of 100,000		(20,000)	P&L YR 1
			→
Balance to YR 2	80,000		
<b>Year 2</b>			
Depreciation 20% of 80,000		80,000	
		(16,000)	P&L YR 2
			→
Balance to YR 3	64,000		
<b>Year 3</b>			
Depreciation 20 % of 64,000		64,000	
		(12,800)	P&L YR 3
			→
Balance to YR 4	51,200		

Reducing balance method (diminishing balance method) assumes that benefits accruing from the use of an asset are higher in the first periods of use and lower in the latter period's e.g.

- Fixtures, furniture and fitting.
- Plant and machinery.
- Motor vehicles.

### **Accounting Treatment on Depreciation**

When non-current assets are depreciated, a new account for each type of asset is opened; this account is called a provision for depreciation whereby the following entries will be made:

Debit – P&L a/c

Credit – Provision for depreciation a/c

With the amount of depreciation charged for the period.

### ***Example on straight-line method***

The entries will be as follows:

Debit – P&L a/c with \$.10, 000

Credit – Provision for depreciation.

Machines a/c with \$10,000 being depreciation provided for the machine.

The ledger accounts will be as follows:

Machinery		Provision for Depreciation Machine	
\$	Sh.	\$	\$
Cashbook	100,000	31/12 Bal c/d	100,000
10,000	P&L	10,000	31/12 Bal c/d

The final accounts extracts will be shown as follows:

(a) Profit And Loss Account (Extract) for the year ended 31<sup>st</sup> December 2022

Expenses	\$.	\$.
Depreciation:		
Buildings	x	
Plant and machinery	10,000	
Furniture, Fixtures and Fittings	x	
Motor vehicles	x	

(b) Statement of financial position (Extract) as at \_\_\_\_\_

Non-Current Assets	Cost (\$)	Total (\$)	NBV
	\$.	Depreciation	
Land	x	-	x
Buildings	x	(x)	x
Plant and Machinery	x	(x)	x
Furniture, Fixtures & fittings	x	(x)	x
Motor vehicles	<u>x</u>	<u>(x)</u>	<u>x</u>
	<u>x</u>	<u>x</u>	<u>x</u>

**NBV: Net Book Value**

**Example 3**

A company starts in business on 1 January 2022. You are to write up the motor cars account and the provision for depreciation account for the year ended 31 December

2022 from the information given below. Depreciation is at the rate of 20 per cent per annum. Using the basis of one month's ownership needs one month's depreciation.

2022 Bought two motor vans for \$.12, 000 each on 1 January  
bought one motor van for \$.14, 000 on 1 July.

Motor Vehicles A/C			
2022		\$	
1/1	Cash	Book	
24,000			
1/1	Cash	Book	
<u>14,000</u>			
		<u>38,000</u>	
			2022
			\$
			31/12 Balance c/d
			<u>38,000</u>
			<u>38,000</u>

**Calculation for depreciation**

$$1/1 \quad 24,000 \times \frac{20}{100} \times \frac{12}{12} = \$4,800 + 1/7(14,000 \times \frac{20}{100} \times \frac{6}{12} = 1,400)$$

$$= \$4,800 + 1,400 = \$6,200$$

Dr.	Provision for Depreciation A/C			Cr.
2022		\$	2022	\$
31/1	Balance	c/d	31/12 P & L (income statement)	6,200
6,200				

***Income Statement (P&L a/c) (Extract) for the period ended 31<sup>st</sup> December 2022.***

Expenses	<u>\$.</u>	<u>\$.</u>
Depreciation:		
Motor vans	6200	

***Statement of financial position (Extract) as at 31/12/2022***

Non-current Assets	<u>Cost</u>	<u>Total</u>	<u>NBV</u>
Motor vans	38,000	(6200)	31,800
		<u>Depreciation</u>	

**Example 4**

A company starts in business on 1 January 2019, the financial year end being 31

December. You are to show:

- The plant account.
- The provision for depreciation account.
- The statement of financial position extracts for each of the years 2019, 2020, 2021, 2022.

**The machinery bought was:**

2019	1 January	1 plant costing \$8,000
2020	1 July	2 plant costing \$5,000 each
	1 October	1 plant costing \$6,000
2021	1 April	1 plant costing \$2,000

Depreciation is at the rate of 10 per cent per annum, using the straight-line method, plant being depreciated for each proportion of a year.

Dr.	Plant A/C	Cr.
<b>2019</b>	\$	<b>2019</b>
1/1 Cash Book	<u>8,000</u>	31/12 Balance c/d
<b>2020</b>		<u>8,000</u>
1/1/2020 Balance b/d	8,000	<b>2020</b>
1/7/2020 Cash Book	10,000	
1/10/2020 Cash Book	<u>6,000</u>	31/12/2020 Balance c/d
	<u>24,000</u>	<u>24,000</u>
<b>2021</b>		<b>2021</b>
1/1/21 Balance b/d	<u>24,000</u>	31/12/21 Balance c/d
<b>2022</b>		<u>24,000</u>
1/1/21 Balance b/d	24,000	<b>2022</b>
1/4/21 Cash Book	<u>2,000</u>	31/12 Balance c/d
	<u>26,000</u>	<u>26,000</u>

**CALCULATION OF DEPRECIATION**

Calculation of Depreciation	Accumulated Depreciation
<b>2019</b>	<b>2019</b>
\$	\$
8,000 X 10% X 12/12 = 8,000	8,000
<b>2020</b>	<b>2020</b>
10,000 X 10% /6/12 = 500	
6,000 X 10% 3/12 = 150	2,250
8,000 X 10% X 12/12 = 800	
<b>2021</b>	<b>2021</b>
24,000 X 10% X 12/12 = 2,400	4,650
<b>2022</b>	<b>2022</b>
24,000 X 10% 12/12 = 2,400	7,200

$2,000 \times 10\% \times 9/12 = 150$	
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Dr				Provision for Depreciation A/C				Cr.			
2019				2019				\$			
\$				31/12			P&L	a/c			
31/12	Balance		c/d	<u>800</u>							
<u>800</u>											
2020				2020							
31/12		Balance	c/d	1/1/2020		Balance		b/d			
<u>2,250</u>				800							
			<u>2,250</u>	31/12		P & L		A/C			
				<u>1,450</u>							<u>2,250</u>
2021				2021							
31/12/2021	Balance		c/d	1/1/2021	Balance	b/d					2,250
<u>4,650</u>				31/12/2021	P & L	A/C					
			<u>4,650</u>	<u>2,400</u>							<u>4,650</u>
2022				2022							
31/12/2022	Balance		c/d	1/1/2022	Balance	b/d					4,650
<u>7,200</u>				31/12/2022	P & L	A/C					
			<u>7,200</u>	<u>2,550</u>							<u>7,200</u>

### STATEMENT OF FINANCIAL POSITION EXTRACT

Non-Current Assets NBV(\$)	Cost (\$)	Dep(\$)
<b>2019</b>		
Motor Vehicles	<u>8,000</u>	<u>(800)</u>
		<u>7,200</u>
<b>2020</b>		
Motor Vehicles	<u>24,000</u>	<u>(2,250)</u>
		<u>21,750</u>
<b>2021</b>		
Motor Vehicles	<u>24,000</u>	<u>(4,650)</u>
		<u>19,350</u>
<b>2022</b>		
Motor Vehicles	<u>26,000</u>	<u>(7,200)</u>
		<u>18,800</u>

### DISPOSALS OF ASSETS

A firm may dispose off its non-current assets in the following 3 ways:

- Selling the asset.
- Asset being written-off from damage/accident/theft.
- Asset is scrapped/not used anymore.

When an asset is disposed and is no longer used by the firm, the appropriate entries should be made in the asset account and the total depreciation provided to date on the asset and the entries required will depend on the type of disposal.

When the asset is sold, the following entries will be made:

- (a) Debit – asset disposal a/c  
Credit – asset a/c

**With the cost of the asset being disposed.**

- (b) Debit – provision for depreciation of asset a/c.  
Credit – asset disposal a/c

With the total depreciation provided to date on the asset.

- (c) Debit – cashbook.  
Credit – asset disposal a/c

**With the cash received on disposal.**

When an asset is written off as a result of damage/accident/theft. If it was insured and the insurance company accept liability but by the end of the period the insurance company has not yet paid.

- (a) Debit – asset disposal a/c  
Credit – asset a/c

**With the cost of the asset damaged.**

- (b) Debit – provision for depreciation of asset a/c  
Credit – asset disposal a/c

- (c) Debit – insurance receivable a/c  
Credit – asset disposal a/c

**With the amount expected from the insurance.**

If the insurance pays before the end of the financial period, it will not be necessary to create an insurance debtor so the following entries will be made:

- Debit – cashbook.  
Credit – asset disposal a/c

If the asset is not used anymore or scrapped by the firm, the appropriate entries will be made in the asset account and provision for depreciation a/c only.

Debit – asset disposal a/c  
 Credit – asset a/c

**With the cost of the asset no longer in use.**

Debit – provision for depreciation for asset Credit –  
 asset disposal a/c

**With the total depreciation provided to date.**

The balance in the disposal a/c after the above entries will either be a debit balance or a credit balance. A credit balance represents a profit on disposal, which is reported in the profit and loss a/c together with other incomes. The entry will be:

Debit – asset disposal a/c  
 Credit – P&L a/c

**With the balance in the account.**

A debit balance in the asset disposal a/c is loss on disposal which is reported in the P&L a/c as an expense and therefore the entry will be.

**Example 5:**

A firm has a motor vehicle costing \$10,000 total depreciation provided to date is \$8,000. The firm decides to trade in the motor vehicle with a new one the value of the new one being \$5,000. The supplier of the new vehicle, agree with the firm that the old motor vehicle is worth Sh.300; therefore, the difference will be paid by cash.

Dr.	Motor Vehicle A/C	Cr.	
	\$	\$	
Balance b/d	10,000	Motor Vehicle Disposal	10,000
Disposals	3,000		
Cash Book	<u>2,000</u>	Balance c/d	<u>5,000</u>
	<u>15,000</u>		<u>15,000</u>

Dr	Motor Vehicle disposal A/C	Cr.	
	\$	\$	
Motor Vehicle A/C	10,000	Provisions for Depreciation A/C	8,000
P & L Income statement A/C	<u>1,000</u>	Motor Vehicle A/C	<u>3,000</u>
	<u>11,000</u>		<u>11,000</u>

**The Journal Entries of the above transactions (General Journal)**

	<b>Dr (\$)</b>	<b>Cr. (\$)</b>
Motor Vehicle Disposal A/C Motor Vehicle A/C <b>(Motor Vehicle being traded in now transferred to disposal a/c)</b>	10,000	10,000
Provisions for depreciation A/C Motor Vehicle disposal A/C <b>(Total Depreciation provided for motor vehicle)</b>	8,000	8,000
Motor Vehicle A/c Asset disposal A/C Cash Book <b>(New Motor vehicle acquired via Trade in value of \$3,000 &amp; cheque payment of \$2,000)</b>	5,000	3,000 2,000
Asset disposal A/C Income statement <b>(Profit made on disposal)</b>	1,000	1,000
<b>(In-case of a Loss on Disposal)</b> Income Statement (P & L) A/C Asset Disposal A/c	xxxx	xxxx

**NB:**

If the firm trades in an old asset for a new one, the following entries will be made in addition to the movements in the asset and depreciation a/c.

Debit – asset a/c (value of the new asset)

Credit – cashbook (cash paid as difference of new value i.e. trade in value of old asset) Asset disposal a/c (with trade-in value of old asset)

**ACCRUALS (Revenues and Expenses)**

**Revenue (Income);**

**Accrued Income**

This is income that relates to the current year but cash has not yet been received. An accrued income should be reported in the profit & loss account and the same income will be shown in the balance sheet as a current asset.

**Example 6:**

A firm lets out part of its properties and receives rent of \$.20, 000 per month, assuming that this is the first year of renting and rent is received in arrears (rent 4 January is received early Feb). in the year 2022

Dr.  
Cr.

**Cash Book**

Year 1	\$	\$
Feb (rent 4 Jan)	20,000	
Mar (rent 4 Feb)	20,000	
April (rent 4 Mar)	20,000	
May (rent 4 Apr)	20,000	
June (rent 4 May)	20,000	
July (rent 4 Jun)	20,000	
Aug (rent 4 July)	20,000	
Sept (rent 4 Aug)	20,000	
Oct (rent 4 Sept)	20,000	
Nov (rent 4 Oct)	20,000	
Dec (rent 4 Nov)	<u>20,000</u>	
	<u>220,000</u>	

Dr.  
Cr.

**Rent-Income A/C**

Year 1	\$	Year 1	\$
		Jan C/B	20,000
		Feb C/B	20,000
		Mar C/B	20,000
		April C/B	20,000
		May C/B	20,000
		Jun C/B	20,000
		July C/B	20,000
		Aug C/B	20,000
		Sept C/B	20,000
		Oct C/B	20,000
31/12/2022		Dec Accrued income c/f	<u>20,000</u>
<u>240,000</u>			<u>240,000</u>
	<u>240,000</u>		

Although the cashbook is showing that rent received amounts \$220,000, the full rental income of \$240,000 will be reported in the Profit & Loss a/c as rent income and the accrued rent for Dec of \$.2,000 will be reported in the balance sheet as a current asset.

**Expenses: Accrued Expenses**

An accrued expense is an expense that is payable or due for payment but has not yet been paid during that period. An accrued expense should be charged in the P&L account and shown in the balance sheet as a current liability. Assume in the above example that the firm is meant to pay the rent, thus it becomes an expense with the facts still the same i.e. \$.20, 000 payable in arrears. The ledger account will be as follows.

<b>DR.</b>	<b>CASH BOOK</b>		<b>CR.</b>
Year \$	1	Year 1	\$
		Feb (rent 4 Jan)	2,000
		Mar (rent 4 Feb)	2,000
		Apr (rent 4 Mar)	2,000
		May (rent 4 Apr)	2,000
		June (rent 4 May)	2,000
		July (rent 4 June)	2,000
		Aug (rent 4 July)	2,000
		Sept (rent 4 Aug)	2,000
		Oct (rent 4 Sept)	2,000
		Nov (rent 4 Oct)	2,000
		Dec (rent 4 Nov)	2,000

<b>DR.</b>	<b>RENT EXPENSES A/C</b>		<b>CR.</b>
Year 1	\$	Year 1	\$

C/B	Rent for Jan	20,000	
	Rent for Feb	20,000	
	Rent for Mar	20,000	
	Rent for Apr	20,000	
	Rent for May	20,000	
	Rent for June	20,000	
	Rent for July	20,000	
	Rent for Aug	20,000	
	Rent for Sept	20,000	
	Rent for Oct.	20,000	
	Rent for Nov	20,000	
31/12	Bal c/d	<u>20,000</u>	31/12/2022 A/C Income Statement <u>240,000</u>
		<u>240,000</u>	<u>240,000</u>

## PREPAYMENTS

### PREPAID INCOME

This is income that is not yet due but cash has been received for it. This happens where an income is payable in advance e.g. Rent payable 3 months in advance. A prepaid income should not be reported in the current financial period but should be carried forward and reported in the period it relates to.

*The accounting treatment will be to show it as a current liability.*

#### Example 7:

A firm receives rent income of \$.50, 000 per month payable quarterly in advance. Assuming that the firm's rental income began in 1st March and the financial year, end is on 31st December 2022. The ledger accounts will be:

<b>\$.150,000</b>	<b>\$.150,000</b>	<b>\$.150,000</b>	<b>\$.150,000</b>	<b>\$.150,000</b>
1/3/2022	1/6/2022	1/9/2022	1/12/2022	1/3/2023

<b>DR.</b>	<b>CASH BOOK</b>	<b>CR.</b>
Year 2022	\$   Year 2022	\$

1/3/2022	Rent	150,000	
1/6/2022	Rent	150,000	
1/9/2022	Rent	150,000	
1/12/2022	Rent	150,000	

<b>DR.</b>		<b>Rent Income A/C</b>	
<b>CR.</b>			
Year 2022	\$	Year 2022	\$
		1/3/2022	Cash Book
		150,000	
Income Statement (50,000x10)	500,000	1/6/2022	Cash Book
31/12/2022 Balance c/d	<u>100,000</u>	150,000	
	<u>600,000</u>	1/9/2022	Cash Book
		150,000	
		1/12/2022	cash Book
		<u>150,000</u>	
			<u>600,000</u>

Rent for the 4 quarters of 12 months has been received as per the cashbook but because the end of the financial year is at 31 Dec, rent for 2 months is pre-paid. This \$.10, 000 is not charged in the P&L but is carried forward as current liability in the balance sheet.

### PREPAID EXPENSES

A prepaid expense is an expense that is not payable but cash has already been paid. A prepaid expense should not be charged in the P&L a/c but should be carried forward to the next financial period and should be shown in the balance sheet as a current asset.

#### Example: 8:

Assume as in the previous illustration, that all the facts are as stated except that rent is an expense. The ledger accounts is as follows:

<b>DR.</b>		<b>CASH BOOK</b>		<b>CR.</b>	
Year 2022	\$	Year 2022		\$	
		1/3/2022	Rent	150,000	
		1/6/2022	Rent	150,000	
		1/9/2022	Rent	150,000	

	1/12/2022	Rent	150,000
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**DR.** **Rent expenses A/C**  
**CR.**

Year 2022	\$	Year 2022	\$
1/3/2022 C/B (Mar, April, May)	150,000		
1/6/2022 C/B (June, July, Aug)	150,000	31/12/2022 Income Statement	500,000
1/9/2022 C/B (Sept, Oct, Nov)	<u>150,000</u>	31/12/2022 Balance	c/d
	<u>600,000</u>	<u>100,000</u>	<u>600,000</u>

**NB:** Rent of \$100,000 for 2 months is carried forward to the next financial period and shown in the balance sheet as a current asset.

Accrued Incomes and Expenses and Prepaid Incomes and Expenses are shown in the Balance Sheet as follows:

**ABC ENTERPRISES**  
**Statement of Financial Position (Balance Sheet)**  
**As at 31<sup>st</sup> December 2022**

	\$ '000'	\$'000'
<b>Non-Current Assets</b>		
Property Plant & Equipment	35,000	
Motor Vehicles	<u>22,000</u>	<b>57,000</b>
<b>Current Assets</b>		
Inventory	25,000	
Accounts Receivables	14,000	
<b>Prepaid Expenses</b>	<b>12,000</b>	
<b>Accrued Revenues</b>	<b>7,500</b>	
Cash at Bank	9,500	
Cash in Hand	<u>4,800</u>	
	72,800	
<b>Current Liabilities</b>		
Accounts Payables	15,000	
<b>Prepaid Revenues</b>	<b>18,000</b>	

<b>Accrued Expenses</b>	<b>8,500</b>	
9 month Loan	<u>9,000</u>	
	<b>(50,500)</b>	<b><u>22,300</u></b>
<b>NET ASSETS</b>		<b><u>79,300</u></b>
<b>Financed by:</b>		
Capital +Liabilities		
Capital		45,000
Net Profit for the year		17,000
Drawings		(8,800)
<b>Non-Current Liabilities</b>		
10 years Credit Bank loan		<b><u>26,100</u></b>
<b>Capital Employed</b>		<b><u>79,300</u></b>

**NB: Check on the highlighted items in blue fonts (The Prepaid & accrued incomes and the accrued and prepaid expenses)**

**REFERENCES**

IASB. (n.d.). international financial reporting. <https://www.ifrs.org>  
 McCallig, J. (2008). Introductory financial accounting: Using international financial reporting standards. John McCallig.  
 Williams, J., Haka, S., Bettner, M. S., Meigs, R. (2002). Financial accounting. Irwin/McGraw-Hill.