Course Name	**: Accounting Fundamentals and Principles**
Course Code	**: APBBA 1101**
Course level	**: level 1**
Course Credit	**: 4 CU**
Contact Hours	**: 60 Hrs**

Course Description

The Course stipulates the rationale of accounting principles in the day today business environments. It provides modalities of how best accounting procedures can be shaped to enhance business transactions in the market. It explains also various concepts that are commonly used in the accounting field, illustrations of different accounts and their calculations as well as understanding the assumptions of accounting.

Course Objectives

- To help students acquire basic knowledge and skills in preparing different forms of accounts
- To enable students in interpreting and analyzing financial statements
- To initiate them to earlier practices of managerial accounting.
- To help the students appreciate the role of Accounts in Business setting

Course Content

Introduction to Accounting

- Definition of Accounting
- Importance of Accounting information
- Components of Accounting
- Role of the accountant in society

The need for Accounts

- Users of financial statements and their information needs
- The objective of financial statements
- Qualitative characteristics of good financial information
- Constraints on relevant and reliable information

Factors that shape financial accounting

- Laws
- Accounting standards
- Accounting concepts (underlying Assumptions)
- European Union Derivatives

Understanding concepts used in Accounting

- An asset
- Liabilities
- Equity
- Performance
- Income
- Expenses
- Reliability of measurement
- Recognition of assets and liabilities

The accounting principles/assumptions

- The going concern concept
- The matching/accruals concept

- The consistency concept
- The prudence concept
- Materiality concept
- Historical cost concept

Control Accounts
- Format of the control accounts
- Advantages of the control accounts
- How accounting details are recorded

Cash books
- Drawings up a cash book, and its importance(two column and three column cash books)

Partnership Accounts
- Definition of partnership accounts
- The partners' capital accounts
- Partner's current accounts
- Partnership and Goodwill
- Accounting treatment of loans in a partnership
- Basic steps of sharing out partners' profits
- Revaluation

Mode of delivery Face to face lectures

Assessment
Course work 40%
Exams 60%
Total Mark 100%

Definitions:
Financial Accounting is the art of collecting financial data which is quantifiable in monetary terms, recording all that has been collected, classifying data and summarising in a significant manner and in terms of money, transactions and events which are at least of a financial character and analyzing data to enable interpreting the result thereof.

1. Any events and transactions of financial nature are recorded in books of accounts. Events of non-financial nature say the quarrel between the project manager and the chairman Board of trustees cannot find room in the books of accounts.

2. The records must portray the significance of all transactions and events individually and collectively class by class and as a whole.

3. The partners involved must be able to gather the true message of the results as embodied in the statement finally prepared.

The account process involves identifying, measuring and communicating economic information to permit judgement and decision by the user of the information.
Measurement is concerned with assessing or evaluating data so as to state its significance correctly.
Communication is done through reports and financial statements.

IMPORTANCE OF ACCOUNTING INFORMATION

- Some user groups use financial accounting primarily for standard purposes and others for decision-making purposes.

- Managers of all forms of organisations whether profit making or non-profit making require information to assist them in their decision making and control activities.
- Information is required about the viability of a project; whether to lease or buy, profitability of production line, the competitive position in the market, the introduction of a new product and whether to recruit or retrench.

COMPONENTS OF ACCOUNTING DISCIPLINE

1. FINANCIAL ACCOUNTING

Kohler's dictionary of accounting defines financial accounting as "Accounting for revenues, expenses, assets and liabilities of a business, a term often limited to the accounting concerned with published financial reports in contrast to internal aspects of accounting such as cost accounting."

According to this definition, financial accounting is that branch of accounting that is concerned with the determination of the results of operation of an organisation during a given period and financial position of the organisation as on a date at the end of the period.

It fulfils this objective by establishing a balance between revenues and expenditures/expenses (Statement of Comprehensive Income) and by laying out the assets and liabilities of the organisation (Statement of Financial Position) as on the date at the end of the trading period. The focus of financial accounting is primarily on historical report.

The information compiled by the financial accounting is intended for external use by investors, employees and their union, government-agencies and others.

The information provided by those groups usually consists of the Statement of Comprehensive Incomes, Statement of Financial Position and statements of changes in the financial position for the period under review.

Financial accounting can also be looked at as a branch of accounts which is heavily constrained by the generally accepted accounting principles and whose major focus is on the historical, custodian and stewardship aspect of accounting.

It is worth noting the features of these definitions as follows:

i) **Accounting principles**

Financial accounts are prepared on the basis of pronouncements of the financial accounting standards board. (F.A.S.B) An independent standard setting body. These pronouncements are referred to as generally accepted accounting principles (G.A.A.P).

The purpose of G.A.A.P is an attempt to ensure that the resulting reports are understandable, reliable and relating consistent between comparable periods.

ii) **Historical**

Financial accounting deals with historical records such as revenues that have either accrued or have been realised and expenses that have been incurred or obligation to incurring has been entered. Further more financial accounting reports comes at the end of the period concerned not before.

iii) **Custodian and store**

Financial accounts are prepared by a person who is responsible in the position of an agent. It is the financial accounting concerned with the custody or management of assets and discharge of liabilities by one person on behalf of another.

2. COST ACCOUNTING

Cost accounting is a form of mechanism by means of which costs of products and services are ascertained and controlled. It is that branch of accounting dealing with classification, recording, allocation, summarisation and reporting of current and prospective costs. Included in the field of cost accounting are the designs and corporations of costing systems and procedures, the method of determining costs by departments, functions, responsibilities, activities, products, territories, periods and other units of forecasted future costs and standards or desired costs as well as historical costs. The comparison of costs on different periods of actual estimated, budgeted or standard costs and of alternative costs and presentation and interpretation of cost data as an aid to management in controlling current and future operations.

3. MANAGEMENT ACCOUNTING

Management accounting is that type of accounting that provides information specifically to management for decision-making. It also provides information to management.
The major difference between financial and management accounting is that financial accounting is prepared for the benefit of many other groups apart from management where as management accounting is prepared primarily for purpose of management.
Management accounting is the process of identification, measurement, accumulation, analysis, preparation and interpretation as well as communication of information that assists the executive in fulfilling organisational objectives.
M.A seeks to meet the needs of management or in general the needs of the asset informal to the business.
It is designed for or adopted to the needs of information and control at various administration levels of the organisation.

4. FINANCIAL MANAGEMENT AND AUDITING
Financial management and auditing though not branch of accounting are common financial issues that need to be understood and differentiated from accounting.
Financial management deals with acquisition of funds and allocation of those funds to various competing issues to the organisation. Financial management functions do cover acquisition of funds, allocation of funds in various uses and management of liquidity.
Auditing is an independent examination of accounting and other records of an organisation with the aim of making on the operations of the organisation and financial position of that organisation.

Financial Accounting, management accounting, financial management and auditing

⇒ Financial accounting is a process of reporting the results and financial position of a business to satisfy the information needs of persons not involved in the day to day running of the business such as the suppliers, customers, the inland revenue and the general public. It entails the collection of raw-date, the recording, the classifying, the summarising, the analysing, interpreting, the reporting and even forecasting processes
⇒ Management accounting is primarily concerned with providing information as a guild to the more efficient conduct of the business. Since management is responsible for planning and controlling the resources of the business, management accounts is an information system which analyses data to provide information as a basis for managerial action. On the basis of the information from the management account, strategies can be drawn for the future that may be collective, preventive, competitive or otherwise in order to achieve the desired goals.
⇒ Financial management entails decisions taken to raise finance and control financial resources. Financial management includes decisions as to how the B/s should be funded (financing decisions), how the finance should be invested (investment decision) whether profit should ploughed back or distributed as dividends (dividend decisions) and how much credit should be given/taken (Cash management/or operating decision)

Auditing is the process of giving an independent opinion on financial statements of a business. It is a monitoring process of large businesses when ownership is divorced from management.
Auditors report as to whether or not the accounts of a business show a true and fair view of the business results for the year and financial population at the end of the year. The auditors in their report will refer to the profit and loss account, The Statement of Financial Position and the notes to the account.

THE ROLE OF THE ACCOUNTANT IN SOCIETY
He's role depends on where he works:
1. In the public practice the accountant would prepare accounts, provide general business advice and ensure tax compliance and tax planning of the businesses.

Whereas in industry and commerce, the accountant will make credit management decisions, prepare annual statutory accounts and provide cost information to management. He can also act as internal auditor or a tax adviser.
Generally the accountant interprets financial and complex accounting information to a lay man or he acts as indictor between the business and any authority.

An enterprise is an organisation that has pooled financial and non-financial resources together and operates these resources to achieve it's objectives. This enterprise may be a trading concern or a non-trading concern.

Trading concerns have profit as their main objective. Therefore it pools resources and operates them to generate profit (the excess of revenues over costs).

Trading concerns/enterprises may take the following form:-

Sole proprietorships: An individual accumulates financial resources and operates them to generate profits The business is usually relatively small & is operated by one individual plus members of his family if need be. Profits made belong to owners and no other party has a stake in it.

Partnerships: Unlike the sole proprietorship this business setting is a result of a set of individuals with a common objective of profit who pool financial, managerial and other resources and operate them or engage employees to run the business. Relatively partnerships have a higher capital raised than the sole proprietorships. Profit is shared among the partners as agreed and if no agreement was made, it is shared equally. Where necessary a partner may advance the business a loan.

Body corporate: Ltd - private, plc public co: Companies unlike the first who forms of businesses have their financial resources pooled by shareholders (owners) who more often than not, are not involved in the operations but share in the profits and ensure that the employees engaged (especially the management team) are satisfying their interests. It is overseen by a board of directors, which hires the business's managerial staff.

Cooperative: Often referred to as a "co-op business" or "co-op", a cooperative is a for-profit, limited liability entity that differs from a corporation in that it has members, as opposed to shareholders, who share decision-making authority.

Non-trading concerns
These most of the time are NGO, clubs or associations or charitable organizations.
Their objectives vary e.g. disease, control, HIV, poverty eradication, promotion of sports, education, religion etc.
The financial accounts are drawn to account for the financial resources advanced.

Business entity convention
Unlike the legal concept of personality in accounting a business is an entity separate from the person (owner). All the owner does is to provide capital to enable the operations to take off.
This capital (accumulated financial resources) is considered a special obligation (Debt) of the business that lives with the business and may be repaid when the operations cease.

THE NEED FOR ACCOUNTS
The objective of producing corporate reports (accounts inclusive) is to communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information. The classes of people who might need information about a business are:
Users of financial Statements and Their Information Needs

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include the following:

(a) *Investors*. The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) *Employees*. Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(c) *Lenders*. Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) *Suppliers and other trade creditors*. Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuation of the enterprise as a major customer.

(e) *Customers*. Customers have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.

(f) *Governments and their agencies*. Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises, determine taxation policies and as the basis for national income and similar statistics.

(g) Public. Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.

Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management.

Qualitative characteristics of good financial information:

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

i) Materiality
The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the enterprise irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate to the business.

ii) Reliable
To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

iii) <u>Faithful Representation</u>

To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a statement of financial position should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.

iv) <u>Relevant</u>

To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

<u>The predictive and confirmatory roles of information are interrelated.</u> For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the enterprise to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the enterprise would be structured or the outcome of planned operations.

v) <u>Complete</u>

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

vi) <u>Comprehensible (comprehensive)/Understandable</u>

An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

vii) <u>Comparability</u>

Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.

viii) <u>Neutral (purposeful and unbiased of the information)</u>

To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

ix) <u>Substance over Form</u>

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an enterprise may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the enterprise continues to enjoy the

future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

x) Prudence

The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognized by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise o the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Constraints on Relevant and Reliable Information

Timeliness

If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the economic decision-making needs of users.

Balance between Benefit and Cost

The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgemental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared; for example, the provision of further information to lenders may reduce the borrowing costs of an enterprise. For those reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Balance between Qualitative Characteristics

In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

True and Fair View/Fair Presentation

Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an enterprise. The application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.

Underlying Assumptions

Accrual Basis

In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognized when they occur (and not as

cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Going Concern

The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Financial Position, Performance and Changes in Financial Position

The economic decisions that are taken by users of financial statements require an evaluation of the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an enterprise to pay its employees and suppliers, meet interest payments, repay loans and make distributions to its owners. Users are better able to evaluate this ability to generate cash and cash equivalents if they are provided with information that focuses on the financial position, performance and changes in financial position of an enterprise.

Notes and Supplementary Schedules

The financial statements also contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the statement of financial position and statement of comprehensive income. They may include disclosures about the risks and uncertainties affecting the enterprise and any resources and obligations not recognized in the statement of financial position (such as mineral reserves). Information about geographical and industry segments and the effect on the enterprise of changing prices may also be provided in the form of supplementary information.

FACTORS THAT SHAPE FINANCIAL ACCOUNTING

The accounting discipline just like all other discipline is regulated to enable harmonised reporting and comparability. The following factors put together play an important role in the financial reporting:-

Laws

These result from a parliamentary process. In place are a number of statutes. Most important is the company's Act (Cap 110) of the Laws of Uganda.

It requires that companies prepare financial statements on annual basis to be presented to the owners in the Annual General Meetings (AGM)

Accounting standards

International Financial Reporting standards (IFRS),
International Accounting standard (IAS),
International Financial Reporting Interpretations Committee Interpretation (IFRIC),
Statements of standard accounting practices (SSAPs),
UK - Financial Reporting Standards (FRS)

The accounting standards committee through the standard setting process came up with a number of statements of standard accounting practices which are guidelines on presentation, disclosure or appropriate treatment of a number of issues that arise during financial reporting. However, due to changes overtime, the International Accounting Standards Board was replaced by the International Financial Reporting Standards Board and the revised International Financial Standards are numbered in order that they are revised.

The recommended treatment is to be complied with by all reporting entities.

c) Accounting concepts principles (Underlying Assumptions)

These are principles that underlie the preparation of financial statements unless specifically stated they are implied (read into the financial statements by a knowledgeable user)

d) European Union Derivatives

These directives are incorporated in financial reporting practices of the entire European community and any other states that have adopted their reporting culture.

Generally Accepted Accounting Practices (GAAPs)

These are practices in the accounting discipline that may be traced from time immemorial and have been lived with the profession.

The stock exchange

This also has an influence on financial reporting in that the values attached to securities are determined by the

Other international influences

A number of regulatory bodies exist on both local or international levels.

Reporting may be influenced by the needs of a given nation, region (e.g the COMESA) or trade area like (P.T.A)

THE FINANCIAL STATEMENTS

These are summaries of the accounting records prepared usually by senior accounts staff for purposes of the user.

They show the operations of an enterprise over again financial reporting period and the financial position of the enterprise.

The reporting period vary according to the circumstances of a given enterprise but the normal accounting period is one year (any period of twelve months)

Complete set of Financial Statements

A complete set of financial statements comprises:

(a) a statement of financial position as at end of the period;

(b) a statement of comprehensive income for the period;;

(c) a statement of changes in equity for the period;

(d) A statement of cash flows for the period;

(e) Notes, comprising a summary of significant accounting policies and other explanatory information; and

(f) A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity may use titles for the statements other than those used in this standard.

Then financial statements are sometimes referred to as 'final accounts'.

- **Features of Financial Accounting Information:**
- **Accounting Standards:** Financial accounts are prepared on the basis of standards set by the board of the International Financial Reporting Standards Committee (IASC), an independent standard setting body. These Standards are referred to as International Financial Reporting Standards (IFRS). The purpose of IFRS is an attempt to ensure that the resulting reports are understandable, reliable and relating consistent between comparable periods.
- **Historical:** Financial accounting deals with historical records such as revenues that have either accrued or have been realised and expenses that have been incurred or obligation to incurring has been entered. Further more financial accounting reports comes at the end of the period concerned not before.
- **Custodian and store:** Financial accounts are prepared by a person who is responsible in the position of an agent. It is the financial accounting concerned with the custody or management of assets and discharge of liabilities by one person on behalf of another.

The Elements of Financial Statements

Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the statement of financial position are assets, liabilities and equity. The elements directly related to the measurement of performance in the statement of comprehensive income are income and expenses. The statement of changes in financial position usually reflects statement of comprehensive income elements and changes in financial position elements.
The presentation of these elements in the statement of financial position and the statement of comprehensive income involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the enterprise in order to display information in the manner most useful to users for purposes of making economic decisions.

Financial Position

The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

(b) A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(c) Equity is the residual interest in the assets of the enterprise after deducting all its liabilities.

The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognized in the statement of financial position. Thus, the definitions embrace items that are not recognized as assets or liabilities in the statement of financial position because they do not satisfy the criteria for recognition. In particular, the expectation that future economic benefits will flow to or from an enterprise must be sufficiently certain to meet the probability criterion before an asset or liability is recognized.

Assets

The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the enterprise. The potential may be a productive one that is part of the operating activities of the enterprise. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

An enterprise usually employs its assets to produce goods or services capable of satisfying the wants of needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the enterprise. Cash itself renders a service to the enterprise because of its command over other resources.

The future economic benefits embodied in an asset may flow to the enterprise in a number of ways. For example, an asset may be:

(a) used singly or in combination with other assets in the production of goods or services to be sold by the enterprise;
(b) exchanged for other assets;

(c) used to settle a liability; or
(d) distributed to the owners of the enterprise.

Many assets for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the enterprise and if they are controlled by the enterprise.

Liabilities

An essential characteristic of a liability is that the enterprise has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an enterprise decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

The settlement of a present obligation usually involves the enterprise giving up resources embodying economic benefits in order to satisfy the claim of he other party. Settlement of a present of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;
(b) transfer of other assets;
(c) provision of services;
(d) replacement of that obligation with another obligation; or
(e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

Although equity is defined as a residual, it may be sub-classified in the statement of financial position. For example, in a corporate enterprise, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the enterprise to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an enterprise have differing rights in relation to the receipt of dividends or the repayment of capital.

Performance

Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the enterprise in preparing its financial statements.

The elements of income and expenses are defined as follows:

(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

(b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or than those relating to distributions to equity participants.

The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognized in the statement of comprehensive income.

Income

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an enterprise. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element.

Expenses

The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the enterprise. Expenses that arise in the course of the ordinary activities of the enterprise include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the enterprise. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element.

Capital Maintenance Adjustments

The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the statement of comprehensive income under certain concepts of capital maintenance. Instead these items are included in equity as capital adjustments or revaluation reserves.

Recognition of the Elements of Financial Statements

Recognition is the process of incorporating in the Statement of Financial Position or statement of comprehensive income an item that meets the definition of an element and satisfies the criteria for recognition set out. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the Statement of Financial Position or statement of comprehensive income totals. Items that satisfy the recognition criteria should be recognized in the Statement of Financial Position or statement of comprehensive income. The failure to recognize such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

An item that meets the definition of an element should be recognized if:

(a) it is probable that any future economic benefit associated with the item will flow to or form the enterprise; and
(b) the item has a cost or value that can be measured with reliability.

The Probability of Future Economic Benefit

The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the enterprise. The concept is in keeping with the uncertainty that characterizes the environment in which an enterprise operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared. For example, when it is

probable that a receivable owed by an enterprise will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognize the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognized.

Reliability of Measurement

The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognized in the Statement of Financial Position or statement of comprehensive income. For example, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognized as an asset or as income; the existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.

Recognition of Assets

An asset is recognized in the Statement of Financial Position when it is probable that the future economic benefits will flow to the enterprise and the asset has a cost or value that can be measured reliably.

An asset is not recognized in the Statement of Financial Position when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the enterprise beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the statement of comprehensive income. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the enterprise or that management was misguided. The only implication is that the degree certainty that economic benefits will flow to the enterprise beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of liabilities

A liability is recognized in the Statement of Financial Position when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognized as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of Income

Income is recognized in the Statement of Comprehensive Income when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

Recognition of Expenses

Expenses are recognized in the Statement of Comprehensive Income when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

Measurement of the Elements of Financial Statements

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the Statement of Financial Position and Statement of Comprehensive Income. This involves the selection of he particular basis of measurement. They include the following:

(a) Historical cost. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) Current cost. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) Realisable (settlement) value. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) Present value. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Concepts of Capital and Capital Maintenance

A financial concept of capital is adopted by most enterprises in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the enterprise. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the enterprise based on, for example, units of output per day.

Concepts of Capital Maintenance and the Determination of Profit

The concepts of capital above give rise to the following concepts of capital maintenance:

(a) Financial capital maintenance. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) Physical capital maintenance. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the enterprise (or the resources or funds need to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

THE ACCOUNTING CONCEPTS /ASSUMPTIONS /PRINCIPLES

Accounting practice has developed gradually over a long period of time. Many of its procedures are operated automatically by accounting personnel and there procedures in common use imply the acceptance of certain concepts. These concepts are the basis of our current accounting system.

Fundamental accounting concept

These are the broad basic assumptions, which underlie the periodic financial accounts of businesses enterprises. They are referred to by all accounting committees and above all, identified as fundamental by statute (The companies Act 1985) which also adds the separate valuation principles, They are:-

1- The going concern concept

This is the assumption that the business will continue in its operational existence for the foreseeable future (at least 12 months from all the reporting date) and that there is no intention or necessity to cut back the scale of its operations significantly (e.g shut down one of the departments or shop, supplying to a given sales deport) or to cease operations completely (wind-up)

2- The matching/accruals concept

This is the assumption that the financial statements disclose items in the period that they relate the revenues shown are those generated/earned during the given period and they are treated together with costs necessary incurred in generating such revenues. Any incomes received in the period which they don't relate to are not disclosed in the comprehensive income statement and any expense the benefits of which are not enjoyed during the period are also not shown in the financial statement (the comprehensive income statement).

3- The consistency concept

The consistency concept is the assumption that similar items have been awarded similar treatment and the same treatment is applied from one period to another in accounting for such items to allow for comparisons and decision making.

For example, if stocks are valued at their stocks cost during period 1, the period 2 stocks should as well be valued at cost and not at market price or replacement cost.

4- The prudence concept

A person is said to be prudent when he gives the most cautions presentation of the situation in accounting a knowledgeable user assumes that the prepares has been cautions to the extent that he has not anticipated any gains (all gains reported have been realised) and any expenses or losses foreseen with reasonable certainty have been recognised in the financial statements. One accounting standard; statements of standard accounting practices (SSAP). Disclosure of accounting policies describes these four concepts as fundamental accounting concepts. The companies Act 1985 adds to these four a fifth:

5- Materiality concept

This is the assumption that only material items appear in financial statements. Any immaterial items have not been highlighted or reported distinctly.Items are material if their omission or misstatement would affect the impact of the financial statements on the reader. Materiality as a concept is relative but some items disclosed in amounts are particularly sensitive and even a very small misstatement of such item would be seen as a material error.For example where the disclosure of the absolute amount if a statutory requirement. In assessing materially the content of the item is important; not only its amount i.e. consider the class of transactions, the amount balances and from the financial statement as a whole.

6- Historical cost concept

The basic principles of accounting is that transactions are normally stated in accounts at their historical amount i.e. at their values when they occurred and the value of items in the financial statements is based on the price that was paid for them. This is because there is an objective documentary evidence to prove the transaction e.g. the purchase price of an asset or amount paid for an expense on the invoice.

Accountants prefer to deal with objective costs rather than estimates. However the principle is faced with problems when the market value of property is higher than cost or where the assets wear and tear out and reduce value with usage and passage of time and the effects of inflation.

7- The money measurement concept

Accounting deals with quantifiable information i.e the information that can be measured in monetary terms. Much as most people will agree to the monetary valuations, accounting can never tell every thing about a business (qualitative workforce problems etc are not easy quantifiable.

8- Entity Concept:-This is the assumption that the affairs of an entity are treated as separate from the non-business activities of its owners. The items recorded in the books of the business are therefore restricted to the transactions of the business. The only time that the personal resources of the proprietor affects the accounting records of a business is when the proprietor introduces capital into the business or makes a drawing.

9- The dual aspect concept

This is the assumption that the preparer of the financial statements recorded the two aspects of each of the transaction of the business. The financial effect of each of the aspects is equal but opposite, one representing an asset of the business and the other representing claims against the assets.

10- The realisation concept

This concept is the reverse of prudence. It holds the view that incomes should never be anticipated unless they are realised. This guards against exciting owners about revenue that will never arise.

Income is realised when the goods or services sold are provided for the buyer who accepts liability to pay for them the monetary value agreed. At this point income is in cash or near cash form. The point at which income is realised may be different from time the customer pays for the goods or takes delivery.

The accounting period convention

For accounting purposes the life time of the business is divided into arbitrary periods of a fixed length, usually one year. At the end of each arbitrary period, at least two financial statements are prepared, the Statement of Financial Position and the profit and loss account which is drawn on the basis of matching concept. This is done to strike a compromise between theoretical accuracy and the needs of uses who require periodic financial statements which will form the basis of subsequent financial decisions.

The substance over form convention

This is the assumption that the preparer reflected the economic. Substance of transactions in the accounts irrespective of their legal form. For example, where assets are acquired on hire purchase or lease terms, those assets are not owned by the user until (in the hire purchase agreement) the final instalment has been paid and the hire purchase has exercised the option to buy. However, he should record as fixed assets in his amounts at the start of the hire purchase I lease agreement the cost of such assets. The substance of the transaction is that the accounts should reflect the use of a fixed asset in the business and the legal form is that the user does not have title to the fixed asset.

THE ACCOUNTING EQUATION

The whole of financial accounting is based upon a very simple idea; The accounting equation

If a business is to be set up and start trading then it needs resources.

Assuming that it is the owner of the business who has supplied all of the resources; This can be shown as;

Resources in the business = Resources supplied by the owner.

The amount of resources supplied by the owner is called CAPITAL. The actual resources that are then in the business are called ASSETS. This means that when the owner supplies all the resources the equation above can be shown as

Assets = Capital

It is assumed that people other than the owner supply assets to a business. The amount owing to these people is known as LIABILITIES. Therefore the equation can be modified as;

Assets = Capital + Liabilities

Each side of the equation will always have the same total value because it is the same thing thus

Resources: what are they? = Resources: who supplied them

= Assets (CAPITAL + LIABILITIES)

Its a fact that the total value of each side will always equal one another, and that this will always be true no matter how many transactions they may be. The actual assets, liabilities and capital may change, but the total of these assets will always equal the total liabilities + capital.

Assets consists of tangible, intangible, investments and current assets where as liabilities consists of long term and current liabilities. Capital is the owner's equity or the network of a business and comprises the initial out lay and any further capital introduction and any reserves adjusted for what is drawn out of the business by the owner.

ACCOUNTING CONCEPTS

- These are basic assumptions which underlie the periodic financial accounts of a business enterprise.

The accounting concepts are recommended within the International Accounting Standard No. 1 (IAS 1 - Presentation of financial statements).

These concepts include:

i) Historical cost concept
(ii) Money measurement concept
iii) Business (separate) entity concept
(iv) Realisation concept
v) Dual (double entry) concept
(vi) Accruals concept
vii) Going concern concept
(viii) Prudence concept
ix) Consistency concept
(x) Substance over form concept
xi) Materiality concept
xii) Objectivity/ Neutrality/True & Fair View

i) Historical cost concept

- It means that assets are normally shown at cost price; and that is basis for valuation of the asset.
- This implies that:
  - a) Transactions are stated at their value when they occurred.
  - b) Assets are stated at their historical cost, such that the value of an asset in the Balance sheet is based on the price that was paid for it.

This concept is usually objective because there is usually documentary evidence to prove the purchase price of assets acquired, or amounts paid for expenses (i.e Invoices, GRNs, DNs will be available).

However, there are some problems with the principle of Historical Cost, namely :

- the wearing out of assets over time.
- the increase in market value of property over time
- inflation

ii) Money measurement concept

Accounting is mainly concerned with facts or transactions to which a monetary value can be attributed. Therefore, Accountants will mainly record those transactions that :-

a) Can be measured in money terms and

b) Most people will agree to the money value of the transaction i.e. fair value in the eyes of a "reasonable man".

However, this implies that accounting (Book-keeping) may NOT give you all the details about a business enterprise, for example,

1. What does proper Book-keeping tell us about the good or bad character of the Top Managers anyway ! !
2. Do properly maintained Books of Accounts, ever inform us that the Labour force (Workers) are unhappy and about to strike ?

iii) The Business Entity concept

- This recognises the fact that for accounting purposes, a business is considered to be a separate entity from its Owners and/or Managers.
- This means that the business transactions (affairs of the company) are to be treated as being quite distinct from those of the non-business activities of the owners and/or managers.
- The items to be recorded in the books of the company, are therefore restricted to the business transactions only.

- The only time that the personal resources of the proprietor affect the accounting records of the business is when the proprietor (Boss) introduces money (Initial or Added capital) into the business or takes out money from the business (drawings).

Scenario:

1. Mr. Tyson Tonto, the owner of T.T & Sons, a wholesale shop in Kampala's Downtown (Kikubo), has appointed you to be the Assistant Accountant in his business. He has authourised you to issue a cheque worth 2 million shillings from the business bank account, for the payment of College tuition fees for Amarios Tonto Junior who has recently joined the University.

2. This morning, Mrs. Bond Tonto gave her husband, Mr. Tyson Tonto, Shs. 200,000/- for toys for their youngest son, Squadron Tonto. Mr. Tonto has smilingly informed you ! !

3. Yesterday Mrs. Bond Tonto visited their wholesale shop and picked household goods worth Shs 150,000/- and Mr. Tonto has advised you to write off those goods since they were not sold to any customer.

4. Early this Month, Mr.Tyson Tonto managed to negotiate for a 3 year loan of Shs 25 million from his personal bankers and has acquired a Corona saloon car worth Shs 8 million for himself and a Van worth Shs.13 million for the business. He is not willing to talk to you about the balance.

5. Mr.Tyson Tonto took pack of Ug Waragi from his shop paying cash Shs 40,000

Required: Comment about the above transactions.

iv) Realisation Concept

This concept recognises that profits can only be taken into account when actual earning has occurred. The Normal criteria observed include:

1.Goods or services are provided/delivered to the buyer.
2.Buyer accepts liability to pay for goods or services
3.The monetary value of the goods or services has been established
4.The buyer will be able to pay for the goods - i.e. the buyer is not bankrupt!!

Earning is neither that time when the order is received from the customer nor that time when the goods are finally paid for.
Earning occurs when a sale deal is assumed sealed - above criteria.
Consequently, profits are recognised in our Books of accounts when realised or earned.

v) Materiality concept

It recognises that only material items should appear in the financial statements.

Items are material transactions, if their omission or misstatement would affect the impact of financial statements, i.e. if a material transaction is omitted or misstated, the users take a different decision than they would have made without this omission or misstatement.

An error which is too trivial to affect anyone's understanding of accounting reports is referred to as immaterial.
However, small (trivial) transactions may be lumped up together with other trivial but similar items.
Likewise some transactions may be fairly estimated if immaterial and especially when the effort (time and labour) is not cost effective

Scenario

Is it worth establishing exact number of pens or sheets of duplicating paper that have been consumed by the finance department for the month of June ?

If the answer is YES, then we need to visit all the desk in the finance department in order to establish the balances of unused pens and paper !!

If the answer is NO, then we may assume that pens and sheets of duplicating paper already issued to finance department are already used up. After all they will be used up anyway !!

vi) Dual (Double entry) concept

For every business transaction that occurs there are two accounting records to be passed.

First entry - to be debited in an account A.

Second entry - to be credited in a another account B.

Both debit and credit entries to be equal in value (amounts in shillings or other currency)

- This dual concept emphasises the fact that a business enterprise owns assets and owes liability (to the owner and lenders).
- The assets are therefore funded by the owner and /or lenders

  A = C + L

Note: In accounting it is not the number of debit entries or credit entries that matters, but it is the total of debit entries that should be equal to the total of credit entries.

vii) Accruals (matching) concept

It states that in computing the profit, revenue earned must be matched against the expenditure incurred in earning it.

Furthermore, Revenues are recognised in the accounts when they are earned regardless of whether these incomes are received or not yet received)these Debtors).

Likewise costs and expenses are recognised in the accounts when they are incurred, whether these costs/expenses are already paid or outstanding (i.e. creditors and accruals).

Therefore, net profit is the difference between revenues and expenses

Net Profit = Revenue – Expenses i.e the sales and other revenues to be recognised for the year ended 31st December 2001 will be compared with all the costs and expenses for the year ended 31 December 2001, this way we shall derive the Net Profit of the year 2001.

viii) Going concern concept

The Going concern concepts implies that the business will continue in operational existence for the foreseeable future, and that there is NO intention to put the company into liquidation or to make drastic cutbacks to the scale of operations.

For the continuously operating business, the main importance of the Going Concern Concept is that assets of the business should NOT be valued at their "Break-up" or "Piece-meal" or "Net separable value" - which is the amount the business would sell for if the assets were to be sold off one by one.

If the Business is a Going Concern then the business will be valued as a whole, such that both the tangible assets e.g furniture and intangible assets e.g. Goodwill, may be included.

ix) Prudence Concept

It states that, where alternative procedures or alternative valuations are possible, the one selected should be the one which gives the most cautions presentation of the business's financial position or results. For example :-

- Assume that you are a fisherman who has made a Good catch of fish for the day, but you find yourself left with half of your catch by the end of your working day. Imagine the value of your closing stock !!
- Alternatively assume you are in textile business and you recently went to Dubai and Hong Kong, coming back with 10 pieces of dresses each costing Shs100,000.

  You have already sold the 10 pieces at shs 150,000 each but 8 of them on credit and your customers have not yet paid up !! Out of past experience 10% of debtors never pay you. What is your Debtors' figure in the Balance Sheet ?
- Likewise, assume you have bought

CONTROL ACCOUNTS

When a company carries out many transactions, it will have a lot of accounts records to keep. It will also follow that due to the voluminous nature of the accounts work, many errors and omissions may go undetected by the Trial Balance.

Therefore, companies with large volumes of accounts data to keep are advised to maintain a control account for each of the ledgers. Only those ledgers whose control accounts do not balance are the ones which will need a detailed check to identify the errors.

Format of the control accounts

	Total of the opening balances	X
Add:	Total entries which increase the control account	X
Less:	Total entries which Decrease the control account	(X)
	Overall new total (Closing balance of Control account)	X X

Advantages of the Control accounts

1. Locating or detection of errors
2. Normally under a responsible / senior official therefore fraud is prevented
3. Management can extract control accounts' balances of debtors and creditors faster i.e. before the Junior officer derives the accurate balances from the Sales ledger (debtors book), the Sales ledger control account may be used.

a) A new clerk takes over responsibility for some of the sales records on 1 January 20x2. The summary figures he receives from his predecessor are as follows (at 1 January 20x2):

	Shs'000
Sales ledger control account	10,000
Sales ledgers: total of debit balances	10,483
Sales ledgers: total of credit balances	497

At 31 December 20x2, after his first year of responsibility the clerk arrives at the following summary figures:

	Shs'000
Sales ledger control account	16,600
Sales ledgers: total of debit balances	15,547
Sales ledgers: total of credit balances	551

On investigation you find the following facts, all of which relate to between 1 January 20x2 and 31 December 20x2:

i) June sales total was added as Shs 9,876,000 when is should have been correctly added as Shs8,967,000.
ii) A sales invoice which should have been charged to A's ledger account with an amount of Shs 642,000 had actually been charged to B's ledger account with an amount of Shs426,000.
iii) A credit note for customer D of Shs 123,000 had been incorrectly treated as a sales invoice in her ledger account. (Customer D's account had a large debit balance at 31 December 20x2).
iv) Contra entries of Shs 800,000 correctly entered in the separate ledger accounts, had been omitted from the control accounts.
v) Cash discounts given of Shs 74,000 have been completely ignored by the clerk.

Required

i) Calculate, with necessary workings, the adjusted figures at 31 December 20x2 for sales ledger control account, total of sales ledger debit balances and total of sales ledger credit balances.
ii) Produce a clear statement of the net amount of the remaining errors which the clerk appears to have made during the year 20x2 which have not yet been discovered.

Not for Profit Organisations (Clubs & Societies)

This are concerns whose intention is NOT to make profits but to provide vital services and facilities to the society (members of the general public). Their main intention is to improve the general welfare of society.
Examples may include :- UNICEF, UNDP, UWESO, SOS-Kakiri, Red Cross Society, CARE International, The Church of Uganda, Uganda Golf Union, FUFA, The Scouts clubs, ICPAU, ACCA, The Makerere Guild e.t.c

Upon critically analysing these examples, it is evident that although some of the above generate income, all the above clubs and Societies are Not set up to make any profits but to cater for you and me such that we may have better lives by providing health facilities, education facilities, social enmities, provide shelter to the poor, poverty eradication programmes and so on.

Accounting details will be recorded in the following :

1. **Receipts and Payments book** – will record all monies received and paid ut on behalf of the organisation. It is the *Cashbook* (if it is properly maintained). *Note : the balance may be given or you may have to extract by comparing the receipts against the payments made; the balance may be either a debit or credit (overdraft) balance.* The Receipts side (DR) Payments book may show donations received, proceeds from ticket sales, rent received, membership fees received, etc. The Payments side may show rent paid, donations paid, purchases actually paid, other expenses paid, Fixed assets acquired etc.

2. **Bar trading account** – this will show any profit or loss made out of the canteen, restaurant, bar etc . Some organisations may run bars or canteens as income generating activities, therefore it is vital to anlyse these operations to ascertain whether these canteens or bars are self sustaining or not.

Bar trading account

Bar Sales (Bar takings)	X		
Opening stock (bar)	X		
Bar purchases	X		
Closing stock	(X)		
Cost of Sales	**(X)**		
Bar gross profit		XX	
less: Bar expenses			
Bar man's salary		X	
Bar rental		X	
Bar depreciation		X	
Net profit on Bar operations		**XX**	

Note : *The net profit from the bar is an income if a profit and an expense if a deficit, to be reflected in the Income and Expenditure account.*

3. **Subscriptions accounts** – since most of these organisations are funded by members, it proper to record the details of the membership fees received, fees in arrears (unreceived but due), fees in advance (received but not yet due), and the fees actually recognisable as Income for a particular period

The Annual Subscription account

DEBIT SIDE	**Shs**	**CREDIT SIDE**	**Shs**
Balance B/f – Arrears Subscriptions	X	Balance B/F – Advance subscriptions	X
Subscriptions earned (I&E a/c)	X	Subscriptions received (see Receipts side)	X
Balance C/f – Advance Subscriptions	X	Balance C/F – Arrears subscriptions	X
TOTALS	XX	**TOTALS**	XX
Balance B/f – Arrears Subscriptions	X	Balance B/F – Advance subscriptions	X

Note : **The common/ prudent practice for the NPOs is to ignore the Subscription in arreas since they may not take any action even when a member refuses to pay, but the EXAMINERS normally require recognition of the subscriptions in arrears.**

The Life membership account
Some of the members may decide to make one lump sum payment to the organisation, in respect of their subscriptions such that no more subscription fees are due from these members. The organisation may then set a policy of recognising that life membership fees over the remaining life span of the member, who has paid the life membership.
Note: follow the scheme given by the examiner

The Accumulated Fund B/F
Often the examiners leaves you with the burden of establishing the accumulated fund available at the beginning of the accounting period.
Technique to follow:
Accumulated fund = Fixed assets + Current assets – Current and long term liabilities

4. **Income and Expenditure account** – although these organisations are Not making profits, they earn income and also make payments in line with their objectives. Therefore we need to check on whether the organisation generate enough incomes to cater for the expenses it incurred in a a certain period or not. This is the equivalent to the trading, profit and loss account for the trading concerns and it is prepared it is prepared on *accruals basis*

Format of the Income and Expenditure account
The Raretes Golf club
Income and Expenditure account for the year ended 31st December 2002

Incomes		***Shs***	
Donations earned (small) X			
Subscriptions earned (from the subscriptions accounts)		X	
Net Profits from the Bar operations		X	
Surpluses on special fund raising activities e.g Dinner dances, tournaments, speeches		X	
Other "revenue" incomes		X	
Total incomes XXa			
Expenditure			
Donations offered		X	
Rent for the year		X	
Office Depreciation, exclude bar depreciation	X		
Telephone & postage		X	
Office salaries		X	
Other office expenses (revenue)	X		
Total expenses XXb)			
SURPLUS OR DEFICIT (to be added to the Balance sheet figures)			***XX a-b***

5. **Balance Sheet** – to show the Assets, Accumulated Fund and Liabilities.

The balance sheet of the non profit making organisations is similar t that of the trading concerns with the **EXCEPTION of the Capital and reserves part.**
The NPOs maintain an Accumulated Fund account instead of a Capital account.

Format of the Balance Sheet
The Raretes Golf club
Balance Sheet as at 31st December 2002

	Cost	**Depreciation**	**Net Book Value**
Fixed assets	**Shs'millions**	**Shs'millions**	**Shs'millions**
Equipment	400	130	270
Vehicles	220	100	120
	620	***230***	***390***
Current assets			
Stocks(bar + others)		60	
Subscriptions in arrears		30	
Prepayments		25	
Cash balances		95	
Total Current assets			**210**
Total Assets Employed			**600**
Financed by:			
Accumulated Fund B/F		310	
Add: Surplus for the year		105	
Add: Donations (Big)		90	
Accumulated Fund C/F			505
Life Membership a/c			55
Current Liabilities			
Subscriptions in advance		17	
Trade creditors-bar purchase		13	
Accruals		10	
Total Current Liabilities			**40**
Total Funds Employed			**600**

Activity / Example
The following is a summary of the receipts and payments of Bitakuli Members' club during the year ended 31st July 2002

Receipts	Shs'000	Payments	Shs'000
Cash & bank balances b/f	210	Secretarial expenses	163
Competition tickets	437	Rent	1,402
Members' subscriptions	1,987	Speakers' expenses	1,275
Donations	177	Donations to charities	35
Refund of rent	500	Prizes for competitions	179

The following valuations are also available as at :

	31st July 2001	31st July 2002
	Shs'000	Shs'000
Equipment (original cost)	975	780
Subscriptions in arrears	65	85
Subscriptions in advance	10	37
Owing to suppliers of prizes	58	68
Stocks of prizes	38	46

Required:
Prepare the Income and Expenditure account for the Club and a Balance Sheet as at 31st July 2002.
(show the subscriptions account and the prizes account at a minimum)

STOCKS AND IAS 2

Stocks are the items which an organisation holds in its stores or premises either for Re-sale or for usage (consumption within business as stationery, raw materials).
Types of Stocks include:-
Stocks of Raw materials, which will be used for the manufacturing of Products,
Stocks of Work –in-progress, which will comprise the incomplete/ unfinished /half –made products,
Stocks of Finished goods, which are readily available for either sale or usage and
Stocks Consumable stores (e.g stationery, lubricants, fuel, cleaning materials, spare parts e.t.c).

Stock Taking Activity

Normally organisations carry out the Stock taking activity, to establish the physical quantities of stocks, attach a value and therefore establish their STOCK VALUATION for the Balance Sheet purposes.
Stock taking may be carried out at the end of an Accounting period or during the Accounting period.

The Storekeeper is the custodian of stocks and the main responsibilities include

- keeping all the organisation's stocks safe i.e against theft, damages and other foreseable dangers
- properly maintaining the stores, such that it has all the relevant favourable conditions to the stocks being maintained there e.g the storage for Fish require a good refrigeration system whereas the storage of Cement requires a dry store.
- Properly maintaining the stores records especially the quantities i.e Stock bin cards should be accurately updated.
  Key documents include Goods Received Note, Sales invoice, Loading orders, Purchase orders, Delivery notes to mention but a few.

Continuous stock taking
Perpetual stock taking

Cost or Net realisable value

IAS 2 recommends that:-
Stocks should be valued at either the Cost or Net Realisable Value but whichever is LOWER.
This ensures that the Prudence concept is upheld.

Tutorial note :

(i) this test is carried out on each category of stocks to ensure that this principle is respected. Damaged stocks, obsolete stocks, and slow moving stocks are normally adjusted to either cost or net realisable value whichever is lower.
(ii) cost implies the historical cost, which will include all costs incurred to have the stocks in their present location and conditions
(iii) Net Realisable value is the **Selling price** less the **related sales costs/related modification costs**, necessary for the sale to occur

Activity/Example

Tarjan Limited had stocks worth Shs.94,390,000/- as at 31st August 2002, its year end. During the stock taking exercise it was observed that several items which had cost a total of Shs.12,750,000/- had been damaged. The Production Manager has arranged for these to be repaired at a cost of Shs.1,400,000/- and the Sales Manager has confirmed a Sales order with one of the customers, who has agreed to pay Shs.13,150,000/- for these damaged goods provided they have been duly repaired and delivered to the Customer's premises. The delivery costs for this sale is estimated to be Shs.200,000/-
Required:
Advise the Assistant Accountant on the stock figure to include in the Balance sheet as at 31st August 2002.

Solution:

Damaged stocks		**Shs**
At Selling price		13,150,000
Less: repair costs	(1,400,000)	
Delivery costs	(200,000)	
Net Realisable Value	**11,550,000**	

At Cost 12,750,000

Good stocks	*Shs.*
Total cost of all stocks in the stores	94,390,000
Less: Damages at cost	(12,750,000)
Add: Damages at Net Realisable Value	11,550,000
Therefore the Cost to be included in the Balance sheet	**93,190,000**

Stock Valuation Methods

FIFO, LIFO and AVCO are the most common methods.

IAS 2 recommends Cost methods to be used for stock valuation purposes, and in particular FIFO and AVCO are preferred.

The following details relate to the purchase and issues of Material 22XA for the month of March 2002.

Date	Quantity Purchased	Price per Kilogram	Quantity Issued
01.03.2002	100	300	-
05.03.2002	200	400	-
07.0 3.2002	-	800	150
15.03.2002	400	450	-
20.03.2002	-	900	450
27.03.2002	100	500	-
31.03.2002	-	1000	50

Required: Establish the Stock Valuation using FIFO, LIFO and AVCO methods

a) **FIFO – First in, First out**

This method assumes that the first goods to be received are the first goods to be issued

Refer to the Activity/example about Material 22XA

Date		Receipts			Issues			Balance	
	Quantity	Unit cost	Amount Shs.	Quantity	Unit cost	Amount Shs.	Quantity	Unit cost	Amount Shs.
01.03.	100	300	30,000	-	-	-	100	300	30,000
05.03.	200	400	80,000				100 200 300	300 400	30,000 80,000 110,000
07.03	-	-	-	100 50	300 400	30,000 20,000	150	400	60,000
15.03	400	450	180,000	-	-	-	150 400 550	400 450	60,000 180,000 240,000
20.03	-	-	-	150 300 450	400 450	60,000 135,000 195,000	Nil 100	450	45,000
27.03	100	500	50,000	-	-	-	100 100 200	450 500	45,000 50,000 95,000
31.03	-	-	-	50	450	22,500	50	450	22,500

							100 150	500	50,000 72,500

b) **LIFO – Last in, Last out**

Goods which came in last are assumed to be issued out first i.e each issue of goods is made from the most recent consignment of goods received before the issue date, and where there is NOT enough left of the latest consignment, then the balance needed is issued from the next previous

Refer to the Activity/example about Material 22XA

Date		Receipts			Issues			Balance	
	Quantity	Unit cost	Amount Shs.	Quantity	Unit cost	Amount Shs.	Quantity	Unit cost	Amount Shs.
01.03.	100	300	30,000	-	-	-	100	300	30,000
05.03.	200	400	80,000				100 200 300	300 400	30,000 80,000 110,000
07.03	-	-	-	150	400	60,000	100 50 150	300 400	30,000 20,000 50,000
15.03	400	450	180,000	-	-	-	100 50 400 550	300 400 450	30,000 20,000 180,000 230,000
20.03	-	-	-	400 50 450	450 400	180,000 20,000 200,000	Nil 100	 300	 30,000
27.03	100	500	50,000	-	-	-	100 100 200	300 500	30,000 50,000 80,000
31.03	-	-	-	50	500	25,000	100 50 150	300 500	30,000 25,000 55,000

c) **AVCO – Weighted Average Cost**

With every new receipt (purchases) of goods made, the average cost for all the items in the stores is re-calculated.

Average cost is the **total cost of all the items** in the stores **divided** by the **total number of items** (quantity) in the stores.

Refer to the Activity/example about Material 22XA

Date		Receipts			Issues			Balance	
	Quantity	Unit cost	Amount Shs.	Quantity	Unit cost	Amount Shs.	Qty	Amount Shs.	Average Cost Shs.
01.03.	100	300	30,000	-	-	-	100	30,000	300
05.03.	200	400	80,000				100 200	30,000 80,000 110,000	366.67

							300		
07.03	-	-	-	150	366.667	55,000	150	55,000	366.67
15.03	400	450	180,000	-	-	-	150 400 550	55,000 180,000 235,000	427.27
20.03	-	-	-	450	427.27	192273	100	42,727	427.27
27.03	100	500	50,000	-	-	-	100 100 200	42,727 50,000 92,727	463.635
31.03	-	-	-	50	463.635	23,182	150	69,545	463.635

The effect of the stock method on the Gross profits may be analysed as follows:

Material 22XA

Trading Account per		FIFO Shs.	AVCO Shs	LIFO Shs
Sales	(150*800) + (450*900) + (50*1000)	695,000	695,000	695,000
Opening Stock		Nil	Nil	Nil
Purchases	(30,000+80,000+180,000+50,000)	340,000	340,000	340,000
Less: Closing Stock		(72,500)	(69,545)	(55,000)
Cost of Sales		267,500	270,455	285,000
Gross Profits		427,500	424,545	410,000

It can be noted from the above analysis, that profits may be affected by the Stock valuation method chosen.

Activity/ practice question 5.1

Master Outfits Ltd has been in business for the past 3 years, dealing in Suits. Their purchases and sales of goods have been as follows:

		Purchases	Sales	
Year1	January	40 at 200,000/= each	November	50 at 325,000/= each
	September	30 at 220,000/= each		
Year 2	February	20 at 230,000/= each		
	May	10 at 245,000/= each		
	October	34 at 250,000/= each	December	28 at 720,000/= each
Year 3	April	17 at 270,000/= each		
	August	60 at 300,000/= each	September	62 at 825,000/= each

Required:

Calculate the Gross Profit for each of the three years using FIFO, LIFO and AVCO methods

Activity/ practice question 5.2

The results of a company's stocktaking at the financial year end were:

Item	Category	Cost (Shs.000)	Net Realisable Value
1	X	20	21
2	X	30	28
3	X	10	9
4	Y	70	73

5	Y	90	88
6	Y	100	102
7	Z	200	210
8	Z	250	240
9	Z	280	270

Required: Give the stock figure for Balance sheet purposes.

Activity
Megalot Ltd made the following purchases and sales of stock item C4321 during May 2002:
May 10th Purchased 3,000 units at Shs.6,000/= each
May 15th Sold 2,500 units at Shs.9,500/= each
May 17th Purchased 1,000 units at 6,650/= each
May 27th Sold 900 units at 9,750/= each
The opening stock was 250 Units at 5,500/= each
Required : (a) Compute the gross profit using FIFO, LIFO and AVCO bases
(b) Suppose that a physical check on item C4321 at end of May revealed 830 Units. What factors might account for the difference ?

What is the correct valuation for the following stock items
(a) 200 calculators invoiced at Shs 40,000/= each less 20% discount. The goods were delivered to the head office with a carriage charge of Shs 50,000/= for the consignment. Since purchase, the goods have been transported to a branch at a cost of Shs 56,000/= and the calculators have been rust proofed at a cost of Shs 3,000/= each. The invoice from the supplier was paid less a settlement discount of 5%.

(b) A Company's financial year ended 31st July 2002, which happened to be a Wednesday. It was not possible to take stock on that day, and stocktaking therefore took place on Saturday 3rd August 2002, when the stores were closed. The value at cost, of the raw material stock was Shs 9,320,600. However, during Thursday 1st and Friday 2nd August the following transactions occurred:

Raw materials costing Shs.1,041,700 were received from suppliers
Raw materials costing Shs.23,500 were returned to suppliers
Raw materials costing Shs.899,100 were issued from the stores
Raw materials costing Shs.54,600 were returned to the stores in good condition

Certain items included in the stocktaking valuation at a cost of Shs.783,200 were found to have a net realisable value of Shs.672,400. These items were not part of the four transactions occurring on 1st and 2nd August 2002.

Required
(i) State the value of the company's stocks of raw materials as at 31st July 2002

Tutorial Note : Some of the factors affecting the stock valuation method include: - ignorance, convenience, custom (company policy), taxation, remuneration purposes, advice from Experts (Auditors), and lack of information.

PARTNERSHIP ACCOUNTS

A partnership is a relationship between people carrying on business in common (together), with the view of making a profit. A number of partners is normally a minimum of two people and a maximum of 20 people.

The liability of the individual partners is normally ***unlimited***. Partnerships are normally run in accordance with their partnership agreements or deeds where applicable otherwise the *Partnership Act 1890* applies.

Partnership Deed
This is a written *(formal)* agreement among the partners regarding terms and conditions of the partnership business. Provisions normally include:

- The profit sharing ratio (PSR)

- The rates of the interests applicable on the Partners' capital or Partners' drawing (if any).
- The salaries payable to each Partner (if any).
- Goodwill valuation in the case of changes in Partnership.
- Other necessary and obvious provisions may include:
  - Name of the Partnership
  - The Location of the business
  - Type of business to deal in, etc...

The Partners' Capital Accounts ("Fixed" Capital A/cs)
Partners contribute money to set up and run a business. These monies are recorded in the "Fixed" Capital A/cs

DR	Cashbooks or Asset account (e.g. car)	X
CR	Capital Account	X

Being money introduced into the business.

This capital account is a fixed (constant) account whose balances do not change with changes in day to day financial positions. These capital balances may only change in the case of changes within the partnership, i.e.

- Introduction of a new partner
- Retirement of the partner (or death)
- Revaluation of a partnership.

Dr		Partners' Capital Account			CR
Details	A	B	Details	A	B
Balance c/d	x	x	Balance B/f	x	x
	xx	Xx		xx	xx
			Balance b/f	x	x

Partners' Current Accounts
These are accounts in which day to day transactions affecting the partners would be recorded e.g. drawings, salaries, interest and capital balances, profits attributed to individual partners, etc..

Dr		Partners' Current Account			
	A	B		A	B
Drawings	x	x	Balance b/d	x	x
			Appropriation/Profit a/c	x	x
			Appropriation/salary a/c	x	x
			Appropriation/Interest on capital Account	x	x
	xx	Xx		xx	xx
			Balance b/f	x	x

Profit and Loss Sharing Ratio
These are normally stated in the Partnership deed and are usually based on the initial capital contribution or based on the individual partner's ability to solicit business (Clients) or manage the Partnership.

Partners' Drawings
Sometimes partners are entitled to withdraw some money from the partnership for their personal use. Partners may be required to pay interest on these drawings (to discourage them from making unnecessary withdrawals). Remember drawings directly reduce on Capital.

Interest on Capital
Some Partnership in their agreements provide that payments be made for interest on Partners' capital contributions. Partners with big capital balances end up earning interest on capital, as an incentive for partners to increase or maintain their capital (investment monies) within the partnership. *Interest on capital is not an expense to the partnership but a profit to the partners*. Normally charged on the opening capital balances of the partners.

Partners salaries

A partner may be responsible to perform some extra duties within the running of the business. Some partners are grossly involved in the day -to -day management of the business. As per the partnership deed such partners may be entitled to salaries.

A partner's salary is not a partnership expenses but it is part of the profit appropriations.

Appropriation of the Profit

The Appropriation A/c is prepared to divide the partnership profit or loss among the partners as specified in the Partnership Deed. The profits made by the partnership may be shared by the partners in the form of salaries, interest on capital and the remainder (residual) profits.

Accounting entries in relation to appropriation of profits may be as follows:

1. Net profit made during accounting period

DR	Profit and Loss Account	X	
CR	Appropriation Account		X

2. Partners salaries

DR	Appropriation Account	X	
CR	Current Account	X	

Note: If these salaries have already been paid to the partners, then the cash A/c has been credited and drawing A/c has already been debited therefore:

DR	Appropriation Account	X	
CR	Drawings Account		X

3. Interest on Capital
   DR Appropriation Account
   CR Current Account

4. Interest on drawings
   DR Current Account
   CR Appropriation Account

5. Share of Profit (remainder)
   DR Appropriation Account
   CR Current Account
   Share of Loss
   DR Current Account
   CR Appropriation Account
   Drawings
   DR Current Account
   CR Drawings Account for each partners.

N.B. The Trading Profit and Loss Account of a sole trader and a Partnership are similar, except for this appropriation (sharing) of profits.

Guaranteed Minimum Profit
Debit balance on current account

Some times the partners overdraw their current account by taking home more money than their profits that are due to them in a certain accounting period. In this case, there will be a debit balance in the current account of that partner i.e. the partner owes the business money.

If the business is still a going concern, this debit balance will be adjusted against the subsequent year's profits.

Partnerships and Goodwill
Goodwill means the reputation of the business. It is an intangible asset arising from the business' ability to make more profit as compared to other firms in the same trade and with the same assets.

This earning ability may be influenced by:

- Location of the business
- Good performance of the business (operational performance) i.e. the firm deliver well.
- Employment of high calibre staff (qualified experience, high integrity)
- Good management skills
- Broadly basic clients

The value of the partnership may be presented in the financial statements (Balance sheet statement will reflect the total assets owned by the business).

However, these assets will be based on the past recorded transactions. If the firm can yield/can be valued at a higher amount that its balance sheet asset figures, the difference is positive Goodwill.

Goodwill is the difference between the value of the entire business as a going concern and the value of its net separable assets.

Accounting Treatment of Loans in a Partnership

When a partner gives a loan within a partnership, they become creditors. Upon receiving the loan (in cash or cheque form) debit cash book, credit Loan account, being the loan liability).

DR Cash Book
CR Loan Account

Being the recognition of the loan.

In the balance sheet, this will be shown as either a current liability (if payable within the next 12 months or a long term liability if repayable after the next 12 months).

Upon calculation of interest as per the partnership deed, interest on loan (from partners) will be recorded as follows:
DR Profit and Loss Account (Interest Account)
CR Current Account

Interest on loans offered by the partners is an expense to the partnership and not on appropriations of Profits.

Tutorial Note:

If there is no partnership deed, the partnership Act 1890 applies i.e. interest will be awarded at 5% per annum on the loans by the partners to the business,

<u>Basic steps of sharing out Partners' Profits</u>
a) Establish the Net Profit for the period.

b) Appropriate profits as Interest on Capital, as salaries of the partners
DR Appropriation Account
CR Partners' Current Account

c) If the partners agreed to pay interest on drawings, calculate the interest on drawings due from each partner.
DR Current Account

CR Appropriation Account

d) As for the residual profits (net profit + Interest on Drawings - Interest on Capital - Partners salaries) share out in accordance with the Partners' Profit sharing ratio.

DR Appropriation Account
CR current Account

In case of a resultant loss,
DR current Account
CR Appropriation Account.

For drawings,
DR Current Account
DR Drawings Account

Retirement or Death of a Partner

Changes in a partnership automatically dictate preparation of a new partnership deed. This is due to the fact that wherever changes occur, **legally** the partnership dissolves and a new one is formed.

Therefore when a partner leaves the firm, his share of assets is calculated and transferred to him (or the representative). During these calculations assets are re-valued, liabilities are established, goodwill may be ascertained, etc..

REVALUATION

This involves the comparison of the market values of the assets and liabilities, with their net book values in the existing books of Accounts.

a) If the assets; Net Book Value NBV is higher than the new value (possibly market value), then there is a loss on revaluation i.e. asset valued at lower than NBV.
DR Revaluation Account
CR Assets Accounts
Being a loss on revaluation.

b) If the asset is valued at higher than NBV,
DR Asset Account
CR Revaluation Account
Being Profit of revaluation.

Upon establishing the overall balance on the revaluation Account (Credit balance = Profit, Dr. Balance = loss).

i) Credit balance = Profit
DR Revaluation Account
CR Partners' Capital Account using profit sharing ratios.
Being partners' share of profits on revaluation

ii) Debit balance = Loss
DR Capital Accounts of partners
CR Revaluation Account
Being partners' share of loss on revaluation.

GOODWILL

The excess of the price paid for the business over the market value of its individual assets and liabilities.

N.B. The value of goodwill may be given by the examiner or you may be given the scheme of calculation to follow.

Treatment of Goodwill in the Accounts

A business may choose to:

i) Write off goodwill immediately. In this case goodwill never appears in the balance sheet. This is normal treatment for the non-purchased goodwill, i.e. such as for the partnership. Upon establishing the value of goodwill, the following entries will be passed.

First entries DR Goodwill accounts using (old profit sharing ratio)
CR Partners' Capital Accounts only with old/existing partners are affected.

Second set of entries DR Partners' Capital Account (the new/existing partners affected. Using new profit sharing ratio)
Dr Goodwill Account

A,B and C are in partnership, sharing profits equally, C is retiring and Goodwill has been agreed at £30,000. Their capital accounts have £70,000, £45,000 and £56,000 respectively. Their current accounts have £15,000, £24,000 and £4,000 DR. respectively. A and B will contribute share profits equally.

Required: Present Goodwill, Capital and current Accounts.

GOODWILL ACCOUNT

Balance b/f	30,000	Capital	30,000

CAPITAL ACCOUNT

	A	B	C		A	B	
Goodwill	15,000	15,000	-	Balance b/f	70,000	45,000	56,000
				Goodwill	10,000	10,000	10,000

CURRENT ACCOUNT

A	B	C	A	B	C
		4,000	15,000	24,000	

ii) Write off goodwill over a period of years (i.e. amortised [depreciation] goodwill). This treatment assumes that goodwill has a definite or limited useful life and therefore it will be offset (charged) against profits.

Normal treatment for purchased goodwill. This goodwill appears in the balance sheet, and the amortised/depreciated amount in ma certain period will appear in the Profit and Loss Account.

iii) Retain the goodwill in the books of Accounts (on assumption that the reputation of the business is continuously improving).

ADMISSION OF PARTNERS

When a new partner is joining the firm:

i) The old existing partners will be interested in ensuring that they receive all their share of the profits already earned.

ii) The new partner will be interested in making sure that he doles not suffer a share of any previously incurred losses. Therefore it is necessary to ascertain the networth of the existing partners (including Goodwill shares) and sometimes involving the revaluetion of assets and liabilities.

Note: The total additional capital introduced by the new partner will be recorded as follows:

DR Assets Account (cash book/car etc.)
CR New partner's Capital Account.

Value of goodwill as the ;partnership admits a new partner.

First
DR Goodwill Account
CR Partners' Capital Account
(Use old P.S. Ratiuo)

Second
DR All the partners' Capital Accounts
CR The goodwill Account
(Use new P.S. Ratilo)

Example
Scap, Iron and Ore are partners in a scrap metal business, sharing profits in a ratio 5:3:2 respectively. Their capital and current accounts balances on 1 January 19x2 were as follows;

	Capital Account	Current Account
Scrap	24,000	2,000
Iron	18,000	(1,000)
Ore	13,000	1,500

Interest at 10% per annum is given on the fixed capitals and salaries of £8,000 per annum are credited to iron and Ore. Expansion of the business was hindered by lack of working capital. So Scrap made a personal loan of £20,000 on 1 July 19x2. The loan was to be repaid in full on 30 June 19x5 and loan interest at a rate of 15% per annum was to be credited to Scrap's account every full year. The partnership profit (before charging loan interest) for the year ending 31 December 19x2 was £63,000 sand the partners had made drawings of:

Scrap £16,000; Iron £16,500; Ore £19,000 during the year.

Required:

Prepare the Trading, Profit and Loss Appropriation Account, the Partners' Capital and Current Accounts, and the partnership Balance Sheet, in respect of the year ended 31 December 19x2.
Non Profit Making Organisations (Clubs & Societies)

This are concerns whose intention is NOT to make profits but to provide vital services and facilities to the society (members of the general public). Their main intention is to improve the general welfare of society.
Examples may include :- UNICEF, UNDP, UWESO, SOS-Kakiri, Red Cross Society, CARE International, The Church of Uganda, Uganda Golf Union, FUFA, The Scouts clubs, ICPAU, ACCA, The Makerere Guild e.t.c

Upon critically analysing these examples, it is evident that although some of the above generate income, all the above clubs and Societies are Not set up to make any profits but to cater for you and me such that we may have better lives by providing health facilities, education facilities, social facilities, provide shelter to the poor, poverty eradication programmes and so on.

Accounting details will be recorded in the following :

6. **Receipts and Payments book** – will record all monies received and paid out on behalf of the organisation. It is the *Cashbook* (if it is properly maintained). *Note : the balance may be given or you may have to extract by comparing the receipts against the payments made; the balance may be either a debit or credit (overdraft) balance.* The Receipts side (DR) Payments book may show donations received, proceeds from ticket sales, rent received, membership fees received, etc. The Payments side may show rent paid, donations paid, purchases actually paid, other expenses paid, Fixed assets acquired etc.

7. **Bar trading account** – this will show any profit or loss made out of the canteen, restaurant, bar etc . Some organisations may run bars or canteens as income generating activities, therefore it is vital to analyse these operations to ascertain whether these canteens or bars are self sustaining or not.

Bar trading account

Bar Sales (Bar takings)	X	
Opening stock (bar)	X	
Bar purchases	X	
Closing stock	(X)	
Cost of Sales	**(X)**	
Bar gross profit		XX
less: Bar expenses		
Bar man's salary		X
Bar rental		X
Bar depreciation		X
Net profit on Bar operations		**XX**

Note : *The net profit from the bar is an income if a profit and an expense if a deficit, to be reflected in the Income and Expenditure account.*

8. **Subscriptions accounts** – since most of these organisations are funded by members, it proper to record the details of the membership fees received, fees in arrears (unreceived but due), fees in advance (received but not yet due), and the fees actually recognisable as Income for a particular period

The Annual Subscription account

DEBIT SIDE	**Shs**	**CREDIT SIDE**	**Shs**
Balance B/f – Arrears Subscriptions	X	Balance B/F – Advance subscriptions	X
Subscriptions earned (I&E a/c)	X	Subscriptions received (see Receipts side)	X
Balance C/f – Advance Subscriptions	X	Balance C/F – Arrears subscriptions	X
TOTALS	XX	**TOTALS**	XX
Balance B/f – Arrears Subscriptions	X	Balance B/F – Advance subscriptions	X

Note : **The common/ prudent practice for the NPOs is to ignore the Subscription in arrears since they may not take any action even when a member refuses to pay, however the EXAMINERS normally require recognition of the subscriptions in arrears.**

The Life membership account

Some of the members may decide to make one lump sum payment to the organisation, in respect of their subscriptions such that no more subscription fees are due from these members. The organisation may then set a policy of recognising that life membership fees over the remaining life span of the member, who has paid the life membership.

Note: follow the scheme given by the examiner

The Accumulated Fund B/F

Often the examiners leaves you with the burden of establishing the accumulated fund available at the beginning of the accounting period.

Technique to follow:

Accumulated fund = Fixed assets + Current assets – Current and long term liabilities

9. **Income and Expenditure account** – although these organisations are Not making profits, they earn income and also make payments in line with their objectives. Therefore we need to check on whether the organisation generate enough incomes to cater for the expenses it incurred in a a certain period or not. This is the equivalent to the trading, profit and loss account for the trading concerns and it is prepared it is prepared on *accruals basis*

Format of the Income and Expenditure account

The Raretes Golf club

Income and Expenditure account for the year ended 31st December 2002

Incomes		*Shs*
Donations earned (small) **X**		
Subscriptions earned (from the subscriptions accounts)		X
Net Profits from the Bar operations		X
Surpluses on special fund raising activities e.g Dinner dance, tournament, speeches		X
Other "revenue" incomes		X
Total incomes XXa		
Expenditure		
Donations offered		X
Rent for the year		X
Office Depreciation, exclude bar depreciation	X	
Telephone & postage		X
Office salaries		X
Other office expenses (revenue)	X	
Total expenses XXb)		
SURPLUS OR DEFICIT (to be added to the Balance sheet figures)		***XX a-b***

10. **Balance Sheet** – to show the Assets, Accumulated Fund and Liabilities.

The balance sheet of the non profit making organisations is similar t that of the trading concerns with the **EXCEPTION of the Capital and reserves part.**

The NPOs maintain an Accumulated Fund account instead of a Capital account.

Format of the Balance Sheet

The Raretes Golf club

Balance Sheet as at 31st December 2002

	Cost	**Depreciation**	**Net Book Value**
Fixed assets	**Shs'millions**	**Shs'millions**	**Shs'millions**
Equipment	400	130	270
Vehicles	220	100	120
	620	***230***	***390***
Current assets			
Stocks(bar + others)		60	
Subscriptions in arrears		30	
Prepayments		25	
Cash balances		95	
Total Current assets			**210**
Total Assets Employed			**600**
Financed by:			
Accumulated Fund B/F		310	
Add: Surplus for the year		105	
Add: Donations (Big)		90	
Accumulated Fund C/F			505
Life Membership a/c			55
Current Liabilities			
Subscriptions in advance		17	
Trade creditors-bar purchase		13	
Accruals		10	
Total Current Liabilities			**40**
Total Funds Employed			**600**

Activity / Example

The following is a summary of the receipts and payments of Bitakuli Members' club during the year ended 31st July 2002

Receipts	Shs'000	Payments	Shs'000
Cash & bank balances b/f	210	Secretarial expenses	163
Competition tickets	437	Rent	1,402
Members' subscriptions	1,987	Speakers' expenses	1,275
Donations	177	Donations to charities	35
Refund of rent	500	Prizes for competitions	179

The following valuations are also available as at :

	31st July 2001	31st July 2002
	Shs'000	Shs'000
Equipment (original cost)	975	780
Subscriptions in arrears	65	85
Subscriptions in advance	10	37
Owing to suppliers of prizes	58	68
Stocks of prizes	38	46

Required:

Prepare the Income and Expenditure account for the Club and a Balance Sheet as at 31st July 2002.
(show the subscriptions account and the prizes account at a minimum)

FINAL ACCOUNTS OF LIMITED COMPANIES:

Limited companies developed as a result of the need for owners not taking part in the management of the business. This is also coupled with the limitations of sole trade and partnership businesses.

A limited company is a legal person set up by law. A company once set up can sue or be sued in its own name.

The process of setting up a company is initiated by promoters, who draft the constitution of the company. The constitution consists of:

- Memorandum of association and
- Articles of association.

TYPES OF COMPANIES

Limited liability companies: In event that such a company fails to pay its debts, the members are only liable to the debts up to the amount of capital in form of shares they subscribed.

Private companies: These are companies;

- Whose membership is limited to a minimum of 2 and a maximum of 20,
- Whose shares are not easily transferable,
- That can not raise capital from the public.

Public companies: These are companies;

- Whose minimum membership is 7 with no maximum,
- Whose shares can be transferable and
- Which can invite members of the public to subscribe for shares.

Key definitions of capital:

1) Authorised share capital: This is the share capital that the company has been allowed to issue out to shareholders. It can also been referred to as registered or nominal capital.
2) Issued share capital: This refers to the total share capital actually issued to shareholders.

3) Called up share capital: This comprises that proportion of the issued share that the company directors have asked the shareholders to make payment for.
4) Uncalled up share capital: This is the proportion of the issued share capital which remains to be received in future.
5) Paid up capital: This is the total of the amount of share capital that has been paid for by the shareholders.

Types of shares

Shareholders of limited companies are entitled to rewards in form of dividends. The amount of dividends that each shareholder receives depends on the type of shares as follows:

Preference shareholders are entitled to a fixed percentage dividend and are supposed to receive it before any other shareholders receive anything. In the final accounts preference shares are stated as, say; 50,000 10% preference shares of shs. 1,000 each. This means that the total capital raised was;

Shs. 50,000,000 (50,000 shares x shs. 1,000)
and the dividend entitlement is;
Shs. 5,000,000 (shs. 50,000000 x 10%)

Ordinary shareholders: These are also referred to as equity shareholders rank for dividend from the remainder of the total profits. It is worthy of mention that the remaining profits of the company belong to the ordinary shareholders. They can be stated as, say, 20,000 Ordinary shares of shs. 1,000 each. The dividend for ordinary shareholders is normally determined by directors mid way (interim) or at the end of the year **(final**).

The income statement

The income statement of a limited company is drawn up in the same as that of sole traders in all respects except for the following additional items;

1) In the profit and loss account other expenses are considered like;

- Directors remuneration; This payment to directors is only found in company accounts.
- Debenture interest; A debenture is used when money is borrowed by a company in form of a loan and a certificate is issued out to loan providers. The debenture attracts a %age interest.
- Audit fees

2) Another addition is the appropriation account as shown below;

	shs.	Shs.
Profit before taxation		XXX
Less corporation tax		(XXX)
		XXX
Add retained profits b/f		XXX
Profit after taxation		XXX
Less		
General reserves	XXX	
Preference dividends		
Interim	XXX	
Final	XXX	
Ordinary dividend	XXX	
Interim	***XXX***	XXX
Final		XXX
Retained profits c/f		

The balance Sheet

The balance sheet would appear as follows;

Non current assets	Shs.	Shs.	Shs.
A			
B			XXX
			XXX
Current assets			XXX
Inventories			
Accounts receivables		XXX	
Cash at bank		XXX	
Cash in hand		XXX	
Prepayments		XXX	
		XXX	
Current liabilities		XXX	
Accounts payables			
Accrued expenses	XXX		
Taxation	XXX		
Debenture interest	XXX		
Proposed dividends	XXX		
Working capital.	***XXX***	(XXX)	
			XXX
Long term liabilities			XXX
Debentures			
Other loans			
Capital employed			
		XXX	(XXX)
		XXX	XXX
Financed by:			
Ordinary shares			XXX
Preference shares			XXX
Retained profits c/f			XXX
Reserves			XXX
			XXX

References

1. Business accounting 1; Frank wood (11th Edition)
2. Professional Accountants in Business Committee *International Good Practice Guidance: Evaluating and Improving Costing in Organizations*. New York: International Federation of Accountants. July 2009. p. 24. Retrieved 10 November 2011.
3. "Taking Control of IT Costs". Nokes, Sebastian. London (Financial Times / Prentice Hall): March 20, 2000. ISBN 978-0-273-64943-4
4. Friedl, Gunther; Hans-Ulrich Kupper and Burkhard Pedell (2005). "Relevance Added: Combining ABC with German Cost Accounting". *Strategic Finance* (June): 56–61.
5. Sharman, Paul A. (2003). "Bring On German Cost Accounting". *Strategic Finance* (December): 2–9.
6. Financial accounting F3 ACCA study guide (December 2012)
7. A straight approach to accounting. WAHAB
8. Fundamentals of accounting; Ben Joseph Omunuk Sserwang