

SECTION
7

FINANCIAL STATEMENTS OF A SOLE PROPRIETORSHIP



Financial Accounting

Financial Reporting.

Introduction

In this section, focus will be placed on the preparation of the financial statement of a sole proprietorship. Look back to earlier strands in business management where you were introduced to the benefits, challenges and sources of funds available to the sole proprietor. In financial accounting, you will be engaged in the practical application of financial reporting principles, develop your ability to prepare financial statements while learning how to include adjustments such as accruals, prepayments, depreciation and provision for doubtful debts.

At the end of this section, you will be able to

- Prepare a financial statement of sole proprietorship (including adjustments like accruals, prepayments, depreciation and provision for doubtful debts.)

Key Ideas:

- Final accounts refer to the set of financial statements prepared at the end of an accounting period to summarise the financial performance and position of a business.
- Adjustments are accounting entries made at the end of an accounting period to allocate income and expenses to the appropriate period, ensuring that financial statements reflect the true financial position.
- Trading Account is a part of the income statement that shows the results of buying and selling goods and services. It calculates the gross profit by comparing net sales with the cost of goods sold.
- Profit and Loss Account is a financial statement that shows a company's revenues and expenses over a specific period, resulting in the net profit or loss for that period.
- Statement of Financial Position, which is also known as the balance sheet, presents the financial position of a company at a specific point in time, detailing assets, liabilities, and shareholders' equity.

FINANCIAL STATEMENT OF A SOLE PROPRIETOR

Sole Proprietorship

A sole proprietorship is a business entity which is owned, financed, managed and controlled by one person. The sole proprietor enjoys all profits made by the business and bears all risks, including losses.

Final accounts

A final account is a financial statement that provides a complete overview of a business's financial performance and position at the end of the financial year. It presents the business's assets, liability and equity at the end of the reporting period. This information is useful to the management, investors, owners, shareholders and other users of accounting information.

The trial balance forms the basis for the preparation of the final accounts.

The final account of a sole proprietor includes the income statement (trading, profit or loss) and statement of financial position (the balance sheet).

Trading account

This is an account which is prepared to determine the gross profit or loss of a business. Opening inventory, closing inventory and any direct expenses such as purchases made, carriage inwards, returns outwards and wages are recorded on the debit side of trading account.

Net sales are income, and it is calculated by deducting the value of return inwards from the value of total sales. Net sales are recorded at the credit side of the trading account.

Gross profit is the excess of net sales or sales over the cost of goods sold. The excess cost of goods sold over the net sales, or sales, is the gross loss.

Profit and Loss (P&L) account

This account is an extension of the trading account prepared at the end of a financial year to determine the net profit or net loss of a business. The net profit is the actual or true profit of the business before tax. The P&L account can be referred to as a financial statement that summarises the cost, revenue and net income or loss of a business or firm over a period of time.

All incomes are added to the gross profit or gross loss (if any) and all expenses are deducted from the gross profit. Gross profit is credited to the profit or loss account as revenue. Some expenses that form part of the profit or loss account are sales tax, provisions, maintenance, administrative expenses, selling and distribution expenses, depreciation, freight and carriage on sales, wages and salaries.

Some revenues that appear on the credit side of the income statement account are commission received, rent receivable, discount received, profit obtained from the sale of assets, etc.

An income statement format is shown below:

Example of profit or loss account for the year ended 31ST December, 20X1

| | GH¢ | GH¢ | GH¢ |
|-------------------------------------|-----|-----|------------|
| Sales | | | xxx |
| Less: Sales returns | | | xxx |
| Net sales | | | xxx |
| Less: Cost of Sales | | | |
| Opening inventory | | xxx | |
| Add: Purchases | xxx | | |
| Add: Carriage inwards | xxx | | |
| Less: Return outwards | xxx | | |
| Net purchase | | xxx | |
| COGAS | | xxx | |
| Less: Closing inventory | | xxx | |
| Cost of goods sold | | xxx | |
| Add: wages | | xxx | |
| Cost of sales | | | (xxx) |
| Gross profit c/d | | | xxx |
| Add: other incomes | | | |
| Commission received | | xxx | |
| Discount received | | xxx | |
| Rent received | | xxx | |
| Decrease in provision for bad debts | | xxx | |
| Interest received | | xxx | xxx |
| | | | xxx |
| Less: Operating expenses | | | |
| Wages and salaries | | xxx | |
| Insurance | | xxx | |
| Bad debts | | xxx | |
| Electricity | | xxx | |
| Advertisement | | xxx | |
| Increase in provision for bad debts | | xxx | |
| Depreciation | | xxx | xxx |
| Net profit/loss | | | <u>xxx</u> |

Activity 7.1

1. Identify sole proprietorship businesses in your community.
2. Summarise the advantages of sole proprietorship for these businesses.
3. Identify the disadvantages that these businesses face as sole proprietors.
4. Make a poster presentation of your answers.

Activity 7.2

1. Describe the purpose of a trading account and a profit and loss account.
 - a. You can use the table below to support your response.

| Type of account | Purpose |
|-------------------------|---------|
| Trading account | |
| Profit and loss account | |

Activity 7.3

1. In groups, create a template for the income statement of a sole proprietor.
2. Discuss the categories of items that need to be included in an income statement.
3. Analyse the following information and use it to prepare an income statement of a sole proprietor using the template you created in part 1.
Trial balance as of 30th June, 20X4.

| | Dr - GH¢ | Cr - GH¢ |
|----------------------------|----------------|----------------|
| Return inwards | 2,000 | |
| Sales | | 90,000 |
| Discount allowed | 7,000 | |
| Discount received | | 1,500 |
| Inventory (31st May, 20X3) | 20,000 | |
| Purchases | 50,000 | |
| Carriage inwards | 1,000 | |
| Return outwards | | 12,000 |
| Insurance | 4,800 | |
| Rates | 2,000 | |
| Electricity | 4,500 | |
| Bad debt | 2,200 | |
| Rent | 12,000 | |
| Total | 103,500 | 103,500 |

Note:

Closing inventory on 30th June, 20X4, Gh¢30,000

- Present your responses on a flip chart and compare with another group for feedback and discussion.

Statement of Financial Position (the balance sheet)

The balance sheet is a financial document that shows a business's total assets, liabilities and capital, and how the assets are financed, either through debt or equity. It can also be referred to as a statement of net worth or a statement of financial position. The balance sheet follows the fundamental accounting equation which states that: **Assets = Liabilities + Equity**.

A business's statement of financial position (balance sheet) is a list of ledger balances arranged according to whether they are assets, capital or liabilities and also shows the financial position on a specific date.

Below is an example of a balance sheet format.

| Fixed Assets | Cost | Acc. Dep. | NBV |
|---------------------|------|-----------|-----|
| Motor Van | xxx | xxx | xxx |
| Building | xxx | xxx | xxx |
| Fixtures & Fittings | xxx | xxx | xxx |
| Premises | xxx | xxx | xxx |

| Fixed Assets | Cost | Acc. Dep. | NBV |
|---------------------------------|------|-----------|-------------------|
| Land | xxx | xxx | xxx |
| Goodwill | xxx | xxx | xxx |
| Current Assets | | | |
| Stock | | xxx | |
| Receivable | xxx | | |
| Less prov. for doubtful debts | xxx | xxx | |
| Bank | | xxx | |
| Cash | | xxx | |
| Expense prepaid | | xxx | |
| | | xxx | |
| Less Current Liabilities | | | |
| Payables | xxx | | |
| Expenses owing | xxx | | |
| Income prepaid | xxx | xxx | |
| Working capital | | | <u>xxx</u> |
| Net Assets | | | <u>xxx</u> |
| Financed by | | | |
| Capital | | | xxx |
| Add Net profit | | | xxx |
| | | | xxx |
| Less Drawings | | | xxx |
| | | | xxx |
| Long-term liabilities | | | |
| 5% Debentures | | | xxx |
| Capital employed | | | <u>xxx</u> |

Activity 7.4

1. In groups, discuss the purpose of statement of financial position.
2. Create a template for a statement of financial position.
3. Discuss the categories of items that need to be included in the statement.
4. Analyse the information below which relates to GTP Enterprises as of June 30, 20X6. Using the template you have created, prepare the statement of financial position.

| | GH¢ |
|---------------------|--------|
| Capital | 25,000 |
| Cash | 12,000 |
| Accounts Receivable | 9,000 |
| Inventory | 15,000 |
| Office Furniture | 7,000 |
| Net profit | 10,000 |
| Accounts Payable | 5,000 |
| Bank | 5,000 |
| Creditors | 8,000 |

5. Compare your responses with another group for feedback and discussion.

Extension task 1

What does your answer tell you about the financial position of GTP Enterprises at this point in time?

Extension task 2

Answer the following question to support the review of your learning.

The following trial balance was extracted from the books of Greatness Enterprise for the year ended 30th September, 20X2.

Trial balance as of 30th September, 20X2.

| | Dr - GH¢ | Cr - GH¢ |
|-------------------------------|----------------|----------------|
| Salaries | 1,000 | |
| Receivables and Payables | 20,000 | 16,500 |
| Return inwards | 3,000 | |
| Sales | | 91,000 |
| Discount allowed | 7,000 | |
| Discount received | | 3,000 |
| Inventory (31st August, 20X1) | 20,000 | |
| Purchases | 52,500 | |
| Carriage inwards | 2,000 | |
| Return outwards | | 14,000 |
| Bad debt | 2,200 | |
| Cash in hand | 30,000 | |
| Drawings | 40,000 | |
| Bank overdraft | | 25,000 |
| Insurance | 6,300 | |
| Rates | 1,000 | |
| Electricity | 4,500 | |
| Capital | | 153,500 |
| Land and building | 43,000 | |
| Furniture and fitting | 37,000 | |
| Equipment | 33,500 | |
| Total | 303,000 | 303,000 |

Note:

Closing inventory on 30th September, 20X2, Gh¢30,000

Use the information provided in the trial balance to prepare the:

- a. Income statement for the year ended 30th September, 20X2
- b. Statement of financial position as of 30th September, 20X2.

ADJUSTMENTS IN FINAL ACCOUNTS

In the previous lesson, you were introduced to the final accounts of a sole proprietor. You prepared an income statement and statement of financial position (without adjustments) for a sole proprietor from a given trial balance. We will now focus on the various types of adjustments that can be made to final accounts.

Adjustments

Adjustments refers to the necessary changes made to the accounts of a business to ensure that the financial report complies with the accounting principles. These adjustments are made at the end of an accounting period. The purpose of the adjustment is to ensure that the final accounts reveal the true profit or loss and the true financial position of a business.

Types of adjustment in a final account

1. Closing inventory
2. Outstanding or accrued expenses
3. Outstanding or accrued income
4. Prepaid expenses
5. Prepaid income
6. Bad debts
7. Allowance for receivable (Provision for doubtful debt)
8. Depreciation

1. Closing inventory

The total value of inventory items that have remained unsold in the store or warehouse at the end of a given period is known as the closing inventory. Closing inventory includes raw materials, finished goods, work in progress and so on.

Example: Imagine you have GH¢12,000 worth of goods and sell goods amounting to GH¢9,500 by the end of the accounting period. This means that the closing inventory will be goods worth GH¢4,500.

Treatment of closing inventory

- a. The closing inventory is subtracted from the “cost of goods available for sale” (in the income statement).
- b. The closing inventory is added to “current assets” in the statement of financial position.

2. Outstanding or accrued expenses

These are expenses that a business incurred but have not yet been paid for. The expense is recorded in the accounting period in which it is incurred.

Example: If you have unpaid electricity of GH¢100 at the end of the accounting period then it should be registered as an expense within this period even though it remains unpaid.

Treatment of outstanding or accrued expenses

- a. Outstanding or accrued expenses are added to the “expense paid” in the income statement.
- b. Outstanding or accrued expenses are added to the “current liabilities” in the statement of financial position.

3. Outstanding or accrued income

This is income that has been earned by the business but has not yet been received.

Example: Assume you invested GH¢5,000 into treasury bills at an interest rate of 20%. By 31st December, you have earned an interest of GH¢1,000 but the bank have not credited your accounts.

Treatment of outstanding or accrued income

- a. Outstanding or accrued income is added to the “other incomes” in the income statement.
- b. Outstanding or accrued income is added to the “current assets” in the statement of financial position.

4. Prepaid expenses

This is the amount of expenses paid in excess of what has been incurred.

Example: Assume you paid GH¢3,000 as rent within an accounting period, but the total amount that you were supposed to pay for the period was GH¢ 1,800. This means that GH¢ 1,200 is categorised as a prepaid expense.

Treatment of prepaid expense

- a. A prepaid expense is deducted from the “expense paid” in the income statement.
- b. A prepaid expense is added to the “current assets” in the statement of financial position.

5. Prepaid income

This is an amount of income that is received in excess of the amount that was earned in that accounting period.

Example: Assume you receive a rent payment of GH¢800,000 from a tenant for a period of five years. However, the rent you charge the tenant is GH¢160,000 a year. Therefore, the prepaid income is GH¢640,000 over the next 4 years.

Treatment of prepaid income

- a. Prepaid income is deducted from the “amount received” in the income statement.
- b. Prepaid income is added to the “current liabilities” in the statement of financial position.

6. Bad debt

Bad debt is an amount money that the sole proprietorship cannot collect from its customers, after all reasonable attempts of recovery have been made. Bad debt usually occurs when the debtor goes into bankruptcy, becomes untraceable, through death, or when the additional cost of pursuing the debt is more than the amount the creditor could collect. This debt, once considered to be bad, will be written off by the company as an expense.

Example - Bad Debt: A buyer, who is supposed to pay GH¢1,000 to the sole proprietorship, was declared bankrupt and the amount was later written off as bad debt.

From the sole proprietor’s perspective, the debt of GH¢1,000 should be treated as bad debt (expense) in the income statement and deducted from the total receivables figure.

Treatment for bad debt

- a. Bad debt is treated as an expense in the income statement.
- b. Bad debt is deducted from the “total receivables”.

Note: If the bad debt figure is in the trial balance, do not deduct it from the receivables.

7. Allowance for receivables or provision for doubtful debt

Provisions are amounts set aside out of profit and other surpluses to provide for depreciation, renewal, uncollectible debts, etc.

Doubtful debts are those debts which a business is unlikely to collect. The reasons for potential non-payment include disputes over quantity supplied, delivery, the conditions of the item, or the financial stress of a customer’s operations.

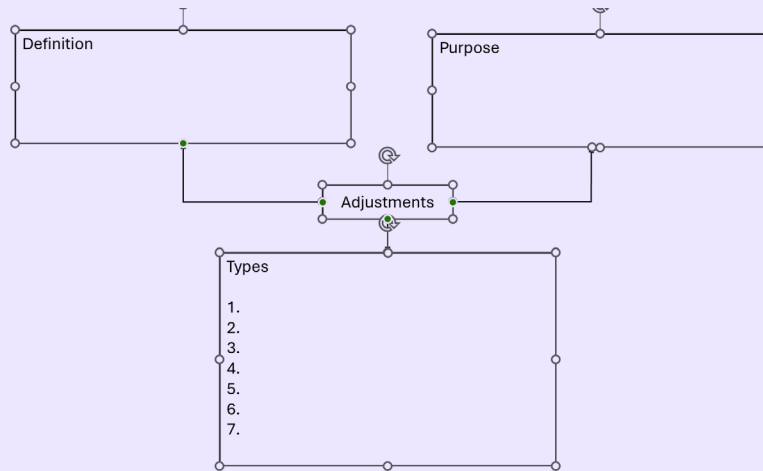
Allowance for receivables is an estimation of part of receivables that will need to be written off during a given period.

Treatment for allowance for receivables (provision for doubtful debt)

- a. An increase in provision for doubtful debt is treated as an expense in the income statement.
- b. A decrease in the provision for doubtful debt is treated as an income in the income statement.
- c. Provision for doubtful debt is deducted from the receivables figure in the current asset in the statement of financial position.

Activity 7.5

1. In pairs, discuss the meaning of “adjustments” in the context of final accounts.
2. Identify the purpose of adjustments.
3. Identify **seven** types of adjustment.



Activity 7.6

1. Analyse the following scenario and answer the questions that follow:
Your parents rent a shop in which they sell shoes and dresses. They pay GH¢ 2,500 per year as rent. In the year 20X3, they decided to pay GH¢4,000 to the shop owner as rent in that year.
 - a. Identify the term used in accounting for the excess money paid by your parents.
 - b. Describe how the excess money would be treated in your parent’s books of account.
 - c. If circumstances were different and your parents had paid GH¢ 1,800 to the shop owner as rent for the year 20X3, how that would be treated in their books of account?
2. Share your answers with a colleague for feedback

Activity 7.7

1. In groups discuss how the following accounting adjustments would be treated in the final accounts of a sole proprietor.
 - a. Bad debt
 - b. Accrued expenses

c. Allowance for receivable

2. Make a presentation of your responses using a flip chart. You could use a table such as the one below to present your answers:

| Type of adjustment | How is the adjustment applied? |
|--------------------------|--------------------------------|
| Bad debt | |
| Accrued expenses | |
| Allowance for receivable | |

DEPRECIATION

Depreciation is the decrease in the value of a fixed assets (non-current asset) resulting from wear and tear and the passage of time.

Advantages or Reasons for Depreciation

1. Depreciation helps to determine the accurate value of an asset at its disposal. That is, to show the net book value of the non-current asset in the balance sheet. Determining an accurate value also supports pricing if an asset is to be sold on.
2. Depreciation helps to spread the cost of an asset over its estimated useful life.
3. It helps to determine the true net profit of a business for each accounting year. That is, in order not to overstate the profit for any year of operation to comply with the prudence concept.
4. It helps to ascertain the profit or loss on the disposal of non-current assets.
5. It helps to preserve the capital in a business by preventing the amount of depreciation from being available for distribution as a dividend.
6. Depreciation can be used as a basis for assessing insurance claims.
7. It serves as a guide in determining when to replace the fixed/non-current asset.

Causes of Depreciation

Causes of depreciation fall into several categories, namely physical deterioration, economic factors, time factors and depletion. Examples include;

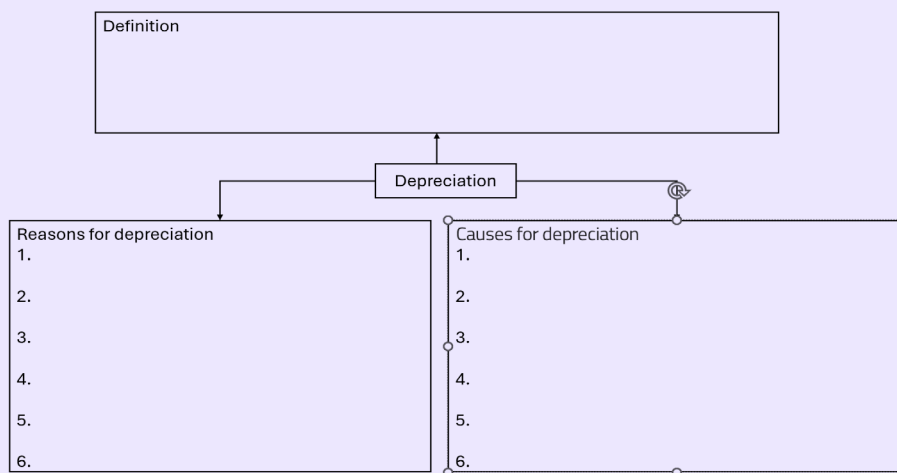
1. Wear and tear when the assets are in use.
2. Physical deterioration caused by erosion, rust, rot and decay from being exposed to weather.

3. **Obsolescence** – This is when a non-current asset becomes out of date as a result of technological advancement.
4. **Inadequacy**– This is a situation where an asset is unable to meet the growth in demand and changes in the size of the firm.
5. **Lapse of time** – This applies to assets with a fixed period of legal life such as leases, patents and copyrights.
6. **Depletion** – This applies to resources that are of a limited or finite availability. The value of assets such as mines, stone quarries, oil refineries, etc usually reduce as extraction continues.

Activity 7.8

1. In pairs, discuss the meaning of depreciation.
2. Agree on the definition of depreciation
3. Outline the reasons for depreciation
4. Identify the causes of depreciation.

You can use the below structure to present your findings.



Methods of Depreciation

The most commonly used methods of depreciation are straight line, reducing balance, revaluation and sum of the year's digit method.

1. Straight line method or Fixed instalment method.

With this method, a fixed rate (percentage) is always applied to the cost of the asset to determine the depreciation charge. It makes provision for an equal or fixed amount to be charged as depreciation for each year of the useful life of an asset. It is calculated as follows:

Cost – Residual (scrap) value ÷ Estimated Useful Life = Depreciation charge

Example:

On 1st March, 20XX Abu bought a motor bike at GH¢3,000. The estimated useful life was 6 years with a residual value of GH¢300.

In this example, depreciation = $\frac{\text{GH¢}3,000 - \text{GH¢}300}{6 \text{ years}}$

Therefore, depreciation to be charged for each year is GH¢450.

2. Reducing balance method or Diminishing balance method

With this method, the depreciation charge is determined by applying a fixed rate on the book value of the asset. The depreciation charge declines every year.

Example:

K. B. bought new equipment for GH¢16,000 on 1st February, 20X1. The machine was expected to have a four-year life, at the end of which it is expected to be sold for GH¢6,554. The rate of depreciation is 20% per annum. Calculate the depreciation charge for years 1 and 2.

YEAR 1

Book value of equipment = GH¢16,000

Depreciation charge = GH¢16,000 x 20% = GH¢3,200

YEAR 2

Net book value of the equipment = GH¢16,000 - GH¢3,200 = GH¢12,800

Depreciation charge = GH¢12,800 x 20% = GH¢2,560

Note that at the start of each year that the net book value decreases based on the previous years' depreciation.

3. Revaluation method

The revaluation method is a practice where an asset is revalued at the end of every year. At the end of the year, the new value is compared with that of the last value. The difference between the asset's values for two years is taken as depreciation.

Example

An asset cost GH¢2,000 on 1st February, 20X5.

As of 31st December, 20X5 the value placed on the asset was GH¢1,600.

What is the depreciation charge for the year?

Depreciation = GH¢2,000 - GH¢1,600 = GH¢400

4. Sum of the years' digits

This method involves calculating a depreciation expense by summing up all the digits in the projected lifespan of the asset. The digits are added together as a basis for arriving at the amount of depreciation for each year. The early years of the assets have a higher depreciation charge than later years. The first year's depreciation is calculated by using the digit of the last year as a proportion to the total digits and multiplying by the cost of the asset. The process continues until all the years are exhausted.

Example.

Yaw Bayere has provided you with the information below on a production machine with a cost of GH¢300,000 and an estimated lifespan of four years. You are required to calculate the depreciation charge for the machine during its lifespan using the sum of the years' digits.

Sum of years' digits = 1+2+3+4 = 10

Depreciation for year 1

$$\frac{4}{10} \times \text{GH¢}300,000 = \text{GH¢}120,000$$

Depreciation for year 2

$$\frac{3}{10} \times \text{GH¢}300,000 = \text{GH¢}90,000$$

Depreciation for year 3

$$\frac{2}{10} \times \text{GH¢}300,000 = \text{GH¢}60,000$$

Depreciation for year 4

$$\frac{1}{10} \times \text{GH¢}300,000 = \text{GH¢}30,000$$

Activity 7.9

1. Discuss the different methods of calculating depreciation.
2. Make a poster presentation of the key points of your discussions to share with the class. Your poster should summarise each of the methods covered in the lesson. Include examples to help show how these methods are used in practice.

Activity 7.10

1. In groups, analyse and answer the following questions
 - a. Zebilla Ltd. purchased a delivery van on January 1, 20X4, at a cost of GH¢50,000. The estimated useful life of the van is 5 years, and its residual value at the end of its useful life is expected to be GH¢5,000.

Calculate the annual depreciation for the van using the following methods:

- i. Straight line method
- ii. Reducing balance method (using a 20% depreciation rate)
- iii. Sum of the years' digits method

For each method remember to calculate the depreciation for each of the five years.

Show your workings for each stage of your calculations.

- b. Kumi and son company owns machinery that was purchased on January 1, 20X3, for GH¢80,000.

The company uses the Revaluation Method to calculate depreciation.

The machinery's value was re-assessed at the end of each year, with the following revalued amounts:

| Date | Value (GH¢) |
|-------------------|-------------|
| January 1, 20X3 | 80,000 |
| December 31, 20X3 | 72,000 |
| December 31, 20X4 | 64,000 |
| December 31, 20X5 | 56,000 |
| December 31, 20X6 | 48,000 |

Calculate the depreciation to be charged for each year using the Revaluation Method.

2. Present your response using a flip chart and share with another group for feedback.

Extension task 3

Using one of your worked examples from activity 7.10, explain how depreciation would be treated in the final accounts of that business.

Extension task 4

Answer the following questions to support the review of your learning.

Scenario 1

Joman Manufacturing purchased a piece of equipment on January 1, 20X4, for GH¢100,000. The equipment has an estimated useful life of five years and a residual value of GH¢10,000.

At the end of each year, Joman Manufacturing reassesses the value of the equipment for the Revaluation Method as follows:

December 31, 2024: GH¢85,000

December 31, 2025: GH¢70,000

December 31, 2026: GH¢55,000

December 31, 2027: GH¢40,000

December 31, 2028: GH¢25,000

Calculate the annual depreciation for each of the five years using the following methods:

- a. Straight Line Method
- b. Reducing Balance Method (with a depreciation rate of 25%)
- c. Sum of the Years' Digits Method
- d. Revaluation Method

For each method remember to calculate the depreciation for each of the five years.

Show your workings for each stage of your calculations.

Scenario 2

The cost of a motor vehicle is GH¢30,000 and the rate of depreciation is 5% per annum.

Calculate the depreciation charge for each of the first five years of the asset using the straight-line method.

An asset costs GH¢18,000 on 1st January, 20X5. As of 31st December 20X5, the value placed on the asset was GH¢15,000.

What is the depreciation charge for the year using the revaluation method

ADJUSTMENTS IN FINAL ACCOUNTS

Adjustments, including closing inventory, accumulated expenses, accrued income, prepaid expenses, prepaid income, provision for bad and dubious debts, and depreciation were covered in the previous section.

This section allows you to practice including the adjustments you have just covered in the financial statements of a sole trader.

Before completing these exercises, it will be useful to refer back to start of this section and revisit the format of a trading, profit and loss account and balance sheet.

Activity 7.11

1. In groups, carefully analyse the information below, paying particular attention to the adjustments and how these will need to be reflected in the business's financial statements.

Santo Enterprise is a business owned and managed by Bob Santo. The business has been operating throughout the year, and as the year ends, Bob Santo wants to prepare the financial statements to understand the financial position and performance of his business.

Below are the balances extracted from the books of Santo Enterprise as of December 31, 2016:

| | GH¢ |
|------------------------------|---------|
| Capital | 315,200 |
| Purchases | 259,800 |
| Sales | 484,700 |
| Carriage inwards | 17,410 |
| Premises at cost | 215,000 |
| Equipment at cost | 198,000 |
| Trade debtors | 76,800 |
| Bank overdraft | 63,509 |
| Trade creditors | 64,820 |
| Cash in hand | 13,400 |
| Stock (Jan. 1, 2016) | 27,680 |
| Salaries and wages | 56,700 |
| Provision for doubtful debts | 13,000 |
| Discount allowed | 11,450 |
| Drawings | 70,000 |
| Discount received | 22,800 |
| Electricity | 29,229 |
| General expenses | 37,060 |
| Rent | 43,000 |
| 9% Debentures | 100,000 |
| Return inwards | 24,500 |
| Return outwards | 16,000 |

Additional information:

- Stock in trade on December 31, 2016 was GH¢29,400;
- Provision for doubtful debt to remain at 8% of debtors.
- General expenses owing totaled GH¢12,860;
- Rent prepaid GH¢19,500.

Depreciation is to be provided as follows:

- Premises 12.5% on cost
 - Equipment 10% on cost
2. Prepare for the following financial statements for Santo Enterprise
 - a. Trading, Profit and Loss Account for the year ended December 31, 2016.
 - b. Balance Sheet as of December 31, 2016.
 3. Type your answer in MS Excel format and compare with other groups for feedback

Activity 7.12

1. Study the information below.

Esi Kwansima owns a small dressmaking business. On 31st December 2004, the following balances appeared in her books:

| | GH¢ | GH¢ |
|---|---------------|---------------|
| Capital, 1 st January 2004 | | 20,000 |
| Equipment at cost | 7,200 | |
| Stock, 1 st January 2004 | 5,800 | |
| Purchases and sales | 22,000 | 51,600 |
| Returns inwards and outwards | 1,000 | 600 |
| Carriage inwards | 300 | |
| Carriage outwards | 500 | |
| Trade debtors | 10,000 | |
| Trade creditors | | 5,980 |
| Provision for bad debts | | 600 |
| Bad debts written off | 380 | |
| Wages and salaries | 7,360 | |
| Discount allowed and received | 240 | 1,100 |
| Advertising | 1,400 | |
| Electricity | 1,000 | |
| Rent and rates | 2,320 | |
| General expenses | 440 | |
| Cash | 7,120 | |
| Bank | 14,820 | |
| Provision for depreciation of equipment | . . . | 2,000 |
| | <u>81,880</u> | <u>81,880</u> |

Additional information:

- Stock on 31st December 2004 was valued at GH¢7,400,000.
- Wages owing on 31st December 2004 amounted to GH¢100,000.

- Provide for bad debt 5% on debtors.
 - Provide for depreciation on equipment at 10% on cost.
2. Prepare the following financial statements:
 - a. Trading, Profit and Loss account for the year ended 31st December 2004
 - b. A Balance sheet as of that date.

Remember to include all relevant adjustments.

3. Share your answers with your colleague for feedback

Activity 7.13

1. In groups examine the following trial balance that was extracted from the books of *Free SHS Trading Enterprises* on 31st December 2018.

| | DEBIT | CREDIT |
|-----------------------------------|------------------|------------------|
| | GH¢ | GH¢ |
| Sales | | 2,400,000 |
| Purchases | 2,110,000 | |
| Freehold Buildings at cost | 250,000 | |
| Freehold land | 80,000 | |
| Capital | | 571,000 |
| Investments | 50,000 | |
| Bank overdrafts | | 12,500 |
| Trade creditors | | 74,000 |
| Trade Debtors | 165,000 | |
| 5% Loan | | 100,000 |
| Discount Allowed | 2,500 | |
| Discount Received | | 6,500 |
| Provision for depreciation: | | |
| Freehold buildings | | 25,000 |
| Fixtures and fittings | | 128,000 |
| Fixtures and fittings at cost | 320,000 | |
| Stock 1st Jan. 2018 | 210,000 | |
| Returns outwards | | 40,000 |
| Miscellaneous expenses | 65,000 | |
| Administration expenses | 28,000 | |
| Selling and distribution expenses | 83,500 | |
| Bad debts written off | 2,000 | |
| Provision for doubtful debts | | 9,000 |
| | 3,366,000 | 3,366,000 |

Additional information:

- Write off GH¢ 5,000 as bad debt.

- Provision for doubtful debts is to be made at 5% of trade debtors.
- Miscellaneous expenses prepaid at 31st December 2018 amounted to GH¢2,000.
- Administration expenses accrued at 31st December 2018 amounted to GH¢3,500.
- A years' interest on the loan is due and unpaid.
- Stock on 31st December 2018 amounted to GH¢360,000.

Provide for depreciation as follows:

- Freehold building 5% on cost,
 - Fixtures and fittings 10% on cost.
2. In your groups discuss the treatment of the various adjustments that will need to be made to SHS Trading Enterprises' financial statements.
 3. Prepare the Trading, Profit and Loss Account for the year ended 31st December 2018; **and** a balance Sheet as at that date for Free SHS Enterprise. Remember to include all adjustments.
 4. Share your answers with another group for feedback and discussion.

Extension task 5

Answer the following question to support the review of your learning

Based on the following information, prepare final accounts for Adwumawura, a general merchant based in Akim Oda, for the year ended 31st December 20X3.

- Stocks on 31st December 20X3 were valued at GH¢436,740.
- Outstanding liabilities were GH¢5,640 for wages due and GH¢1,020 for unpaid rent.
- Insurance had been prepaid by GH¢720.
- You are to write off GH¢4,800 as irrecoverable debts while a provision of 5% on the remaining debtors balance is to be made for doubtful debts.
- Depreciation is to be calculated at 5% and 20% per annum of Fixtures and Fittings and Motor van respectively.

This is Adwumawura's trial balance on 31st December, 20X3.

| | GH¢ | GH¢ |
|------------------------------------|-----------|-----------|
| Advertising | 93,900 | |
| Bank Loan | | 89,280 |
| Capital | | 600,000 |
| Carriage inwards | 24,180 | |
| Carriage outwards | 52,500 | |
| Cash at bank | 25,500 | |
| Cash in hand | 1,320 | |
| Creditors | | 186,120 |
| Debtors | 412,800 | |
| Discount | 25,080 | |
| Drawings | 144,000 | |
| Fixtures and Fittings | 75,600 | |
| Lighting and heating | 11,220 | |
| Motor vans | 41,100 | |
| Office salaries | 30,600 | |
| Postage and internet data | 4,080 | |
| Provision for bad debts | | 19,200 |
| Purchases | 1,274,280 | |
| Purchases returns | | 66,600 |
| Rates and insurance | 30,120 | |
| Rent | 3,060 | |
| Sales | | 2,054,100 |
| Sales returns | 99,120 | |
| Salesmen's salaries and commission | 97,080 | |
| Stationery | 7,200 | |
| Stocks, 1st January 20X3 | 352,560 | |
| Wages | 210,000 | |
| | 3,015,300 | 3,015,300 |

Review Questions

1. Your brother, who is the owner of a business enterprise, is preparing his financial statements for the year ending December 31, 2016. As he reviews the accounts, he notices that not all expenses and incomes are straightforward. For example, he has prepaid rent, some general expenses that haven't been paid yet, and a provision for doubtful debts that needs to be adjusted. Your brother asks you, "Why do I need to make these adjustments before finalising my accounts? Can't I just use the figures as they are?"

Explain to your brother the purpose of making adjustments in the final accounts. Use examples from his business to make your explanation practical and relevant to his situation.

2. Describe what depreciation means and highlight three key factors that cause it?
3. What are three practical methods you can use to account for depreciation on your assets as a sole proprietor, and what is the ideal situation under which each method will be used?
4. Suppose you purchased an asset for GH¢26,000, which is expected to last for five years with a scrap value of GH¢9,000.
How much would the depreciation charge be each year over the five years using the following methods?
 - a. Straight Line Method
 - b. Sum of Years' Digits Method
5. Joe Lapinto has given you details about a machine as of March 1, 20X2. The machine's cost is GH¢15,000, and it has an accumulated depreciation of GH¢7,000. The machine is depreciated using the reducing balance method at a rate of 10% per annum.
What is the depreciation expense for the year?
6. How do the income statement and the statement of financial position help us to understand a company's financial health?

EXTENDED READING

- Agyemang, G., & Osei, Y. (2020). *Corporate Financial Reporting in Ghana*. Kumasi, Ghana: Asante & Sons Publishing. **(Read pages 102-145)**
- Asiedu, N. A., & Ofori, B. (2019). *Essentials of Financial Accounting*. Takoradi, Ghana: Heritage Press. **(Read pages 87-130)**
- Kwesi, J. A., & Boateng, S. K. (2018). *Fundamentals of Financial Accounting*. Tema, Ghana: Ghanaian Academic Press. **(Read pages 150-200)**
- Mensah, P. K. (2015). *Advanced Financial Accounting*. Accra, Ghana: Kwadwoan Publishing. **(Read pages 130-180)**

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1. ACCA Manual. (2005). Accounting Framework. AT Foulk Lynch.
2. ICAG. (2019). Study Text - Financial Accounting.
3. NaCCa. (2023). Business Studies Curriculum.
4. Oduro, E. (2001). Principles of Financial Accounting for Senior High Schools (3rd ed.). Terror Publications.
5. Wood, F. (1993). Business Accounting 1 (6th ed.). Pitman Publishing.

GLOSSARY

| | |
|----------------------------|---|
| Bank Overdraft | A facility provided by a bank that allows an account holder to withdraw more money than is currently available in their account, up to a pre-approved limit. It is a short-term borrowing option and often comes with interest. |
| Carriage Inwards | This refers to the transportation cost incurred by a business to bring goods or raw materials to its premises. It is considered a direct cost and is usually added to the cost of goods purchased. |
| Carriage Outwards | This refers to the transportation cost incurred by a business to deliver goods to its customers. It is considered an indirect selling expense and is typically recorded in the profit and loss account. |
| Debentures | Long-term debt instruments issued by a company to borrow money from the public. Debenture holders are creditors of the company and are entitled to receive interest at a fixed rate. |
| Expenses | Costs incurred by a business in the process of earning revenue, such as rent, utilities, salaries, and materials. |
| Financial Statement | This is a formal record of a company's financial activities, including the statement of financial position or balance sheet, income statement, and cash flow statement, used to provide insights into the financial health of the business. |
| Gross Profit | The difference between net sales and the cost of goods sold (COGS). It indicates the profitability of a company's core activities before deducting operating expenses. |
| Income | The total amount of money earned by a business from its operations, including sales revenue and other sources of revenue such as interest or investments. |
| Inventory | Goods and materials a business holds for the purpose of resale. It includes raw materials, work-in-progress, and finished goods. |
| Net Profit | The amount of profit left over after all expenses, such as interest and taxes, have been subtracted from total income. It shows the true profit that owners of a business are entitled to. |
| Payables | Amounts a company owes to its suppliers or creditors for goods or services received. These are short-term liabilities that need to be paid usually within one accounting year. |
| Receivables | Amounts owed to a company by its customers for goods or services delivered on credit. These are considered short-term assets and are expected to be collected in the near term. |
| Scrap Value | The estimated remaining value of an asset at the end of its useful life, after it has been fully depreciated. It is the amount expected to be received from selling the asset as scrap. |

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Service (GES)



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