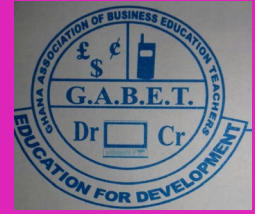


MINISTRY OF EDUCATION
GHANA ASSOCIATION OF
BUSINESS EDUCATION TEACHERS



ACCOUNTING

for Senior High Schools

Year 2



Josephine Kyei Baffour
Nimako Osei Victoria

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GHANA ASSOCIATION OF BUSINESS
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Ghana Education
Service (GES)





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FOREWORD

Ghana's new Senior High School Curriculum aims to ensure that all learners achieve their potential by equipping them with 21st Century skills, knowledge, character qualities and shared Ghanaian values. This will prepare learners to live a responsible adult life, progress to further studies and enter the world of work. This is the first time that Ghana has developed a Senior High School Curriculum which focuses on national values, attempting to educate a generation of Ghanaian youth who are proud of our country and can contribute effectively to its development.

The Ministry of Education is proud to have overseen the production of these Learner Materials which can be used in class and for self-study and revision. These materials have been developed through a partnership between the Ghana Education Service, teacher unions (Ghana National Association of Teachers- GNAT, National Association of Graduate Teacher -NAGRAT and the Pre-Tertiary Teachers Association of Ghana-PRETAG) and National Subject Associations. These materials are informative and of high quality because they have been written by teachers for teachers with the expert backing of each subject association.

I believe that, if used appropriately, these materials will go a long way to transforming our Senior High Schools and developing Ghana so that we become a proud, prosperous and values-driven nation where our people are our greatest national asset.

Haruna Iddrisu MP

Minister for Education

SECTION

1

ACCOUNTING CONCEPTS AND CONVENTIONS



FINANCIAL ACCOUNTING AND CONCEPTUAL FRAMEWORK

INTRODUCTION

In this section, we will look at the basic concepts (assumptions) and conventions (rules) of financial accounting, which are essential for preparing accurate financial statements. The lessons will help you to understand how these principles guide the recording, summarising, and reporting of financial information for businesses. We will focus on how to practically use these concepts so that you will understand how to prepare reliable and clear financial statements. By the end of this section, you should be able to understand and explain key accounting concepts and conventions, and discuss how they are used in preparing financial statements. Learning the content of this section well is important for you as an accounting student because it connects to other parts of accounting and finance, like financial reporting, auditing, and management accounting. This shows why the content of this section is essential when it comes to delivering comprehensive business education.

KEY IDEAS

- **Concepts** are broad assumptions which underlie the preparation of periodic financial accounts of business enterprises.
- **Conventions** are rules or guidelines that guide accounting practices, ensuring consistency and reliability in financial reporting.

INTRODUCTION TO ACCOUNTING CONCEPTS AND CONVENTIONS

Meaning of Accounting Concept and Conventions

Before beginning to explore the types of accounting concepts and conventions, it is important to understand the meaning of these terms.

Accounting concepts are broad assumptions which underlie the preparation of periodic financial accounts of business enterprises. Accounting concepts are fundamental principles or guidelines that support the practice of accounting and ensure consistency, reliability and transparency in financial reporting.

Accounting conventions refer to established practices and procedures that are followed and serve as the foundation for accounting rules and standards.

Types of Accounting Concepts

The diagram below gives an overview of the concepts that will be covered in this section.



Figure 1.1: Overview of concepts

You should note that in your lessons, there will not be enough time to be able to cover each of these concepts in depth.

You will work through a selection of examples in class, but you may also be assigned particular concepts to learn about as homework. As a minimum you will be assigned work on the following concepts:

1. Going concern
2. Accrual
3. Business entity
4. Prudence

1. **Going Concern Concept**

The going concern concept assumes that a business will continue in operational existence for the foreseeable future and that there is no intention to put the company into liquidation or to cease its operations.

This concept underpins the preparation of financial statements, influencing the valuation of assets, the treatment of liabilities and the overall financial reporting. It explains why assets of the business should not be valued at their realisable/saleable value.

Table 1.1: Scenarios and their relevant concepts

Scenario	Relevance of concept
JKB Inc., a retail company, has experienced financial difficulties due to increased competition. Despite the losses, the management believes the company will recover and continue operating. The financial statements are prepared assuming the company will remain a going concern.	The going concern concept assumes the company will continue operating, allowing for the valuation of assets at cost rather than the liquidation value.
A business pays GH¢24,000 for an annual insurance policy.	Under the going concern assumption, the business records this as a prepaid expense and allocates GH¢2,000 to insurance expense each month over the year. Without the going concern assumption, the entire GH¢24,000 would be recorded as an expense immediately.
MY FUTURE SELF CONCEPT, a manufacturing company, plans to expand its operations despite current financial struggles.	Under the going concern concept, the financial statements reflect this expansion, assuming the company's continuation.
A software company receives GH¢250,145 in advance for a one-year subscription service. The company recognises this amount as deferred revenue and gradually recognises it as income over the year.	The going concern concept supports this approach, assuming the company will continue to provide the service throughout the year.

2. Accrual Concept

The accrual concept is a fundamental principle in accounting that prescribes how and when revenues and expenses are recognised in financial statements.

According to this concept, the effects of transactions and events should be recognised when they occur, be recorded in the accounting books and reported in the financial statements in the period in which they relate. In other words, revenues and expenses are recorded when they are earned or incurred, regardless of when the cash is received. This provides a more accurate picture of a company's financial performance and position over a given period.

Table 1.2: Accrual Concept

Aspect of the accrual concept	Example
Interest accrual	A retail business takes out a loan to purchase additional inventory. Although the loan agreement states that interest is payable semi-annually, the company records an interest expense at the end of each month as it accrues. This ensures that the expense is matched with the period in which the loan is used, even if the payment is not due for another few months.

Prepaid expenses	<p>A consulting firm pays for a software subscription that covers the next 12 months.</p> <p>Instead of recording the entire cost as an expense when the payment is made, the firm spreads the expense over each month of the subscription period.</p> <p>This monthly recording reflects the actual usage of the software throughout the year.</p>
Unearned revenue	<p>An event management company receives full payment in advance for organising an event that will take place over the next four months.</p> <p>Initially, this payment is recorded as unearned revenue (a liability).</p> <p>As the company completes stages of the event over the months, it gradually recognises the revenue in its income statement to reflect the work done</p>
Depreciation	<p>A delivery company purchases a van for GH¢50,000, expecting it to be in service for eight years.</p> <p>Instead of recording the entire GH¢50,000 as an expense in the year of purchase, the company spreads the cost across the eight years.</p> <p>This means each year, GH¢6,250 is expensed as depreciation to match the cost with the periods that benefit from using the van</p>
Accrued expenses	<p>A marketing agency uses freelance services in November and December but receives the invoice in January.</p> <p>The expense for these services is recorded in November and December when the work was performed, not when the invoice is received or paid.</p> <p>This way, the financial statements accurately reflect the expenses during the months they were incurred</p>

3. Business Entity Concept

The business entity concept, also known as the separate entity concept, requires that for accounting purposes a business is treated as a separate entity, distinct from its owner(s) and any other business.

This separation guarantees that the financial transactions and records of the business are not mixed with those of the owners or other entities.

Table 1.3: Examples of how this concept can apply to different types of business entity

Type of business entity	Scenario	How the concept is applied
Sole proprietorship	<p>Asante runs a landscaping service where he mows lawns and provides garden maintenance. He has a business bank account where he deposits payments from clients and records expenses for equipment, gas, and supplies.</p>	<p>Asante's personal expenses, such as his car payment or grocery bills, are not included in the business records. The landscaping service's revenues and expenses are treated separately from Asante's personal finances, even though he is the sole owner.</p>

Partnership	Harriet and Josphine opened a coffee shop together. They decided to maintain a joint business account for the shop and record all income from sales, as well as expenses for supplies and rent, separately from their personal finances.	Although Harriet and Josephine are partners and share ownership, the coffee shop's financial records are kept distinct from their personal financial activities, providing clear records for managing the business and dividing profits.
Corporation	ABC Tech Inc. is a technology company that develops software products. It has hundreds of shareholders who have invested in the company. The company maintains financial records that only reflect the company's revenues, expenses, assets and liabilities, without including the personal finances of the shareholders or executives.	Since ABC Tech Inc. is a separate legal entity, its financial records stand alone, ensuring that the company's financial performance is reported accurately and not influenced by any personal financial activity of its shareholders or leadership.
Limited Liability Company (LLC)	Four friends establish an LLC to launch a food truck business. Each member contributes funds to get the business started. The LLC maintains financial records for earnings from food sales and expenses such as ingredients, vehicle maintenance and permits, which are separate from the members' individual finances.	The LLC's financial activities are kept separate from the personal finances of the friends who own it, which ensures that the business finances are accurately tracked and reported.
Non-profit Organisation (NPO)	A community group forms a non-profit organisation to run a local food pantry. They receive grants and donations from individuals and organisations which they use to purchase food and supplies. All transactions are recorded in the organisation's financial records, distinct from the personal finances of any board member or volunteer.	The NPO's financial records are separate from the personal finances of those who run or support the organisation. This ensures that the funds are used responsibly and transparently for the intended charitable purposes.

4. Prudence (Conservatism) Concept

The prudence concept is an accounting principle that requires accountants to be cautious when recording transactions and preparing financial statement. Essentially, it means that expenses and liabilities should be recorded as soon as possible

The use of prudence means that assets and income are not overstated and liabilities and expenses are not understated to give an overly optimistic view of a business's financial position. Equally, the application of the prudence concept does not allow for assets and income to be understated or liabilities and expenses to be overstated.

The main goal of this concept is to give a fair representation of a business's financial position or performance.

Table 1.4: Examples of how the prudence concept might be applied

Scenario	How the concept is applied
<p>A company faces potential fines due to non-compliance with environmental regulations.</p> <p>While the outcome is uncertain, the company estimates that it might need to pay GH¢150,000 if found liable.</p>	<p>The company should record a provision (or liability) for the potential fine of GH¢150,000 in its financial statements to ensure that its financial position is presented with caution, even though the resolution of the case is pending.</p>
<p>A clothing retailer has seasonal inventory worth GH¢80,000, but due to changes in fashion trends, the current market value of the inventory is only GH¢55,000.</p>	<p>In line with the prudence concept, the inventory should be recorded at the lower market value of GH¢55,000.</p> <p>This reflects the potential loss in value and prevents the overstatement of assets.</p>
<p>A service company has GH¢500,000 in accounts receivable.</p> <p>Based on current economic conditions, it estimates that 8% of these receivables may not be collected.</p>	<p>The company should create a provision for doubtful debts of GH¢40,000 ($GH¢500,000 \times 8\%$).</p> <p>This cautious approach ensures that the value of accounts receivable on the balance sheet is realistic and not overstated.</p>
<p>A software development company has a contract to deliver a custom application and has received an initial payment.</p> <p>However, there is significant uncertainty about receiving the remaining payment due to the client's financial difficulties.</p>	<p>The company should only recognise the portion of revenue it has already received or that is certain to be collected.</p> <p>Any doubtful portion should not be recorded as revenue until it becomes more likely that the payment will be received.</p>
<p>A transportation company owns a fleet of buses that are expected to last for 12 years.</p> <p>However, due to higher-than-expected usage and maintenance issues, it appears the buses might only last for 9 years.</p>	<p>The company should revise its depreciation schedule to account for the shorter useful life, leading to higher annual depreciation expenses.</p> <p>This reflects the decreased value of the buses more accurately and prevents future financial statement distortions.</p>
<p>A tech firm owns a 3D printer that was a major asset at the time of purchase.</p> <p>However, due to rapid technological advancements, newer models have made it significantly less valuable in the market.</p>	<p>The company should record the printer at its current market value and recognise an impairment loss.</p> <p>This ensures that the financial statements reflect the reduced value of the asset and present an accurate view of the company's financial status</p>

Activity 1.1 Accounting Concepts and Conventions

Take part in a discussion with your classmates on the meaning of accounting concepts and conventions.

In your group, refine your definitions to ensure you understand them clearly then record them for reference.

Term	Definition
Accounting concept	
Accounting convention	

Activity 1.2 Identifying Accounting Concepts

In small groups, discuss the following statements and identify the accounting concept to which they refer.

1. The concept which states that the affairs of a business are to be treated as being separate from the private activities of the owner is.....
2. The concept that enables a business to determine the actual profit and loss for a particular period is.....

Activity 1.3 Identifying Concepts and Conventions

The manager of InvestCorp is faced with the following problems. Identify the concepts and conventions that could be applied in each circumstance, justifying your answer.

1. The long-term future success of the company is extremely uncertain.
2. The company is working on a long-term contract and has received a partial payment. The managing director insists no entry should be made till the full amount is received.
3. Although the sales have not yet actually taken place, some reliable customers of the company have placed several large orders that are likely to be extremely profitable.
4. One of the owners of the company has invested his drawings in some stocks and shares.
5. The company purchased a piece of equipment for GH¢2,000 with an expected useful life of 10 years. The head of production department insists that the full amount be expensed in the year of purchase.

6. The company has issued shares to multiple shareholders and keeps its financial records completely separate from the personal financial records of its shareholders and executives.
7. The business pays for a one-year insurance policy in advance. “The expense should be recorded at once and not monthly,” says the Estate Officer.
8. The company purchases a patent for GH¢50,000, which has a legal life of 20 years.
9. Make a poster presentation of your work to the class.

TYPES OF ACCOUNTING CONCEPTS AND CONVENTIONS

As we have learnt earlier, there are ten accounting concepts and conventions. We have taken a look at four of these concepts in our previous lessons. Let us now take a look at the other six which are listed below.

1. Consistency Concepts
2. Dual Aspect Concept
3. Money Measurement Concept
4. Full Disclosure Concepts
5. Accounting Period Concept
6. Realisation Concept

Each of the ten concepts has been covered in detail within this manual so that you can refer back to this section in your own time to learn more.

1. Consistency concepts

The consistency concept can be defined as the use of the same principles and methodologies from one accounting period to another, or between different business entities within the same period.

Applying this concept makes it easier for users of financial statements and information to make comparisons over time or between entities. This means that the use of the consistency concept support comparability, which is considered to be a key characteristic of financial information.

When changes are necessary, they must be clearly revealed, justified and their effects on financial statements explained to ensure transparency and maintain trust.

Examples explaining the consistency concept include the following listed below.

- a. *KCL Inc. values inventory using the First-In-First-Out (FIFO) method.* They continue using FIFO throughout the accounting period for consistent financial reporting. Using the same accounting methods throughout the year helps to make the financial statements comparable.

If the company changes to the Weighted Average Cost method, it must disclose the change, provide justification and show the financial effect on previous periods for comparability.

- b. Alliance Ltd uses the *straight-line depreciation method* for all assets. The depreciation method is consistent for accurate financial statement preparation.
- c. *CSU Software recognises revenue from software sales when the product is delivered to the customer.* CSU Software continues to recognise revenue upon delivery year after year. Stakeholders can rely on the revenue figures being recognised in a consistent manner, facilitating better comparison and analysis.

If CSU Software starts recognising revenue based on a subscription model, where revenue is recognised over the period of the subscription, the change must be disclosed, and its impact explained.

2. Dual Aspect Concept

The dual aspect concept, also known as the duality principle or double entry accounting, is a fundamental concept in accounting that forms the basis for recording financial transactions.

This concept simply requires that every transaction has two effects or aspects - every debit entry should have a corresponding credit entry, and every credit entry should have a corresponding debit entry. It is the basis of the double entry system of bookkeeping.

By following the dual aspect concept, businesses can produce reliable financial statements that reflect true financial position and performance, for informed decision-making, and enhance transparency and accountability.

Table 1.5: Examples of Dual Aspect Concept

Type of transaction	Scenario	Application of dual aspect concept		
		Debit	Credit	Explanation
Purchase of inventory	A company purchases inventory for GH¢17,800 with cheque.	Inventory GH¢17,800 (Increase in Inventory - Asset).	Bank GH¢17,800 (Decrease in Cash at bank - Asset)	This transaction adheres to the dual aspect concept by recording the increase in inventory (an asset) as a debit, reflecting the company's acquisition of goods. Simultaneously, the decrease in cash at bank (another asset) is credited, indicating the use of bank to make the purchase.
Obtaining a loan	A company obtains a loan of GH¢550,000 from a GCB Plc Bank.	Cash GH¢50,000 (Increase in Cash - Asset).	Loan Payable GH¢50,000 (Increase in Loan Payable - liability).	The dual aspect concept is applied here by recording the increase in cash (an asset) with a debit, representing the receipt of funds from the loan. An increase in loan payable (a liability) is credited, indicating the company's obligation to repay the borrowed amount.

Payment of salaries	A company pays its employees GH¢19,567 cash for January salaries.	Salaries Expense GH¢19,567 (Increase in Salaries Expense).	Cash GH¢19,567 (Decrease in Cash - Asset).	<p>This transaction represents the dual aspect concept by recording the decrease in Cash (an asset) with a credit, reflecting the outflow of funds to pay salaries.</p> <p>An increase in Salaries Expense (an expense account, part of equity) is debited, recognising the cost incurred by the company for the services provided by its employees.</p>
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3. Money Measurement Concept

The money measurement concept, also known as the monetary unit assumption, is a fundamental principle in accounting that states that all financial transactions should be recorded and reported in monetary terms.

This concept is essential for ensuring that financial reporting remains objective, reliable and comparable. By focusing on transactions and events that can be expressed in monetary terms, companies provide stakeholders with clear, accurate and verifiable financial information necessary for decision-making and analysis.

Financial accounting should record only transactions which can be measured in monetary terms. It should be noted that there are also factors (such as loyalty of employees, competence of management, competitiveness of product and customer services) which influence decision making or may have a bearing on judgements of success or worth of an organisation

Table 1.6: Examples of money measurement concept

Scenario	How the concept is applied
A software development company spends significant resources on research and development (R&D) to develop a new software product. However, the company cannot capitalise these R&D costs on its balance sheet under the money measurement concept because R&D expenditures are considered non-monetary items. Only when the software is completed and ready for sale and its development costs can be reliably measured, can those costs be capitalised as an intangible asset.	The money measurement concept prevents the inclusion of R&D expenditures directly in the financial statements until a specific monetary value can be assigned to the completed software product. This illustrates how the concept ensures that financial statements focus on objective and measurable monetary items, thereby maintaining the reliability and comparability of financial information.
The following items are recorded in the book of accounts for a company: Sale of goods worth GH¢12,300, Purchase of raw materials GH¢45,000,	The goods which are recorded are listed in the book of accounts because they have a monetary value.

Rent paid GH¢13,900. The success of the business is also affected by the following factors which are not recorded in the book of accounts:

sincerity

loyalty

honesty of employees

Whilst qualitative factors such as customer loyalty may impact the profit or loss of a business entity they are not recorded in the book of accounts as they do not have a direct monetary value.

4. Full Disclosure Concepts

The concept of full disclosure states that all material information relevant to the financial statements of a business entity should be disclosed in the financial statements or their accompanying notes. This principle is crucial for transparency and ensuring that the users of financial statements have access to all relevant information to make informed decisions.

This concept enhances transparency, reduces the risk of discrepancies in the information presented to management and external users, as well as promoting trust in the integrity of financial reporting.

Examples of how a business entity might apply the full disclosure concept.

- a. Companies include notes on financial statements explaining accounting policies.
- b. If a company is involved in pending litigation, it must disclose details such as the nature of the claim, potential financial impact and the company's assessment of the likelihood of an unfavourable outcome.
- c. For financial instruments and other assets and liabilities measured at fair value, companies disclose the methods and assumptions used to determine fair values. This ensures transparency regarding the valuation process and the reliability of reported fair values.
- d. Companies disclose significant events that occur after the balance sheet date but before the financial statements are issued, or available to be issued. This could include the acquisition of another company, the sale of a major asset, or a significant change in financial position.
- e. Detailed information about employee benefit plans, such as pension plans and stock-based compensation, is disclosed. This includes the nature of the plans, obligations and costs incurred by the company.

5. Accounting Period Concept

The accounting period concept, also known as the accounting time period principle or the periodicity concept, explains that the economic activities of a business can be divided into specific and regular time periods for the purpose of financial reporting.

This concept assumes that the life of a business is divided into parts. It may be of one year, six months, three months, one month, etc. But usually one year is taken as one accounting period - which may be a calendar year or a financial year.

All the transactions are recorded in the books of accounts on the assumption that profits on these transactions relate to a specified period. Therefore, this concept requires that a

balance sheet and profit and loss account should be prepared at regular intervals.

The accounting period concept is crucial for ensuring that financial reporting is systematic, consistent and comparable over time, thereby enhancing transparency and aiding decision-making for both internal and external users of financial information.

Table 1.7: Examples of how the accounting period concept may be applied

Accounting period	Example
Annually	<p>Most companies prepare annual financial statements that cover a 12-month period, typically from January 1st to December 31st (Some may have different date – for example 1st April – 31st March).</p> <p>These statements include the income statement, balance sheet and cash flow statement, providing a comprehensive view of the company's financial performance and position over the year.</p>
Quarterly	<p>Publicly traded companies often release quarterly financial reports in addition to their annual reports.</p> <p>Each quarter covers a three-month period e.g. 1st October – 31st December; 1st January – 31st March; 1st April-30th June; 1st July – 30th September.</p>
Monthly	<p>To compare and analysis month-on-month performance and positing of businesses, some businesses prepare monthly financial statements for decision making.</p> <p>Financial statements can be prepared for 1st January to 31st January; 1st February – 28th February etc.</p>

In addition to annual and quarterly reports, businesses may issue interim financial statements covering shorter periods, such as a specific month or a period of a few weeks. These reports provide snapshots of financial performance and are often used for internal management purposes or to meet specific regulatory requirements.

The accounting period concept also applies to budgeting and forecasting. Businesses create budgets for specific periods (e.g., quarterly or annually) to plan and allocate resources effectively. Actual financial results for these periods are then compared with the budgeted figures to assess performance and make adjustments as needed.

6. Realisation Concept

The realisation concept, also known as revenue recognition principle, states that revenue from any business transaction should be included in the accounting records only when it is earned, or realised. In other words, a transaction is recorded at the point when goods or services have been delivered rather than when payment is received. This principle involves realising revenue, or recognising it as deserved, and recording it only when the business officially completes the earning process rather than when they actually receive the payment.

Table 1.8: Examples of Realisation Concepts

Scenario	How this concept is applied
<p>Prime Mart received an order to supply gold ornaments worth GH¢50,000.</p> <p>They supplied ornaments worth GH¢35,000 up to the year ending 31st December 2016 and rest of the ornaments were supplied in January 2017.</p>	<p>The revenue for the year 2016 is recorded as GH¢35,000.</p> <p>The fact that the business received an order is not considered as revenue as the goods have not been delivered within this accounting period.</p>
<p>Future Self sold goods for GH¢130,500 for cash in 2021.</p> <p>The goods were delivered during the same year.</p>	<p>The revenue for year 2021 is recorded as GH¢130,500 as the goods were delivered in the same year.</p>
<p>HomeZone sold goods on credit for GH¢27,900 during the year ending 31st December 2019.</p> <p>The goods were delivered in 2019 but the payment was received in June 2020.</p>	<p>HomeZone's revenue for the year 2019 is GH¢27,900, because the goods have been delivered to the customer in this accounting period.</p> <p>Revenue became due in the year 2019 itself and revenue is realised when the goods are delivered to the customers.</p>

Activity 1.4 Discussion on accounting concepts

Your teacher may invite a presenter into class to lead a discussion on accounting concepts.

- List three questions you would like to ask an expert below:

a.		
b.		
c.		

- Working in small groups, discuss the examples that were covered in the presentation. Consider:
 - If you are all clear on the meaning of each concept
 - A situation in which each concept would be applied
 - How each concept is used in the preparation of financial statements
 - Are there advantages or disadvantages to each of these concepts?

Write a short report summarising your discussion and present this to the wider class.

Activity 1.5 Identifying the Accounting Concepts and Conventions that underly them

1. In small groups, discuss the following scenarios and identify the accounting concept and convention that underlies each one.

Scenario	Accounting concept
A manufacturing company, has been using the straight-line method to depreciate its machinery for the past five years.	
A newspaper company sells an annual subscription. On January 1st, a customer subscribes to the newspaper for a year and pays GH¢560 upfront.	
NovaTech Software recognises revenue from software sales when the product is delivered to the customer	
Purchase of Inventory with Cash Transaction - a company purchases inventory for GH¢5,000 in cash	
MedPro disclose their policies for managing financial risks, such as interest rate risk, foreign exchange risk and credit risk	
Trendy Furnics (TF) sells a dining table. On June 15th, TF delivers the dining table to a customer. The customer agrees to pay for the table in 30 days.	
A company pays its employees GH¢8,000 in salaries for the month.	
The managing director wants to include the loyalty and honesty of employees in the financial statements	
A company discloses a significant environmental liability, such as clean-up costs or compliance costs related to environmental regulations to the notes accompanying their financial statement.	

2. Write down the key points of your discussion and share your responses with another group for feedback.

Activity 1.6 Self- Assessment

Discuss three examples of accounting concepts and how they could be applied.

ADVANTAGES OF ACCOUNTING CONCEPTS AND CONVENTION

You will look at the reasons why each of the accounting concepts you have studied in the previous week are used by businesses.

You should note that in your lessons there will not be enough time to be able to cover each of these concepts in depth.

You will work through a selection of examples in class, but you may also be assigned particular concepts to learn about as homework. As a minimum you will be assigned work on the following concepts:

1. Going concern
2. Accrual
3. Business entity
4. Prudence
5. Consistency

Each of the ten concepts has been covered in detail within this manual so that you can refer back to this section in your own time to learn more.

Table 1.9: Advantages of Accounting Concepts and Conventions

Concept or convention	Advantages of its use
Going concern concept	Accurate Asset Valuation: This concept assumes that a business will keep running in the foreseeable future. hence assets are valued based on their use in ongoing operations, not as if they were sold off. For example, machinery is valued based on its long-term use in helping to generate wealth rather than its sale value, which allows for a steady valuation based on its lifespan and usage. That is why such fixed assets are recorded at historical cost minus accumulated depreciation.
	Consistent Financial Reporting: By assuming the business will continue, financial statements are prepared in a stable and consistent way, allowing stakeholders to look at financial performance over time and make reliable comparisons.
	Operational Continuity: This assumption allows businesses to keep operating normally, fulfilling commitments to customers, suppliers and partners as well as maintain ongoing relationships.
	Legal and Regulatory Compliance: Many accounting rules, like Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), are based on the going concern concept. Businesses are expected to use this assumption unless there are clear plans to close down thereby ensuring that their financial statements meet standard requirements.
	Employee Stability: The going concern concept helps employees feel secure in their jobs as it suggests the business intends to keep operating and supporting its workforce in the long term.

Concept or convention	Advantages of its use
Accrual concept	Matches Revenues and Expenses: Accrual accounting records revenues when they are earned and expenses when they are incurred, not necessarily when cash changes hands. This method matches income and related expenses to give a true picture of profits in a particular period.
	Better Long-Term Planning: Recognising revenues and expenses when they happen (rather than when cash is exchanged) helps in making forecasts and long-term plans. Through long term planning, businesses can better estimate future revenues and expenses.
	Reflects Economic Reality: Accrual accounting shows the true economic activities of a business, rather than just when cash is received or paid. This gives a more accurate snapshot of the company's financial status.
	Facilitates Smooth Tax Planning: By matching revenues and expenses with the appropriate time period, businesses can estimate tax liabilities more accurately, making tax planning easier.
	Better Management Decisions: Accurate financial information from accrual accounting allows management to make informed decisions on resource allocation, pricing and financial management.
Concept or convention	Advantages of its use
Business entity concept	Legal Protection: This concept treats the business as separate from its owners, meaning owners' personal assets are protected from business debts and liabilities. This is essential for limiting personal risks.
	Clear Financial Reporting: By separating business and personal transactions, financial reports are clearer and only reflect business activities. This enhances the trustworthiness of financial statements for investors, creditors and regulators.
	Enhances Accountability: Treating the business as a separate entity encourages management to act responsibly and in the best interest of the business. This makes it easier to assess the performance of the business on its own against established standards.
	Supports Growth and Expansion: As the business grows, the entity concept allows businesses to treat each added unit or part as a separate entity. This helps to make accounting simpler as well as maintain clarity across the organisation.
Prudence concept	Risk Mitigation: The prudence concept encourages caution by recognising potential losses or liabilities early. This gives a more conservative view of the financial position of a business and helps to provide a better picture to stakeholders about the possible risk and liabilities they face.

Prudence concept	Enhanced Credibility: Conservative financial statements are generally preferred by investors and creditors as they reflect potential liabilities and avoid overstating profits thereby helping to build trust.
	Better Decision-Making: By using conservative estimates under the prudence concept, management can make informed decisions with a realistic view of the business's position, especially under uncertainty.
	Legal and Tax Compliance: Using the prudence concept helps businesses to follow regulations by accurately reporting the financial performance and status of the organisation which reduces the chances of disputes or penalties due to wrong financial reporting.
Concept or convention	Advantages of its use
Consistency concept	Comparability: Using consistent accounting methods allows stakeholders to compare financial results over time. This makes it easier for investors, creditors and financial analyst to effectively spot trends and assess the financial stability of a business in order to make informed decisions.
	Reliability: Consistent application of accounting standards makes financial data more reliable by reducing the chances of distortion from changing policies and methods. The preparation of reliable financial statements and accurate reporting based on the consistent adherence to accounting standard helps to builds trust among stakeholders.
	Transparency: The consistency concept promotes transparency in financial reporting by ensuring that accounting practices are predictable and understandable. Stakeholders can have confidence that the financial information provided is consistent and reflects ongoing operations and financial performance accurately.
	Facilitates Auditing: Auditors rely on consistency to verify the accuracy of statements. Consistent practices make it easier for auditors to check records against standards and regulations in order to provide assurance on the accuracy of financial statements.
	Legal and Regulatory Compliance: Many accounting standards and regulations require the consistent application of accounting policies. Adhering to these standards ensures compliance with legal requirements and regulatory guidelines. Consistency helps businesses avoid penalties, fines, or legal disputes related to inconsistent financial reporting.
	Predictability for Management: Consistency in accounting methods provides predictability for management in financial planning and decision-making. Management can rely on consistent financial data to analyse performance, allocate resources and develop strategies for growth and profitability.

Concept or convention	Advantages of its use
Dual aspect concept	Accuracy and Error Detection: The dual aspect concept is key to keeping accurate financial records. Under this concept every transaction is recorded in two parts: a debit and a credit. This ensures that if the accounts do not balance (that is debits don't match credits), it signals an error that must be fixed. This balancing system helps to prevent mistakes before preparing financial statements.
	Complete Record of Transactions: Double-entry bookkeeping, following the dual aspect concept, keeps a full record of each transaction. It shows where funds come from (credit) and where they go (debit), making it easier to trace each transaction and maintain transparent records.
	Financial Statement Preparation: The dual aspect concept ensures that financial statements accurately represent the financial status of the business. By keeping the accounting equation balanced ($\text{Assets} = \text{Liabilities} + \text{Equity}$), it allows for the reliable preparation of the balance sheet, income statement and cash flow statement.
	Legal and Regulatory Compliance: Many laws require double-entry bookkeeping and the dual aspect concept to make sure financial statements are accurate and meet regulatory standards. This helps to avoid legal issues.
	Enhanced Accountability: By recording every transaction transparently, the dual aspect concept discourages fraud and mismanagement. This accountability is important for maintaining trust with investors, creditors and regulators.

Concept or convention	Advantages of its use
Money measurement concept	Objectivity: The money measurement concept focuses only on transactions that can be expressed in monetary terms. This makes financial reports more objective and reduces personal bias in financial reporting.
	Clarity and Simplicity: By recording items that can be valued in money only, financial statements become clearer and easier to understand. Monetary terms provide a standard measure, which helps stakeholders, like investors to easily compare financial data.
	Efficiency in Audit and Review: Auditors find it easier to check the accuracy of financial reports when all transactions are in monetary terms. They can quickly verify if amounts match and meet accounting standards. This increases the credibility of accounting reports.
	Effective Resource Allocation: By measuring financial activities in monetary terms, managers can better understand the financial impact of each activity and allocate resources more effectively to improve performance.

Disclosure concept	Transparency: Full disclosure in financial reports ensures that all important information about the company's financial health and methods used in reporting is available to stakeholders. This level of openness is essential for making informed decisions.
	Enhanced Decision-Making: Investors, creditors and others can make better choices when financial statements include all necessary information. Comprehensive disclosures help assess risks, uncertainties and the overall impact of significant events on the company's finances.
	Compliance with Accounting Standards: Accounting standards like GAAP and IFRS require businesses to disclose certain information in their financial statements. Following these standards ensures consistency and comparability in reporting.
	Credibility and Accountability: Full disclosure builds trust and demonstrates a commitment to ethical financial practices. It shows stakeholders, including investors, employees and the community that the business values transparency.

Concept or convention	Advantages of its use
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Accounting period or periodicity concept	Regular Reporting: Dividing the financial year into shorter periods (like months, quarters or years) allows for regular updates of financial information. This enables investors, managers and other stakeholders to make timely decisions based on the latest financial data.
	Performance Evaluation: By reviewing results from specific periods, businesses can track profits, expenses and cash flows to identify trends and make necessary changes to improve performance.
	Budgeting and Planning: Breaking the financial year into periods helps in setting realistic financial goals, budgeting resources effectively and monitoring progress.
	Compliance and Accountability: Dividing the finances of a business into accounting periods ensures that businesses meet legal and regulatory reporting requirements. It holds management accountable for providing regular, accurate financial reports.
	Comparison and Analysis: Consistent accounting periods allow stakeholders to compare data over time to evaluate growth, identify performance trends and see if the company is meeting industry standards.

Concept or convention	Advantages of its use
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Realisation concept	Accurate Matching of Revenue and Expenses: The realisation concept states that revenue should be recorded when it is earned not just when cash is received. This helps to match income with the costs of generating it. This helps to give a clearer view of profits for a particular period.
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Realisation concept	Consistency and Comparability: By setting rules for when to recognise revenue, the realisation concept allows for consistency in financial reporting. This helps stakeholders compare financial results across periods which enables them to make informed decisions.
	Transparency and Disclosure: Using the realisation concept ensures that companies clearly state the criteria for recognising revenue. This helps stakeholders to understand the methods behind revenue figures.
	Compliance with Accounting Standards: Rules like GAAP and IFRS require businesses to follow the realisation concept for revenue recognition. This enhances credibility and ensures that financial statements meet accepted standards.
	Better Decision-Making: Accurate revenue recognition gives investors, creditors and management reliable data to assess the company's profitability and make better investment or business decisions.

Activity 1.7 Group Discussion

- In small groups, study the scenario below and discuss the questions that follow.
MedPro has unsold stock at the end of year. The cost price is GH¢12,000 and its market price is GH¢15,500.
 - At which price should the unsold stock be recorded?
 - Which accounting concept explains this treatment?
 - What is the benefit of this concept to the business and its' stakeholders?
 - What would your decision be if the cost price was GH¢13,400?
- Type/write your responses and present it to your class for discussion and feedback.

Activity 1.8 Accounting Concepts

Your teacher will assign you or select a particular accounting concept to study in your groups.

- Write a summary on the concept focusing on;
 - The purpose of your assigned concept
 - Its advantages
 - A scenario when it would be applied
- Share your work with other groups in the class for feedback.

Activity 1.9 Self- Assessment

Discuss the advantages of any three types of accounting conventions and concepts.

LIMITATIONS OF ACCOUNTING CONCEPTS AND CONVENTIONS

We have learnt about accounting concepts and conventions and how they guide the preparation and presentation of financial statements. These principles help ensure consistency, comparability, and reliability in accounting information. However, it is important to understand that these concepts and conventions also have limitations. In this lesson, you will explore some of the weaknesses or challenges associated with using accounting concepts and conventions in real-life financial reporting.

Table 1.10: Limitations of Accounting Concepts

Concept or convention	Limitations of its use
Going concern concept	Uncertain Future Viability: The going concern idea assumes that a business will continue to operate into the future. However, if there are serious risks, like a financial crisis, sudden economic changes or unexpected events (such as a pandemic), the business might struggle to stay profitable. This could make the assumption unreliable.
	Lack of Predictive Accuracy: The going concern concept is only a basic assumption that helps prepare financial statements, but it does not guarantee the future of the business. Even if the business seems stable now, it might still face unexpected financial troubles or close suddenly.
	Limited Use in Certain Industries: Some industries are more likely to face business closures due to factors like changing technology, tight competition or new regulations. Startups and businesses in fast-changing sectors, for example, often have a higher risk of not lasting.
	Reliance on Management's Opinion: The going concern concept depends on management's judgment about the company's future. If they are overly optimistic, they may misjudge the company's prospects, which could lead to inaccurate financial reporting.
Accrual concept	Complexity and Subjectivity: Accrual accounting is complex because it involves estimating when earnings or expenses happen, even if cash is not exchanged right away. Different people might have different views on when to recognise revenue or expenses. This adds subjectivity to financial statements
	Difference Between Profit and Cash Flow: Accrual accounting might show a profit, even if no cash is available. This can make it hard to understand the real cash situation because revenue is recorded when earned (not necessarily received) and expenses are recorded when incurred (not necessarily paid).

Accrual concept	Risk of Manipulation: Accrual accounting allows flexibility in timing revenue and expense recognition which can be manipulated. For example, companies might record income earlier or delay expenses to show higher profits temporarily. This can mislead investors.
	Harder to Interpret: People who are not familiar with accrual accounting might find it challenging to understand financial statements. The assumptions and estimates involved in this method can make statements confusing for some stakeholders like investors or creditors.
Business entity concept	Difficulties for Small Businesses: For small business owners, like sole proprietors or partnerships, it can be hard to separate personal and business finances. The entity concept requires separate records which can be tough to maintain for small businesses and might not reflect the true way the business operates.
	Challenges with Intercompany Transactions: If one parent company controls multiple entities, each must keep its own accounting records. This can make it hard to see the financial position of the entire group clearly.
	Complex Organisational Structures: Large organisations, like those with many subsidiaries, can find it difficult to apply with the entity concept accurately. This approach might not fully reflect the close financial relationships between parts of the business and financial transactions within the subsidiaries
	Risk of Misrepresentation: For businesses with many related-party transactions or close links, separate accounting might not capture the full economic reality. This will potentially lead to a misunderstood or misrepresented view of the financial health of the business
Prudence concept	Subjectivity in Decision-Making: The prudence concept relies on management's judgment to recognise potential risks. This can lead to differences in financial reports since different people might apply conservatism differently.
	Risk of Understating Value: Using prudence sometimes leads to undervaluing assets or income in the financial statements which could make the business seem weaker than it is. This might give stakeholders an overly cautious impression.
	Influence on Decision-Making: If management is too conservative, they might avoid investments that could benefit the company in the long run. This cautious approach might prevent the company from growing or staying competitive
	Increased Complexity: Prudence adds complexity to financial reports because it requires careful consideration of potential losses or risks. This complexity can make it hard to strike a balance between being conservative and being clear about the company's true position.
Consistency concept	Limits on Flexibility: The consistency principle requires the same accounting methods over time which can make it hard for companies to adapt to changes. For example, in fast-changing industries, this might prevent a company from updating its accounting methods to reflect new realities.
	Outdated Policies: Accounting methods that were appropriate before might become less relevant over time. However, the consistency concept encourages sticking with the same policies which could result in financial reports that do not accurately represent the current situation.

<p>Consistency concept</p>	<p>Difficulty in Comparing Companies: Consistency helps with comparing a company’s own reports over time, but it can make comparing different companies harder. For example, if different companies use different accounting methods for similar transactions or economic events, it might be challenging for investors to analyse the financial health of the business accurately.</p> <p>Complexity in Interpretation: The consistency concept requires detailed documentation of accounting policies. However, the complexity of these policies can make them difficult to understand. This complexity can make it harder for stakeholders to interpret financial statements accurately.</p> <p>Less Flexibility in Special Situations: Some unique transactions may require special accounting treatment to truly reflect their nature, but consistency can limit the ability to handle these exceptional cases appropriately and, as a result, lead to a distorted financial view.</p>
<p>Dual aspect concept</p>	<p>Complexity in Understanding: The dual aspect concept is based on the idea that every transaction affects two accounts (debit and credit). This requires a solid grasp of accounting principles, especially how different transactions impact various accounts. For beginners, understanding these rules can be confusing and hard to learn.</p> <p>Dependence on Accurate Recording: To ensure accurate financial reports, every transaction must be recorded correctly. Mistakes in recording transactions can lead to imbalances in accounts which can make the financial statements inaccurate and unreliable.</p> <p>Assumptions Application Challenges: The dual aspect concept assumes every transaction has two clear parts: a debit and a credit. However, some complex transactions or unique business models may not fit neatly into this system. This sometimes makes it difficult to apply this concept accurately.</p> <p>Challenges in Reflecting Economic Reality: While the dual aspect concept balances the accounting equation, it may not show the true economic reality of complex transactions. Certain financial items, such as complex contracts or off-balance sheet items, may not be accurately represented under this concept.</p>
<p>Money measurement concept</p>	<p>Exclusion of Non-Monetary Factors: This concept only considers factors that can be measured in money. Important non-financial factors like employee satisfaction, customer loyalty and intellectual property, which can greatly affect the performance of a company, are ignored because they cannot be easily measured in monetary terms.</p> <p>Inability to Capture Inflation and Currency Changes: Since financial statements often use historical costs (the original purchase price), changes in currency value or inflation can distort the values of assets and liabilities over time. This may lead to assets appearing undervalued or overvalued in financial statements.</p> <p>Subjectivity in Valuation: The concept relies on historical costs for assets and liabilities. However, in a fast-changing market, these costs might not reflect current values due to the quick changes in the value of assets. This makes it harder for investors to assess the true economic worth of a company’s assets.</p>

<p>Money measurement concept</p>	<p>Comparability Issues: Different companies may use various methods to value their assets which can make comparing financial statements difficult. This can be challenging for investors who want to compare the performance and financial status of different companies.</p> <p>Limited Disclosure of Intangible Assets: Intangible assets like brand value, goodwill and intellectual property are often not adequately valued. As a result, financial statements may not fully reflect the company's total worth or potential for growth.</p> <p>Difficulty in Adjusting to Economic Changes: Rapid economic changes, like new technologies or regulatory updates, can affect the real value of a company's assets. Updating financial statements to reflect these changes can be difficult and may introduce inconsistencies in financial reporting and decision making.</p>
<p>Concept or convention</p>	<p>Limitations of its use</p>
<p>Full disclosure concept</p>	<p>Subjective Materiality Judgments: Deciding what information is “material” (important enough to disclose) can be subjective. Different companies may have different standards for materiality, which can lead to inconsistencies in what they disclose in their financial reports.</p> <p>Information Overload: Full disclosure often means including a lot of information in financial reports. This can overwhelm readers and make it difficult for them to find the most relevant details needed for informed decisions.</p> <p>Concerns about Competitive Information: Some companies may hesitate to disclose information that could harm their competitive edge, like strategic plans or pricing details. This can result in less transparency for stakeholders.</p> <p>Complexity in Interpretation: Detailed disclosures can make financial statements harder to interpret, especially for readers without accounting expertise. Understanding the full impact of the information disclosed may require specialised financial or industry knowledge.</p>
<p>Accounting period or periodicity concept</p>	<p>Problems of Timing Transactions: This concept divides a business's life into specific periods (e.g., months, quarters or years). But not all transactions fit neatly into these periods, which can make it difficult to match revenues and expenses accurately.</p> <p>Challenges with Seasonal Businesses: Companies with seasonal or cyclical patterns may struggle to show accurate financial results for a single period. This can lead to misleading comparisons of financial statements between different periods, which will eventually impact decision-making.</p> <p>External Event Impacts: Unexpected events like natural disasters or economic downturns can greatly impact a business within a specific period. The accounting period concept may not capture these impacts accurately, which will affect the reliability of the financial report</p> <p>Misleading Trends Analysis: Breaking financial data into fixed periods may make it hard to spot long-term trends. Short-term fluctuations or one-time events can lead to misunderstandings if viewed without considering the broader context.</p> <p>Comparability Concerns: Different companies may have different accounting periods or reporting frequencies. This makes it harder to compare financial performance directly across businesses.</p>

Concept or convention	Limitations of its use
Realisation concept	Subjectivity in Recognising Revenue: The realisation concept involves deciding when revenue is “earned” and can be recorded. For transactions with complex arrangements or long-term contracts, it can be hard to determine the exact point at which revenue should be recognised, leading to variations in practices
	Differences in Timing: Revenue is recorded when it is earned, not when cash is received. This timing difference can affect cash flow analysis as it may not show a company’s actual liquidity situation.
	Challenges with Uncertain Outcomes: Uncertainty about whether a customer will pay or if revenue-generating activities will be completed may delay revenue recognition. This impacts the reliability of financial information.
	Handling Complex Transactions: Barter deals, non-monetary exchanges or transactions that span multiple periods can be difficult to account for under the realisation concept. This complexity can lead to inconsistent practices in revenue recognition.
	Industry-Specific Issues: Certain industries, like software, construction or long-term service contracts, may require special guidelines for revenue recognition because of the unique nature of their activities. Without such guidelines, revenue recognition may vary widely among companies in these fields.

Activity 1.10 Research on implications of the limitations of accounting concepts

Research the implications of at least two limitations of the following concepts and conventions on a business.

1. Consistency concept
2. Dual aspect concept
3. Money measurement concept
4. Full disclosure concept
5. Accounting period
6. Realisation concept

Write down your research findings and compare them with a classmate for feedback.

Activity 1.11 Limitations of Accounting Concepts

The case study highlights the limitations of at least one of the accounting concepts covered in this section.

Case Study: Nyarko Enterprise's Accounting Dilemma

Nyarko Enterprise is a family-owned stationery supply business located in Cape Coast. The company has been operating for over 10 years. Recently, it has faced serious financial challenges, including rising costs, unpaid customer invoices, and the death of the company's founder.

Despite these challenges, the accountant prepared the financial statements for the year ended 31st December 2024, assuming that the business would continue operating as usual. No notes were included to explain the company's financial struggles or any doubts about its future.

The accountant also included income from a large government school contract that had not yet been paid, even though the payment had been delayed for over six months.

Meanwhile, the new owner used company money to pay for personal expenses like rent and school fees, but these were not recorded as personal drawings in the books.

Lastly, important aspects such as the company's good reputation in the community and loyalty from long-time employees were not included anywhere in the financial statements, although they contribute significantly to the business's value.

1. Carefully review all of the information you have been given and consider the following questions:
 - a. Which accounting concept was the organisation applying?
 - b. Summarise the key points in the case study.
 - c. What were the limitations of the accounting concept/s used in this scenario? What were the implications for the business?
 - d. How did this affect the preparation of financial statements, and what was the impact on the business?
2. Prepare a short presentation to share with your class for discussion and feedback.

EXTENDED READING

- "Accounting Principles" by Jerry J. Weygandt, Paul D. Kimmel and Donald E. Kieso
- Any approved financial accounting book by NaCCA can be used as a further reading material.
- "Financial Accounting Theory" by William R. Scott
- "The Importance of Accounting Standards" - Journal of Accounting and Economics

REVIEW QUESTIONS

1. Which concept assumes a company will continue operating?
2. Explain the money measurement concept.
3. What is the consistency concept?
4. Discuss the significance of the going concern concept in preparation of financial statements.
5. MedPro Ltd has uncertain revenue recognition due to potential customer disputes or returns. Explain how the prudence concept should be applied.
6. EriAsa Corp. prepares annual financial statements. Discuss the importance of the accounting period concept in the preparation of their financial statements.
7. Discuss the implications of the (two) limitations of the accrual concept.

SECTION

2

CORRECTION OF ERRORS, BANK RECONCILIATION STATEMENT AND CONTROL ACCOUNTS



FINANCIAL ACCOUNTING AND DATA ANALYSIS

INTRODUCTION

Welcome to Section Two of Financial Accounting. In this section, we will explore both practical applications and theoretical concepts related to key areas in financial data analysis. To start, we will focus on identifying and correcting accounting errors, examining their impact on trial balances and financial statements and learning how to make accurate entries in the journal and ledger. Next, we will dive into bank reconciliation statements, exploring why discrepancies occur between the cashbook and bank statements and then proceed to create our own reconciliation statements to resolve these differences. Additionally, we will learn about control accounts—their purpose and how to make entries in the receivables and payables control accounts. By the end of this section, you will be able to identify, correct, and interpret accounting errors, as well as prepare accurate reconciliation and control accounts, which are essential for precise financial reporting.

KEY IDEAS

- **Accounting errors** are mistakes in financial accounting that result from the misapplication of accounting principles and methods.
- **Bank reconciliation statement** is a statement, or a report prepared by a business at the end of the month or period to show any differences arising between the bank statement balance and the cashbook (bank column) balance at that date
- **Bank statement** shows the list of debit and credit transactions that have happened in a particular bank account.
- **Control accounts** are a summary account in the general ledger that consolidates (combines) the total balances of several related detailed accounts
- **Payable control account** is an account in which records are kept of all transactions relating to all creditors in total.
- **Receivable control account** is an account in which records are kept of all transactions relating to all debtors in total.

INTRODUCTION TO CORRECTION OF ERRORS

Meaning of Errors

Errors are mistakes in financial accounts which are accidental and may be due to the incorrect application of accounting principles [rules] and methods.

Types of Errors

There are two types of errors.

1. Errors that do not affect the agreement of the trial balance
2. Errors that affect the agreement of the trial balance

We will look at each of these in more detail.

Errors that do not affect the agreement of the trial balance

These types of errors occur when two or more mistakes in the accounting records cancel each other out, resulting in a trial balance that still agrees.

For example, if an error in one account mistakenly increases a debit and a similar error in another account mistakenly increases a credit by the same amount, the trial balance will still show that debits equal credits.

This situation can be misleading because it creates the impression that the accounts are accurate even though there are underlying mistakes. As a result, these errors can be difficult to detect since they do not affect the overall balance of the accounting ledger, though they can still impact the accuracy of financial statements.

Examples of this type of error are discussed below.

1. Error of omission

An error of omission in accounting happens when a transaction is entirely missed and not recorded in the accounting books. This means that the transaction is left out completely. Such an error can occur due to oversight, carelessness, or not realising that the transaction should be noted.

Errors of omission can have a big impact on financial statements because they make the records incomplete or incorrect.

For instance, if a company forgets to record a payment received or an expense paid, this can lead to an inaccurate picture of the financial health of a business. This could affect decisions made by users of accounting information who rely on the financial statements to understand the true situation of a business.

Example 2.1

A business pays GH¢3,000 for utility expenses but forgets to record the payment in its accounting records.

2. Error of commission

In accounting, this type of error occurs when a transaction is recorded in the wrong account of the same type or class.

In this case, the right amount is sent to the wrong personal account in the same class. What this means is that the transaction is recorded in a different account than where it should be recorded.

Example 2.2

A payment of GH¢2,000 received from Appiah is mistakenly recorded in Ampiah's account.

3. Error of principle

An error of principle in accounting happens when a transaction is recorded in the wrong type of account.

This means that while the correct amount is posted, it is placed in an account that belongs to the wrong class or category of account.

For instance, recording the sale of an asset as revenue would be an error of principle. An error of principle changes the nature of the financial data, which can mislead decision-makers about the financial health and performance of the business.

Example 2.3

The sale of an old equipment worth GH¢50,000 has mistakenly been recorded in the sales account.

4. Error of original entry

An error of original entry happens when a mistake is made when a transaction is recorded in the books of account at the initial stage.

This type of error usually involves entering the wrong amount in the books of original entry, which is then carried over to both the debit and credit sides of the ledger.

Since the mistake affects both sides equally, the trial balance may still match, making the error harder to spot.

Example 2.4

Purchase of office equipment worth GH¢8,000 has been recorded as GH¢800 in the books of account

5. Error of complete reversal of entry

This type of error happens when the correct accounts are used, but the entries are recorded on the wrong side of each account.

In other words, the double-entry for a transaction is reversed, whereby accounts that should be credited are debited and accounts that should be debited are credited.

For instance, if a company receives cash from a customer, the correct entry would be to debit the cash account and credit the customer's account. However, an error of complete reversal of entry would occur if the cash account is credited and the customer's account is debited. Although the trial balance might still balance because the amounts are the same on both sides, the financial records would be incorrect.

Example 2.5

Rent of GH¢5,000 paid by cheque was debited to the bank account and credited to the rent expense account.

6. Error of duplication

This type of error occurs when a transaction is recorded more than once in the accounting records.

In other words, both the debit and credit entries for the same transaction are made twice (or more), causing the total amounts in the accounts to be overstated by the same value.

Let's say an expense item is recorded twice. In such a situation, the debit and credit columns of the trial balance will still match; however, the duplicate entries will lead to the wrong account balances being determined. This will eventually affect financial reporting by making it seem as though the business has spent more, though that is not the case.

Example 2.6

A payment of GH¢3,000 cash is received from a customer. The cash account is debited twice, and the customer's account is credited twice with GH¢3,000.

7. Compensating error

This type of error happens when one or more mistakes on one side of an account are balanced out by errors of the same amount on the opposite side of the same account or a different account.

Essentially, these errors cancel out each other, thereby making the trial balance appear correct even though there are inaccuracies.

Example 2.7

The rent expense account is overstated by GH¢700 on the debit side, and the sales account is also overstated by GH¢700 on the credit side. Clearly, an error on the debit side of one account has been compensated by an error of equal amount on the credit side of another account, so the trial balance will still appear correct.

Activity 2.1 Meaning of Errors

1. In groups, discuss the following
 - a. The meaning of "error" in financial accounting.
 - b. The types of errors that could be made by accountants which do not affect the agreement of the trial balance.
2. Summarise your discussions and make a poster presentation to the larger class.

Activity 2.2 Identification of Errors

1. In groups, brainstorm and write down 10 business transaction scenarios that result in errors that do not affect the agreement of the trial balance.
2. For each transaction, identify the type of error that has occurred in the scenario you have given.
3. Exchange your work with that of another group for feedback.

You can use **Table 2.1** to support your response. An example has been provided for you.

Table 2.1: Identification of Errors

	BUSINESS TRANSACTION	TYPE OF ERROR
	A sale of office furniture for GH¢3,000 was wrongly entered in the sales account.	<i>Error of principle</i>
1		
2		
3		
4		
5		
6		
7		
8		
9		
10		

Errors that affect the agreement of the trial balance

Errors that affect the agreement of the trial balance are mistakes that cause the total amount on the debit and credit columns of the trial balance not to match. These errors disrupt the balance between the two sides of the trial balance, making it obvious that there is an issue that needs correction.

Common types of such errors are discussed below.

1. Single Entry (partial omission)

This error occurs when only one part of a double-entry transaction is recorded, either as a debit or a credit, without the corresponding entry on the other side.

In other words, this error happens when one entry of a transaction is recorded and the other is left out.

For instance, if a purchase is recorded as a debit in the purchases account but no corresponding credit entry is made in the cash or bank account, the trial balance will not agree.

Example 2.8

Purchase of goods from Sakora Ventures for GH¢3,000 was recorded correctly in the purchases account but was not posted to the supplier's account in the purchase ledger.

2. Error of Transposition

This error occurs when the positions or sequence of the figures are changed when recording.

In other words, this occurs when the digits of an amount are accidentally reversed during recording.

Example 2.9

A payment of GH¢462 to a supplier was recorded in the cash account as GH¢426, but was correctly entered in the supplier's account.

It should, however, be noted here that when the same wrong figure is used in both the cash and suppliers accounts, the trial balance totals will agree.

3. Partial Reversal of Entries

This type of error happens when a transaction is posted correctly in one account but mistakenly recorded on the wrong side of the corresponding account (i.e. debit instead of credit or vice versa).

Although the transaction is recorded, the placement on the wrong side alters the intended impact on the financial records.

Example 2.10

A cash payment of GH¢1,200 to a supplier was recorded by debiting the supplier's account and debiting the cash account

4. Error of Casting (under-cast and over-cast)

This error occurs where the amount involved is overstated or understated in one of the accounts.

In other words, this error happens when the figures in one account are added up or stated incorrectly, thereby resulting in an over-cast (overstatement) or under-cast (understatement).

It is important to note that this mistake only affects one account and does not impact the corresponding entry.

Example 2.11

Payment for office rent amounting to GH¢1,200 was recorded in the rent expense account as GH¢12,000.

This is an example of an overcast, where the amount was overstated in the account. On the other hand, if the rent expense had been recorded as **GH¢120**, that would be an undercast where the amount was understated in the account.

5. Other errors may also occur through the addition of the trial balance figures.**Activity 2.3 Identification of errors**

Copy **Table 2.2** into your book.

1. For each of the scenarios, identify the type of error that has occurred from the following list:
 - a. Single entry (Partial omission)
 - b. Error of transposition
 - c. Partial reversal of entries

d. Error of casting

Table 2.2: Types of Accounting Errors

	ACCOUNTING ERROR	TYPE OF ERROR
	An electricity expense of GH¢1,280 is mistakenly recorded as GH¢1,820 in the expense account.	
a	A cheque of GH¢4,600 issued in payment to a supplier is recorded only in the supplier's account	
b	Overcast of a page in the return inwards journal amounting to GH¢ 2,300	
c	A credit sale of GH¢1,000 to a customer has been correctly entered in the sales account but credited to the customer's account	
d	Return inwards for the week amounting to GH¢570 is posted to the personal account only	
e	A rent expense of GH¢ 450 has been correctly entered in the cashbook but debited to the rent expense account as GH¢ 405	
f	The total sales for the month in the sales daybook are incorrectly added up as GH¢50,000	
g	Weekly total of discount allowed of GH¢820 to debtors from the debit side of the cashbook is posted to the credit side of discount allowed account	
h	A credit purchase of GH¢ 5,200 has been correctly entered in the purchases daybook, but credited in the suppliers' account as GH¢ 2,500	
i	A careless addition of the purchases daybook resulted in the total purchases for the month being overstated by GH¢ 750	
j	Goods sold worth GH¢ 3,700 to a debtor have been correctly entered in the sales daybook but not posted to the debtor's account	

2. Share and discuss your answers with a colleague for feedback.

Activity 2.4 Test yourself!

Answer at least one of the following questions to support the review of your learning from this lesson.

1. Explain three types of errors in financial accounting.
2. For each type of error you explained above, discuss one example and its potential impact on financial statements.

EFFECTS OF ERRORS ON THE TRIAL BALANCE AND THE FINANCIAL STATEMENT

Now that you are familiar with the types of errors and their examples, we can move on to discussing how these errors impact the trial balance and the financial statements.

Errors That Do Not Affect the Trial Balance Agreement

Even if the trial balance totals are equal, there can still be errors in the accounts that have important effects on financial reporting. We will now look at how these errors affect the trial balance and financial statements.

Trial Balance

1. **Balanced Trial Balance:** A trial balance can show equal totals on both sides (debits and credits), but there can still be errors in individual accounts.

Examples of these include

- a. **Compensating Errors:** When one mistake cancels out another, such as overstating one expense by GH¢1,000 and understating another by the same amount, resulting in balanced totals.
 - b. **Errors of Omission:** A transaction is completely missed and not recorded at all.
 - c. **Errors of Principle:** Transactions are recorded in the wrong type of account, like recording a repair cost as an asset instead of an expense.
2. **Impact on Individual Accounts:** Even if the trial balance looks correct, specific accounts may be inaccurate due to errors, which will affect the correctness of financial information represented in the trial balance.

For example, errors can lead to the overstatement or understatement of assets, liabilities, revenues, or expenses, though the debit and credit side of the trial balance matches.

This will affect the true financial picture of the company.

Financial Statements

1. **Misstatement of Financial Results:** Errors can lead to misstated financial results in the income statement and balance sheet.
 - a. **Income Statement:** Errors can change the reported net income as incorrect revenue or expense amounts are used to calculate the final profit or loss.
 - b. **Balance Sheet:** Errors can misstate the values of assets, liabilities and equity, which will eventually affect the company's overall financial position.
2. **Decision Making:** Incorrect financial statements can mislead managers, investors and lenders in their decisions when they rely on the inaccurate financial information for assessments and projections.
3. **Audit and Compliance:** Serious errors can lead to audit problems and non-compliance with regulations, which may result in fines or penalties and other legal consequences.

Example of Scenarios

Example 2.12

A company records electricity expenses of GH¢1,500 as GH¢15,000. Even if another mistake balances this out, the total expenses would be overstated and therefore affect the income statement and balance sheet.

Example 2.13

If revenue from a GH¢10,000 sale is not recorded, revenue and net income will be understated, even though the trial balance stays balanced.

NOTE: Errors that do not affect the trial balance totals can still cause significant problems by misrepresenting financial information. Accountants need to identify and fix these errors to ensure that financial statements are accurate and reliable.

Errors That Affect the Trial Balance Agreement

These types of errors not only affect the trial balance by making the total debits and credits unequal, but they also have a significant impact on financial statements.

Trial Balance

1. **Unbalanced Trial Balance:** If the trial balance does not balance (debits do not equal credits), this shows that there are errors that need to be fixed. Common causes include:
 - a. **Mathematical Errors:** When mistakes in adding or subtracting figures in the ledger accounts or preparing the trial balance.
 - b. **Posting Errors:** When amounts are posted incorrectly from the journal to the ledger.
 - c. **Transposition Errors:** When numbers are switched around when recording, which results in disagreement of the totals of the trial balance (e.g., writing GH¢1,250 as GH¢2,150).
2. **Detection of Errors:** When the trial balance does not balance, it alerts accountants to search for and correct the mistakes before preparing the financial statements to ensure accurate financial reporting.

Financial Statements

1. **Misstated Financial Results:** Errors in the trial balance can result in inaccuracies in the financial statements.
 - a. **Income Statement:** Errors can lead to incorrect revenue or expense figures. This will affect the determination of net income as well as profitability analysis and impact on associated decision-making.
 - b. **Balance Sheet:** Assets, liabilities or equity may be misstated. For example, an overstated accounts receivable or understated loans payable can mislead users about the company's financial health.
 - c. **Impact on Ratios and Analysis:** Incorrect data affects financial ratios, leading to faulty analysis of liquidity, profitability, and the overall financial status of a company.

2. **Legal and Regulatory Compliance:** Preparation of incorrect financial statements due to errors can lead to non-compliance with accounting rules, resulting in fines and other legal problems.

Example of Scenarios

Example 2.14

A posting error where a GH¢8,000 rent payment is entered as GH¢80,000 in the rent account. This misstated expense causes the trial balance to be unbalanced, as well as affects the income statement and the balance sheet.

Example 2.15

A transposition error where a sale of GH¢2,300 is recorded as GH¢3,200. This mistake means the trial balance does not agree and leads to an incorrect revenue figure being stated in the income statement, which in turn affects the determination of net income

Activity 2.5 Effect of Accounting Errors

1. Study these scenarios
 - a. An expense of GH¢7,000 is recorded by debiting the cash account and crediting the expense account.
 - b. Purchases of GH¢1,800 are correctly debited in the purchases account but credited as GH¢18,000 in a supplier's account.
 - c. Debiting motor repair expense of GH¢1,200 paid by cheque to the Motor Vehicle account and missing the credit bank account entry.
 - d. A credit purchase of GH¢2,000 is left out of the books entirely.
 - e. Sales of GH¢1,204 are recorded as GH¢2,014 in both the debtor's account and the sales accounts.
 - f. A loan repayment of GH¢15,000 is correctly entered in the bank account but omitted from the loan account.
 - g. Recording only the debit for a payment of GH¢3,000 to a supplier without the corresponding credit to the bank account.
 - h. A payment of GH¢4,000 received from a customer is recorded by debiting the sales account and crediting the cash account.
 - i. Travelling expenses of GH¢500 paid in cash are posted twice as a debit to the travelling expenses account but only once as a credit to the cash account.
 - j. An amount of GH¢3,000 received from Musah is recorded in Mensah's account.
2. For each of the scenarios, indicate "YES" or "NO" to show whether or not it adversely affects the recording of revenues, expenses, assets or liabilities.
3. Share your response with a colleague for feedback.

You can use the table below to support your response. An example has been provided.

Table 2.3: Effect of Accounting Errors

S/N	SCENARIO	Does the error adversely affect the recording of:			
		REVENUE	EXPENSES	ASSETS	LIABILITIES
	A cash sales transaction of GH¢4,500 is recorded as GH¢5,400	Yes	No	Yes	No
a	An expense of GH¢7,000 is recorded by debiting the cash account and crediting the expense account.				
b	Purchases of GH¢1,800 is correctly debited in the purchases account but credited as GH¢18,000 in a supplier's account.				
c	Debiting motor repair expense of GH¢1,200 paid by cheque to the Motor Vehicle account and missing the credit bank account entry.				
d	A credit purchases of GH¢2,000 is left out of the books entirely.				
e	Sales of GH¢1,204 is recorded as GH¢2,014 in both the debtor's account and the sales accounts.				

f	A loan repayment of GH¢15,000 is correctly entered in the bank account but omitted from the loan account.				
g	Recording only the debit for a payment of GH¢3,000 to a supplier without the corresponding credit to the bank account.				
h	A payment of GH¢4,000 received from a customer is recorded by debiting the sales account and crediting cash account.				
i	Travelling expenses of GH¢500 paid in cash is posted twice as a debit to the traveling expenses account but only once as a credit to the cash account.				
j	An amount of GH¢3,000 received from Musah is recorded in Mensah's account.				

Activity 2.6 Effect of Accounting Errors

Organise yourselves into groups of not more than five. Each group will be assigned a specific type of error.

In your groups, analyse the impact of this type of error. It might help to come up with a scenario to put the error into context. Record this in your workbooks.

Discuss:

1. whether or not the error will affect the agreement of the trial balance
2. which accounts are affected by the error
3. how this type of error impact financial statements and may distort financial reporting.

Type your response in MS Word format and present it to the class for discussion and feedback.

Engage with the presentations of other groups and ask questions. You may find it helpful to make notes on the discussions on types of errors presented by other groups.

Activity 2.7 Self-Assessment

1. Identify and explain five types of errors in financial accounting and their potential impact.
2. Explain the effect of errors that affect the agreement of the trial balance on the trial balance and the financial statements.

SUSPENSE ACCOUNT AND THE USE OF JOURNAL ENTRIES TO CORRECT ERRORS

Meaning of the Suspense Account

1. A suspense account is a temporary account used to record any differences in the trial balance while errors in the ledger accounts are being found and fixed.
2. When the trial balance totals do not match, a suspense account is created to hold the difference until the errors are traced and corrected.
3. This account helps to keep the trial balance balanced temporarily.
4. Once the errors are located and corrected, the suspense account is adjusted and should have a zero balance.

Correction of Errors That Do Not Affect the Agreement of the Trial Balance

These types of errors are corrected using the general journal or journal proper. The correction of such errors usually involves two accounts, where one account is debited and the other is credited. To fix the error, it is important to check if the balance of an account was increased or decreased by mistake.

For instance,

1. If the error made the account balance higher, it needs to be corrected by decreasing that balance.
2. If the error made the account balance lower, it needs to be corrected by increasing that balance.

Correction of Errors That Affect the Agreement of the Trial Balance

These errors are fixed using the journal proper and the suspense account. The difference found in the trial balance is placed in the suspense account.

Therefore;

1. If the debit side of the trial balance is lower than the credit side, the difference is entered on the debit side of the suspense account.
2. If the credit side is lower, the difference is entered on the credit side of the suspense account

Example 2.16

A TRIAL BALANCE WITH A LOWER DEBIT SIDE

	DEBIT GH¢	CREDIT GH¢
Sales		4,400
Purchases	3,110	
Furniture at cost	5,710	
Trade creditors		740
Trade Debtors	165	
Stock	210	
Capital		10,000
Administrative expenses	1,020	
	10,215	15,140

THE TRIAL BALANCE WITH SUSPENSE ACCOUNT SHOWING THE DIFFERENCE

DEBIT	CREDIT
GH¢	GH¢

Sales		4,400
Purchases	3,110	
Furniture at cost	5,710	
Trade creditors		740
Trade Debtors	165	
Stock	210	
Capital		10,000
Administrative expenses	1,020	
Suspense Account	4,925	
	15,140	15,140

The suspense account would therefore look like this:

	Suspense Account	
	GH¢	GH¢
Trial balance difference	4,925	

These errors usually affect only one account, so the corresponding entry is made in the suspense account to balance the transaction.

The affected account is debited or credited as needed and the suspense account is debited or credited to complete the journal entry.

Once all the errors that affected the trial balance have been corrected, the suspense account should balance out to zero.

Note: When completing the activities, every journal entry should include an explanation (narration) of the change, unless otherwise specified by the question that this is not required.

Activity 2.8 Suspense account

Organise yourselves into small groups of not more than five. In your groups, brainstorm the meaning and purpose of a suspense account.

In your discussions, consider how the suspense account is used in the correction of errors.

Record the outcomes of your discussion in your books or on a flip chart to present to the class.

Activity 2.9 Correction of Errors

In groups, study the case below.

The trial balance of OSIKA Enterprise failed to agree. The difference was entered in the suspense account.

The following errors were detected:

1. A sum of GH¢1,000 received from Sammy has not been posted to his account.
2. The sales daybook was undercast by GH¢560
3. Return on outwards book was overcast by GH¢140.
4. Discount received GH¢410 from Doris had been correctly entered in the cashbook but not posted to Doris's account.
5. Goods worth GH¢750 returned to a supplier were recorded in his personal account as GH¢570.
 - a. Discount allowed was overcast by GH¢310.
 - b. Discount received column in the cashbook has been overcast by GH¢400.

Working in your groups, prepare the following:

- Journal entries to correct the errors for:
 - o Sammy's account
 - o Sales daybook
 - o Return outwards book
 - o Doris's account
 - o Supplier's account
 - o Discount allowed and received
- Suspense account entries

What is the difference in the suspense account balance?

Activity 2.10 Correction of errors (Extension task)

Read the case study below and complete the tasks which follow.

Nsabaa Ltd. is preparing its financial statements for the year. When the accountant was preparing the trial balance, a difference of GH¢1,165 was found. After some investigation, the accountant decided to credit the suspense account temporarily until the errors causing the difference were identified and corrected.

Upon further investigation the following errors were detected.

- a. A payment of GH¢3,000 for office equipment was wrongly debited to the Repairs and Maintenance Account.
- b. A sale of GH¢ 1,000 was completely omitted from the Sales Account.

- c. A sales invoice of GH¢8,500 correctly recorded in the sales ledger had been entered in the sales daybook as GH¢7,925.
- d. A purchase invoice for GH¢1,500 posted to the purchase ledger has been recorded in the sales daybook.
- e. A credit sale of two pieces of machinery worth GH¢5,000 each was wrongly credited in the sales account.
- f. The purchases daybook has been overcast by GH¢1,720.
- g. A trade discount of GH¢700 on goods purchased has been recorded as part of the purchase price. The correct amount has been paid to the supplier.
- h. A cheque for GH¢530 received from a debtor has been entered in the cashbook as payment.
- i. A cheque payment of GH¢ 500 for rent was entered twice in both the rent account and the Bank account.
- j. An amount of GH¢6,735 in the cash payment book has been carried forward as GH¢6,375.
- k. Return of goods worth GH¢215 to a supplier had been posted to the credit side of his account even though it was correctly entered in the return outwards book.
- l. The discount received, amounting to GH¢650 in the cashbook, had been posted to the wrong side in the nominal ledger.

1. For each error, identify the type of error and explain its effect on the trial balance.
2. Describe how each error should be corrected.
3. Prepare the journal entries needed to fix the mistakes.
4. Show the suspense account and its closing balance.
5. Share your response with your teacher for feedback.

CORRECTING ERRORS USING THE JOURNAL AND LEDGER ENTRIES

You have been introduced to types of errors, their examples and how to correct these errors using journal entries and the suspense account.

You will now be given further activities to apply the principles of error correction using journal entries and the suspense account.

Activity 2.11 Correction of errors

Business Studies Enterprise extracted its trial balance and discovered a difference of GH¢1,030 debit. A review of the ledger revealed the following errors:

- a. A sum of GH¢120 on a creditor's account was omitted from the balance of creditors.
- b. An item of furniture purchased for GH¢960 was debited to repairs.

- c. The payment side of the cash account had been undercast by GH¢650.
- d. The total of one page of the sales daybook had been carried forward as GH¢2,154, whereas the correct amount was GH¢2,514.
- e. A debit note of GH¢210 received from a customer had been posted to the wrong side of his account.
- f. A debit of GH¢520, presumed bad earlier and written off, was recovered during the year. The debtor's personal account was credited, but no corresponding entry was made.

You are required to:

1. Prepare journal entries to correct the errors.
2. Write up the suspense account.

Study the suggested answer for **Activity 2.11** below to support your work on **Activity 2.12** and **2.13**

Table 2.4: Journal Entries

	PARTICULARS	DEBIT	CREDIT
		GH¢	GH¢
a.	Suspense account	120	
	Creditors' account		120
	Omission of GH¢120 from the creditors' balance has now been corrected		
b.	Furniture Account	960	
	Repairs account		960
	Purchase of furniture debited to repairs, now corrected		
c.	Suspense account	650	
	Cash account		650
	Correction of an undercast of the payment side of the cash account		
d.	Suspense account	360	
	Sales account		360
	Correction of the undercast of the sales day book		
e.	Suspense account	420	
	Customer's account		420
	Entry of a debit note on the wrong side of the customer's account corrected		
f.	Cash book	520	
	Suspense Account		520
	Bad debt recovered, omitted from the cash book now corrected		

Suspense Account						
			GH¢			GH¢
Creditors' A/c			120	Trial Balance Diff		1,030
Cash A/c			650	Cash A/c		520
Sales A/c			360			
Customer's A/c			420			
			1,550			1,550

Activity 2.12 Correction of errors

1. Working in groups, review the following case study.

A sole trader prepared a trial balance which failed to agree, and the difference was placed in a suspense account. An audit of the books revealed the following errors:

- a. Trade discount of GH¢19,000 received from a supplier had been posted to the purchases account.
 - b. One of the pages of the sales returns journal totalling GH¢8,000 was not posted to the return inwards account.
 - c. A payment of GH¢19,600 for insurance has not been entered in the cashbook.
 - d. A cheque for GH¢49,000 paid to a supplier was entered in the cashbook as a receipt.
 - e. A payment of minor repairs of GH¢11,000 to plant and machinery was wrongly posted to the plant and machinery account.
 - f. A sales invoice of GH¢158,950 to a customer was not entered in the books.
 - g. A discount received from a supplier of GH¢25,500 was entered on the wrong side of the personal account.
2. For each of these errors, consider how these mistakes were made what type of errors they are.
 3. Discuss how you would correct each of these mistakes in the relevant journals and how this would be presented.
 4. You are required to prepare:
 - a. Journal entries to correct the errors.
 - b. A summary of the suspense account
 5. Present your work on flip charts to the class for discussion.

Activity 2.13 Correction of Errors

1. In pairs, study the case below.

The accountant of Abima Koka Trading Ltd. has prepared the trial balance, but it shows a difference of GH¢ 1,260.

To balance the trial balance, the difference was credited to the suspense account.

After reviewing the records, the following errors were identified.

- a. Sales of GH¢ 540 were recorded on the credit side of the purchases account.
 - b. A payment of GH¢ 300 for stationery was posted to the office equipment account.
 - c. A cash sale of GH¢ 720 was completely omitted from the books.
 - d. Rent paid, GH¢ 500, was recorded in the debit side of the wages account.
 - e. Discount allowed of GH¢ 60 was posted to the credit side of discount received.
 - f. The balance of GH¢ 450 in the debtor's account was incorrectly carried forward as GH¢ 540.
 - g. A purchase of goods on credit for GH¢ 850 was recorded as GH¢ 580.
 - h. A credit sale of GH¢395 was entered in the debtors account but wrongly debited to the purchases account.
 - i. A GH¢ 400 insurance premium paid was entered on the debit side of the insurance expense account but was not posted to the cash book.
 - j. A purchase return of GH¢ 250 was debited to the purchases account instead of being credited.
 - k. A loan repayment of GH¢ 200 was correctly entered on the credit side of the bank account but was not recorded in the loan account.
2. Identify the effect of each error on the trial balance.
 3. Prepare journal entries needed to correct the errors.
 4. Post the corrected entries to the relevant accounts.
 5. Prepare the suspense account.
 6. Share your responses with another pair for feedback.

INTRODUCTION TO BANK RECONCILIATION STATEMENT

Meaning of bank statement and bank reconciliation statement

Cashbook

A cashbook is a document used by businesses to keep track of all cash, bank, and discount transactions. It shows the money that comes in and goes out of the business (i.e., cash receipts and payments). This helps businesses to manage their cash flow effectively.

Bank Statement

A bank statement is a report provided by the bank that lists all debit (outgoing) and credit (incoming) cash transactions in a specific bank account. This statement is sent by banks to their customers periodically (often monthly) and shows the balance of an account as of a specific date. It helps customers to see all the transactions that have been processed by the bank during the period.

Bank Reconciliation Statement

A bank reconciliation statement is a report prepared by a business at the end of a month or accounting period. It compares the balance shown in the cashbook of a company (specifically the bank column) to the balance shown on the bank statement. The purpose is to find and explain any differences between these two balances.

Why Prepare a Bank Reconciliation Statement?

Some of the key reasons for preparing a bank reconciliation statement are summarised in Table 2.5.

Table 2.5: Reasons for preparing a bank reconciliation statement

Reason	Explanation
Detection of Errors	Bank reconciliation helps to identify mistakes such as recording a transaction with the wrong amount, omitting a transaction, or posting the same transaction twice. It also helps to identify errors made by the bank such as deductions or deposits which have not been recorded correctly.
Prevention of Fraud	Reconciliation can reveal unauthorised or fraudulent transactions that may have gone unnoticed. By regularly comparing the cashbook and bank statement, a business can ensure that all cash transactions are legitimate and correctly recorded. This acts as a safeguard against fraud.
Ensuring Accurate Financial Records	Bank reconciliation ensures that the cash balance shown in the business's records is correct. This is important for creating accurate financial reports which are necessary for assessing the financial health of the business. Reliable financial records help stakeholders like managers and investors to make better decisions.
Identification of Unrecorded Transactions	During reconciliation, a business may discover bank charges, interest earned, or other transactions not yet recorded in its books. This ensures that all deposits made, and cheques issued are accounted for and helps to provide a complete picture of the company's financial transactions.
Compliance and Audit Requirements	Regular bank reconciliations help a business stay compliant with financial regulations and standards. It also provides a clear audit trail for external auditors by showing that the company's cash transactions are accurate and verified. This is essential for passing audits and demonstrating good financial practices.

Activity 2.14 Banking errors

1. Take five minutes to think about the types of errors that might be made by banks in the preparation of accounts. Make a note of these in your workbooks.
2. Turn to the person sitting next to you and compare your ideas, and then share as part of a wider class discussion. Add to your list based on the feedback and ideas of your classmates.

Activity 2.15 Bank Statement and Bank Reconciliation Statement

1. In pairs, discuss the meaning of the following.
 - a. A Bank Reconciliation Statement
 - b. A Bank Statement

Record your definitions in your workbook.

Identify and explain five (5) reasons to prepare a bank reconciliation statement.

	Reasons to prepare a bank reconciliation statement
1	
2	
3	
4	
5	

2. Compare your responses with another pair

Activity 2.16 Identification of items on a Bank Statement

1. In your group Scan the QR code below and download the PDF file.



2. Open the downloaded file and examine it to identify and write down these components
 - a. The account type
 - b. The start date of the statement

- c. The end date of the Statement
 - d. The total number of deposits made
 - e. The total number of withdrawals made
 - f. The total debit amount
 - g. The total credit amount
 - h. The opening balance
 - i. The closing balance
3. Record your answers in a table in your workbooks and compare your responses with another group for feedback.

CAUSES OF THE DIFFERENCES BETWEEN CASHBOOK AND BANK STATEMENT BALANCE

Causes of the Differences between the Cashbook and the Bank Statement Balances

There are several reasons why the balance shown in the cashbook may not match with the balance on the bank statement. Here are some common causes and explanations.

1. **Unpresented Cheques:** These are cheques that a business has given to suppliers or creditors for payment but have not yet been cashed by the supplier or presented at the bank for withdrawal. While these cheques are recorded as payments in the cashbook, they do not appear in the bank statement until the supplier or creditor cashes them. In other words, if a business writes a cheque to a supplier but the supplier has not taken it to the bank yet, the bank statement would not show this payment.
2. **Uncredited Cheques:** These are cheques that a business has received from customers and recorded as receipts in the cashbook but have not yet been processed by the bank. This means that while the cashbook shows the cheque as received, the bank statement does not, since the bank has not yet credited it to the account. For instance, if a customer settles the amount owed a business by cheque and the business records it but the bank has not yet cleared the cheque, it will cause a difference between the cashbook and the bank statement.
3. **Standing Orders:** A standing order is a regular instruction from a business to its bank to make periodic payments to certain people or organisations (e.g., monthly rent, utility bills, or insurance premiums). These transactions show up in the bank statement automatically but may not be recorded in the cashbook until the statement is received. For example, a monthly payment for insurance might be deducted by the bank without the business immediately noting it in the cashbook.
4. **Credit Transfers:** These are payments made directly into the bank account of a business by third parties, often without the business knowing until they check their bank statement. For instance, a customer might pay an invoice directly into the bank which shows up in the bank statement but has not been recorded in the cashbook yet.

5. **Bank Charges and Commissions:** Banks often charge fees for services such as maintaining the account, processing transactions, or handling foreign transfers. These charges are debited against the bank account of the business and will appear on the bank statement, but will not be found in the cashbook until they are recorded. For example, if the bank charges a GH¢50 service fee, it will reduce the bank statement balance but will not reflect in the cashbook until the business updates its records.
6. **Dividends or Interest Received:** If a business earns dividends from investments or receives interest income, this money is often paid directly into the bank account. These payments will appear on the bank statement but may not be recorded in the cashbook until the bank statement is reviewed. For example, a dividend payment of GH¢1,000 from shares will show on the bank statement but would not be in the cashbook until it is noted.
7. **Errors Made by the Bank:** Sometimes, banks make mistakes in the account of a business, such as leaving out transactions, duplicating entries, recording the wrong amounts or reversing entries. These errors can be on either the debit or credit side of the bank statement and will cause differences until they are corrected.
8. **Errors Made by the Business:** Businesses can also make mistakes in their cashbook, such as leaving out entries, recording the wrong amount or totalling account balances incorrectly. These errors can lead to discrepancies between the cashbook and the bank statement until they are corrected.
9. **Dishonoured Cheques:** These are cheques that the bank refuses to pay when they are presented for payment. When a cheque is dishonoured, it means that even though the business has recorded it as a receipt, the bank rejects it and returns it unpaid. This could be due to reasons such as:
 - a. **Insufficient funds:** The account does not have enough money to cover the cheque amount.
 - b. **Mismatch between words and figures:** The amount written in words does not match the numbers.
 - c. **Stale cheque:** The cheque is dated too far in the past and is no longer valid.
 - d. **Post-dated cheque presented early:** The cheque is dated for a future date and is presented before that date.
 - e. **Signature irregularities:** The signature does not match the specimen signature on file.
 - f. **Wrong date:** The cheque has an incorrect date.

Activity 2.17 Cashbook and Bank Statement Balance Differences

1. In groups, discuss the reasons for the differences between the cashbook balance and bank statement balance.
2. Identify and explain six (6) reasons why a cheque may be dishonoured.
3. Make a poster presentation or PowerPoint presentation to your classmates.

Activity 2.18 Differences between cashbooks and bank statements

1. Organise yourselves into groups of not more than five. You will be provided with some examples of cashbooks and bank statements.
2. In your groups, identify the differences between the documents. What might have caused these differences?
3. Record your analysis within your workbooks and be prepared to share your findings with the class for discussion and feedback.

PREPARATION OF THE UPDATED CASHBOOK

The best way to prepare an updated cashbook is to review the bank statement and identify if any transactions have been left out of the cashbook. It is important to identify transactions that should have been recorded in the cashbook but were not.

Once these items are found, they need to be added to the cashbook to ensure it matches the bank records.

Examples of items that may need to be added

1. Dishonoured cheques (cheques the bank did not pay)
2. Credit transfers (money directly paid into the bank account by others)
3. Standing orders (regular payments made by the bank on behalf of the business)
4. Bank charges and fees
5. Dividends and interest received
6. Any errors that were made.

The rule for recording these items is straightforward

1. **Items that decrease the bank balance** (e.g., bank charges, standing orders and dishonoured cheques) should be **credited** in the cashbook.
2. **Items that increase the bank balance** (e.g., credit transfers, interest and dividends received) should be **debited** in the cashbook.

Once you have ensured that all transactions are recorded in the cashbook, it will show a revised and accurate bank column balance for comparison with the bank statement balance. This updated balance is essential for matching the cashbook with the bank statement and ensuring accurate financial records.

Format of updated cashbook

Table 2.6: Updated Cashbook

	GH¢		GH¢
Balance b/d	xxx	Balance b/d (if any)	xxx
Credit Transfer	xxx	Standing Order	xxx
Dividend received	xxx	Bank Charges and Commissions	xxx

Interest received	xxx	Dishonoured cheques	xxx
Error (undercast)	xxx	Error (undercast)	xxx
Error (overcast)	xxx	Error (overcast)	xxx
		Balance c/d	xxx
	xxxx		xxxx
Balance b/d	xxx		

Activity 2.19 Preparing an updated cashbook

1. In pairs, discuss the steps involved in preparing an updated cashbook.
2. Summarise the process in a flow chart and record this in your workbooks.

Activity 2.20 Format of the Updated Cashbook

1. In groups, prepare a template for an updated cashbook. Your teacher will provide you with examples to examine.
2. Select four items each from the debit and credit side of the updated cashbook format and discuss the reasons why those items are shown on the debit or credit side.
3. Summarise your discussion in your workbooks and share your responses with another group for feedback.

You can use **Table 2.7** to support your work

Table 2.7: Format of the Updated Cashbook

S/N	ITEMS ON CREDIT SIDE	REASON FOR SHOWING ON THE CREDIT SIDE
	<i>Dishonoured Cheques</i>	<i>These represent amounts that were initially recorded as receipts (debit) but were later not received due to insufficient funds or other issues. Since the expected cash inflow did not occur, it reduces the cashbook balance hence requiring a credit entry to adjust for the unrealised funds (i.e. offset the initial debit in the cashbook)</i>
1		
2		
3		
4		
5		

S/N	ITEMS ON DEBIT SIDE	REASON FOR SHOWING ON THE DEBIT SIDE
1		
2		
3		
4		
5		

Activity 2.21 Preparing an updated cashbook

1. Organise yourselves into groups of not more than five. In your groups, read and review the case study below.

Stephen's cashbook on 30th June, 20X1 showed a credit balance of GH¢ 60,500 while his bank statement on the same day showed a debit balance of GH¢35,300.

An investigation revealed the following:

- a. The receipts side of the cashbook had been undercast by GH¢5,000.
 - b. Bank charges of GH¢3,800 entered on the bank statement had not been entered in the cashbook.
 - c. A cheque for GH¢26,000 drawn by Duodo had been charged by the bank in error to another customer's account.
 - d. A dividend of GH¢1,500 paid directly to the bank had not been entered in the cashbook.
 - e. A cheque for GH¢3,500 paid into the bank had been dishonoured and shown as such by the bank but no entry of the dishonour had been made in the cashbook.
 - f. A cheque drawn for GH¢3,200 had been entered in the cashbook in error as GH¢2,300.
 - g. A cheque for GH¢2,100 drawn by another customer of the same name had been charged to Stephen's bank account in error.
2. Prepare an updated cashbook for Stephen.
 3. Share your response with another group for comparison, feedback and discussion.

Activity 2.22 Preparation of the Updated Cashbook (Extension activity)

1. Analyse the case study below

The Cashbook of BIGGLES CLOTHING showed a debit balance of GH¢7,560 on 31st March, 20X3, while the bank statement showed a credit balance of GH¢ 5,630.

On investigation, the following discoveries were made;

- a. A trade association membership due of GH¢1,560 paid by the bankers of Biggles Clothing directly under a standing order instruction had not been recorded in the cashbook.
 - b. Interest on government Treasury Bills totalling GH¢930 was credited by the bank on 31st March; no entries were made in the Cashbook.
 - c. A cheque of GH¢330 issued for the payment of rent had been entered on the wrong side of the Cashbook.
 - d. The receipt side of the Cashbook had been overcast by GH¢1,500
 - e. A dividend warrants for GH¢1,890 had been correctly credited to the account of Biggles Clothing, but nothing appeared in the Cashbook
 - f. A cheque for GH¢3,090 deposited had been returned by the bank with the remarks “No funds available”, but no adjustment had been made in the Cashbook.
 - g. A payment of GH¢1,830 by cheque to Mr. Kudiagbor had been entered in the Cashbook as GH¢1,930
 - h. A Cheque for GH¢240 drawn in respect of electricity had been incorrectly entered in the Cashbook as GH¢420
 - i. A customer, ABC Ltd, had transferred GH¢1,340 directly into the bank account of Biggles Clothing to settle an outstanding invoice. This had not yet been recorded in the Cashbook
 - j. The bank statement showed banker’s charges totalling GH¢220. These had not been entered in the Cashbook
2. Prepare the updated cashbook from the information given above.
 3. Compare your response with one of your peers for discussion and submit your updated cashbook to your teacher for feedback.

PREPARATION OF BANK RECONCILIATION STATEMENT

Preparing a bank reconciliation statement means matching the corrected cashbook balance with the bank statement balance. This process involves adjusting for certain items, such as unpresented cheques, uncredited cheques and errors made by the bank.

To do that, the following rules mentioned below must be followed.

1. Unpresented Cheques

These are cheques that the business has issued and recorded in the cashbook (reducing the balance) but have not yet been cashed or presented to the bank for payment. Since they have already been deducted in the cashbook but have not yet appeared on the bank statement, they need to be added back to the adjusted cashbook balance to match the bank statement.

Example 2.17

If a business wrote a cheque for GH¢2,000 to a supplier, this amount is credited in the cashbook and reduces the balance. If the cheque has not been presented to the bank, it would not show on the bank statement so the GH¢2,000 must be added back when preparing the reconciliation.

2. Uncredited Cheques

These are cheques that the business has received and recorded in the cashbook as deposits, thereby increasing the cashbook balance, but which have not yet been processed and credited by the bankers of the business. Since these amounts have been added to the cashbook but do not appear in the bank statement, they need to be subtracted from the adjusted cashbook balance to align it with the bank statement.

Example 2.18

If a customer's cheque for GH¢1,500 is recorded in the cashbook as a receipt, it increases the cashbook balance. However, if the bank has not yet processed this cheque, the GH¢1,500 should be subtracted from the adjusted cashbook balance.

3. Errors Made by the Bank

Sometimes, banks make mistakes that can affect the balance. These errors need to be corrected in the reconciliation. These errors can be categorised into debit in error and credit in error.

- a. **Credit in Error:** If the bank mistakenly credits (adds) money to the account of a business, it means the bank statement would show a higher balance than it should. To correct this and match the cashbook with the bank statement, the same amount should be added to the adjusted cashbook balance.
- b. **Debit in Error:** If the bank mistakenly debits (deducts) money from the account of a business, it means the bank statement would show a lower balance than it should. To correct this, the amount needs to be subtracted from the adjusted cashbook balance.

Example 2.19

If the bank accidentally credits GH¢500 to the account of a business, the same GH¢500 should be added to the adjusted cashbook balance to match the bank statement. Conversely, if the bank mistakenly debits GH¢300, then an equal amount of GH¢300 should be subtracted from the adjusted cashbook balance to match the bank balance.

Preparing the Reconciliation Statement

The reconciliation statement can be prepared using different starting points:

1. Balance as per the adjusted cashbook
2. Overdraft as per the cashbook
3. Balance as per the bank statement
4. Overdraft as per the bank statement

The goal is to ensure that the adjusted cashbook balance matches the balance shown in the bank statement after all adjustments are made.

This process helps to identify any differences and ensures that the financial records are accurate and complete.

Format of bank reconciliation statement

Example of a bank reconciliation statement using an adjusted cashbook as the starting point.

Bank Reconciliation statement as at

	GH¢	GH¢
Balance as per updated cashbook		xxx
add: Unpresented Cheques	xxx	
Credited in Error	xxx	<u>xxx</u>
		xxx
less: Uncredited Cheques	xxx	
Debited in Error	xxx	<u>xxx</u>
Balance as per Bank Statement		<u>xxx</u>

Alternatively

Example of a bank reconciliation statement using the bank statement balance as the starting point.

Bank Reconciliation statement as at

	GH¢	GH¢
Balance as per bank statement		xxx
add: Uncredited Cheques	xxx	<u>xxx</u>
Debited in Error	xxx	xxx
less: Unpresented Cheques Credited in Error	xxx	
	xxx	<u>xxx</u>
Balance as per updated Cashbook		<u>xxx</u>

Activity 2.23 Process of preparing a bank reconciliation statement

1. Turn to your partner and discuss the process of preparing a bank reconciliation statement.
2. Record this as a flow chart in your workbooks. Take part in a wider class discussion on how bank reconciliation statements are prepared and amend your recorded process as necessary.

Activity 2.24 Preparation of Bank Reconciliation Statement

1. Working in small groups, study the case below.

Dorvic Enterprise cashbook showed a debit balance of GH¢ 4,500 on December 31, 20X2. Further examination revealed the following:

- a. A direct debit of GH¢350 for subscription had been paid by the bank.
 - b. Bank charges of GH¢500 had not been reflected in the cashbook.
 - c. Payments settled by standing orders were omitted from the cashbook; electricity bill GH¢ 70, insurance GH¢100, medical bill GH¢120.
 - d. A dividend of GH¢320 paid directly into the bank had not been entered in the cashbook.
 - e. It was discovered that the cashbook balance brought down was undercast by GH¢ 180.
 - f. Cheques amounting to GH¢4,800 issued had not been presented for payment.
 - g. Cheques amounting to GH¢1,990 paid into the bank had not yet been credited.
2. Prepare the updated cashbook and the bank reconciliation statement as of December 31st 20X2.
 3. Record your answers on flipcharts and present to the wider class for discussion and feedback.

Activity 2.25 Cashbook balance

1. In groups, study the case below.

Franstech Enterprise

Franstech Enterprise, a small business, maintains a current account with GCB Bank. As of September 30, 2024, the Bank Statement of Franstech Enterprise showed a closing balance of GH¢12,500. However, the cashbook, maintained by Franstech Enterprise, showed a different balance of GH¢13,200 at the end of the same month.

After further investigation to find out what caused the difference it was discovered that Franstech Enterprises issued cheques to suppliers totalling GH¢2,500, but these cheques had not yet been presented to the bank for payment.

Also, deposits of GH¢1,200, being customer payments paid into the bank on September 29, had not been recorded by the bank.

Furthermore, the bank deducted GH¢150 as service charges, which the business had not yet recorded in the cashbook. Again, the bank credited Franstech Enterprise account with GH¢200 in interest, which is not reflected in Franstech Enterprise cashbook.

2. In your groups, update the cashbook balance and prepare the Bank Reconciliation Statement for Franstech Enterprise as of 30th September.
3. Present your response to your teacher for review.

Bank Overdraft

A bank overdraft is a type of short-term loan facility provided by a bank to its customers that allows a customer to withdraw more money than they currently have in their account up to an agreed limit. This means the customer's account balance can go below zero (that is, have a negative balance). The bank charges interest on the amount that is overdrawn until the overdraft is repaid. This means the customer pays for using the extra money. A bank overdraft is useful for covering short-term cash needs, such as paying bills or making urgent purchases when funds are low.

Format of bank reconciliation statement when the balances are overdraft

Bank Reconciliation statement as at

	GH¢	GH¢
Overdraft as per updated Cashbook		xxx
add: Uncredited Cheques	xxx	<u>xxx</u>
Debited in error by bank	<u>xxx</u>	xxx
less: Unpresented Cheques	xxx	
Credited in error by bank	<u>xxx</u>	<u>xxx</u>
Overdraft as per Bank Statement		<u>xxx</u>

Alternatively,

Bank Reconciliation statement as at

	GH¢	GH¢
Balance as per Bank Statement(O/D)		xxx
add: Unpresented Cheques	xxx	<u>xxx</u>
Credited in Error	<u>xxx</u>	xxx
less: Uncredited Cheques	xxx	
Debited in Error	<u>xxx</u>	<u>xxx</u>
Balance as per updated cashbook (O/D)		<u>xxx</u>

Activity 2.26 Discussion on bank reconciliation statements

1. Your teacher will share examples of bank reconciliation statements with you. Alternatively, go back and review the examples given above.

2. Working in small groups, identify five items in the statement and explain what they tell you.
3. Consider how you tell if the statement was prepared from a balance that was in debit or credit.
4. Share your answers as part of a wider class discussion examining the format of bank reconciliation statements.

Activity 2.27 Preparation of Bank Reconciliation when the balances are overdrawn

1. Carefully study the information below.

As the newly appointed accountant of a company, you are presented with a bank statement and a cashbook for October. At the end of September, the cashbook showed an overdraft balance of GH¢5,000, while the bank statement showed an overdraft of GH¢4,500. After examining the records for October, you identified the following differences:

- a. A check for GH¢1,200 was issued but has not been presented to the bank.
 - b. A deposit of GH¢800 was made by a client directly into the bank account but was not recorded in the cashbook.
 - c. Bank charges of GH¢50 were not recorded in the cashbook.
 - d. The bank statement includes an error in which a GH¢100 debit entry was recorded twice.
 - e. The bank has credited GH¢500 for interest on the overdraft, which has not been recorded in the cashbook.
2. Use the information provided to prepare a bank reconciliation statement for October
 3. Analyse the impact of each adjustment on the overdraft balance and decision-making.
 4. Compare your responses with those of your colleague for feedback.

INTRODUCTION TO CONTROL ACCOUNTS

Meaning of Control Account

A control account is a summary-level account in the general ledger which summarises transactions in all subsidiary accounts. A ledger's control account at the end of a financial period indicates that the entries were made correctly if it matches the sum of the balances of the individual accounts in that ledger. As a discrepancy would indicate the ledger that needs careful examination to identify errors, this might facilitate checks. It is important to remember that not all errors can be detected by control accounts. The

control account will still balance even if specific types of errors (for example errors or omission, compensating errors) occur, just like in the trial balance.

Control accounts are often referred to as self-balancing ledgers because ledgers, which have control accounts system are proved to be correct as far as the double entry is concerned. Although the concept might theoretically be applied to all ledgers, the control account is often limited to purchases and sales. Control accounts are sometimes called total accounts since they are basically summaries of the transactions that are recorded in a specific ledger.

Importance of control accounts

1. They provide a check on the accuracy of entries made in the personal accounts.
2. They assist in the location/identification and correction of errors.
3. They act as an internal check on the work of clerical staff.
4. They are used to determine debtors' and creditors balances more quickly.
5. They are used to find missing figures when preparing accounts for Single Entry and Incomplete Records.
6. They serve as a check on fraudulent acts and checks on the accuracy of the ledger keepers.

Types of control controls

<p>Receivables (Sales) Ledger Control Account</p>	<p>An account in which records are kept of all transactions relating to all debtors in total. The balance on the receivables control account therefore represents the sum of the individual balances owed by credit customers in the sales ledger. It simply tracks any amounts owed to the business.</p> <p>It is also called the sales ledger control account or total debtors account.</p> <p>It is debited with all items that increase debtors' balance and credited with all items that decrease the debtors' balance.</p>
<p>Payables (Purchases) Ledger Control Account</p>	<p>An account in which records are kept of all transactions relating to all creditors in total. The balance on payables control account therefore represents the sum of the individual balances owed to trade creditors in the payable ledger.</p> <p>It is credited with all items that increase creditors' balance and debited with all items that decrease creditors' balance</p>

Activity 2.28 Control accounts

1. Working in pairs, discuss the meaning of control accounts. Share your definition with another pair and refine your meaning if needed.
2. Record your agreed definition in your workbooks.

3. Organise yourselves into groups of not more than five to look in more detail at control accounts. In your groups, discuss the following:
- the importance of control accounts
 - the names of different types of control accounts
 - the purpose of different types of control accounts

Share the outcomes of your discussion with the class for feedback. You could record your responses in **Table 2.8** such as the one below.

Table 2.8: Recording Template

Control Accounts	
Definition	
Why are they important?	
Types of control account	
Name	Purpose

RECEIVABLES CONTROL ACCOUNT

The format for the receivables control account is shown below. In this lesson we will examine this more closely and practice preparing a receivables control account.

Receivables control account

Balance b/d	xxx	Balance c/d	xxx
Credit sales	xxx	Cash received from customers	xxx
Dishonoured cheques	xxx	Cheques received from customers	xxx
Bills receivables dishonoured	xxx	Bills receivables	xxx
Cash refunds to customers	xxx	Discounts allowed	xxx
Interest Charge on customers' overdue a/c	xxx	Return inwards	xxx
Noting charges	xxx	Bad debts written off	xxx
Balance c/d	xxx	Allowances on goods damaged	xxx
		Set off	
		Balance c/d	xxx
	XXX		XXX
Balance b/d	xxx	Balance b/d	xxx

NOTE

- a. **Opening credit balance:** In a receivables ledger control account, the usual balance is a debit, representing amounts customers owe. However, an opening credit balance can occur due to customer overpayments, advance payments, or returns awaiting refunds. This credit balance reflects money the business owes to customers.
- b. **Set off:** These arise where there are balances on both supplier's account and customer's account for the same individual or business. A person may be both a customer and a supplier and it is sometimes necessary to set off one balance against the other. The set offs are sometimes referred to as contra entries.
- c. **Noting charges:** This is a charge by the bank for processing bill of exchanges. It is therefore debited to the sales ledger control account.

Activity 2.29 Receivables control account

1. You will be provided with an example of a receivables control account. In pairs, study the format.
2. Identify items in the format of receivables control account.
3. Write down five items each in the debit side and credit side of the receivables control account and compare with another pair. Record your responses in your workbook.

Table 2.9: Recording Template

Debit side		Credit side	
1		1	
2		2	
3		3	
4		4	
5		5	

Activity 2.30 Contra entry

1. In groups, discuss instances where an account can have a set off or contra entry.
2. Write down your responses and share with another group. Record your answers in your workbooks and add to or adjust these based on your discussions.

Activity 2.31 Creating a template for formatting receivables control account

1. In groups, create a template for the format of a receivables control account.
2. Use the information below, to prepare the receivables control account for Takashi Ltd. for the month of March, 20X4.

	GH¢
Debtors' balance at 1/3/20X4	5,000
Credit balance on customers account at 1/3/20X4	1,250
Discount allowed	750
Bills receivable	4,500
Bad debts	3,250
Receipts from debtors	21,500
Set – off of a customer's account against a credit balance	900
Credit sales	32,500
Dishonoured cheques	1,600
Bills receivable dishonoured	750
Allowances to debtors for defective goods	200
Balances of debtor from the receivable ledger at the end	20,000

3. Present your answer on a flip chart for discussion and feedback.

PAYABLES CONTROL ACCOUNT

The format of a payables control accounts is shown below. In this lesson we will examine this more closely and practice preparing a payables control account.

Payables ledger account			
Balance b/d	xxx	Balance b/d	xxx
Cash paid to suppliers	xxx	Credit purchases	xxx
Cheque paid to suppliers	xxx	Dishonoured cheques	xxx
Bills payable	xxx	Dishonoured bills	xxx
Discount received	xxx	Cash refunds (receipts)	xxx
Return outwards	xxx	Balance c/d	xxx
Sales ledger set off (contra)	xxx		
Balance c/d	xxx		
	xxx		xxx
Balance b/d	xxx	Balance b/d	xxx

NOTES

Opening credit balance: The payables control account usually has an opening credit balance representing the amount owed to suppliers. It is therefore unusual to have an opening debit balance in the payables control account, but it can happen at times.

An opening debit balance represents an amount owed by the suppliers to the business, probably as a result of overpayments in settlement of the firm's accounts, or cash deposits made by the firm to the suppliers for which goods have not yet been supplied.

The following items are not shown in the control account:

1. provision for bad debts
2. cash sales and cash purchases
3. provision for trade discount
4. carriage inwards and outwards.

Activity 2.32 Payables control account

1. You will be provided with an example of a payables control account. In pairs, study the format of payables ledger control account.
2. Identify items in the format of payables control account.
3. Write down four items each in the debit side and credit side of the payables control account and compare with another pair.
4. Write your responses in your workbook.

Table 2.10: Recording Template

Debit side		Credit side	
1		1	
2		2	
3		3	
4		4	

Activity 2.33 Missing items from payables ledger

1. In groups, discuss items that are not shown in the control account.
2. Write down two of these items and share with another group for comparison.

Activity 2.34 Creating a template for formatting payables ledger control account

1. In groups, create a template for the format of a payables ledger control account.
2. The following balances were extracted from the books of Nimfour Trading Co. Ltd. at the end of the year 31st December, 20X2. Prepare the payables ledger control account for the company to determine the amount owed to suppliers.

	GH¢
Bills payable	2,000
Cheques paid to creditors	4,000
Credit purchases	8,300
Creditors balances on 31/12/20X1	250
Debit balance on 31/12/20X1	870
Discount received	310
Purchases returns	440
Set – off	450
Debit balances on 31/12/20X2	3 00

Note: A cheque paid to a creditor for **GH¢ 2,350** was dishonoured.

3. Present your answer on a flip chart for discussion and feedback.

PREPARATION OF RECEIVABLES AND PAYABLES CONTROL ACCOUNT

This lesson will be dedicated to working through additional examples to prepare receivables and payables accounts. You will be working in groups so will have lots of opportunities to collaborate with your peers. Ask questions if you are unclear on any of the activities – there will be lots of opportunities for discussion.

Activity 2.35 Preparing the receivables and payables ledger control accounts

1. In groups, create templates for the format of the receivables ledger control account and payables ledger control account.
2. Analyse the following information and use it to prepare both the receivables ledger control account and the payables ledger control account for XZY company for the month of October, 20X4.

Balance as of 1st October, 20X4	GH¢	
Payable ledger	224,500 (Credit)	1,000 (Debit)
Receivable ledger	860,000 (Debit)	2,200 (Credit)
Transactions during October, 20X4		GH¢
Cash purchases		4,500,000
Credit sales		8,000,000
Cash sales		9,200,000
Credit purchases		6,300,000
Allowances from suppliers		25,000
Cheques received from credit customers		6,000,000
Cash received from credit customers		800,000
Discount received		120,000
Cheques paid to creditors		4,700,000
Receivable ledger debit balance transferred to payable ledger		150,000
Allowances to customers		300,000
Bills of exchange payable		1,000,000
Bills of exchange receivable		200,000
Cheques from customers dishonoured		180,000
Provision for discount on debtors		50,000
Bad debts written off		80,000
Discount allowed		100,000
Refund to customers for overpayment		210,000
Interest charged on debtors' overdue account		20,000
Receivable returns		100,000
Returns outwards		60,000
Balance on 31st October, 20X4:		
Sales ledger		2,000 (Credit)
Purchases ledger		900 (Debit)

Activity 2.36 Creating template for formatting payable ledger control account

1. Use the templates for the format of the receivables ledger control account and payables ledger control account that you created for the previous activity.

2. Analyse the following information and use it to prepare both the receivables ledger control account and the payables ledger control account for this company for the month of June, 20X4

Balance as of 1st June, 20X4		GH¢
Payable ledger	112,500 (Cr)	1,000 (Dr)
Receivable ledger	460,000 (Dr)	1,200 (Cr)
Transactions during June, 20X4		
Cash purchases		2,500,000
Credit sales		4,000,000
Cash sales		4,700,000
Credit purchases		3,300,000
Allowances from suppliers		23,000
Cheques received from credit customers		3,000,000
Cash received from credit customers		400,000
Discount received		60,000
Cheques paid to creditors		2,700,000
Receivable ledger debit balance transferred to payable ledger		75,000
Allowances to customers		150,000
Bills of exchange payable		500,000
Bills of exchange receivable		100,000
Cheques from customers dishonoured		90,000
Provision for discount on debtors		25,000
Bad debts written off		40,000
Discount allowed		50,000
Refund to customers for overpayment		110,000
Interest charged on debtors' overdue account		10,000
Receivable returns		50,000
Returns outwards		30,000
Balance on 30 th June, 20X4:		
Receivable ledger		1,000(Cr)
Payable ledger		500 (Dr)

3. Present your answer on a flip chart and share with another group.

EXTENDED READING

- "Accounting Principles" by Jerry J. Weygandt, Paul D. Kimmel and Donald E. Kieso
- "Frank Wood's Business Accounting 1" by Frank Wood and Alan Sangster
- Any approved financial accounting book by NaCCA can be used as a further reading material.
- You can also click on the following links or scan the QR codes to watch tutorial videos on the following topics.
- **Correction of Errors and Suspense Account**
<https://youtu.be/91dQlwdwf44?si=FOjiEBy4qGhbfjTa>



https://youtu.be/_qoIRr-b6hk?si=AOrsivzZe-7Cfc95



- **Bank Reconciliation**
https://youtu.be/nCaLSi8riXM?si=1kGD3w0p-S_2NoIU



<https://youtu.be/CiCZ1ljl-M8?si=Z9lWCdNjETMTsogK>



- **Control Accounts**
<https://youtu.be/iCOOUEm4PvE?si=WNxi4miRgIgvOUar>



<https://youtu.be/8Cfzj5vWkcQ?si=Gsbv7W5zZmuMiUXQ>



REVIEW QUESTIONS 2

1. What is an “error” in financial accounting?
2. What is the difference between a bank statement and a bank reconciliation statement?
3. Explain the use of the suspense account in correcting errors.
4. Why is it important for a business to reconcile its bank statement regularly?
5. Why is it important to reconcile the receivables and payables ledger control account regularly?
6. Explain the treatment of each of the following in control accounts
 - a. A cheque received from a debtor but dishonoured by a bank
 - b. Discount received
 - c. Returns inwards
 - d. Set off
7. What would happen to the trial balance and the overall financial statements if a large cash transaction is recorded with a transposition error, and it is not corrected?
8. You are preparing the trial balance for your business at the end of the accounting period, but the totals do not balance: Your credits are GH¢5,900 higher than your debits. After analysing the trial balance, you note the following transaction errors:
 - a. Credit purchases of GH¢8,500 from Victoria have been entered in the purchases account but credited as GH¢5,800 in Victoria’s account.
 - b. The sales account was overstated by GH¢7,400.
 - c. Discount allowed GH¢4,000, has been credited to the discount received account.
 - d. Vehicle expenses, GH¢500, have been debited to the vehicles account.
 - e. Payment of GH¢2,600 from a credit customer, Soloman, has been entered correctly into the cashbook but has been debited to Soloman’s account
 - f. Returns outward of GH¢1,600 have been correctly entered into the payables ledger but omitted from the returns outwards account.

Prepare the suspense account to correct the errors and address the imbalance of the trial balance.
9. Consider a situation where frequent discrepancies occur between the cashbook and the bank statement. What measures can a business take to address and minimise these discrepancies?
10. The following balances have been extracted from the books of Johnson Ltd.

		GH¢
January 20X4:	sales ledger balance	96,000
January 20X4:	purchases ledger balance	160,000

Purchases journal	1,600,000
Sales journal	4,000,000
Cash and cheque from customers	2,320,000
Cheques paid to suppliers	1,200,000
Return outwards journal	24,000
Return inwards journal	40,000
Discount allowed	44,000
Discount received	1,680
Bad debts written off	1,200
Customer's cheque dishonoured	480
Balance of sales set off against balance in the purchase ledger	8,000
Petty cash to suppliers	16,000
Bills receivable	1,280
Bills payable	2,520
Discount allowed, now disallowed	240
Service charges added to unpaid accounts	832
Credit note issued to customers	39,440
Balances at 31 st December 20X4:	
Purchases ledger	24,000 DR
Sales ledger	400,000 CR

You are required to prepare:

- a. total debtors account
 - b. total creditors account
11. How can modern accounting software and technology help to identify and correct accounting errors? What are the benefits and possible drawbacks of using technology for correcting these errors?
 12. Analyse the impact on a business if they were not to prepare a bank reconciliation statement. Consider the related financial statements and operational implications.

SECTION

3

NOT FOR PROFIT MAKING ORGANISATION, SINGLE ENTRY AND INCOMPLETE RECORDS



FINANCIAL ACCOUNTING AND REPORTING

INTRODUCTION

Welcome to section three of your studies. Here, you will acquire an understanding of how to prepare accounts for non-profit organisations and how to prepare accounts for single-entry and incomplete records. You will explore the concepts, challenges and practical applications of these topics. By the end of the section, you should understand not-for-profit organisations, be able to define their purpose and features and be able to prepare income and expenditure accounts. Additionally, you will learn how to handle incomplete records by identifying their causes, understanding the challenges they present, and being able to prepare accurate financial statements.

KEY IDEAS

- **Capital Approach:** This is a method of estimating profit or loss by comparing the owner's capital at the beginning and end of a period, while considering additional capital introduced and drawings made.
- **Income Statement Approach:** This is a method where various components of revenue and expenses are reconstructed to estimate net profit or loss. This involves gathering available data such as sales, purchases and operating expenses to create a profit and loss statement.
- **Incomplete Records** is a situation where a business or organisation does not maintain a complete and systematic set of accounting records, often due to using a single-entry system or informal bookkeeping practices.
- **Non-profit Organisations:** These are organisations established to serve a social, educational, religious or charitable purpose without the intention of making a profit for their owners or stakeholders. Any surplus revenue generated is reinvested to further the organisation's mission.
- **Single Entry System:** This is a simplified accounting method that records only one side of each transaction, typically focusing on cash and personal accounts. It lacks the detailed structure of double-entry bookkeeping and may result in incomplete records.

INTRODUCTION TO NOT-FOR-PROFIT MAKING ORGANISATION

Meaning of Not-for-Profit Making Organisation

Not-for-profit organisations are groups or institutions that work to help people or serve the community instead of making money. These organisations are sometimes called non-trading organisations because they do not sell products or services for profit. Examples of such groups include churches, mosques, schools, associations, societies and clubs. They focus on providing support, education or social activities to benefit the public without aiming to make money for themselves.

Sources of finance for not-for-profit making organisations include:

1. Subscription fees/dues
2. Entrance/registration fees
3. Life membership fees
4. Donations received
5. Profit from trading activities, e.g., restaurants, entertainment, etc.
6. Government grants

Purpose of Not-for-Profit Organisations

Not-for-profit organisations are created to serve purposes other than making money. Their main goal is to help people or support a specific cause without giving extra income to owners or shareholders. Some of the key purposes of not-for-profit organisations are summarised in **Table 3.1**.

Table 3.1: Purposes of not-for-profit organisations

Social Welfare	<p>These organisations aim to help solve social problems like poverty, homelessness and hunger.</p> <p>They provide support, aid and services to those who need it most.</p>
Education	<p>Not-for-profits often work to improve education by running schools, colleges, universities, research centres and scholarship programs.</p> <p>They focus on making education more accessible to people.</p>
Healthcare	<p>Many not-for-profits provide medical services, fund medical research and promote health awareness.</p> <p>Their work helps to prevent diseases and improve public health.</p>
Environment	<p>These organisations work to protect and preserve nature. They run activities like conservation projects, recycling programs and advocating for laws that help the environment.</p>
Community development	<p>These organisations focus on improving communities by supporting economic growth, building housing and making better local facilities.</p>
Charity	<p>Not-for-profits collect and distribute money to support different causes.</p> <p>They may offer financial help to individuals or other organisations in need.</p>

Features of Not-for-Profit Organisations

Not-for-profit organisations (NPOs) have unique qualities that make them different from for-profit businesses. Some of the main features include:

1. **Non-Distribution of Profits:** Any profit left over (surplus) is used to further the organisation's goals and activities instead of being shared among owners or shareholders.
2. **Purpose-Driven:** These organisations are started for a specific reason, such as helping society, supporting education, doing charitable work, promoting religion or helping local communities.

3. **Tax-Exempt Status:** Many NPOs do not have to pay income taxes on the money they receive. This allows them to use more of their funds to support their cause.
4. **Funding Sources:** They get their money from different places, such as donations, grants, membership fees, fundraising events and sometimes government aid. Some may also earn money through activities that are in line with their mission.
5. **Governance:** NPOs are often managed by a board of directors or trustees who oversee the organisation's operations. These board members usually volunteer their time to make sure the organisation follows its mission and legal requirements.
6. **Transparency and Accountability:** NPOs need to be clear and open about how they use their funds. They often provide regular financial reports to show donors, members and the public how their money is spent.
7. **Legal Status:** These organisations must register and follow specific laws and regulations that differ by country or region. This includes keeping proper records and meeting reporting requirements.
8. **Social Impact:** The success of an NPO is measured by how much positive change it creates, not by how much profit it makes. People often judge their effectiveness by measuring the extent to which the achievement of their goal benefits society.
9. **Membership and Participation:** Many NPOs have members who pay membership fees and actively take part in the group's activities and decision-making.
10. **Ethical Standards:** NPOs are expected to operate honestly and fairly. They should treat people with respect and uphold high ethical values in all their work.

Activity 3.1 Discussion on examples of organisations that help people in your local community or area

1. Turn to your partner and discuss examples of organisations that help people in your
2. local community or area. Do you think they are not-for-profit organisations? Why?
3. With your partner, define what you understand to be a not-for-profit organisation.
4. Share your definition and examples as part of a wider class discussion. Refine your answer if needed as a result of these discussions.

Activity 3.2 Discussion on not-for-profit organisations

1. Your teacher will arrange you in small groups to continue your discussion on not-for-profit organisations. In your groups, answer the following questions.
 - a. What are the purposes of not-for-profit organisations?

- b. What makes not-for-profit organisations different from profit-making organisations?
 - c. How are not-for-profit organisations funded?
2. Record your answers in your workbooks.

Activity 3.3 Purpose and Features of NPOs

1. In your groups, study the case below and provide answers to the questions that follow.

On a visit to Nyameye, Mr Bempong observed the poverty in the local community, with many people struggling with the affordability of housing and providing food for their families. Following his visit and in collaboration with international colleagues, they founded the Skills Development Club as a not-for-profit organisation. Their main aim was to provide food and shelter to homeless individuals in the Nyameye community.

- a. What are the Skills Development Club's primary purposes and features?
 - b. How does Skills Development Club differ from institutions that are set up to make a profit?
 - c. What implications does the Skills Development Club's purpose have on its operations and financial management?
2. Present your answers on a manila card to your class for discussion and feedback.

Activity 3.4 Self-Assessment

Answer at least one of the following questions to support the review of your learning from this lesson.

1. Identify the sources of funding for not-for-profit making organisations
2. Explain the purpose of not-for-profit making organisations
3. Discuss the features of not-for-profit making organisations.

NOT-FOR-PROFIT MAKING ORGANISATIONS

Terminologies used in the Administration of Not-for-Profit Making Organisations

Summarised below is a list of terms commonly used in the financial administration of not-for-profit making organisations. It is important to be familiar with these terms before we move on to look at the accounts for NPOs and how to prepare their financial statements.

1. **Accumulated Fund:** This is like the main capital or total worth of a not-for-profit organisation. It is calculated by finding the difference between everything the organisation owns (assets) and what it owes (liabilities) at any given time.
2. **Subscription:** This is a regular payment or dues that members make to the not-for-profit organisation. Members might pay these dues daily, weekly, monthly, quarterly, twice a year or yearly. If a member has not paid their dues by the time the accounts are prepared, it is called a *subscription in arrears* and is listed as a current asset on the organisation's balance sheet. If a member pays more than their required dues, it is called a *subscription prepaid* and is recorded as a current liability on the balance sheet.
3. **Receipts and Payments Account:** This is similar to the cashbook used by profit-making businesses. The left side (debit side) shows the starting cash or bank balance and all the money received, while the right side (credit side) shows all the payments made and the ending cash or bank balance.
4. **Income and Expenditure Account:** This account is like the profit and loss account of a regular business. It only records regular income and expenses and shows whether the organisation has a surplus (that is, if their income is greater than expenses) or a deficit (if their expenses are greater than income).
5. **Entrance Fees:** These are payments made when someone first becomes a member of a club or organisation. The money received from entrance fees is usually recorded as income in the year it is received.
6. **Honorarium:** This is a payment or token of appreciation given to a professional or expert who provides services to the not-for-profit organisation. It is recorded as an expense for the organisation.
7. **Bar Profit:** This is the profit earned from activities like selling drinks or food in a not-for-profit organisation. It is calculated by preparing a bar trading account where the cost of what was sold is subtracted from the money earned from sales.

Format of Receipts and Payments Account for a Not-for-Profit Organisation

An example of a receipts and payments account for an NPO is included below.

Receipt and Payment Account

		GH¢		GH¢
Cash in hand (1/1/2021)		xxx	Purchase of office equipment	xxx
Cash at bank (1/1/2021)		xxx	Purchase of furniture	xxx
Subscriptions: 2020	xxx		Repairs	xxx
	2021 xxx		Wages and Salaries	xxx
	2022 xxx	xxx	Donation (Given out)	xxx
Donations (received)		xxx	Fund raising expenses	xxx
Sale of programme tickets		xxx	Bar expenses	xxx
Bar sales		xxx	Insurance	xxx
Receipt from bar debtors		xxx	Programmes expenses	xxx
Proceeds from fund raising		xxx	Transport expenses	xxx
Transfer from deposit account		xxx	Secretarial expenses	xxx

Interest on bank deposits	xxx	Rates	xxx
		General Expenses	xxx
		Balance c/d	xxx
	xxxxx		xxxxx

Format of an Income and Expenditure Account

An example of an income and expenditure account for an NPO is included below. The differences between receipts and payments accounts and income and expenditure accounts are summarised in the following table.

Income and Expenditure Account for the year ended.....		
Income:	GHC	GHC
Subscriptions	xxx	
Donations received	xxx	
Bar profit	xxx	xxx
Expenditure:		
Rent and rates	xxx	
Printing and postage	xxx	
Secretary's expenses	xxx	
Salaries	xxx	
General expenses	xxx	
Depreciation: Equipment	xxx	(xxx)
Surplus		xxx
OR		
Deficit		(xxx)

Table 3.2: Differences between receipts and payments accounts and income and expenditure accounts

Receipts and Payments	Income and Expenditure
Receipts are shown on the debit side, and payments are shown on the credit side.	Expenses and losses are shown on the debit side, and income is shown on the credit side.
It starts with the opening balance of cash in hand and at the bank.	It has no opening balances.
Accounts are prepared on a cash accounting basis.	Transactions are treated on an accrual basis, or accounts are prepared on the accrual basis.
Capital expenditure as well as revenue expenditure items appear in the receipts and payments account.	Only revenue expenditure items appear or are included in the income and expenditure account.
The difference of the two sides is the cash in hand and at the bank at the end of the period.	The difference of the two sides is either surplus or deficit for the period
It is a real account.	It is a nominal account.
All receipts and payments are shown irrespective of the year to which they relate.	Only those expenses and income which are related to the period are used to prepare it.

Activity 3.5 Key terminology used in financial accounts for not-for-profit organisations

1. Your teacher will arrange you in small groups. Create your own glossary of key terminology used in the administration of financial accounts for not-for-profit organisations.
2. You may use the internet on digital devices to support your research to generate definitions.
3. Discuss each term and make sure you have a consensus in your group on its definition.
4. Record your glossaries in your workbooks so that you can refer back to them later on.

Activity 3.6 Terminologies in NPO Administration

1. Study the scenario below.

Skills Development Club, a Non-profit-making organisation in Nyameye, has been operating for one year. They decide to prepare an income and expenditure account to know the total amount of income received and how it has been expensed.

2. As the Financial Secretary of the organisation, help the members to get a deeper understanding of the following:
 - a. The purpose of preparing an Income and Expenditure Account.
 - b. The differences between Receipts and Payments Account and Income and Expenditure Account.
3. Type your responses in MS Word format and share with your colleagues for discussion and feedback.

Activity 3.7 Self-Assessment

Answer at least one of the following questions to support the review of your learning from this lesson:

1. Discuss three terminologies that apply to not-for-profit making organisations.
2. Identify the differences between receipts and payments accounts and income and expenditure accounts.

PREPARATION OF FINANCIAL STATEMENT FOR A NOT-FOR-PROFIT MAKING ORGANISATION

How to Calculate the Accumulated Fund (Using a Statement of Affairs)

The accumulated fund (which is like the capital for not-for-profit organisations), is found using the accounting equation:

$$\text{Accumulated fund} = \text{Assets} - \text{Liabilities}$$

This is done through the statement of affairs. In this statement, all the assets are listed on one side and all the liabilities on the other side. The difference between the total assets and total liabilities is what we call the accumulated fund, which represents the organisation's financial worth at a particular moment.

Format of a statement of affairs

STATEMENT OF AFFAIRS AS AT		
ASSETS	GH¢	GH¢
Equipment	xxx	
Motor van	xxx	
Bar stock	xxx	
Subscription accrued	xxx	
Cash/bank balance	<u>xxx</u>	xxx
LESS LIABILITIES		
Subscription in advance	xxx	
Creditors for bar	xxx	
Expenses accrued	xxx	
Creditors	<u>xxx</u>	<u>xxx</u>
Accumulated fund		<u>xxx</u>

An example is presented below.

You have been asked to prepare the Statement of Affairs of NYAMEDEA Fun Club from the following list of balances as at 1st January, 2022.

Bank	1,000
Debtors	5000
Stock	16,000
Machinery	4,000
Loan	5000

Based on this information, the statement of affairs will look like this:

In the books of NYAMEDEA Fun Club

Statement of Affairs as at 1st January, 2022

GH¢		GH¢	
<u>Assets:</u>		<u>Liabilities</u>	
Machinery	4000	Loan	5,000
Stock	16,000	Accumulated fund	<u>21,000</u>
Debtors	5,000		<u>26,000</u>
Bank	<u>1,000</u>		
	<u>26,000</u>		

How to Prepare the Subscription Account

The subscriptions/dues account is created to find out how much should be recorded in the income and expenditure account as subscriptions for the current accounting year.

If any money has been received that does not belong to the current year, it should be subtracted from the total.

On the other hand, any money that is supposed to be collected for the current year but has not been paid yet should be added.

In simple terms, subscriptions that have been paid in advance (beyond the current year) should be subtracted, while subscriptions that are still unpaid (owed for the current year) should be added. This helps to show the true amount of income from subscriptions for the year.

Format of Subscription Account

An example of the format of a subscription account is included below.

Subscriptions Account (2020)

GH¢		GH¢	
Bal. b/f (Owing from previous year - 2019)	xxx	Bal b/f (Advance from previous year (2019)	xxx
Income and Expenditure A/c difference)	xxx	Bad debts (if any)	xxx
Bal. c/d (Advance for next year - 2021)	xxx	Cash received	
		2019	xxx
		2020	xxx
		2021	xxx
		Bal c/d (Owing for current year - 2020)	<u>xxx</u>
	<u>xxxx</u>		<u>xxxx</u>
Bal. b/d (Owing - 2021)	xxx	Bal b/d (Advance - 2021)	xxx

Here is an example

	1/1/2020	31/12/2020
Subscription owing	1,800	750
Subscription prepaid	2500	1250

Subscription received during the year amounted to GH¢ 5,500.

You have been asked to prepare the subscription account for the year.

Solution**Subscription account for the year ended 31st December, 2020**

GH¢	GH¢
Bal. b/d (opening owing) 1800	Bal. b/d (opening prepaid) 2500
Income & Expenditure(Difference) 5700	Receipts & Payments 5500
Bal. c/d (closing prepaid) <u>1250</u>	Bal. c/d (closing owing) <u>750</u>
<u>8750</u>	<u>8750</u>
Bal. b/d 750	Bal. b/d 1250

Activity 3.8 Accumulated fund

1. Form a small group with your friends.
2. In your groups, discuss the method of calculating the accumulated fund using the statement of affairs.
3. Summarise your answers as a brief process flow and record this in your books.

Activity 3.9 Subscription account

In groups, discuss how to prepare a subscription account. Create a template format that you could use in worked examples.

Record this in your books to refer back to later.

Activity 3.10 Calculating the accumulated fund

1. In your groups, analyse the following lists of assets and liabilities of Accounting Social Club for the year ended 31st December, 20X3. Use this information to calculate the accumulated fund.

	GH¢
Furniture and fittings	4,000
Recreational equipment	2,700
Subscription in advance	2,000
Rent accrued	5,000
Caretakers' wages prepaid	500
Subscription in arrears	5,000
Bank	10,000
Cash	1,000

2. Share your answers with another group for discussion and feedback.

Activity 3.11 Preparation of Financial Statements for NPOs

1. You have been given the following information regarding the Unity Fun Club for the year 2018.

	GH¢
Subscriptions unpaid at the beginning of 2018	4,700
2017 Subscriptions received in 2008	4,700
2018 Subscriptions received	38,500
2018 Subscriptions remaining unpaid at the year ended	1,500
2019 Subscriptions received in the current year	5,500

2. In your groups, prepare the club's subscription account based on this information. You may use the templates you created in Activity 3.7 to format your account.
3. Share your answers with another group for discussion and feedback.

Activity 3.12 Preparing statement of affairs

1. Study the following data presented by Skill Development Club covering their assets and liabilities for the year ended 31st December, 20X2

	GH¢
Equipment	12,500
Furniture & Fittings	6,500
Subscription in advance	9,500
Rent accrued	3,890

Cleaners' wages paid	1,580
Bar stock	2,500
Subscription in arrears	2,500
Bank	2,600
Cash	800

2. Prepare a statement of affairs for Skill Development Club to determine their accumulated fund as at December 20X2.
3. Record your answer in your workbooks and share with your teacher for feedback.

PREPARATION OF THE INCOME AND EXPENDITURE ACCOUNT FROM RECEIPTS AND PAYMENTS ACCOUNTS OF NOT-FOR-PROFIT MAKING ORGANISATIONS

How to Prepare the Income and Expenditure Account

The income & expenditure account (the profit and loss account) is prepared by debiting all expenditure like rent, general expense, honorarium, donations given, stationery, electricity, depreciation, etc. and crediting all income like subscriptions, bar profits, surplus from dance, donations received, etc.

If the debit (expenditure) total is more than the credit (income) total, the difference is called a deficit (loss), but if the credit (income) total is more than the debit (expenditure) total, the difference is called a surplus (profit).

Format of Income and Expenditure Account of a Not-for-Profit Making Organisation

The format of an income and expenditure account is shown below .

Income and Expenditure Account for the year ended.....		
	GHC	GHC
Income:		
Subscriptions	xxx	
Donations received	xxx	xxx
Bar profit	xxx	
Expenditure:		
Rent and rates	xxx	

Printing and postage	xxx	
Secretary's expenses	xxx	(xxx)
Salaries	xxx	
General expenses	xxx	
Depreciation: Equipment	<u>xxx</u>	
Surplus		<u>Xxx</u>
OR		
Deficit		<u>xxx</u>

Here is an example

The following is the Receipts and Payments Accounts of VON Social Club for the year ended 31st December, 20X2.

Receipts and Payments for the year ended 31 st December, 2022				
	GHC	GHC		GHC
Cash in hand	1/1/2022	500	Purchase of sports equipment	1,800
Cash at bank	1/1/2022	1,000	Repairs	1,500
Subscriptions		7,500	Salaries	1,700
Donations		2,000	Insurance	1,000
End of year show		15,000	Show expenses	3,200
Transfer from deposit account		<u>3,000</u>	Transport expenses	500
			Secretarial expenses	300
		<u>29,000</u>	Purchase of furniture	3,000
Bal. b/d		16,000	Balance c/d	<u>16,000</u>
				<u>29,000</u>

Additional information

- Equipment was valued at GHC3,250 and furniture GHC1,550 on 31st December, 20X1
- Depreciation is to be provided as follows:

Equipment	GHC505
Furniture	GHC55
- The following expenses were outstanding:

Salaries	GHC300
Transport	GHC100
Repairs	GHC250

You have been asked to prepare the Income and Expenditure Account for the year ended 31st December, 20X2.

Solution

Based on the information provided, the income and expenditure account will look like this:

VON SOCIAL CLUB

Income and Expenditure Account for the Year ended 31st December, 20X2

	GH¢	GH¢		GH¢
<u>Expenditure</u>			<u>Income</u>	
Repairs	1,500		Subscriptions	7,500
Add owing	<u>250</u>	1,750	Donations	2,000
Salary	1,700		End of year show	15,000
Add owing	<u>300</u>	2,000		
Transport expenses	500			<u>24,500</u>
Add owing	<u>100</u>	600		
Insurance		1,000		
Show expenses		3,200		
Secretarial expenses		300		
Depreciation:				
Equipment		505		
Furniture		55		
Surplus		<u>15,090</u>		
		<u>24,500</u>		

Activity 3.13 Preparing income and expenditure account

1. Form small groups with friends.
2. In your groups, discuss how to prepare an income and expenditure account. Create a template format that you could use in worked examples.
3. Record this in your workbooks to refer back to later.

Activity 3.14 Preparation of Financial Statements for NPOs

In your groups, analyse the receipts and payments accounts of God is Good Social Club for the year ending 31st December 20X2.

Receipts and Payments Accounts

	GH¢		GH¢
Cash in hand 1/1/20X2	500	Purchase of sports equipment	1,800
Cash at bank 1/1/20X2	1,000	Repairs	1,500
Subscriptions		Salaries	1,700

20X1	1,200	Insurance	1,000
20X2	4,000	Show expenses	3,200
20X3	2,300	Transport expenses	500
Donations	2,000	Secretarial expenses	300
End of year show	15,000	Purchase of furniture	3,000
Transfer from deposit account	3,000		
		Balance c/d	16,000
	<u>29,000</u>		<u>29,000</u>

Additional information

Equipment was valued at GHC3,250 and furniture GHC1,550 on 31st December, 20X1

Depreciation is to be provided as follows:

- Equipment GHC505
- Furniture GHC55

The following expenses were outstanding:

- Salaries GHC300
- Transport GHC100
- Repairs GHC250

Subscriptions owing by members were as follows:

- 31st December, 20X1 GHC1,200
- 31st December, 20X2 GHC2,100

The balance in the bank deposit account of 31st December, 20X1 was GHC3,000.

Prepare each of the following:

- Statement of affairs as of 31st December, 20X1;
- Subscription account for the year ended 31st December, 20X2;
- Income and expenditure account for the year ended 31st December, 20X2.

Present your answers on flip charts and share with another group for discussion and feedback.

Activity 3.15 Subscription, expenditure account and Statement of affairs

- In pairs, study the data below relating to the Skills Development Club.

Account balances in the books of Skills Development Club as at 31st December 20X7 are as follows:

	GH¢		GH¢
Plots of Land	120,000	Subscription in arrears	2,400
Building (Cost GH¢96,000)	72,000	Subscription in advance	900
Equipment (Cost GH¢12,000)	8,000	Bank and cash	19,500
Furniture (Cost GH¢9,000)	7,200	Accrued expenses. 3,000	

The financial secretary of the club prepared the following receipts and payments account for the year ended 31st December, 20X8

Receipts and Payments Accounts

	GH¢		GH¢
Balance at 1/1/20X8	19,500	Entertainment	9,000
Subscription	90,000	Repairs and maintenance	4,500
Entrance fees	12,000	Postage and telephone	2,100
Sale of land	48,000	Extension to buildings	14,000
Bank interest	2,000	Equipment	4,200
Donations	7,500	Electricity	3,600
Sundry income	1,500	Salaries	60,000
		General expenses	3,000
		Balance at 31/12/20X8	8,100
	180,500		108,500

The following additional information has also been supplied by the financial secretary of the club

- Subscriptions received included GH¢2,400, which had been in arrears as of 31st December, 20X7 and GH¢1,300, which had been paid for the year starting from January 2019. Subscription by members as of 31st December 2018 amounted to GH¢3,000.
- The land sold had a book value of GH¢40,000 on 1st January 2018.
- Details of accrued expenses are as follows:

	31/12/2017	31/12/2018
	GH¢	GH¢
Electricity	300	400
Salaries	2,700	6,000
Total	3,000	6,400

- It is the policy of the club to depreciate assets as follows;

- i. Buildings 5% on cost
 - ii. Equipment 20% on cost
 - iii. Furniture 10% on cost
2. Prepare the following for Skills Development Club:
 - a. Subscription account for 20X8.
 - b. Income and expenditure account for the year ended 31st December, 20X8.
 - c. Statement of affairs as at 31st December, 20X8.
3. Present your answers to your teacher for feedback.

Activity 3.16 Preparation of Financial Statements for NPOs

1. Read and discuss the case below

The Navrongo branch of Tree Planting Club was formed on 1st January 20X6. During the club's first annual general meeting on 31st December 20X6, the honorary financial secretary presented to the members the following report covering the first year's activities of the club.

"The financial results of our first year's operation have been successful. 100 senior members joined the club and each of them paid in full the annual subscription of GH¢150. In addition, 20 of these members paid their subscriptions for the second year (GH¢150 each). 50 junior members also joined the club but only 45 have paid their annual subscriptions of GH¢100 each. The remaining five have promised to pay their subscription on 15th January 20X7.

We are thankful to Mr. Fertilizer who lent the club an amount of GH¢20,000 on 1st July 20X6 at an annual interest rate of 10%. The loan is to be repaid in the year 20X9. The interest for this year has been paid.

Our social activities proved very successful; receipts were GH¢12,000, compared with expenses of GH¢4,500. The expense figure (GH¢4,500) includes GH¢500 outstanding bills, which the club will settle in January, 20X7. Also, in January, we paid GH¢9,000 for office furniture, which, by my estimation, can be used for nine more years.

Payment for operating expenses was as follows:

- a. rent GH¢3,000.
- b. electricity GH¢1,800.
- c. stationery GH¢600
- d. miscellaneous expenses GH¢1,200.

The electricity bill for December, GH¢200, has just been received, but payment will be affected next week.

We have deposited GH¢30,000 into a savings bank account, and the remainder of our cash is now in the office safe. I estimate that we have earned GH¢6,000 interest during the year on the savings account".

2. Based on this, prepare the following accounts for the year ended 31st December, 20X6.
 - a. Subscription account
 - b. Receipts and payments account
 - c. Income and expenditure account.
3. Show the Statement of Affairs of the club as at 31st Dec. 20X6.
4. Share your answers with your teacher for feedback.

INTRODUCTION TO SINGLE ENTRY AND INCOMPLETE RECORDS

What are Single Entry and Incomplete Records?

A single-entry and incomplete records system is a way of recording business transactions where the usual double-entry bookkeeping method is not used.

In this system, the two-sided effect of each transaction is not recorded. Instead, only a few important accounts are kept, which means not all financial activities are fully tracked, hence the term “incomplete records”.

This type of system often relies on basic cash-based accounting. Consequently, it does not include detailed records of assets, liabilities, expenses or income.

Characteristics of Single-Entry Systems and Incomplete Records

Some of the key characteristics of single entry and incomplete records are summarised in the table below.

Table 3.3: Key characteristics of single-entry and incomplete records

No Debits and Credits	The system does not use the concept of debits and credits, which are essential in double-entry bookkeeping.
Not Systematic	The records are not kept in an organised way. This means that means accountants often need to piece together records from limited data. This process can be slow and may lead to mistakes.
Partial Financial Data	Only some financial information, like cash receipts and payments, is recorded. Other important transactions are often left out.

Scattered Data:	The financial information is not kept in a consistent format, making it hard to prepare accurate financial reports.
Different Profit Calculation Methods	Businesses using this system may not use the same method for calculating profit every time, leading to inconsistencies.
No Clear Distinction	A distinction between long-term (capital) and short-term (revenue) expenses is usually not made clear
No Adjustments	Adjustments for items like closing stock and depreciation on assets are often not made.

Reasons for Using Single Entry and Incomplete Records

Whilst it may seem that single-entry systems and incomplete records are less rigorous, there are reasons why business entities choose to use them. The most common reasons are listed below.

1. **Simple and Easy to Use:** This system is simpler to understand and use, especially for people who do not have a formal accounting background.
2. **Good for Small Businesses:** It works well for small operations that have few transactions and simpler financial needs.
3. **Saves Cost and Resources:** This system is cheaper to maintain because it requires less money and fewer people to manage.
4. **Saves Time:** Recording and keeping financial data takes less time. This is useful for small businesses that do not have much time to spare.
5. **Lack of Accounting Knowledge:** Business owners or managers might not have enough knowledge of accounting principles, so they end up using simpler or incomplete records.
6. **No Need for External Reporting:** Some small businesses do not need to prepare detailed financial statements for outside reporting.
7. **Avoiding Taxes:** Some businesses may choose not to keep full records to reduce their tax obligations.
8. **Keeping Business Details Private:** Some businesses prefer not to have detailed records to keep their financial operations private and away from public view.

Activity 3.17 Group discussion

1. Take five minutes to think about the type of business that may not keep full financial records using the double-entry system.
2. Make a note of them in your workbook and be prepared to share your examples in a class discussion.

Activity 3.18 Characteristics and reasons for Incomplete records

- Form a small group with your friends. In your group, discuss the following:
 - The concept of single entry and incomplete records.
 - The characteristics of single-entry and incomplete records.
 - The reasons for using single-entry and incomplete records.
- Summarise your discussion in a notebook and make a flip chart presentation to the class for discussion and feedback.

Activity 3.19 Characteristics and reasons for Incomplete records

- Copy the table below into your book.
- Read the statements carefully and state if you “AGREE” or “DISAGREE” with each one regarding incomplete records.

	STATEMENT	AGREE/DISAGREE
	Incomplete records refer to a bookkeeping system where only partial financial transactions are recorded.	AGREE
A	Incomplete records are kept in an organised and detailed manner	
B	Recording and keeping financial data takes less time when using the single-entry system	
C	Businesses with a very low volume of transactions may use incomplete records because a full accounting system is unnecessarily complex for their needs.	
D	Incomplete records do not follow the double entry system in accounting for business transactions	
E	A business using incomplete records will find it easy to track historical financial trends for decision-making purposes.	
F	A statement of affairs can be used to estimate the financial position of a business that maintains incomplete records	
G	Incomplete records typically result in a lack of detailed information about assets and liabilities	
H	Incomplete records can still accurately capture all accounts payable and receivable without additional adjustments.	
I	Single-entry bookkeeping, which results in incomplete records, focuses primarily on recording cash inflows and outflows	

J	Incomplete records can still provide sufficient data to accurately calculate tax liabilities without further analysis.	
K	A major advantage of incomplete records is that it makes it easy to prepare a comprehensive balance sheet.	
L	A business might use incomplete records due to a lack of accounting knowledge or resources	
M	One reason businesses choose incomplete records is to achieve better long-term financial tracking	
N	Preparing financial statements from incomplete records involves challenges like reconciling unrecorded transactions	
O	The use of incomplete records makes it easier for businesses to implement accrual-based accounting practices	

3. Compare your results with a colleague for feedback

DISADVANTAGES OF SINGLE ENTRY AND PREPARING PROFIT OR LOSS USING THE CAPITAL COMPARISON METHOD

Disadvantages of Single Entry and Incomplete Records

Using a single-entry or incomplete records system can create difficulties when trying to prepare financial reports. Here are some of the main drawbacks:

1. **Less Accurate and Trustworthy:** These systems are more likely to have mistakes because they do not have built-in checks and balances like the double-entry bookkeeping system has. This affects how reliable the financial reports are.
2. **Risk of Poor Financial Management:** With incomplete record-keeping, businesses may struggle to manage their finances properly and make sound decisions due to lack of reliable data.
3. **Hard to Get Loans or Investments:** Banks and investors usually ask for detailed financial statements before giving loans or investing in a business. Single entry or incomplete systems often cannot provide the needed information hence making it difficult to secure funding.
4. **Limited Business Growth:** Without accurate financial data, it will be difficult for a business to plan for expansion, manage its budget or create effective strategies.
5. **Operational Problems:** Single entry and incomplete records can make everyday business operations less efficient and harder to manage smoothly.
6. **Difficulties in Auditing:** Audits become more challenging because there are not enough detailed records. This makes it easier for mistakes or inaccuracies to go unnoticed.

7. **Problems with Tax Compliance:** Many tax authorities require businesses to keep detailed and accurate financial records. Single-entry systems and incomplete records often do not meet these standards, leading to possible issues with tax reporting. This can result in mistakes in declaring income, expenses and other financial details needed for tax filings.
8. **Higher Risk of Fraud:** These systems are more open to fraud since each transaction is only recorded once, making it easier for errors or dishonest actions to go unnoticed compared to double-entry systems, where every transaction is cross-checked.

Preparation of profit and loss using the capital balances approach from single-entry records

We will now look at how to prepare profit and loss statements from single-entry records based on the following approaches:

1. Using the capital balance or statement of affairs
2. Using the income statement.

Capital or Statement of Affairs Approach

This approach is used to find the capital by preparing a statement of affairs, which involves subtracting total liabilities from total assets. It is especially useful when there is not enough information to create full financial statements.

This method helps to calculate profit when only details like assets, liabilities, drawings and additional capital are available.

Steps to Follow

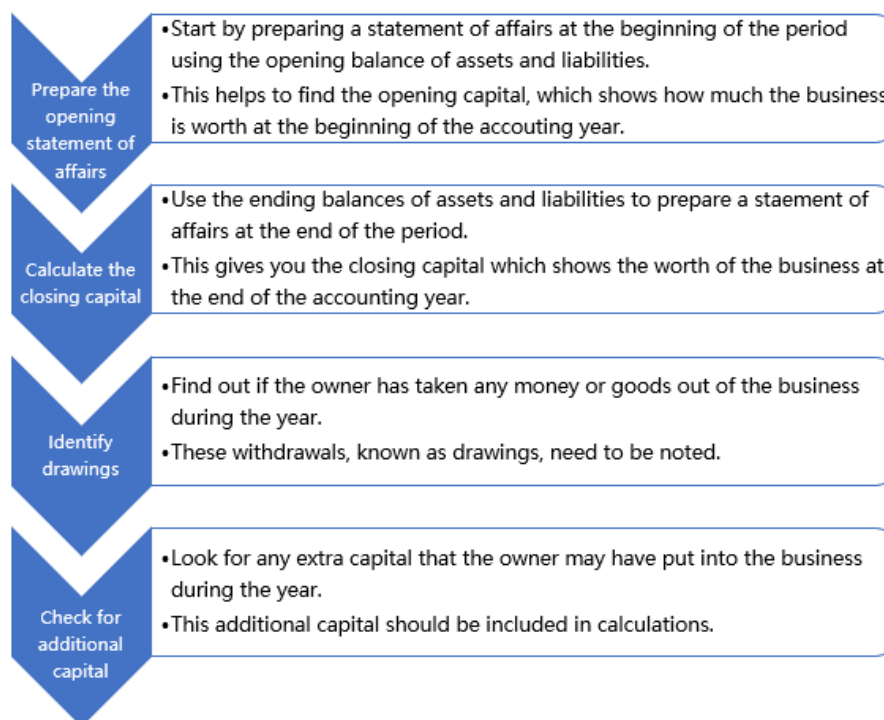


Figure 3.1: Preparation of profit and loss using the capital balances approach

The format of statement of profit or loss

Statement of profit or loss for the year

Closing capital	xxx	
Add drawings	<u>xxx</u>	xxx
Opening capital	xxx	
Add additional capital	<u>xxx</u>	xxx
Profit/loss		xxx

The calculations can be summarised as follows

Net profit = (closing capital + drawings) – (opening capital + additional capital)

OR

Net profit = (closing capital + drawings) – opening capital – additional capital

NOTE

1. The drawings have been added to the closing capital because if the drawings had not been made, the closing capital would have been greater.
2. The additional capital has been added to the opening capital because both create the total amount that the proprietor has put into the business.

Here is an example

DIB presented the following information relating to the year ended 31st December, 20X0.

	GH¢
Capital – 1/1/20X0	35,000
Capital – 31//12/20X0	43,000
Drawings in cash and goods	7,000
Capital introduced	5,000

Calculate DIB’s profit or loss from the information above.
The resulting profit and loss statement will look like this:

In the books of DIB

Statement of profit or loss for the year ended 31/12/20X0

	GH¢	GH¢
Closing capital	43,000	
Add: drawings	<u>7,000</u>	50,000
Less: opening capital	35,000	
Capital introduced	<u>5,000</u>	<u>40,000</u>
Profit <u>10,000</u>		

Activity 3.20 Disadvantages of Incomplete Records

1. In groups, discuss the disadvantages of incomplete records and the single-entry system.
2. Summarise your discussions on a manila card.
3. Make a poster presentation to your class for feedback.

Activity 3.21 Capital Approach Format for Profit and Loss Determination

1. Prepare five flash cards and write on each of the cards one of the following
 - a. Add drawings
 - b. Profit/loss
 - c. Opening capital
 - d. Closing capital
 - e. Add additional capital
2. Arrange the flash cards on a flipchart to depict the capital approach format for the determination of profit or loss under incomplete records.
3. Share with your colleague for feedback. Make a note of your agreed process in your workbooks to refer back to later.

Activity 3.22 Preparing statement of affairs

1. Working in groups, analyse the information in the following scenario.

Joshua runs a butchery for which proper accounting records are not kept. However, you have been able to ascertain the following:

	01/01/20X1	31/12/20X1
	GH¢	GH¢
Creditors	720	1180
Debtors	300	550
Stock	840	1140
Bank	1,570	120 O/D
Cash	230	246
Motor vehicle	7,200	5,400
Fixtures and fittings	4,000	3,000

Joshua withdrew GH¢250 cash and sold GH¢20 worth of meat per week.

2. Within your groups, organise the following using this information:

- a. A statement of affairs as of 1st January 20X1 and 31st December, 20X1.
 - b. A statement of profit for the year ended 31st December, 20X1.
3. Compare your statements with another group for discussion and feedback.

CONVERTING FROM SINGLE ENTRY TO DOUBLE ENTRY OF INCOMPLETE RECORDS

Income Statement Approach

The income statement approach involves preparing an income statement and a statement of financial position at the end of the accounting year to show the financial position of the business.

The business owner typically keeps a cashbook that records all cash and bank transactions, as well as balances of debtors (people who owe the business) and creditors (people the business owes) at both the beginning and the end of the year.

To calculate profit using this method, follow the steps discussed below.

Table 3.4: Steps for Preparing Final Accounts from Incomplete Records

1. Prepare the opening statement of affairs	<ol style="list-style-type: none"> a. Start by creating a statement of affairs at the beginning of the period to find out the opening capital. b. This shows the financial worth of the business at the start of the year.
2. Adjust the cashbook	<ol style="list-style-type: none"> c. Make any necessary adjustments to the cashbook to ensure that it shows the correct closing balance at the end of the year. d. This helps to reflect the true cash position.
3. Find total sales	<ol style="list-style-type: none"> e. Prepare the receivables ledger control account to determine the credit sales (sales made on credit). f. Add these credit sales to the cash sales recorded in the cashbook to get the total sales for the year.
4. Determine the total purchases	<ol style="list-style-type: none"> g. Prepare the payables ledger control account to find the credit purchases (purchases made on credit). h. Add these to the cash purchases recorded in the cashbook to calculate the total purchases for the year
5. Adjust expense and revenue account	<ol style="list-style-type: none"> i. Make adjustments to the expense and revenue accounts, including depreciation, to ensure that the closing balances are accurate. j. These adjustments are necessary for the preparation of the profit and loss account.
6. Include missing transactions	<ol style="list-style-type: none"> k. Record any transactions that were not included in the books, such as assets introduced by the owner, or drawings (money or goods taken out by the owner).

7. Prepare the final income statement and the statement of financial position

1. Once all adjustments have been made, prepare the income statement to show the profit or loss for the year and statement of financial position to show the business's overall financial status at the end of the year.

Activity 3.23 Steps for Preparing Final Accounts from Incomplete Records

1. In groups, discuss the steps involved in the process of using the income statement approach to determine the profit or loss and financial position of a business.
2. Create a flowchart that outlines each of the steps you have discussed.
3. Make a poster presentation or PowerPoint presentation to your class for feedback.

Activity 3.24 Preparing income statement and statement of financial position

1. Working in groups, review the information below and complete the task.

Bank account summary for a retailer, Joe, for the year 20X4.

	GHC
<i>Balance on January 1, 20X4</i>	<i>1,448</i>
<i>Cash from customers</i>	<i>34,722</i>
<i>Payment to suppliers</i>	<i>28,364</i>
<i>Rent and rates</i>	<i>1,488</i>
<i>Drawings</i>	<i>5,816</i>

You are given the following additional information:

	Jan. 1	Dec. 31
	GHC	GHC
Furniture	1,000	1,000
Stock	5,260	4,380
Debtors	2,900	3,270
Creditors	3,750	3,940

During the year, wages amounting to GH¢1,300 and GH¢220 worth of general expenses were paid in cash out of the cash received from customers. All the remaining cash received from customers was paid to the bank.

2. You are required to prepare an income statement and a statement of financial position as of December 31, 20X4.
3. Compare your responses with another group for discussion and feedback.

PREPARATION OF FINAL ACCOUNTS OF SOLE TRADER FROM INCOMPLETE RECORDS

In the last lesson, you learned the steps involved and the methods for preparing an income statement and a statement of financial position. In this lesson, you will learn how to use those steps to prepare financial statements for sole proprietors who do not keep detailed or proper records. This skill is important for handling businesses where full bookkeeping is not maintained, so that you can piece together the information needed to create clear and reliable financial reports.

Activity 3.25 Preparation of statement of affairs, account and financial position

1. Luther, a sole trader, has the following financial details for the year ended 31/12/20X5.

Cashbook (Summary)

	GH¢		GH¢
Balance b/d	6,000	Creditors	12,000
Sales	10,000	Salaries	5,000
Debtors	20,000	Rent and rates	4,000
Insurance	1,000		
Balance c/d	14,000		
	36,000		36,000

Additional information

	01/01/20X5	31/12/20X5
GH¢	GH¢	
Stock	4,000	2,000
Land and building	15,000	15,000
Motor vehicle	6,000	4,000
Debtors	2,000	3,000
Creditors	1,000	500
Insurance owing	2,000	6,000

2. You are required to prepare
 - a. Statement of affairs as of 1st January, 20X5
 - b. Income statement account for the year ended 31/12/20X5
 - c. Statement of financial position as at 31/12/20X5.

Activity 3.26 Calculate the capital, net profit and financial position

Emma started a business on 01/01/20X6 with **GH¢8,000** capital in cash. She kept very few records of her transactions in the first year of business. The assets and liabilities of the business as at 31/12/20X6 were:

	GH¢
Freehold property	152,000
Debentures	100,000
Stock	48,000
Debtors	5,600
Creditors	15,200
Cash and Bank	10,800

During the year, Emma withdrew GH¢18,000 cash for her personal use. She also paid GH¢12,000, received from the sale of her private car, into the business bank account.

You are required to:

- a. Calculate the capital as at 31/12/20X6.
- b. Prepare the statement of the net profit for the year ended 31/12/20X6.
- c. Prepare statement of financial position as at 31/12/20X6.

Activity 3.27 Account Preparation for a Sole Trader

1. In pairs, read the case below.

Alhaji Sofo started trading as a general merchant on 1 January 20X0.

During his first month of trading, his total sales were GH¢53,000, made up of GH¢10,800 for cash and the remainder on credit terms.

He started the business with his accumulated savings of GH¢20,000 and a loan of GH¢10,000 at an interest rate of 30% per annum.

He rented a store on 1 January and paid GH¢500 as two months' rent.

Operating expenses, including assistants' wages paid during the month, totalled GH¢980.

Electricity bill for the month, estimated at GH¢50, remained unpaid as of 31st January 20X0, and insurance premium for 20X0, amounting to GH¢1,200, was paid on 1st January.

Purchases for the month were GH¢47,000, and so far, GH¢7,000 had been paid to the supplier at 31st January 20X0.

Alhaji Sofo took goods costing GH¢30 for his personal use.

Stock remaining unsold on 31st January cost GH¢15,000.

2. Discuss and prepare the following for Alhaji Sofo:
 - a. The bank account of his business as at 31 January 20X0;
 - b. The trading and profit and loss account for the month of January 20X0;
 - c. A balance sheet as at that date.
3. Exchange your response with another pair for feedback.

Activity 3.28 Account Preparation for a Sole Trader

1. In groups, study the following records which have been extracted from the books of Joe Tampuli Enterprise for the year ended 31st December, 20X8

	GH¢
Capital	10,000.00
Receipts from debtors	98,225.00
Payment to creditors	54,482.50
Advertising	240.00
Postage and telephone	281.50
Salaries	18,087.50
Electricity	487.00
Rent	3,600.00
Carriage outwards	618.50
Return inwards	234.50
Return outwards	412.50
Transport and travelling	2,615.00
Repairs and maintenance	3,256.50
Furniture & Fittings (Cost)	15,725.00
Motor Vehicles (Cost)	16,000.00

Accumulated depreciation:

Furniture & Fittings (1/1/20X8)	4,690.00
Motor vehicles (1/1/20X8)	6,000.00
Cash	4,265.50

Additional Information

		31/12/20X7	31/12/20X8
GHC	GHC		
i.	Stock	6,742.50	9,162.00
ii.	Electricity	–	43.50 (Credited)
iii.	Rent	–	400.00 (Credited)
iv.	Debtors	5,000.00	10,000.00
v.	Creditors	12,500.00	17,500.00

Depreciation is to be provided as follows

- i. Motor vehicles 25%
- ii. Furniture & Fittings 20% on cost

2. Prepare the following for Joe Tampuli Enterprise using MS Excel Spreadsheet
 - a. Trading and Profit and Loss account for the year ended 31st December, 20X8
 - b. Balance sheet as at that date
3. Present your work to your teacher for assessment

EXTENDED READING

- Jerry J. Weygandt, Paul D. Kimmel & Donald E. Kieso. Accounting Principles
- Wood, F. & Sangster, A. Business Accounting 1
- Any approved financial accounting book by NaCCa can be used as further reading material.
- You can also click on the following links or scan the QR codes to watch tutorial videos on the following topics

- **Accounts for Non-Trading Organisations**

https://youtu.be/ko_fIKHyCt8?si=LNiy-D-w8F8Vfoad

https://youtu.be/Zr2p0Ii1Qfg?si=rJSBN_7VxdCYNNaE



- **Single Entry and Incomplete Records**

<https://youtu.be/rIWeycaj7oQ?si=iW9QMYiMa2SCyo-1>

<https://youtu.be/1tpL5ZL5TSA?si=N3QU-GGa9oYxWGcQ>



REVIEW QUESTIONS 3

1. List and describe the main types of accounts and financial statements prepared by not-for-profit organisations and their purpose.
2. Summarise four reasons why a business may use single entry or have incomplete records
3. Explain three differences between income and expenditure accounts and receipt and payment accounts of not-for-profit organisations.
4. Why is it difficult to prepare comprehensive financial statements with incomplete records?
5. Examine the role of not-for-profit organisations in addressing social issues. Provide examples of how specific organisations have made a positive impact in their communities.
6. On January 1, 20X2, the assets and liabilities of Smart Move Social Club were as follows:

	GH¢
Club house (Cost GH¢400,00)	352,000
Equipment	116,900
Electricity owing	12,500
Creditors for bar stocks	13,800
Subscription prepaid	11,200
Subscription in arrears	8,000
Bar stock	19,700
Cash at bank	24,300
Insurance prepaid	5,800

During the year ended December 31, 20X2, receipts and payments were as follows

<u>Receipts</u>	GH¢
Bar Sales	293,900
Subscriptions:	
20X1	8,000
20X2	98,700
20X3	15,600
Donations	20,000
Collection at dances	81,400
<u>Payments</u>	
Dance expenses	25,900
Purchase of bar stock	35,000
Electricity	75,000
Payment of bar supplies	168,500
Insurance	21,000
New equipment	48,000
Bar wages and expenses	17,000

Secretary's expenses	9,000
General expenses	22,000

You are given the following additional information at the end of the year

- Bar stock GH¢21,100
- Clubhouse and equipment to be depreciated at 12½% on cost
- Subscription owing amounted to GH¢15,000
- Secretary's expenses owing GH¢6,300
- Bar stock owing GH¢27,900

You are required to prepare:

- the bar trading account for the year ended 31/12/20X2
- the income and expenditure account for the year ended 31/12/20X2
- the statement of Affairs as at that date

7. Naa Adjele, a second-hand cloth dealer has asked you to help her ascertain her profit or loss for the year ended 31st December 20X0 and a Balance Sheet as at that date. She has not been keeping proper books of account for her business. However, she was able to present to you the following assets and liabilities.

	1 Jan 20X0	31 Dec 20X0
	GH¢	GH¢
Stall shop	7,200.00	6,720.00
Motor Van	2,400.00	1,968.00
Fixtures & Fittings	1,008.00	816.00
Stocks	2,880.00	4,320.00
Cash at bank	448.80	792.00
Cash in hand	96.00	288.00
Trade creditors	240.00	480.00
Rent owing	288.00	504.00

She also provided you with the following additional information:

- In the course of the year, she withdrew cash to the tune of GH¢1,968 for her brothers
 - She won a raffle amounting to GH¢300 and used the proceeds as additional capital for the business
8. How can the results from the Income and Expenditure account and the Statement of Affairs provide insights into the financial health of a non-profit organisation?
9. Compare and contrast the income statement approach and the capital approach (Statement of Affairs) for preparing financial statements from incomplete records. Evaluate which method provides more reliable financial data.

SECTION

4

MATERIAL PURCHASING AND STORAGE, INVENTORY CONTROL, LABOUR AND LABOUR REMUNERATION AND OVERHEAD ANALYSIS



COST ACCOUNTING

Controlling Cost To Improve Organisational Performance

INTRODUCTION

This section is designed to help you gain the knowledge, skills and tools needed to control costs effectively, improve your organisation's performance, reduce unnecessary expenses, and increase profitability. By working through this lesson, you will learn how to recognise what makes up a cost accounting system and the type of information it provides, understand what inventory is, how inventory control works, and how to calculate inventory levels, explain the concept of labour and related terms as well as how to calculate employee remuneration, and finally, prepare an overhead analysis sheet and work out overhead absorption rates.

These topics are essential for you as a cost accounting student. By mastering them, you'll discover how effective costing systems supply reliable data, helping businesses set prices, manage production, make investment choices, and assess their own performance. Ultimately, you'll be equipped to spot areas where improvements can be made and support better decision-making within an organisation.

KEY IDEAS

- Inventory refers to goods or materials that a business owns or intends to sell or use for production purposes.
- Inventory control involves the processes and procedures for managing and regulating inventory levels efficiently.
- Inventory level is the quantity of inventory a business holds at any given moment.
- Labour is the work carried out by employees to produce goods or deliver services.
- Overhead analysis ensures that indirect costs are allocated fairly and appropriately across different departments or products.
- Remuneration is the compensation employees receive for their contributions and work.

THE PROCESS OF PURCHASING AND STORING MATERIALS

Material Control Process

The term “materials” refers to all commodities that are consumed in the production process. Materials can be grouped into direct and indirect materials.

Direct materials are those whose consumption can be identified with the specific product or service, for example, raw materials.

Indirect materials are those that cannot be conveniently identified with a product or service, for example, sandpaper, lubricants and cardboard.

The Purchasing Process

When a business buys materials from a supplier, it's important to keep a record of the purchasing process. The reasons for documenting materials include the following.

1. To make sure the steps for ordering, receiving, and paying for the materials are done correctly;
2. To confirm that the ordered goods were delivered and match in quantity and quality;
3. To keep a record of the materials bought for financial purposes;
4. To provide information on material costs for the cost accounting department.

Procedures and documents

1. The department that needs materials (like the Production Department) sends a request note to the Stores Department, asking for the materials they need.
2. If the Stores Department does not have the materials in stock, they send a request to the Purchases Department to buy the materials. This request must be approved by the Stores Manager.
3. The Purchasing Officer asks suppliers for prices (quotations). After comparing the quotes, they chose the best one. Then, they send a purchase order to the selected supplier, specifying what is needed, how much, the quality and the price.
4. When the supplier delivers the materials, they include a Goods Delivery Note that shows what was sent and how much. One copy stays with the Stores, and another copy is kept by the supplier.
5. The Stores Department then makes a Goods Received Note to record the materials they received, including details like the item code and quantity. This process helps ensure that materials are bought and received properly, keeping everything organised.
6. Copies of the Delivery Note and the Goods Received Note are sent to the Accounts Department, where they are matched with the Purchase Order.
7. The Accounts Department reviews the invoice details and compares them with the Purchase Order and the Goods Received Note before paying the supplier.

Storage of Materials

Storage means keeping materials in a safe and secure way, making sure they are protected from loss, theft or damage. The Stores Department should keep track of how much and what quality of materials they have. For each type of material, there should be a Bin Card that shows how much was received and how much was issued. This Bin Card can be a physical card or a digital record on a computer.

Classification and Coding of Materials

Classification is when we organise items based on what they are or what they are used for. It means putting similar items together into groups.

A code is a set of numbers or symbols used to label a group of items. This helps us quickly identify, organise, and analyse them. Items that are alike are grouped and given a specific code (name and number) so we can easily find and distinguish them.

Coding can be done in the following ways.

- a. Alphabetically: this is where letters are used to represent materials. For example, SDC can be used to represent sodium chloride.
- b. Numerical: Numbers are used to codify materials. For example, 456 represents sodium chloride.
- c. Alphanumeric: this is where a combination of letters and numbers is used to codify materials. For example, SD45C represents sodium chloride.

The goal of classification and coding

1. Make it easy to identify materials quickly.
2. Reduce the need for long descriptions of items in the stores.
3. Improve the storage and distribution of materials.
4. Keep track of the levels of materials available.

Advantages of classification and coding

1. It helps to speed up the recording of information about the materials.
2. It minimises errors in stock taking and valuation of materials.
3. It simplifies clerical work in the material control system.
4. Coding is essential in computerised accounting systems.

Features of a good coding system

1. Unique: Each code should be different from another and should be used for only one item.
2. Clear symbolisation: coding should follow a consistent format, i.e. it should either be alphabetical, numerical or alphanumeric.
3. Brevity: codes should be as short and brief as possible. This will ensure that it can be easily remembered and is consistent with the requirements of classification.
4. Uniformity: Codes should be equal in length and of the same structure. This helps to identify any missing letters or figures.
5. Ambiguity: Coding should avoid the use of similar characters and numbers. For example, the letters O and I are normally not used in coding since they look like zero (0) and one (1).

Activity 4.1 Procuring Business Materials

1. With a partner, describe the step-by-step process a business follows when purchasing materials.
2. Talk about the specific documents and procedures used at each stage of the purchasing process.

3. Consider the impact of a good material coding system. Why is it important for a company to have a well-organised system for identifying materials?
4. Present your responses to another pair and then to your teacher for feedback.

ISSUING OF MATERIALS

Stocktaking

Stocktaking is the process of physically counting the materials in the store/shop. It is a system of physical verification of inventories in the store. The two main methods of stocktaking are periodic stocktaking and continuous stocktaking.

Periodic Stock taking is where stock taking is done at regular intervals during the year. The store may be closed down for the counting to be done.

Advantages of Periodic Stocktaking

1. Normal work of the stores is not disrupted during the stock count since it is closed down.
2. It is less costly in terms of time and money since stock count is at specific periods.
3. Stock figures are more accurate than the figures obtained from continuous stocktaking.
4. There is less clerical work to be done.
5. Staff from other departments can be called to take part in the stock taking.

Disadvantages of Periodic Stocktaking

1. There can be late detection of fraud or errors committed.
2. Since the store is closed down for stock counting, production may be disrupted.
3. Discrepancies, losses and damaged items are not easily detected.

Continuous stocktaking is where an item of stock is counted daily or weekly to ensure that all items in the store are counted at least once within the year.

Advantages of Continuous Stocktaking

1. It avoids disruptions and closure of the store during the year for a major stock count.
2. Discrepancies, losses, deterioration and slow-moving items are detected early.
3. The regular checking of items helps to reduce the occurrence of fraud.
4. It helps to determine closing stock values easily and enables the preparation of interim financial statements.
5. Proper inventory control can be exercised since stock levels are monitored and kept within authorised levels.

Disadvantages of Continuous Stocktaking

1. It is costly in terms of time and money, especially with the use of experienced staff during the stocktaking.

2. There are frequent interruptions within the areas of the store where stocktaking is taking place.

Issuing and Returns of Materials

The Store Department needs to record the quantities and cost of items or materials that are issued to user departments and the quantities that may be returned unused to the Stores. The following documents are key in this process:

Material Requisition Note

This is a formal document from a user department to request materials from the Stores.

A material requisition note is used to record:

1. the details of the quantity of materials issued
2. the user department that received the item
3. the cost of the items issued.

Material Returns Note

This is used to record items that have been returned to Stores by a User Department.

Monitoring of physical inventory

There may be times when inventory records in the Cost Accounting system do not agree with the physical quantities actually held in the Store.

Reasons for this may include the following.

1. Errors in recording and calculation of receipts, issues and returns.
2. Incorrect coding of items causes wrong items to be issued or charged.
3. Omissions in recording of receipts, issues and returns.
4. Theft and pilferage leading to physical loss.
5. Damage to and deterioration of items due to improper handling.

Activity 4.2 A School Store Case Study

1. Go to the school store with a group you form with your classmates.
2. Using a checklist of questions provided by your teacher, interview the storekeeper to understand their process for issuing materials.
3. Look closely at how items are stored and labelled. Pay attention to the organisation of the stock and the records that are kept.
4. Each group will present their findings to the class, sharing what they observed during the visit.
5. As a class, discuss the following questions:
 - a. Which method of stocktaking is best for a school, and why?

- b. How does improper stock management affect teaching and learning?
- c. What can students and staff do to help prevent inventory loss or damage?

MEANING OF INVENTORY, TYPES OF INVENTORY AND OBJECTIVES, INVENTORY MANAGEMENT

Meaning of Inventory

Inventory refers to goods or materials available in the business for sale, production, or resale. These are products or materials a business owns and plans to sell or use.

Types of Inventory

What constitute stocks depends upon the organisation. The types of inventory in manufacturing organisations are outlined in the table below.

Type of inventory	Description	Examples
Raw materials and components	Materials are basic substances or resources used to produce goods or products. Components are pre-made parts or materials used to assemble a final product.	<ul style="list-style-type: none"> • Timber (for furniture) • Cotton (for clothing) • Wheat (for bread). • Engines (for cars) • Batteries (for electronic devices) • Fabric (for clothing).
Products in an intermediate stage of production or completion	Goods or materials that are partially completed and still undergoing processing or manufacturing.	Work-in – progress Partly manufactured goods
Consumable stores	Goods or materials used in business operations that are used up quickly, not reused or resold and are essential for daily operations.	<ul style="list-style-type: none"> • Detergents • Paper • Pens • Toner • Fuel
Finished goods	Completed products are ready for sale or distribution. They are fully manufactured, complete, functional and ready for customer use.	

Meaning of Inventory Control

Inventory control is the management and regulation of inventory levels, including tracking inventory quantities, monitoring inventory movement, maintaining inventory levels and minimising inventory cost.

Why is inventory control important?

The objectives of inventory control are shown in the figure below.



Figure 4.1: Illustration of objectives of inventory control.

Benefits of Inventory Control

1. Inventory control prevents understocking of materials. Understocking leads to material running out earlier than expected. These can lead to stoppages and delays in production, which can lead to loss of profits, customer goodwill and panic buying.
2. Inventory control prevents overstocking of material. Overstocking is when there are more materials than necessary. This results in capital being locked up in stocks, a higher cost of storing stocks and a higher rate of spoilage and pilfering.
3. Inventory control ensures economy in purchasing. Stock control ensures that purchases of materials are done at the right time, in the right quantities and at the most favourable prices.
4. Proper Inventory control will ensure that quality materials are purchased. Inferior materials result in poor quality of goods.
5. Inventory control provides adequate information on the types of materials in the Store Room. There will be data on the quantity, quality or prices of stocks.
6. Inventory Controls ensures that there is minimal wastage of materials. Losses of materials occurred due to obsolescence, pilferage/stealing, evaporation and deterioration.

Activity 4.3 Understanding Inventory Types

This activity will help you and your classmates research and understand the different types of inventory that organisations manage. You will use digital tools or textbooks to find answers to key questions about your assigned inventory type and present your findings to the class. Your teacher will put you in groups for this activity.

1. Using digital tools like a laptop or tablet, or textbooks, research the types of inventory you have been assigned.
2. For your specific type of inventory, answer the following questions:
 - a. What are the main characteristics of this inventory type?
 - b. Provide some real-world examples.
 - c. Explain why organisations choose to keep this type of inventory.
3. Prepare your answers and present your work in the format provided by your teacher or the example below for a class discussion and feedback.

Type of inventory	Description	Examples	Purpose

Activity 4.4 Improving Inventory Control at MFS Clothing

Form a group with some classmates for this activity to analyse the inventory problems of a clothing company, MFS Clothing, and propose solutions to help them improve their performance.

1. Read and discuss the case study about MFS Clothing. Identify the problems the company is facing due to poor inventory management.
2. Prepare an explanation for the management of MFS Clothing on the following:
 - a. Inventory control: What is it, and why is it important?
 - b. Objectives of inventory control: What are the main goals of a good inventory system?
3. Propose Solutions: Discuss and list specific ways that MFS Clothing can improve its inventory management. Think about the issues mentioned in the case study, such as overstocking and stockouts.
4. Present Your Findings: Write your answers on a flip chart and present your findings to the class.

REASONS FOR HOLDING INVENTORY, ASSOCIATED COSTS AND UNDERSTANDING STOCK LEVELS

Reasons for Holding Inventory

1. Inventory is held to meet normal production and sales requirements.
2. Inventory may be held to cater for uncertainties in demand. For example, an unexpected increase in demand can require an increase in production and sales levels.
3. Inventory is held for fear of increases in prices or shortages. Management can decide to hold more inventory if prices are expected to rise.

Cost Associated with Inventory

1. *Acquisition Cost*: This is the cost of purchasing and transporting the goods to the stores.
2. *Ordering Cost*: This is the cost incurred anytime a fresh delivery of goods is required. It includes the cost of preparing a Purchase Order, the cost of receiving deliveries, telephone calls, etc.
3. *Holding/Storage Cost*: This is the cost of keeping inventory in the warehouse. It includes insurance costs, storage costs, cost of pilfering, cost of obsolescence, etc.

Inventory control levels are shown in **Figure 4.2** below.

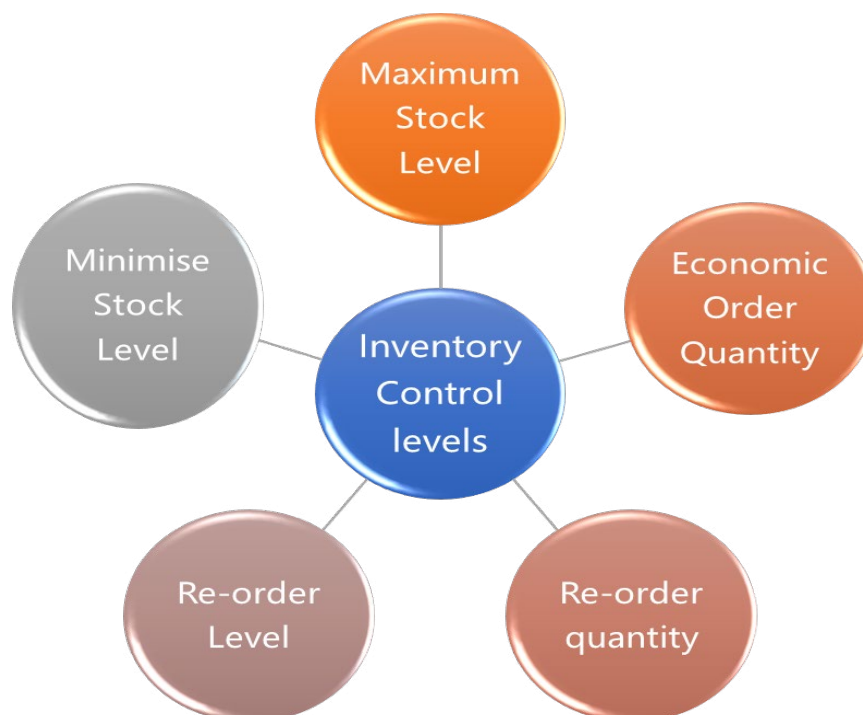


Figure 4.2: Inventory control levels

Explanation of Inventory Control Levels



Importance of Inventory Controls

- Effective inventory control is important and helps to:
 - minimise the amount of money tied up in stock.
 - lower the costs of storing and managing inventory
 - keep production and sales running smoothly
 - reduce the expenses of buying and stocking inventory
 - minimise waste and losses due to expired, damaged or spoiled goods
- Effective inventory management supports stock control and prevents organisations from having too much or too little stock than is needed, both of which can be problematic.

Consequences of Overstocking

- Increase in inventory storage costs: renting more warehouse space, increased utility bills, higher labour costs, etc.
- Physical damage or decay: materials losing quality, getting damaged, rotting, etc.
- Materials becoming outdated: materials no longer in demand, etc.
- Theft or unauthorised taking by employees.

Consequences of Under-stocking

- Decrease in sales as a result of the storage of materials.
- Loss of customers.
- Under use of machines and personnel.
- Unplanned expensive orders to cover the shortfall when customers demand the materials.

Activity 4.5 Understanding inventory control levels

1. Working in your groups from **Activity 4.6**, study the case study below and answer the questions that follow.

JOEKEB, a company dealing in stationery with three stores in the Eastern Region of Ghana, has faced challenges with its inventory management over the past six months. Customers visiting their shops often leave empty-handed due to items being out of stock.

JOEKEB's suppliers have been delivering goods late, and items remain unsold for long periods when the quality deteriorates, and they cannot be sold.

Explain the following to the business to help them improve the management of their inventory and stock control processes:

- a. The different inventory control levels.
 - b. The importance of inventory control levels in effective stock management.
 - c. The consequences of overstocking and understocking.
2. Write down your responses on a flip chart.
 3. Present your work to another group for feedback.

EXPLANATION OF STOCK LEVELS – MINIMUM LEVEL, MAXIMUM LEVEL, RE-ORDER LEVEL, RE-ORDER QUANTITY, ECONOMIC ORDER QUANTITY (EOQ)

In the previous lesson, we looked at inventory control levels and why they are important in effective stock management.

In this lesson, we will look at how you can calculate different stock levels. You may find it useful to go back and re-read the definitions of each level as you look at the formulas.

Formulas Used in Computing the Various Stock Levels

1. Re-order level

Re-order Level = Maximum Lead Time x Maximum Consumption during lead time.

2. Maximum Stock Level

Maximum Stock Level = Re- order level + Re-order Quantity - [Minimum usage x minimum lead time]

3. Minimum Stock Level

Minimum Stock Level = Re-order level - [Average consumption x Average lead time]

4. Average Stock Level

Average Stock Level = $\frac{(\text{Maximum stock level} + \text{Minimum Stock level})}{2}$

Note that lead time is the time (days, weeks or months) it takes for ordered goods to arrive.

Factors that Affect Lead Time

- a. Availability of goods for sale.
- b. Consistency of the supplier.
- c. Means of transport.
- d. Processing/Production time of the material.
- e. Inventory inspection time.
- f. Waiting time at loading and off-loading points.

Activity 4.6 Factors affecting lead time

Pair with a friend and do the following.

1. Identify factors that affect lead time.

a.	Consistency of the supplier
b.	
c.	

2. How do these factors impact stock availability?
3. Write your answers in your workbook and share with another pair for feedback.

CALCULATING VARIOUS STOCK LEVELS – MINIMUM LEVEL, MAXIMUM LEVEL, RE-ORDER LEVEL, RE-ORDER QUANTITY, ECONOMIC ORDER QUANTITY (EOQ).

This lesson should be dedicated to learners applying their knowledge of inventory control and working through practical examples of how to calculate various stock and inventory control levels.

Activity 4.7 Calculating Stock Levels

1. Form a group with a few classmates to review the information provided for Tunga Manufacturing PLC from scenario 1. Then, calculate the following.
 - a. Re-order level
 - b. Maximum stock/inventory level
 - c. Minimum stock/inventory level
 - d. Average stock/inventory level

Scenario 1

Tunga Manufacturing Plc buys materials from Odumase. 3,000 kg of materials are purchased in one order, and it takes 3 – 5 weeks for the ordered supplies to arrive. Weekly consumption is between 350 kg and 550 kg.

- e. Record your workings and final answers on a flip chart and share them with another group to compare your results.
2. Next, review the data for the company purchasing its materials from Asuboa (*Scenario 2*). Calculate the following:
 - a. Re-order level
 - b. Re-order quantity
 - c. Minimum stock level

Scenario 2

A company purchases its materials from Asuboa. It has set its maximum stock level at 80,000 units. Lead time for delivery of supplies is from 5 to 8 weeks. Weekly consumption is between 4,000 units and 5,000 units.

- d. Write your calculations and answers on a separate flip chart and share them with another group.
3. **Extension Task:** Work on the final scenario for ENOLEX Manufacturing Plc. Calculate the re-order level, maximum stock, minimum stock, and average stock. Record your answers in your workbook and share them with your teacher for feedback.

TYPES OF LABOUR AND LABOUR REMUNERATION

What is Meant by Labour?

Labour is the human effort – physical or mental - employed in the production of goods and services.

Labour is the work that people do, whether it is physical tasks like lifting or mental tasks like thinking, to create goods and services. It's the effort people put into making things or providing services that others need

Labour remuneration/cost

It is the money given to workers for the work they do. This payment can come in different forms, such as wages or salaries (regular pay), allowances (extra money for specific needs), commission (extra pay based on sales or performance) and bonuses (additional rewards for good work).

Bases of labour remuneration

1. Time rate
2. Piece rate

Time Rate

This method of remuneration is a method where workers are paid based on the time worked in hours, days or weeks.

It is calculated as the rate multiplied by the time worked.

Time rate = Hours worked X rate per hour/day

Conditions for using the time rate method

1. When it is difficult to measure the amount of work done or the worker's performance.
2. When the job requires careful attention and dedication.
3. When workers prefer to be paid based on time rather than output.
4. When the worker has limited control over the results, such as in research work.

Example

Hours worked = 45 hours

Rate per hour = GH¢120

Gross Wage = 45hrs x GH¢120 = GH¢5,400

Advantages	Disadvantages
Quality goods are produced because workers are not under time pressure.	Close supervision is required to reduce idle time.
There tends to be less wastage of materials because workers are not under a time pressure to produce.	A keeping system must be introduced to check attendance.
An employee can easily calculate his/her income.	Inefficient workers will be rewarded with equal pay as the hard-working workers.
Workers have the option to earn more by working extra hours for overtime pay.	There is little or no incentive to produce more since the salary is guaranteed.
It provides a guarantee of a basic salary for workers.	Output cannot be easily measured or evaluated.

Piece Rate

This method of remuneration is a way of paying workers based on how much they produce. Workers earn money for each unit they complete, and the payment is calculated by multiplying the rate per unit by the total number of units produced. The main types of Piece Rate methods are listed below.

1. Straight Piece Rate
2. Differential Piece Rate
3. Piece Rate with a guaranteed minimum wage

Conditions for using the piece rate method

1. When it is easy to measure the amount of work completed.
2. When workers have control over how much they produce.

3. Where little or no supervision is needed during production.
4. Where work is uniform and standardised.

Advantages

1. Workers have control over their earnings, as they are paid based on the amount they produce.
2. Workers are encouraged to work more since increased output results in higher wages.
3. There is an increase in production since workers are encouraged to produce more.
4. There is fair treatment of workers since payment is based on performance.

Disadvantages

1. Excessive wastage of materials may occur due to the desire /pressure to produce more.
2. There is a problem of fixing the piece rate of remuneration.
3. It requires detailed records of the production of each worker.
4. Poor quality goods may be produced since workers want to produce more.
5. The desire to produce more may have health implications for employees.

Straight Piece Rate

Under this method, the amount earned is based on the number of units produced multiplied by the rate per unit.

Example 4.1

No. of units produced: = 500 units

Rate per unit: = GH¢15

Gross Wage: = 500 units x GH¢15 = GH¢7,500

Differential Piece Rate

Under this method, the rate per unit of output changes at different levels of production.

Example 4.2

GH¢10 per unit for the first 100 units of production

GH¢20 per unit for the output between 101 and 200 units

GH¢30 per unit for the output above 201 units

Therefore, if a worker produces 90 units, they are paid $90 \times \text{GH¢}10 = \text{GH¢}900$

If they produce 131 units they are paid $131 \times \text{GH¢}20 = \text{GH¢}2,620$

And if they produce 210 units, they are paid $210 \times \text{GH¢}30 = \text{GH¢}6,300$

Piece Rate with a guaranteed minimum wage

This system is adopted to compensate employees for low production during a period. To prevent workers from earning low wages, businesses may put in place a guaranteed minimum wage. This is paid to any worker who is not able to produce the required output.

Example 4.3

DORKAY employs four workers who produced the following in a particular month:

Each worker is expected to produce 150 units. Workers are paid at GH¢15 per unit, but the company sets their guaranteed basic salary at GH¢2,000.

Kyei produces 150 units and is therefore paid GH¢2250.

Frempong produces 180 units and is therefore paid GH¢2700.

Kumba produces 120 units and is paid GH¢2000.

If the piece rate is less than the guaranteed salary, then workers will be paid the minimum guaranteed salary.

Activity 4.8 Labour and labour remuneration

1. Pair with a friend, and discuss the concepts of labour and labour remuneration.
2. Write down your definitions of both on sticky pads.
3. Share your answer with another pair for feedback. Do you need to adjust your original definitions?

Activity 4.9 Methods of labour remuneration

1. Work with 3 of your classmates in a group, and identify and discuss the methods of remuneration.
2. Write down the conditions for using each method of remuneration.
3. Present your answers to the larger class.

You could use the table below to present your answers.

Method of remuneration	What does this mean?	Circumstances under which this method would be used.

INCENTIVE SCHEMES

What is an Incentive?

An incentive is an additional payment given to motivate workers to produce more or to reward workers for extra or exceptional performance.

Types of Incentive Schemes

1. Overtime
2. Bonuses

Overtime Premium

Is the extra pay given to workers for working beyond their regular working hours. The payment rate for overtime is higher than the usual hourly rate. Overtime premiums are normally expressed as time plus a fraction, or in multiples of time. For example,

- a. time and a half
- b. time and a fifth
- c. time and a quarter
- d. double time

Example 4.4

A company employs 4 workers, and they work in a month as follows:

Dokua	170 hrs
Esinam	150 hrs
Chidi	200 hrs
Kumba	120 hrs

Each worker is expected to work for 150 hrs. Workers are paid at **GH¢15** per hour, and overtime is paid at time and a half.

Therefore, Dokua's wages for the month will be calculated on the following basis:

$$(150 \times \text{GH¢}15) + (20 \times (\text{GH¢}15 \times 1.5))$$

$$\text{GH¢}2250 \text{ (base rate)} + \text{GH¢}450 \text{ (overtime premium)} = \text{GH¢}2,700$$

Bonus Schemes

It is a payment method where workers receive extra compensation based on the time they save or the targets they meet. Bonuses can be awarded where there have been cost savings through improved performance, or where agreed targets have been met within a given period.

Terms

1. **Time Allowed** – this refers to the expected time to be spent or used on a piece of work.

2. **Time taken** – this is the actual hours used in performing a piece of work
3. **Time saved** – this is ascertained when the time taken is less than the time allowed. It is the excess of time allowed over the time taken.
4. **Bonus Premium** – this money is paid to the worker for saving time.

For example, the expected production is 200 units, and the time allowed is 4 hours. If the time taken is 3 hours, then the time saved will be 1 hour.

Example 4.5

A company has 3 workers who produced the following units in a day.

Odum 25 units

Asor 35 units

Kwaku 45 units

Each worker is expected to work for 8 hours a day and use 12 minutes to produce one unit of the product.

Taking Asor as an example, the total time taken to produce their 35 minutes is 7 hours $((35 \times 12) / 60)$; therefore, they save 1 hour.

The advantages and disadvantages of incentive schemes are summarised in the following table.

Advantages of incentive schemes	Disadvantages of incentive schemes
Incentive schemes reward hardworking employees for their efficiency.	Some incentive schemes can be costly to manage.
Incentive schemes lead to increased production.	It can be challenging to set clear performance levels and determine appropriate payment rates.
Incentive schemes help reduce employee turnover.	The pressure to produce more may affect the health of workers.
Workers can earn more income for putting in extra effort.	The focus on producing more may lead to a decrease in the quality of goods produced.
Incentive schemes attract skilled and high-quality workers to a job.	

Labour Turnover

Labour turnover refers to the number of employees who leave an organisation over a specific period, either voluntarily or involuntarily and are replaced by new workers

Causes of labour turnover

1. Death or Retirement
2. Redundancy
3. Dismissal
4. Seeking greener pastures

5. Poor working conditions
6. Movement to join spouse/partner

Idle Time

Idle time refers to periods when a worker is being paid but is not actively working, through no fault of their own.

Causes of idle time

1. Machine breakdown
2. Power outage
3. Shortage of materials
4. Time spent commuting between departments
5. Routine maintenance of machines
6. Natural disasters like floods

Activity 4.10 Exploring Incentive Schemes

You will work with your partner to discuss various incentive schemes, their examples, and their pros and cons.

1. Form a group with a few friends or classmates to discuss the following:
 - a. The different types of incentive schemes used by businesses.
 - b. Specific examples for each type.
 - c. The advantages and disadvantages of using incentive schemes.
2. Write down your answers, and then share and present your work to the class for discussion and feedback. You can use the provided table format to organise your answers.

You could use a table such as the one below to present your answers.

Types of incentive schemes	Examples
Advantages of incentive schemes	Disadvantages of incentive schemes

Activity 4.11 Labour and Time Management

This activity will help you and your classmates understand key concepts related to workforce management. You'll discuss the meaning and causes of both **labour turnover** and **idle time** in a business.

1. Form a group with a few friends or classmates.
2. In your group, discuss the meaning and causes of both labour turnover and idle time.
3. Write down your answers on sticky pads.
4. Present your answers to the rest of the class for discussion and feedback.

OVERHEADS AND TYPES OF OVERHEADS

Explanation of Overheads

Overhead costs are all the indirect costs an organisation incurs. These include indirect materials, indirect labour and indirect expenses. Overhead costs are expenses that do not come from specific departments or activities but support the organisation as a whole

Types of Overheads

1. Production/Factory Overheads

These are all the indirect costs involved in producing goods in a factory. They include indirect materials, indirect wages and indirect expenses like machine insurance, factory rent, lubricants, depreciation on equipment and electricity. These costs are also called manufacturing overheads.

2. Administration Overheads

These overheads are related to the administrative side of the business. They are the costs that management incurs to organise and control business activities. Examples include stationery, office rent, electricity, telephone bills, management salaries and depreciation of office buildings.

3. Selling & Distribution Overheads

These are overhead costs from the selling and distribution activities of the business. They are spent to attract customers and deliver goods to them. Examples include sales commissions, advertising, promotions, showroom expenses, sales staff salaries, depreciation of delivery vehicles and catalogue costs.

4. Financial Overheads

These are expenses related to managing the financial responsibilities of a business. They include costs for obtaining loans, bank charges, discounts given to customers and interest on loans.

Stages of Overhead Analysis

Overhead analysis is a process used by businesses to identify, allocate and manage indirect costs in order to ensure effective resource allocation and to optimise cost efficiency.

The stages of overhead analysis

1. Collection
2. Classification
3. Allocation
4. Apportionment
5. Absorption.

Explanation of Stages

Collection

Overheads are collected from various departments as they are incurred. The amounts are recorded using documents like vouchers, invoices, bank statements and other key records.

Classification

This is when overheads are grouped based on specific characteristics or features. They can be classified by functional areas such as production, administration, finance, or selling and distribution. Overheads can also be grouped by cost elements, like indirect materials, indirect labour and indirect expenses. Another way to classify overheads is by their behaviour, meaning they can be either fixed or variable.

Allocation

This is when a whole overhead cost is assigned to a specific cost centre or department. Cost allocation is the process of allotting overhead cost to a cost centre or cost unit when the overhead can be conveniently traced to that particular cost centre or cost unit.

Apportionment

Apportionment is the process of spreading overhead costs across different cost centres. When an overhead cost cannot be traced to a particular cost centre, it is shared among various cost centres. The sharing of overhead costs to cost centres is done in proportion to the benefit received by the cost centre. The basis of apportionment becomes the criterion used in apportioning overhead cost to cost centres.

Absorption

Overhead absorption is the process of adding overhead costs to the final cost of a product or service. This is done by calculating an Overhead Absorption Rate (OAR) for each production department. The OAR is then used to include the overhead costs in the unit cost of the product or service.

Activity 4.12 Understanding Overheads - meaning and examples of overhead

You'll brainstorm together with a group of friends, discuss your findings with other groups, and present your final work to the class.

1. Form a group with a few friends or classmates. Discuss and brainstorm what the term **overheads** means to you.
2. Write down your group's definition on a sticky pad. Share your definition with another group for comparison and adjust your definition as needed.
3. In your group, list examples of overheads that a business might have. Classify each example by type. For instance, office rent would be an administrative overhead.
4. Write your work on a flip chart and present your ideas to the class for discussion and feedback. You can use a table to help organise your answers.

Definition of overhead	
Examples of overheads	Type of overhead

Activity 4.13 Understanding Costing Terms

1. Form a group with a few friends or classmates.
2. In your group, explain the meaning of the following terms:
 - a. Allocation
 - b. Apportionment
 - c. Absorption
3. Go back to the list of overhead examples you recorded in the previous activity. For each example, decide if its cost would be allocated to a cost centre or apportioned across multiple cost centres. Justify your decision.
4. Write your answers on a flip chart and present them to the class for discussion and feedback.

PREPARATION OF OVERHEAD ANALYSIS SHEET & REDISTRIBUTION OF OVERHEADS USING REPEATED DISTRIBUTION AND DIRECT ALLOCATION

Preparation of an Overhead Analysis Sheet

An overhead analysis sheet, also called an overhead distribution statement, is used to show how overhead costs are shared among different departments.

The bases of apportionment are the rules used to decide how to divide these overhead costs between the cost centres. The most common bases of apportioning overheads are given below.

	Overhead Cost	Basis of Apportionment
1	Building expenses, Rent & Rates	Floor space or area, value of buildings
2	Electricity / Heating, Power	Number of bulbs, floor space or area, kilowatts of electricity, meter reading.
3	Indirect Labour cost, Supervisor's salary, Canteen cost, Welfare, Medical cost	Number of employees
4	Insurance on materials, store expenses, and handling expenses	Number of requisitions made by department (dept.); value of materials collected by departments.
5	Depreciation/ Repairs on Machines, Maintenance cost,	Value/Cost of machines, maintenance hours

Example

Given below is the cost data of Mildart Manufacturing Company. The company has two production centres, A and B and two service centres, the canteen and maintenance.

Expenses	Total	Dept. A	Dept. B	Canteen	Maintenance
Indirect Labour	157,000	55,000	72,000	22,000	8,000
Indirect Material	436,000	200,000	68,000	26,000	142,000
Heat & Light	113,000				
Rent & Rates	118,000				
Depreciation	400,000				
Supervision	360,000				
Power	280,000				

Additional Information

	Dept. A		Dept. B		Canteen		Maintenance		Total
	Amount	% total	Amount	% total	Amount	% total	Amount	% total	
Floor Space	12	24	16	32	10	20	12	24	50
Value of machines GH¢	120,000	50	88,000	36	16,000	7	16,000	7	240,000
No. of Workers	60	50	40	33	0	0	20	17	120
Labour hours	4,000	57	3,000	43	0	0	0	0	7,000
Kilowatts of Electricity	600	43	500	36	200	14	100	7	1,400

To produce the overhead analysis sheet, you need to complete the breakdown of costs using the basis of apportionment for each type of expense (or overhead).

For each type of expense, complete the table using the relevant basis of apportionment, proportionate to each department.

Overhead analysis sheet for Mildart Manufacturing

Expense	Basis of apportionment	Total	Dept. A	Dept. B	Canteen	Maintenance
Indirect Labour	<i>Direct allocation</i>	157,000	55,000	72,000	22,000	8,000
Indirect Material	<i>Direct allocation</i>	436,000	200,000	68,000	26,000	142,000
Heat & Light	<i>Floor space</i>	113,000	27,120	36,160	22,600	27,120
Rent & Rates	<i>Floor space</i>	118,000	28,320	37,760	23,600	28,320
Depreciation	<i>Value of machines</i>	400,000	200,000	144,000	28,000	28,000
Supervision	<i>Number of workers</i>	360,000	180,000	118,800	0	61,200
Power	<i>kW electricity</i>	280,000	120,400	100,800	39,200	19,600
Total		1,864,000	810,840	577, 520	161,400	314,240

Apportionment of Service Department costs

Service departments exist to provide support to the production cost centres in the manufacturing of products. Service cost centres are usually not income-generating centres; therefore, costs of service departments are redistributed to the production cost centres.

The most common bases of reapportioning service cost centre overheads are given below:

s/n	Service Cost Centre	Basis of Apportionment
1	Canteen	Number of employees
2	Maintenance	Maintenance hours/ Labour Hours
3	Medical/ Welfare	Number of employees
4	Stores	Number of requisitions made by dept.; value of materials issued to depts.
5	Transport	Number of employees

To develop our example for Mildart Manufacturing, we can look at how to apportion the costs for the canteen across the rest of the departments based on the number of employees.

To do this, take the total expenses of the canteen (GH¢ 161,400) and add these to departments A and B in a way that is proportionate to their size.

Department	Number of workers	Proportion	Amount of expenses to be apportioned
A	60	60%	$(161,400 \div 100) \times 60 = \text{GH¢ } 96,840$
B	40	40%	$(161,400 \div 100) \times 40 = \text{GH¢ } 64,560$
Total	100	100%	GH¢161,400

You can use this information to calculate the overheads of each department with the apportioned costs of the canteen.

Department	Expenses	Amount apportioned from the canteen	Combined overhead cost
A	GH¢ 810,840	GH¢ 96,840	GH¢ 907,680
B	GH¢ 577, 520	GH¢ 64,560	GH¢ 642,080

Activity 4.14 Bases for Apportioning Overheads

1. Form a group with a few friends or classmates.
2. In your group, discuss the different bases for apportioning overheads. A basis is a method used to divide costs, such as the number of employees, square footage, or machine hours.
3. Identify eight common business expenses and the appropriate basis for apportioning each. For example, rent might be apportioned based on the floor area occupied by each department. Your teacher may provide you with additional examples to consider.

- Write down the expenses and their corresponding apportionment based on a flip chart. Share your findings with another group for discussion and feedback.

Activity 4.15 Preparation of overhead analysis sheet

In your groups from **Activity 4.14**, discuss the information below and perform the tasks that follow.

SamBoat Manufacturing Company has two production centres and two service centres - Canteen and Maintenance.

Expenses	Dept. A	Dept. B	Canteen	Maintenance	Total
Indirect Labour	57,000	72,000	20,000	8,000	157,000
Indirect Material	200,000	68,000	26,000	142,000	436,000
Heat & Light	36,000	23,500	15,500	38,000	113,000
Rent & Rates					116,000
Depreciation					380,000
Supervision					350,000
Power					230,000

Additional Information

	Dept. A	Dept. B	Canteen	Maintenance	Total
Floor Space	14	18	10	8	50
Value of machines GH¢	130,000	98,000	17,000	17,000	262,000
No. of Workers	65	40	0	25	130
Labour hours	4,500	3,500	0	0	8,000
Kilowatts of Elect.	500	600	150	150	1,400

Tasks

- Prepare an overhead analysis sheet from the above data for the SamBoat company.
- Reapportion the overheads of the service cost centres to the production departments. Calculate the combined overhead costs for Departments A and B.
- Write your answers on a flip chart and share with another group for feedback.

COMPUTATION OF OVERHEAD ABSORPTION RATES USING VARIOUS ACTIVITY LEVELS

Overhead Absorption Rate

Overhead Absorption Rate (OAR) is the rate used to apply overhead costs from cost centres to cost units.

To calculate the OAR, divide the total overhead cost of a cost centre by a suitable activity measure for that cost centre.

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Activity Level}}$$

Types of Activity Levels / Bases of Absorption

Examples of activities/bases of absorption.

1. Machine hours – this method of absorbing overheads applies when machines play a dominant role in the production of goods. It is calculated as:

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Machine Hours}}$$

2. Direct Labour hours - this method of absorbing overheads applies when production is labour-intensive. It is calculated as:

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Labour Hours}}$$

3. Product Units (Cost unit) – this formula is based on the quantity of goods produced. The absorption rate is per item, and it applies where standardised products or jobs are produced.

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Units produced}}$$

4. Direct Materials Cost percentage – this method is based on the cost of materials incurred. It is calculated as:

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Direct Material Cost}} \times 100\%$$

5. Direct Labour/Wages cost percentage – this method is based on the cost of direct labour incurred. It is calculated as:

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Direct Labour Cost}} \times 100\%$$

6. Prime cost percentage – this is where overheads are recovered in relation to prime cost. Prime cost is the total of direct material cost and direct labour cost. It is calculated as:

$$\text{OAR} = \frac{\text{Budgeted Overhead Cost}}{\text{Budgeted Prime Cost}} \times 100\%$$

Activity 4.16 Explanation of overhead absorption rate

1. Working in pairs, explain the overhead absorption rate.
2. Write down your definition and the formula and share with another pair.
3. Working with another pair, identify the different bases for apportionment and how these affect the formula for calculating overhead absorption rates.
4. Record the formulas in your workbooks.

Activity 4.17 Computation of overhead absorption rates

In your groups from the previous activity, study the data below and perform the tasks that follow.

The budgeted cost data for Nimako Productions Ltd is given below:

Total Direct Wages Cost GH¢3,250,000

Total Direct Material Cost GH¢6,000,000

Total Overheads GH¢8,500,000

Additional Information

Labour hours for the year 125,500 hours

Total machine hours 305,000 hours

Total units produced 50,000

Tasks

1. Calculate the following overhead absorption rates for Nimako Productions Ltd. Show all of your workings.
 - a. Machine hours
 - b. Direct labour hours
 - c. Product units
 - d. Direct materials cost percentage
 - e. Direct labour cost percentage
 - f. Prime cost percentage
2. Write your answer on a flip chart and present to the larger class.

ABSORPTION OF OVERHEADS & CALCULATION OF OVER/UNDER ABSORPTION OF OVERHEADS

Overhead Absorption

Overhead absorption is the process of adding overhead costs to the final cost of a product or service. This is done by calculating an Overhead Absorption Rate (OAR) for each production department. The OAR is then used to include overhead costs in the unit cost of the product or service

Over Absorption

Over-absorption happens when the overhead costs assigned to a product, job or service are higher than the actual overheads incurred. This results in the cost of production being overstated.

Under Absorption

Under-absorption happens when the overhead costs assigned to a product, job or service are lower than the actual overheads incurred. This means the actual overheads are higher than what has been added to the product or service cost, which results in the production cost being understated.

Causes of under- or over-absorption of overheads

1. Difference between estimated overhead expenditure and actual overhead.
2. Difference between estimated production volume and actual production units.
3. Differences between the estimated activity levels and the actual activity levels.

Treatment of under- or over-absorption of overheads

1. Over-absorption of overheads increases the cost of production, and this reduces the net profit of the business. To obtain the correct net profit, the amount of overabsorbed overhead should be added to the profit.
2. Under-absorption of overhead decreases the cost of production, and this increases the net profit of the business. To obtain the correct net profit, the amount of underabsorbed overhead should be deducted from the profit.

Calculating over- or under-absorption

To calculate over- or underabsorption, you can follow the following steps:

1. Calculate the overhead absorption rate (OAR)
2. Calculate the overheads absorbed
3. Compare the overheads absorbed with the actual overheads incurred (Overheads absorbed – Actual fixed overhead incurred)

If the answer is above zero (positive), then overheads have been overabsorbed; if they are below zero(negative), then they have been underabsorbed.

Activity 4.18 Overhead Absorption: Under and Over

*This activity will help you and your partner understand a key concept in cost accounting: **overhead absorption**. You'll brainstorm together to define the term, and then you'll explain the difference between under- and over-absorption of overheads.*

1. Form a group with a few friends or classmates. Discuss what **overhead absorption** means and brainstorm a definition.
2. Explain the difference between **under-absorption** and **over-absorption** of overheads.
3. Write your definitions on separate pieces of paper and exchange them with another pair.
4. Discuss their feedback, and if needed, adjust your definitions. Record your final answers in your workbooks.

Activity 4.19 Computation of overhead absorption rates (over or under)

Working in groups, study and discuss the data below and perform the tasks that follow.

The budgeted cost data for Senyo Productions Ltd is given below.

Total Direct Wages GH¢3,250,000

Total Direct Material Cost GH¢6,000,000

Total Overheads GH¢9,500,000

A cost unit was produced by the company with the following details;

Direct Materials Used GH¢2,800

Direct Labour cost GH¢1,900

Machine Hours 12 hours per unit

Direct Labour Hours 10 hours per unit

Additional Information

Labour hours for the year 125,500 hours

Total machine Hours 305,000 hours

Total Units Produced 50,000 units

You are required to do the following after studying the information above.

1. Use this data to calculate the absorption rate
 - a. Per labour hour
 - b. Per machine hour
 - c. Per unit produced

- d. Direct materials cost percentage
 - e. Direct labour cost percentage
 - f. Prime cost percentage
2. Show your workings.
 3. Overheads are recovered at GH¢170 per unit. Compute any over or under absorption of overheads based on each of the six absorption rates.
 4. Write your answers on a flip chart.
 5. Present your answer to another group for feedback.

Extension task

Study the data below and perform the tasks that follow.

The budgeted cost data for Sandy Productions Ltd is given below:

Total Direct Wages	GH¢2,250,000
Total Direct Material Cost	GH¢5,000,000
Total Overheads	GH¢8,500,000

A cost unit was produced by the company with the following details;

Direct Materials Used	GH¢2,600
Direct Labour cost	GH¢1,700
Machine Hours	10
Direct Labour Hours	8 hours per unit

Additional Information

Labour hours for the year 122,500 hours

Total machine Hours 300,000 hours

Total Units Produced 48,000 units

Tasks:

1. Use this data to calculate the following absorption rates
 - a. Per labour hour
 - b. Per machine hour
 - c. Per unit produced
 - d. Direct materials cost percentage
 - e. Direct labour cost percentage
 - f. Prime cost percentage
2. If overheads are recovered at GH¢160 per unit, compute any over- or underabsorption of overheads based on each of the six absorption rates.
3. Record your answers, with all of your working, in your workbooks and share with your teacher for feedback.

EXTENDED READING

- Dadzie Barnabas (2013) *Costing for “U”*, 5th Edition. Obuasi: For U Printing House (Pages 174-251)
- Eric Oduro (2012), *Principles of Cost Accounting for Senior High Schools*, 4th Edition, Terror Publications. (Pages 205 – 330)
- Any Cost Accounting book approved by NaCCA

REVIEW QUESTIONS 4

1. Describe the features of a cost accounting system.
2. Outline three ways in which cost accounting data can benefit management.
3. What is the impact of the objectives of inventory on cost management?
4. Differentiate between a store requisition and a purchase requisition.
5. Explain three effects of overstocking.
6. DIN BESEM Manufacturing company buys materials from a supplier. 5,000 kg of materials are purchased in one order, and it takes 6 - 8 weeks for the ordered supplies to arrive. Weekly consumption is between 400 kg and 600 kg. Calculate the following.
 - a. Re-order level
 - b. Maximum stock/inventory level
 - c. Minimum stock/inventory level
 - d. Average stock/inventory level
7. Define labour compensation.
8. Identify two disadvantages of an incentive scheme.
9. Kwame Ltd employed 25 workers who are paid an hourly rate of GH¢15 each. During November 2019, the company experienced several periods of worker idleness:
 - a. A power cut caused 12 workers to be idle for 3 hours each.
 - b. Unplanned equipment maintenance led to 6 workers being idle for 5 hours each.
 - c. During the month, workers spent 3 hours in total in training sessions and awaiting further instructions.

Calculate the total cost to Kwame Ltd. for all periods of worker idleness during November 2019.
10. Explain the following terms: Overhead Allocation and Overhead Apportionment
11. Specify the criteria for distributing the following overhead costs.
 - a. Canteen
 - b. Indirect wages
 - c. Factory rent
12. Identify two methods for allocating overhead costs.
13. Explain the distinction between overabsorption and underabsorption of overheads with examples.

SECTION

5

PREPARING COST SHEETS FOR JOBS, CONTRACTS, SERVICES AND PROCESS ACTIVITIES



COST ACCOUNTING

Determining Cost of Operation for Pricing and Control

INTRODUCTION

In this section, you will explore various costing methods essential for determining the cost of operations. The section will cover job and batch costing, contract costing, service costing and process accounts. You will be taken through hands-on activities that will help you to solidify your understanding of these key concepts and costing methods. By understanding how to accurately calculate and control costs, you will be better equipped to use appropriate pricing strategies to set the prices of goods and services.

KEY IDEAS

- **Cost Sheet/Statement:** A detailed document that summarises the costs incurred for a particular product or period, which typically includes material, labour, expenses and overhead costs.
- **Job Costing:** A costing method used to determine the costs associated with a specific job or project, where each job is treated as a separate cost unit.
- **Batch Costing:** A method of costing applied when products are manufactured in batches and costs are calculated for each batch before the determination of the cost per unit.
- **Contract Costing:** A method used to ascertain costs for specific long-term projects or contracts, and is often used in construction or large-scale engineering works.
- **Service Costing:** A costing approach for service industries to calculate the cost of providing a service, such as transportation, healthcare or hospitality.
- **Process Costing:** A costing method used to determine the cost per unit of products produced by industries where production is continuous, with the products passing through multiple processes.

PREPARE JOB COST SHEETS TO DETERMINE THE COST AND PROFITS OF A JOB/BATCH ORDER

Job Costing

Job costing is a method used to calculate the cost of specific projects where each job is unique and designed based on the customer's specific needs. Examples include building a house, crafting furniture or making a custom dress. Since each job is different, it is essential to keep track of expenses for each one. To do this, each job is given a job number and a job cost card, where all costs for that job are recorded. This helps to ensure that every amount spent on materials, labour and other costs is accurately recorded for each individual job.

Batch Costing

Batch costing is used when a company produces a large number of identical items as a group or "batch". For example, if a furniture company makes 1,000 identical chairs, they treat the entire production as a single batch. Batch costing is also common in industries like car manufacturing, clothing production, pharmaceuticals and footwear. Companies may fill individual orders by producing a special batch or selecting products from the general stock if they meet the customer's needs.

Costing

In terms of costing, both batches and jobs are treated in the same way using the procedure below.

1. Determine the cost of materials used for the job/batch.
2. Determine the cost of labour hours used by each department on the job/batch.
3. Determine any direct costs associated with the job/batch
4. Determine the overhead to be absorbed on the job/batch.

NOTE: For batch costing, the cost per unit is calculated by dividing the total cost by the number of units produced in that batch.

Elements of cost

The cost price of a product or service is made up of direct materials, direct labour, direct expenses and overhead costs.

This can be represented on a cost sheet as below.

Direct Material	GH¢	GH¢
Material A	xxx	
Material B	xxx	xxx
Direct Labour		
Dept. Y	xxx	
Dept. Z	xxx	xxx
Direct Expenses		xxx
Prime Cost		xxx
Variable Overheads		
Manufacturing	xxx	
Selling & Distribution	xxx	
Administrative	xxx	xxx
Total Variable Cost		xxx
Fixed Overheads		
Manufacturing	xxx	
Selling & Distribution	xxx	
Administrative	xxx	xxx
Production / Total Cost		xxx
Profit		xxx
Selling Price		xxx

Activity 5.1 Exploring Costing Methods and Calculations

*This activity will help you understand the difference between **job** and **batch costing**. You will also learn the practical steps needed to calculate the cost of a product, using a real-world scenario.*

1. Form a group with a few friends or classmates. Discuss the meaning of **Job Costing** and **Batch Costing**.
2. Present your definitions to the class for discussion and feedback.
3. Read the scenario about Madam Yaa Taa, a seamstress who needs to price a special dress for a customer.

Scenario

Madam Yaa Taa is a seamstress. She has received an order to sew a special dress for one of her customers. She is not certain about the process she has to go through to determine the total cost to give her customer the appropriate price quotation for the dress

4. As a student of cost accounting, outline the four basic steps Madam Yaa Taa should follow to determine the total cost and give the correct price quotation for the dress.
5. Share your response with a colleague to get their feedback.

Activity 5.2 Learning the preparation of job cost sheets

1. In groups, study the list of cost items below
 - a. Consumables like lubricants and adhesives
 - b. Cost of hiring specialised equipment for a specific project
 - c. Depreciation on factory equipment
 - d. Electricity used by production machines
 - e. Fabric for producing clothing
 - f. Fees for specialised moulds used in plastic injection moulding
 - g. Freight charges for transporting raw materials directly to the factory
 - h. Insurance premiums for the factory
 - i. Lumber for manufacturing furniture
 - j. Maintenance costs for production equipment
 - k. Packaging materials for finished goods
 - l. Payment to carpenters in a furniture factory
 - m. Plastic granules for making bottles
 - n. Property taxes on the manufacturing facility
 - o. Remuneration for sewing machine operators in a textile firm
 - p. Rent for the factory premises
 - q. Royalty payments for using patented manufacturing technology
 - r. Salaries of administrative staff

- s. Steel sheets for making car bodies
 - t. Testing costs for quality assurance of a specific batch
 - u. Wages of assembly line workers
 - v. Wages of machine operators
 - w. Wages of welders in a metal fabrication company
 - x. Water used for washing in manufacturing processes
 - y. Wood pulp for producing a sheet of paper
2. Group the list under the following categories of cost: Direct material cost, Direct labour cost, Direct expenses, variable overhead or fixed overhead
 3. Share and discuss your response with another group

You can use the table below to support your response

COST CATEGORY	COST ITEM
Direct Material Cost	<i>Wood pulp for producing sheets of paper</i>
Direct Labour Cost	<i>Remuneration for sewing machine operators in a textile firm</i>
Direct Expenses	<i>Testing costs for quality assurance of a specific batch</i>
Variable Overhead	<i>Water used for washing in the manufacturing process</i>
Fixed Overhead	<i>Insurance premium for the factory</i>

Activity 5.3 Preparation of Job Cost Sheet

1. In groups, read the information below outlining the details of a job, number 609.

Cost of materials used ₵165, 500

Labour

Department X 12 hours at GH₵50per hour

Department Y 10 hours at GH₵40per hour

Department Z 3 hours at GH₵60per hour

Machine hours

Department X 10 hours

Department Y 7 hours

Overheads are absorbed in the following ways.

- on machine hour basis in departments X at GH₵30 per hour& Y at GH₵30 and GH₵40
 - on a machine hour basis in department Y at GH₵40 per hour
 - per hour respectively and on a labour hour basis in Dept. Z.
2. Prepare a job costing sheet for job 609.
 3. Present your answers on a flip chart and present to the class for discussion and feedback.

DETERMINATION OF PROFIT USING MARKUP OR MARGIN

Profit is the amount of money left over after a business subtracts all its expenses from its revenue (the money it earns from sales). In other words, it is the extra money a company makes after covering all the costs involved in making and selling its products or services.

The basic formula for calculating profit in simple terms is:

$$\text{Profit} = \text{Selling Price} - \text{Cost Price}$$

How to calculate mark-up or profit on cost

When profit is calculated on cost price or mark-up, the formula is:

$$\text{Profit} = \text{Cost Price} \times \frac{\text{Percentage mark up}}{100}$$

How to calculate the margin or profit on the selling price

When profit is calculated on margin or selling price, the formula becomes:

$$\text{Profit} = \text{Selling Price} \times \frac{\text{Percentage margin}}{100 + \text{Percentage margin}}$$

NOTE: It should be noted here that if you are given the margin but have to convert it to mark-up to be able to calculate the profit on the cost price, the formula becomes

$$\text{Profit} = \text{Cost price} \times \frac{\text{Percentage margin}}{100 - \text{Percentage margin}}$$

Example

The cost price of a job is GH¢7,000. Calculate the profit if:

1. the amount of profit is 15% markup.
2. the amount of profit is 15% margin.

Solution

1. Profit on cost or mark up

$$\begin{aligned} \text{Profit} &= \text{Cost Price} \times \frac{\text{Percentage mark up}}{100} \\ &= 7,000 \times \frac{15}{100} \end{aligned}$$

$$\text{Profit} = \text{GH¢ } 1,050$$

2. Profit on selling price or margin

Note that the selling price is GH¢8,050 (That is 7,000 + 1,050). This is because
Cost Price + Profit = Selling Price

$$\begin{aligned} \text{Profit} &= \text{Selling Price} \times \frac{\text{Percentage margin}}{100 + \text{Percentage margin}} \\ &= 8,050 \times \frac{15}{100 + 15} \end{aligned}$$

$$\text{Profit} = \text{GH¢ } 1,050$$

Activity 5.4 Calculation of Profit on a Job or Batch

Study the information below and complete the tasks that follow.

A company manufactures a product for sale and has the following budgeted overheads.

Department Overhead Cost Activity Level

Blanking GH¢180,000 1,500 labour hours

Machining GH¢430,000 2,500 machine hours

Welding GH¢200,000 1,800 labour hours

Assembling GH¢150,000 1,000 labour hours

Selling and administrative overheads are charged at 20% of factory cost.

An order was received to manufacture 250 units of the product as Batch T5931.

Costs incurred were as follows.

Materials GH¢31,700
Labour
Blanking 128 hours @ GH¢50.25/hr.
Machining 452 hours @ GH¢50.50/hr.
Welding 90 hours @ GH¢50.00 /hr.
Assembling 175 hours @ GH¢48/hr.

GH¢5,250 was paid for the hiring of a special machine to test the product. The time booking in the machine shop was 643 machine hours. Profit is computed at a 15% markup.

- In your groups, calculate the;
 - Total cost of batch T5931
 - Cost per unit
 - Selling price of the product
- Record all of your work and share your work with other groups for comparison.

Activity 5.5 Calculation of Profit on a Job or Batch

- In your groups from the previous activity, study the information below and complete the tasks that follow.

Roberta Shipping Plc has received an order to produce two fishing vessels for Sekondi Fisheries. Each job passes through three departments – Preparatory, Machining and Finishing.

Costs incurred in production are as follows.

Preparatory Dept.

45 beams of wood at GH¢30,000 per beam

16 kg of other materials @ GH¢60,500 per kg

20 labour hours @ GH¢60,000 per hr.

Machining Dept.

10 machine hours @ ₺120,000 per hr.

20 labour hours @ ₺80,000 per hr.

16 kg of materials @ ₺40,000 per kg

Finishing Dept.

15 liters of paint @ ₺450,000 per liter

26 labour hours @ ₺120,000 per hr.

Overhead at each department is estimated at ₺60,000 per labour hour.

Profit margin is 20%.

You are required to calculate;

- a. The cost of producing the two vessels
 - b. The selling price of one vessel.
2. Show all of your working and compare your answers with those of another group.

CONTRACTS AND TERMINOLOGIES USED IN ACCOUNTING FOR CONTRACTS

In contract costing, a contract is an agreement between two main parties: the contractor and the contractee. The **contractor** is the person or company doing the work, and the **contractee** is the person or company who hired the contractor to get the job done.

Key Terms in Contract Costing

Contract Price

This is the total amount of money the contractee agrees to pay the contractor once the entire job is completed. It is the final price both parties agreed on from the beginning.

Work Certified

This refers to the part of the work that has been completed, inspected and officially approved by a qualified person, such as an architect in the case of construction projects. This approval means that the work has met specific standards. The certified work is given a certain value, which is documented in a certificate. This certificate assures the contractee that the work up to this point is done well and according to plan. Work certified can be calculated as:

Work certified = Cost of work to date - (Cost of work uncertified – materials – plant costs)

Work uncertified

This is the part of the work that has been completed but has not yet been inspected or certified by a technical professional. Both certified and uncertified work are considered part of **work in progress** – the job that is still underway and not fully completed.

Certificate for completed work

A certificate for completed work is issued by the professional who inspected the job (like an architect) and confirms that the work was done correctly, following the approved plans and meeting all required standards and regulations.

Progress Payments

These are partial payments that the contractee makes to the contractor during different stages of the job. Instead of paying the full amount at once, payments are made as work progresses. This helps the contractor manage expenses throughout the project and allows the contractee to see ongoing results before paying the full amount.

Retention fee

Retention money is a portion of the contract price that the contractee withholds (does not pay) for a certain period after the work is completed. This is to protect the contractee in case any problems or defects arise that need fixing. The time during which this money is held back is called the **retention period**.

Work-in-Progress

Work-in-progress refers to the total cost of the job done at any given point, including both certified and uncertified work. It is an important value in contract accounts because it shows the contractor's costs and efforts at that stage of the project.

Notional Profit

Notional profit is the estimated or apparent profit on a contract that is not fully completed yet. It is calculated by comparing the value of work certified with the costs involved in that certified work. Notional profit helps the contractor understand how much profit is expected on the certified part of the work in progress.

Formula for Notional Profit

Notional Profit = Value of work certified – Cost of work certified

Also note that the Cost of work certified = Cost of work done to date – Cost of work that is not certified

Putting all together, the notional profit formula can be re-stated as

Notional profit = Value of work certified – (Cost of work done to date – Cost of work that is not certified)

Contract Account

In contract costing, each contract has its own account in the contractor's books to keep track of all expenses and payments. For a completed contract, the account will show all costs and the contract price as income, which gives the final profit. For an incomplete contract, the account shows the costs incurred to date and the value of work done in order to provide an estimated profit.

Format for Contract Account

Name of Contract:

Contract Price:

Site of Contract:

Date of Commencement:

Date of Completion:

Contract Account

	GH¢		GH¢
Purchase of materials	xxxx	Materials at site b/f	xxxx
Materials issued from stores	xxxx	Materials transferred to other	xxxx
Direct wages	xxxx	contracts	xxxx
Direct expenses	xxxx	Value of plants & equipment c/d	xxxx
Overheads	xxxx	Prepared expenses c/d	xxxx
Sub contracts costs	xxxx	Cost of work done c/d	xxxx
Materials from other contracts	xxxx		xxxx
Plants & Equipment used	xxxx		xxxx
Accrued Expenses c/d	<u>xxxx</u>		<u>xxxx</u>
	<u>xxxx</u>		<u>xxxx</u>
Cost of work done b/f	xxxx	Value of work certified	xxxx
Profit made	xxxx	Value of work not certified	xxxx
Profit in suspense	<u>xxxx</u>		<u>xxxx</u>
	<u>xxxx</u>		<u>xxxx</u>
Balances c/d		Balances c/d	
Plants & Equipment	xxxx	All accruals	xxxx
Materials at site	xxxx	Profit	xxxx
Prepayments	xxxx		

Activity 5.6 Key Terms in Contract Costing

1. Form a group with a few classmates.
2. Use the internet to find more information and definitions for the following terms related to contract costing:
 - a. Contract Price
 - b. Work Certified
 - c. Uncertified Work
 - d. Progress Payments
 - e. Retention Money

- f. Work-in-Progress
 - g. Notional Profit
3. Discuss the information you found within your group. Write down the key points from your discussion on a flip chart.
 4. Present your findings to the entire class for a discussion.

Activity 5.7 Calculation of Cost of Work Certified

In your groups from **Activity 5.6**, study each of the scenarios and answer the questions that follow.

1. The following data was extracted from the books of Swanzy Plc

	GH¢
Total cost incurred on contract	600,000
Materials on site	85,000
Cost of work done not certified	84,000
Expenses prepaid	15,000
Plant on site	120,000

- a. Calculate the cost of work certified based on this information.
 - b. Record your work and answer on a flip chart and share with another group.
2. The following information has been extracted from the books of Lloyd and Kiki Contractors.

	GH¢
<i>Plant on site c/d</i>	<i>225,000</i>
<i>Cost of work done not certified</i>	<i>170,000</i>
<i>Materials on site c/d</i>	<i>120,000</i>
<i>Expenses prepaid</i>	<i>35,000</i>
<i>Total cost incurred on contract</i>	<i>900,000</i>

- a. Calculate the cost of work certified based on this information.
- b. Compare your response with another group for feedback and discussion.

Activity 5.8 Analysing and Preparing a Contract Account

1. Form a group with a few friends or classmates.
2. Discuss the Contract Account: Discuss the format of a contract account. Think about the types of expenses and revenue that are recorded and how they are classified as debits or credits.

3. Create a Template: Based on your discussion, create a template for a contract account.
4. Record this template in your workbooks so you can use it for reference in the future.

PREPARE CONTRACT ACCOUNTS TO DETERMINE THE COST OF A CONTRACT, INCLUDING UNCOMPLETED CONTRACTS AND CONTRACTEE ACCOUNTS

Stage of Completion of Contracts

When contracts are started and finished in the same financial year, it is easy to handle them in accounting. But many contracts take longer than one year to complete, and this creates a challenge. For instance, the question is whether we should calculate profit only when the contract is fully finished, or calculate it every year based on the work completed so far.

If we only calculate profit at the end of the contract, all the profit will show up in the year the contract is completed, while the earlier years will show no profit.

This creates two problems, namely:

1. **Uneven Profit Reporting:** The profit trend will look strange where one year will show a high profit and the others will show none.
2. **Tax Burden:** A lot of profit in one year means a higher tax liability for that year.

To fix this, businesses calculate the profit or loss for the contract each year based on how much of the work is completed.

This is called the **stage of completion** or the **percentage of completion**. It follows the **accrual concept** in accounting, which means we match income with expenses during the time the work is done.

This ensures that revenue, costs and profit are recorded proportionately to the progress of the contract.

By using this method, businesses can show profits more consistently each year and avoid misleading or uneven financial reports. Here's how the **stage of completion** is usually calculated.

$$\text{Stage of Completion} = \frac{\text{Contract cost incurred to date}}{\text{Total estimated contract cost}} \times 100$$

This percentage is used to recognise revenue, expenses and profits in the income statement.

Activity 5.9 Meaning of Stage of Completion

Form a group with a few friends or classmates.

1. Discuss the format of a contract account. Think about the types of expenses and revenue that are recorded and how they are classified as **debits** or **credits**.

- Based on your discussion, create a template for a contract account. Record this template in your workbooks so you can use it for reference in the future.

Activity 5.10 Calculation of Stage of Completion

- In groups, carefully analyse the scenario below.

B-Matdor Plc won a contract to build affordable houses for the government in a low-cost town.

The contract amount was GH¢4million in 20X2, but by the end of 20X3, the estimated cost had increased to GH¢4.2 million and to GH¢4.4 million in 20X4.

Cost incurred was as follows

20X2 – GH¢1.1million,

20X3 – GH¢3.15million and

20X4 -GH¢4.2million.

You are required to prepare

- a statement showing the stage of completion for each year of the contract.
 - a statement showing the following as they would be recognised in the income statement for each year.
 - revenue
 - costs
 - profit.
- Record your answers on a flip chart and compare with another group for discussion.

Extension task

KKBK Engineers won a contract to build a modern market for the government in Akim Oda.

The contract amount was GH¢6million in 20X0, but by the end of 20X1, the estimated cost had increased to GH¢6.3 million and to GH¢6.6 million in 20X2. Cost incurred was as follows

20X0 – GH¢1.65million

20X1 – GH¢4.75million

20X2 – GH¢6.3million.

Use the information from the scenario to prepare a statement showing;

- The stage of completion for each year of the contract.
- How are the following to be recognised in the income statement for each year:
 - revenue
 - costs
- Record your answer in your workbook and share it with your teacher for feedback.

Activity 5.11 Contract Account

Working in your groups from **Activity 5.9**, study the information below.

Luther Constructions is contracted to build a sports facility at Nyame Bekyere for GH¢2.1 million.

The data below relates to the contract at the end of the first year.

	GH¢
<i>Materials purchased</i>	321,000
<i>Materials returned to stores</i>	51,000
<i>Direct wages paid</i>	148,200
<i>Direct wages accrued</i>	33,000
<i>Plant on site at cost</i>	90,000
<i>Direct expenses paid</i>	27,900
<i>Direct expenses accrued</i>	13,500
<i>Other expenses incurred at the site</i>	20,700
<i>Overhead cost</i>	34,500
<i>Cost of work not certified</i>	15,300
<i>Value of the plant on site</i>	67,500
<i>Cash received for work certified</i>	675,000

Retention money was agreed at 15% of the work certified, and money in respect of work certified has been received.

Task

1. In your groups, prepare the contract account **and** contractee account.
2. Record your answers and share with another group for feedback.

SERVICE COSTING, IDENTIFY SOME ORGANISATIONS THAT USE SERVICE COSTING, THEIR UNITS OF PRODUCTION

Organisations That Use Service Costing and Units Produced

S/N	TYPE OF SECTOR	COST UNITS
1	Canteens / Restaurants	Plates of meals served
2	Hospitals	Patient days, number of operations done, outpatients treated

3	Schools	Number of learners, school days, cost per learner per semester/year
4	Consultancy	Client hours/ days
5	Maintenance	Maintenance hours / days
6	Provision of electricity	Kilowatt hours
7	Soliciting firms	Courts days/ hours
8	Hotels	Bed /room per night
9	Transport	Passenger per km, tonnes of goods per km

The cost per unit of service is computed as =

$$\frac{\text{Total cost of operation per period}}{\text{Number of service units provided in the period}}$$

Activity 5.12 Identification of Service Organisation and its Cost Units

1. With a few of your classmates, identify ten service sector industries/organisations and provide their possible cost units
2. Present your response to your class for discussion and feedback

You can use the table below to support your work

S/N	Type of sector	Cost units
1	<i>Tourism and Travel Agency</i>	<i>Per traveller, package, or trip</i>
2		
3		
4		
5		
6		
7		
8		
9		

Activity 5.13 Calculating service unit costs in transport services

1. In your groups, read the information provided for Zimbo Plc and complete the tasks that follow.

Zimbo Plc operates a stone quarry and delivers stones in cargo trucks to clients. The distance covered and deliveries on 10th April 20x2 are as follows

Delivery	Tonnes carried	Distance covered in kilometres
1	2.5	20
2	3.1	30
3	6.2	90
4	5.5	80
5	4.5	60

The cost of operation for the day was GH¢571,200.

2. Calculate
 - a. cost per tonne
 - b. cost per kilometer
 - c. cost per ton per kilometre.
3. Record your work and answers and share with another group to compare.

Activity 5.14 Calculating service unit costs in health services

1. Form a group with a few friends or classmates. Read the case below and respond to the questions that follow.

Holy Saviour Clinic incurred a total cost of Gh¢840,000 in June, 20X1. A total of 2,400 patients were treated during that period. The hospital bills patients by adding a markup of 6%.

Using the provided information for Holy Saviour Clinic, calculate the following:

- a. The number of patients per day.
 - b. The cost per patient.
 - c. The total revenue for the month.
2. Be sure to show all of your calculations and the steps you took to arrive at your answers.
 3. After you have completed your calculations, compare your answers with those of another group.

4. Discuss any differences and provide feedback to each other.

In the next lessons, we will be testing your understanding of the principles of service

costing by applying these principles to practical scenarios

Activity 5.15 Finding the Cost Per Unit of a Service

1. Read the information in each scenario carefully and complete the tasks that follow with your group from **Activity 5.14**.
2. Share your answers and work with another group for discussion and feedback.

Manna Hotel is a 100–room facility which charges GH¢500 per room per night. During September 20X2, 400 guests visited the hotel and spent an average of 3 days each. The total cost of running the hotel for the month was GH¢105,000.

You are required to calculate

- a. number of room days available
 - b. number of room days occupied
 - c. room occupancy rate
 - d. average cost per guest
 - e. profit or loss for the month
3. *Royal Feast restaurant incurred a total cost of GH¢120,000 on its operations in April, 20X3. During the period, a total of 1,000 customers visited the restaurant and bought an average of 3 plates of food each. A plate of food is sold for GH¢50.00.*

You are required to calculate;

- a. The number of plates of food sold during the month
 - b. The cost per plate of food
 - c. Total revenue for the period
 - d. Profit or loss for the period,
4. *Bright Child School has an enrolment of 600 learners. The cost of running the school for the year 20X4 was GH¢4,800,000. The school runs two semesters in a year and adds a 20% margin to the fees paid by learners.*

You are required to calculate;

- a. cost per learner per semester
- b. fees payable per learner per semester
- c. profit or loss for the school for the year

PROCESS ACCOUNTS: PREPARATION OF PROCESS ACCOUNTS SHOWING COST PER UNIT OF A PRODUCT AND THE TREATMENT OF NORMAL LOSS, ABNORMAL LOSS/ GAIN, SCRAP VALUE

Terms in Process Costing

Normal Loss

This is the expected loss of materials that naturally happens during production. It is the type of loss that cannot be avoided because it occurs due to normal factors like evaporation, shrinkage or chemical reactions. For example, if you are making juice and some liquid evaporates during boiling, that is normal loss. Businesses treat this type of loss as a regular cost of production because it cannot be avoided.

Abnormal Loss

This is the extra loss that happens unexpectedly during production. It is the loss beyond what was expected (normal loss). Abnormal loss might occur due to problems like poor-quality materials, broken machinery, accidents or mistakes. For instance, if 2,000 units are processed and you expect to lose 5% of them (which is 100 units), it means you should end up with 1,900 units. If at the end of the production process you actually get an output of 1,850 units, it means you have lost an extra 50 units. This extra 50 units are considered as abnormal loss. This extra unit loss is **not** considered as a regular part of the production cost like normal loss but rather charged against or debited to the profit and loss account.

Abnormal Gain

This is the opposite of abnormal loss. It happens when there is less loss than you expected. For example, if you process 2,000 units and expect a 5% normal loss, it means you are expected to get an output of 1,900 units). However, if the actual output becomes 1,930 units, the extra 30 units that have been saved from being lost under normal circumstances is considered as abnormal gain. This gain reduces the cost of production for that process.

Waste

Wastage refers to the portion of materials lost during production that has no value at all. It is completely unusable and cannot be sold or recycled. For example, when peeling vegetables, some peels may be thrown away with no use.

Scrap

Scrap is leftover material from production that still has some value. It can be sold as it is or used to make something else. For example, leftover pieces of fabric from a garment factory can be sold or reused for smaller items. The value of scrap is subtracted from the production cost to reduce expenses.

Spoilage

Spoilage refers to products that are damaged during production and cannot be repaired or used. These goods are thrown away or sold at a lower price. Spoilage might happen due to bad materials, operator mistakes, or faulty machines. For example, cookies that get burnt in a bakery and cannot be sold are considered spoilage.

Defective Products

Defective products are items that do not meet quality standards but can be fixed. These goods can be reworked by using extra materials, time and labour to bring them up to standard. For example, if a table is made with a scratched surface, it might be sanded and polished to make it acceptable for sale.

Conversion Cost: this comprises both labour and overhead costs.

Work in Progress (WIP)

Work in progress refers to products that are not yet finished at the end of the production process. These are the incomplete goods still being worked on.

- **Opening WIP:** The unfinished goods that were carried over from the previous process.
- **Closing WIP:** The unfinished goods at the end of the current process. For instance, if you are baking a batch of bread, the dough that has not gone into the oven yet is considered a work in progress.

Activity 5.16 Terminologies in Process Costing

1. Copy the table below into your book
2. Study the list of terminologies provided below
 - a. Normal Loss
 - b. Abnormal Loss
 - c. Abnormal Gain
 - d. Waste
 - e. Scrap
 - f. Spoilage
 - g. Defective Products
 - h. Work in Progress
3. Complete the table by selecting the appropriate term from the list and record it in the terminology column against the riddle that best describes the meaning of the term.

RIDDLE	TERMINOLOGY
I am not done, I am in between and partially complete. I am on the line, in the making stage. What is my name on this unfinished page?	

I am the product that did not survive. Defects made me unfit to thrive. Faulty and flawed, I am set apart. What am I? Gosh! I miss the mark.	
I am the leftover and the cast aside. There is no use for me because I cannot be applied. I am thrown away without any haste. What is my name?	
I am unexpected and out of line, more than what is normal. An extra loss that is a surprise and goes beyond the standard.	
I am small, useless, but I hold some value. I am sometimes sold for a penny or two. Anyway, I am not a waste because I have some worth to share. What is my name? Take a guess, if you dare.	
I am expected and part of the game, a portion of the input that is usually lost. I cannot be blamed because in every process, I must have my place	
I am created, but not up to standard. Errors in me take me quite far and make me unfit. However, I am mostly fixed and sold like the standard ones, though my fate is not certain. What is my name?	
I am the odd one in the crowd. An extra unit that makes you proud. Unexpected but not a pain. What am I because I am a surprise gain!	

Activity 5.17 Preparation of Process Accounts

- Working in groups with three or more classmates, read the scenario below and perform the tasks that follow.

Adoma produces a product that passes through two processes. Data for the month of July is as follows

	Process 1	Process 2
Material introduced 4,000 units	GH¢5,000	-
Direct Wages (GH¢)	6,000	6,000
Production Overheads (GH¢)	2,800	3,800
Packaging (GH¢)	-	10,000

- a. You are required to prepare the accounts for process 1 and process 2.
 - b. Show the cost per unit at the end of each process.
2. Record your answers and work on a flip chart, and share with another group for comparison and feedback.

Terms in Process Costing

Joint Products

Joint products are two or more products that are made at the same time from a single raw material and have almost the same value. These products cannot be separated or identified individually while they are being produced. They share the same costs (called **joint costs**) until they are separated at a point in the process called the **split-off point**.

For example:

- a. From crude oil, we get products like kerosene, petrol, diesel and jet fuel.
- b. From milk, we can make butter, cheese and cream.

Joint Costs are the total costs spent on raw materials, labour and overheads up to the split-off point. After this point, the products are treated separately. Joint costs can be divided among the products based on:

1. Sales Value: Where the share of costs is based on how much each product will sell for.
2. Production Units: Where costs are shared based on how many units of each product are produced.
3. Weight of Products: Where costs are allocated based on how heavy each product is.

By-Products

By-products are secondary products of little value that are made accidentally while producing the main product. They are not the focus of production but can still be sold for some income. Examples include:

1. Rice husk: A by-product of milling rice. It can be used as a fuel, in making insulation materials or as a soil conditioner.
2. Feathers: A by-product of poultry processing. They are used in making pillows, clothing or insulation materials
3. Bone meal: A by-product of meat processing, made from crushed animal bones. It is often used as a fertiliser or a nutritional supplement for animals.
4. Sawdust: Produced as a by-product when cutting or shaping wood in carpentry and sawmills. It can be used to make particleboard or as fuel.

Accounting treatment for by-products

By-products are usually worth much less than the main product, so they are treated differently in financial records. Here are three common ways to account for them:

- Other income method: The money earned from selling the by-product is recorded as extra income in the income statement.
- Reduction of cost method: The sales money from the by-product is used to lower the cost of making the main product.
- Profit method: If the by-product is worth a lot, the profit from selling it is recorded directly as income in the income statement.

Activity 5.18 Meaning of Joint and By-Products

- Form a group with a few friends or classmates.
- Discuss the meaning of **joint products** and **by-products**. Analyse how each is treated in accounting.
- Summarise the key points from your discussion on a manila card.
- Make a poster presentation for the whole class to explain what you've learned.

Activity 5.19 Joint Cost Allocation and Decision-Making

- With a few classmates, study the scenario below and perform the tasks that follow.

Ron Chemicals produces three products from a joint process costing of GH¢150,000 per month. After leaving the joint process, the products must be further refined before they are saleable. You have been provided with the following information.

Product	Quantity	Further processing cost	Unit selling price
		GH¢	GH¢
A	15,000	350,000	80
B	25,000	100,000	25
C	10,000	250,000	15

Now, do the following after reading the scenario above.

- Allocate the joint cost using the physical quantity method.
 - Allocate the joint cost using the sales value method.
 - Compute the cost per unit of each product after further processing using the physical quantity method of allocating joint cost.
- Share your work with another group for discussion and feedback.

Extension task

ABC Co. Ltd. produces three products (Beer, Grain, and Yeast) through a joint process that costs GH¢250,000. The products can either be sold as they leave the joint process or processed further for sale. The cost accountant has provided additional details regarding the costs and revenues for these products as follows

Product	Quantity	Sales price at split off	Further processing cost	Unit selling price after further processing
		GH¢	GH¢	GH¢
Beer	7,500	25	150,000	63
Grain	10,000	35	175,000	75
Yeast	25,000	50	225,000	88

Your tasks

- Among the three products, allocate joint costs by using the;
 - Physical method
 - Sales value after production method
- Analyse the results you had from task 1 together with other data provided to determine which products the company should sell at the split-off point and which should be processed further for sale. (Make sure to justify your decision)
- Prepare a simple report to the cost accountant of ABC Ltd. on the decision you have taken, together with the justification for the decision taken. Share this with your teacher for feedback.

EXTENDED READING

- Dadzie B. (2024), Costing for 'U' (Pages 186 – 189)
- Eric Oduro (2001), Principles of Cost Accounting for Senior High Schools 3rd Edition, (Pages 290 – 296)

REVIEW QUESTIONS 5

1. Outline the unique and common characteristics of the following costing methods:
 - a. job costing
 - b. batch costing
2. Explain the meaning and significance of the following terms in contract accounting:
 - a. Apparent/Notional Profit
 - b. Cost of Work Certified
 - c. Certificate for Completed Work
 - d. Retention Money
 - e. Contract Price

3. Discuss the treatment of normal loss, abnormal loss, abnormal gain, waste and scrap in process costing.
4. Analyse how joint and by-products are accounted for in financial records, and explain the impact of different methods of allocation on financial reporting and decision-making.
5. *Abima Koka & Co Ltd. had a fixed price contract to build quarters for a mining company at Bogoso.*

The initial amount of revenue agreed was GH¢440,000. The contract began on 1st January 20X2, and the initial estimate of the contract cost was GH¢400,000. By the end of 20X2, the estimate of the total cost had risen to GH¢404,000.

In 2003, the customer agreed to a variation that increased the expected revenue from the contract by GH¢10,000, which resulted in an additional cost of GH¢6,000.

On 31st December 20X3, there were materials at the site of GH¢5,000 for use in the year 20X4.

The contract costs incurred at the end of the years 20X2, 20X3, and 20X4 were GH¢105,040, GH¢308,400 (including material at the site), and GH¢410,000, respectively.

You are required to do the following.

- a. Prepare a statement showing the calculations for the stage of completion
 - b. A statement showing how revenue, cost and profit would be recognised in each of the years 20X2, 20X3 and 20X4
6. *Glover Contractors was awarded a contract valued at GH¢3,750,000 by FranMart Plc to construct affordable houses for its staff on 01/01/20X1. The contract is supposed to be completed in 20X3. Based on the architect's certificate, a retention of 10% has been agreed and is to be released a year after completion. The data below relates to the contract.*

	GH¢
Materials purchases	387,500
Materials issued from stores	122,500
Direct wages	260,000
Overheads absorbed	62,000
Hiring cost of equipment	213,000
Contract expenses	30,000
Material on site 31/12/20X1	85,000
Value of work certified	950,000
Cheque received as payment	855,000
Work certified 31/12/20X1	142,000
Lighting and heating owing	33,500
Prepayment carried down	21,000

You are required to prepare the following for the year ended 31/12/20X.

- a. Contract account
- b. Contractor's Account

7. *Ziggy Blaze Plc. produces three products (i.e. Joint Product A, Joint Product B and a By-Product Z)*

Cost of production before the point of separation is as follows

	GH¢
Material	390,000
Labour	510,000
Expenses	300,000

After the point of separation, the following further costs are incurred before the goods are sold:

	Material	Labour	Expenses
	GH¢	GH¢	GH¢
Joint product A	67,500	15,000	22,500
Joint product B	30,000	90,000	7,500
By-product Z	–	–	–

Sales of the product are as follows

	GH¢
Joint product A	1,800,000
Joint product B	1,425,000
By-product Z	75,000

Joint costs are apportioned between the joint products based on the saleable price at the point of separation, which is

	GH¢
Joint product A	1,350,000
Joint product B	1,050,000

The revenue from Byproduct Z is treated as sundry income

You are required to calculate these.

- a. Cost of production of each product
 - b. Profit on the sale of each product
 - c. Total profit for the company
8. Alata Samina, a product manufactured by Simple Debee Cosmetics passes through three processes to complete. The cost of production for the period was as follows:

Element of cost

	Process 1	Process 2	Process 3	Total
	GH¢	GH¢	GH¢	GH¢
Direct Material	2,000	3,020	3,462	8,482
Direct labour	3,000	4,000	5,000	12,000
Direct expense	500	226	–	726

1000 units @ **GH¢5** were issued to process 1

Production overheads **GH¢6,000**

Output of each process

Process 1 920 units

Process 2 870 units

Process 3 800 units

Normal loss per process was estimated as

Process 1 10%

Process 2 5%

Process 3 10%

The loss in each process represented scrap which could be sold to a merchant at a value as follows:

Process 1 **GH¢3** per unit

Process 2 **GH¢5** per unit

Process 3 **GH¢6** per unit

There was no stock of materials or work in progress in any department at the beginning or end of the period. The output of each process passes directly to the next process and finally to the finished stock. Production overheads are absorbed by each process on a basis of 50% of the cost of direct labour

You are required to prepare the following accounts

- a. Process 1, 2 and 3 accounts
- b. Normal Loss (scrap sale) account
- c. Abnormal loss account
- d. Abnormal gain account
- e. Costing profit and loss account

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GLOSSARY

Accrual Basis Accounting	Records revenues when earned and expenses when incurred, regardless of cash exchange, offering a more accurate financial picture.
Accumulated Fund	Describes the total worth of a not-for-profit organisation.
Adjustments	Changes made to financial statements to reflect accurate financial positions or performance.
Advertisement	A marketing tool used to promote products, services, or brands to potential customers.
Apportionment	Division and allocation of resources, costs, or revenues among various parties or areas.
Assumption	Basic ideas or beliefs taken as true that guide financial reporting and analysis.
Batch Costing	Costing method for products manufactured in batches, calculating cost per batch before unit cost.
Budget	A plan listing expected revenues and expenditures over a specific period.
By-Products	Secondary products of little value made accidentally during main product production.
Capital Approach	Estimates profit/loss by comparing capital at the beginning and end of a period, considering additions and drawings.
Cash Basis Accounting	Records revenues and expenses only when cash is received or paid, offering a simple view of cash flow.
Competitive	A company's ability to compete successfully in its market, often reflected in financial performance.
Contract Costing	Costing method for specific long-term projects, commonly used in construction or engineering.

Depreciation	Gradual reduction in asset value due to wear, age, or obsolescence.
Deterioration	Decrease in quality, condition, or value over time.
Dispatched	Sending out goods, employees, or information for a specific purpose.
Dismissal	Termination of an employee's contract by an employer.
Expensing	Recording costs as expenses in the period incurred, not as assets.
Foreseeable	Future events or circumstances that can be reasonably anticipated.
Fundamental	Basic principles or concepts forming the foundation of financial reporting.
Government Grants	Financial assistance from government for specific activities, recognised as income when conditions are met.
Identical Units	Products made to be identical in size, shape, and quality, often via mass production.
Incomplete Records	When a business lacks a complete set of accounting records, often due to single-entry or informal methods.
Job Costing	Costing method for specific jobs or projects, treating each as a separate cost unit.
Joint Products	Products made simultaneously from one raw material, having similar value and inseparable during production.
Life Membership Fee	One-time payment for lifetime membership, recorded as deferred income and recognised over time.
Liquidate	Convert assets into cash or pay off liabilities, often during business closure.
Measurable	Financial information that can be quantified numerically.
Monetary	Involving financial transactions or values measurable in money.
Obligations	Legal or moral commitments to settle debts or fulfil responsibilities.
Principle	Basic rule guiding accounting practices for consistency and reliability.
Process Costing	Costing method for continuous production industries, calculating cost per unit across processes.
Profit	Revenue minus expenses; the money left over after costs.
Redundancy	When an employee's role is no longer needed due to organisational changes.
Reliability	Accuracy and consistency of financial information for dependable decision-making.
Remuneration	Payment received by an employee for work or services.
Retirement	When an individual stops working full-time, usually due to age or years of service.
Reworked Units	Defective products repaired to meet standards, reducing waste and costs.
Service Costing	Costing method for service industries like transport, healthcare, or hospitality.
Single Entry System	Simplified accounting method recording only one side of transactions, often cash-focused.
Transparency	Financial information that is clear, understandable, and accessible.
Valuation	Determining the economic value of assets, liabilities, or equity.

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This book is intended to be used for the Year Two Accounting Senior High School (SHS) Curriculum. It contains information and activities to support teachers to deliver the curriculum in the classroom as well as additional exercises to support learners' self-study and revision. Learners can use the review questions to assess their understanding and explore concepts and additional content in their own time using the extended reading list provided.

All materials can be accessed electronically from the Ministry of Education's Curriculum Microsite.



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