ACCOUNTANCY
Class XI

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FOREWORD

The introduction of the Bhutanese Accounting Standards (BAS) into our accounting curriculum marks a significant step forward in preparing our students for the dynamic and interconnected world of modern business. By aligning our educational standards with international best practices, we ensure that our graduates possess the knowledge, skills, and values necessary to excel in both domestic and international markets.

The adoption of BAS, which is largely based on the International Accounting Standards (IAS) or International Financial Reporting Standards (IFRS), not only enhances the relevance and applicability of our accounting education but also fosters a global perspective among our students. As these standards are widely adopted across Asia and Europe, our graduates will be well-prepared to get opportunities in the global market.

Beyond the technical aspects of accounting, this curriculum is designed to equip students with the 21st-century skills and competencies essential for success in today's rapidly changing business landscape. By fostering critical thinking, problem-solving, creativity, and effective communication, we are empowering our students to become SMART (Sincerity, Mindfulness, Astuteness, Resilience, and Timelessness) citizens who can innovative and become adaptable professionals.

The Accountancy Curriculum for classes XI and XII focuses on specific accounting standards that are most important for business reporting and are relevant to the educational learning context in Bhutan.

I am confident that this new curriculum will not only produce highly skilled Accounting professionals but also nurtures future leaders who can contribute to the sustainable growth and development of Bhutan based on the pillars of GNH.

Karma Galay
Director General

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Chapter 1
Conceptual Framework for Accounting

Learning objectives:

- Explain accounting
- State the advantages and disadvantages of accounting
- Identify stakeholders in business entities and the information needs of stakeholders
- Explain the elements of financial statements and their recognition principles
- Explain the nature of capital and revenue expenditure
- Explain the meaning and purpose of accounting standards

InFocus

Bhutan's Film industry stands at the threshold of its inter-national breakthrough. However, no longer will traditional film industry concepts and business models lead to the envisaged success. Innovative concepts and new types of internet and social media communication offer new opportunities in this highly competitive market.

Upcoming new film industries in (small) countries pay, worldwide, a growing attention to filmmakers, distributors, exhibitors and audiences to embrace the international market and new media technology. They engage in new markets and gain audiences, and also develop a national identity and international appreciation.

Specific investments can be made in infrastructure, the industries' organisation and talent development to open up the above mentioned assets and national/ international market opportunities.

The commercial film industry is the main generator of film productions. Investors, and sometimes, banks finance commercial productions that are screened in one of Bhutan's 7 cinemas of which the Lugar Theatre with 880 seats is the largest. Today's Bhutan film industry generates an impressive, (low budget) production-level and appears to be a consumption industry, with added value from commercial and artistic perspectives. A total of 152 Bhutanese films were produced in the first decade of the 21st century according to the Motion Pictures Association of Bhutan (MPAB).

Remunerations for actors and singers have gone up from $1,000/- (2006) to $10,000/- per movie for top actors in 2011. Major expenditures for film productions are: logistics, equipment and salaries. The Media Impact Report 2008, shows that out of the total population in Bhutan of 695,000 inhabitants, 25% spend between 100 – 600 Ngultrums (2 -11$) per annum on cinema tickets (1 – 2$ per ticket). 63% don't use cinema facilities at all. The brut revenues for a popular film (up to 90,000 spectators) may reach up to $140,000/- while less popular films may raise half of it and unpopular films risk deficits.

Film professionals, and cultural entrepreneurs, from Australia, US, Thailand, India, Korea, Denmark and other countries have found their way to Bhutan. Some show interest to establish regular relationships with individual, commercial or non-commercial producers and agencies like MPAB and Department of Information and Media (DOIM).

Royal Government of Bhutan (RGoB) sets rules and regulations to direct, support and monitor the film industry. The DOIM is the focal actor on behalf of the Government, fostering a shared national consciousness with regards to the development of a professional and sensitive media industry in Bhutan.

Bhutan InfoComm and Media Authority (BICMA) ensures, on behalf of the government, proper implementation of the 2006 BICMA Act that regulates, Media and Information and Communication Technology (ICT) policies in its broad sense.

MPAB is the umbrella organization for the interests and development of the Bhutan film industry. MPAB coordinates screening at Lugar Theatre and acts as an interest group for their members, pledging for more facilities and tax exemption/tax holidays.

Catching up with the western multimedia entertainment industry through books, magazines internet, DVD/CD, web shops, shows and festivals will open doors to integrate films into a broad supply of entertainment for a growing consumer market in Bhutan and beyond.

[Adapted from Bhutan Film Industry Report, December 2011]

The InFocus subtly discusses the dynamics of business environment. The growth of the industry and the business firms are determined by a strong character of financial management and organisational leadership. Accounting provides an important financial information to support various decisions in the organisation. In fact, the competitiveness of business organisation today depends on the quality and relevancy of accounting information.

Accounting system captures the transactions and events such as sales, purchases, payments etc., for processing the data into information useful to owners, managers, suppliers, government and others having interest in the operation of the business organisation.

For example, in the opening scenario, the movie producer may like to ascertain costs of producing a film by category such as script, props, actors, marketing, equipment and logistics. These costs are then accumulated to determine cost per film. Further, the results may be analysed to assess how costs have changed relative to revenues over the years or for different films. The same information may be provided to the external stakeholders having interest in the business.

This perspective provides us some conceptual understanding of accounting and the roles of an accountant in managing the financial resources and supporting the growth of the organisation. Before we define 'accounting' let us understand the following business case and the financial statements or financial reports prepared by an accountant which can be used by the information users for making investment or related business decisions.

Illustration 1

S Mart and P Mart are two leading retail firms in country X. You want to invest some money in either of these business firms. To make this decision, you went on to Google and extracted the following financial statements.

Statement of Income for the year ending 31st December, 2019

Particulars	S Mart (Nu.)	P Mart (Nu.)
Revenue	8,500,000	11,500,000
Cost of sales	(5,600,000)	(6,550,000)
Gross profit	2,900,000	4,950,000
Expenses	(650,000)	(2,955,000)
Profit from operations Finance cost	2,250,000	1,995,000
Profit before tax	(120,000)	(122,000)
Tax	2,130,000	1,873,000
Net income	(698,000)	(622,000)
	1,432,000	**1,251,000**

Statement of Financial Position as at 31st December, 2019

Particulars	S Mart (Nu.)	P Mart (Nu.)
Non-current assets:		
Property, plant and equipment	4,650,000	8,200,000
Current assets:		
Inventory	890,000	1,203,000
Trade receivables	650,000	450,000
Cash and cash equivalents	555,000	200,000
Total assets	**6,745,000**	**10,053,000**

Equity and liabilities:		
Ordinary share capital (Nu.100 per share)	5,000,000	8,000,000
Retained earnings	1,080,000	710,000
Non-current liabilities:		
Long term loans	230,000	670,000
Current liabilities:		
Trade payables	375,000	405,000
Tax payable	60,000	50,000
Overdraft	-	218,000
Total equity and liabilities	**6,745,000**	**10,053,000**

You started with the basic analysis of the profitability of the two firms as follows:

Accounting Ratios	S Mart	P Mart
Gross profit ratio (Gross profit/Sales)	34%	43%
Return on capital employed (ROCE) [PBIT/Capital employed (Total assets-CL)]	36%	21%
Earnings per share (EPS) (Nu.) (Net profit/No of accrued shares)	29	16

Investors use different methods to analyse financial statements. One of the popular methods used is ratio analysis. The gross profit ratio of P Mart is higher than that of S Mart. What can you say about this higher gross profit ratio? There could be several reasons to explain this higher ratio. One could be that S Mart is able to provide better services to its customers. Another reason could be that S Mart is not able to negotiate trade discounts as P Mart does to benefit from such discounts on their purchases. You could explore other reasons to support this analysis.

ROCE of S Mart is higher than that of P Mart. The better ROCE indicates that S Mart is probably able to control its administrative, selling and distribution expenses. It could also mean that S Mart is under capitalised (i.e. its asset base is not able to sustain its level of activity). On the other hand, P Mart is possibly over capitalised and it is reporting assets on the revaluation model whereas S Mart is reporting on the historical cost model.

P Mart would make a better option for investment provided the management is able to reduce 'non-value adding expenses' to improve its ROCE and offer a better return on investors' money.

1.1 Definition of Accounting

One of the most popular and widely read definitions of accounting is provided by the American Institute of Certified Public Accountants (AICPA). It defines accounting as: "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of financial character, and interpreting the results thereof".

Learning Activity 1

Based on the definition carry out the activity:

In a group, explore the meaning of following terms and concepts in Accounting.

- Art of recording
- Classifying
- Summarizing
- Transactions and events
- Financial character
- Interpreting the results

a. Meaning and nature of business transaction

Transaction is an economic event, for example, purchases of goods, which can be measured in terms of money and thus will affect the financial position of the organisation. Teaching, dancing, script writing, film directing and playing soccer are considered as transactions only if the value of these activities can be measured in monetary terms. Transactions and economic events take place on a day to day basis at the individual household, business, government and other organisations.

However, the volume and the nature of transactions may differ from one organisation to another due to the size and the nature of activities carried out by organisations. Read the newspaper (Kuensel) and you will be surprised to see the amount of goods and services purchased by the government and other public sector organisations on a daily basis through open tender process. Can you think of a business without a transaction? The fact is that all business firms of varying size and nature involve in transactions such as purchases, sales and payments without which the business will not be able to continue. As discussed earlier, the volume and nature of business transactions may vary from one business to another. For example, the small grocery shop near your school may have less volume of transactions (such as purchases and sales) with few hundred value of asset, while companies like Toyota and Samsung may undertake millions of transactions each day. Bhutan Power Corporation Limited (BPCL) reported a total asset of Nu. 28.9 billion as at 31 December 2017 and a profit after tax of Nu. 1.3 billion. These amount of assets and the profit are result of number of years of transactions.

Learning Activity 2
In groups identify at least five transactions or economic events with money received or spent at your school and home, and report it in the following table

Transactions	Place	Amount
	Total	

1.2 The Role of Accounting in the Organisation

Accounting involves identifying and recording of financial transactions with the intention to inform investors and other stakeholders about the financial performance and positions of the organisation. Accounting also captures cost and management information related to business operations and prepares such reports to management for planning and decision making. The continuous monitoring and performance appraisals of business can be assured through proper accounting and reporting systems. The accounting in the modern business organisation enhances organisational capacity to respond to the growing opportunities and risks associated with the business operations.

Traditionally, the role of accounting in companies was more or less confined to external reporting on the accountability and stewardship responsibilities of management to its shareholders. However, there is a gradual expansion of the role of accounting beyond the external reporting requirement. The role of accounting in the global business is to create values and management capabilities through a provision of timely and relevant information, formulating business strategies and monitoring business risk.

The basic function of accounting is same in all organisations. However, the complexity and information needs of the organisations may depend on the expectation of its stakeholders, nature of industry and the governance regulations in which the organisation operates. For example, public sector firms need more advanced accounting and reporting systems since the information need is much more than in the simple sole proprietorship firm.

Accounting information is useful for business owners to secure finance for their business from banks and other financial institutions. Likewise, many small businesses require start-up capital when starting business operations. Entrepreneurs and business owners prepare prospective financial statements to provide banks and investors with information relating to the business' expected financial return. Business owners needing additional financing during business operations often provide banks and investors with a track record of their company's financial information.

Accounting also provides individuals and institutional investors with an analytical comparison of international companies for global investment opportunities or foreign direct investments (FDI).

The accounting industry has seen significant growth over the past several years. Public accounting firms and individual chartered/certified public accountants offer professional accounting services to small and large businesses.

These services comprise of preparation of financial statements for external and internal reporting, filing tax, internal and external audit, valuation, mergers and acquisitions, tax planning, information systems audit, restructuring and administration of insolvency.

The Big-4 (Deloitte, PwC, Ernst &Young and KPMG) firms dominate the accounting service market today. Factors such as increasing government legislations and regulations, increasing number of business firms, and business involving in complex transactions contribute to the rapid growth and development of accounting.

Learning Activity 3

After reading information on roles of accounting, answer the following questions:

1. Why do you think there is need for accounting in any organisation?
2. How do accounting support seamless functioning of a business firm?
3. What would happen to a business firm, if accounting books are not maintained?
4. Which organisation is responsible to look after standard of accounting in Bhutan?

1.3 Features of Accounting

Following are some important features of financial accounting but are not limited to them:

a. Deals with financial transaction

Accounting considers only those transaction and events which are of financial character. If a transaction has no financial character, it not be measured in terms of money and are not be recorded or recognised in the books of accounts. The organisations need both financial as well as non-financial information for making decisions related to its products or services. Financial accounting can provide only financial information that entails financial transactions and events. However, this limitation of financial accounting is addressed by management accounting. In management accounting, both financial as well as non-financial reports are prepared such as customers' satisfaction report, impact of new products on culture, etc.

b. No futuristic transaction

Financial accounting considers only those transactions which have already taken place during a particular period of time. That's why, financial accounting information is also called historical financial information. No futuristic transactions are taken into account even if it may be important from business point of view. However, this limitation of financial accounting is addressed by management accounting. Further, the availability and the capacity of modern data analytics can improve the prospects of forecasting value of accounting information. The users of historical financial statements must perform further analysis of those financial statements in order to obtain information about the future expected cash flows and performance of the business.

c. Accounting is both science and art

Science is a systematic body of knowledge that can be investigated by observations and analysis. Accounting is a body of knowledge based on certain principles (these principles are called Generally Accepted Accounting Principles (GAAP) which is more popular in America and International Financial Reporting Standards (IFRS) which is more popular in Europe, Australia and Asian countries) and framework, the knowledge of which can be attained through systematic study, practice, investigation and careful observation of business data. Accounting is also an art as it requires knowledge, skills, interest and experience to make judgement when preparing and presenting financial information to the users.

d. Accounting is the language of business

Accounting is rightly called the "language of business" since it involves reporting and communicating information about the business. Accounting information is compared between and among companies and industries to measure business performances for investment decisions. Through proper accounting and reporting, management informs the investors and other stakeholders about their stewardship responsibilities and fiduciary duties. The inappropriate accounting or misrepresentation of financial information may mislead users of accounting information.

e. Accounting is a profession

Accounting is a specialised body of knowledge developed with the advancement of commerce and business over the past centuries. Today, accounting is taken as a profession like law, medicine or architecture. The development of accounting as a profession is both stimulated and regulated by the professional accounting bodies such as chartered or certified accountants. The accounting is also one of the highly regulated professions in the world due to high stake in their professional services. A member of the professional accounting body is generally called professional or a qualified accountant.

1.4 Objectives of Accounting

The objectives of accounting can be viewed from different users' perspective such as investors, lenders, creditors, management, employees and other stakeholders. For example, banks and creditors to whom the business owes money need accounting information to assess ability of the business to pay them on time. For government, it is important that the business pays them appropriate taxes. The managers would require accounting information to plan and execute business activities through proper financing and investment decisions. In this section, we discuss some of objectives of accounting.

a. To keep systematic records of business transactions

Business and other organisations engage in numerous transactions of purchases, sales, payment of bills, salaries etc. Accounting helps business entities to maintain complete and systematic record of all business transactions by using the double entry system of bookkeeping. By doing this, business can prevent cash and other assets such as property and inventories from being stolen or improperly used. The proper recording system of financial transactions helps management to achieve efficient and effective management of financial resources and improve business performance. The computerised accounting system increases the speed as well as enhances accuracy of the mechanism of record keeping of business transactions.

b. To determine profit or loss of the business

One of the principal objectives of accounting is to help business ascertain the earnings during the accounting period. By comparing the earnings with the expenses, business can find out whether it has made a profit or a loss during the accounting period. However, the business profit can have different connotation. If the income exceeds the cost of sales, there will be a gross profit. When administrative and other expenses are deducted from the gross profit, the business can ascertain its net profit or the operating profit. This information can be obtained by preparing the statement of income.

c. To ascertain financial position of the business

Simply knowing the profit or loss is not sufficient. Every entrepreneur must know the position of his/her business. This can be achieved by preparing a statement of financial position and statement of cash flows. A statement of financial position shows two things: (i) First the statement of financial position identifies the economic resources controlled by the business such as property, plant and equipment, inventories, cash and cash equivalents. These are known as assets.

(ii) Second the statement of financial position identifies the source of the funds that were used to acquire the assets. These funds are normally provided by the owners (equity) or others (liabilities).

d. To provide accounting information to the interested users

There are many existing and potential investors, lenders and other creditors who cannot require the business entity to provide information directly to them. They rely on the general purpose financial statements for much of their financial information need. The financial statements along with other pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and business outlooks are analysed to assess the past performance of the business over a period of time, prospects for future net cash inflows and estimate the value of the business entity.

e. For legal compliance

All business entities are subject to legal considerations though the application of specific legal provisions might differ. For example, all registered companies are required to prepare and file a copy of annual financial statements under the Companies Act of Bhutan 2016. Similarly, the listed companies prepare and file similar financial statements with the securities exchange under their listing rules. Business entities must also comply with taxation law to account tax payables to the government.

Failure to fulfill legal considerations may bring unnecessary complications to the management and affect the reputation of the entity. Proper accounting and reporting helps business entity to enhance accountability and disclosure of relevant information to the stakeholders

f. For Accountability

Investors and other stakeholders can hold management and those charged with governance responsible for the performance of the business. That is, the investors need to assess how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the business entity's resources. Examples of such responsibilities include protecting the business's resources from unfavourable market conditions and ensuring that the business complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful to existing shareholders and other stakeholders who have the right to vote on or otherwise influence management's actions.

Learning Activity 4

Karma Dorji owns a small business and wondering if there is a need to hire an accountant. He has heard different things about accounting, but not sure what it actually involves. Explain to Karma, the detail job responsibilities of an accountant and convince him to hire an accountant so as to improve performance of his business.

1.5 Branches of Accounting

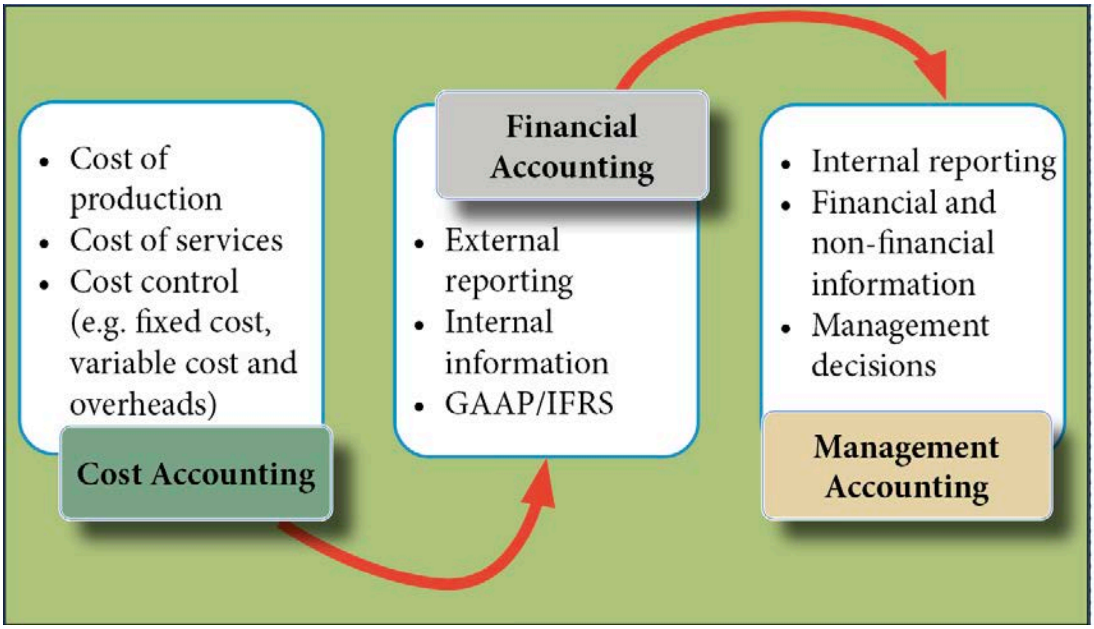


Figure 1.1 *Interlink between cost, financial and management accounting*

The need for accounting information by various users has changed over the period of time. For example, investors now need accounting information to assess various investment opportunities and also demand higher accountability of managers of their fiduciary duties, production manager needs accounting information to manage cost of production and control costs, and sales manager use accounting information to design sales commission.

Similarly, banks and financial institutions need information to provide short and long term finance to business organisations. The reliable and relevant financial information can reduce information risk for the capital provider and thus reduce the cost of capital. The increasing complexity of business operations and government regulations too have contributed to the growing demand for information needs.

To cope with this changing business environment, business organisation has now segregated accounting information into:

a. Cost accounting information,

b. Financial accounting information, and

c. Management accounting information.

Thus, the subject matter of accounting has been broadly categorised as:

a. Cost Accounting,

b. Financial Accounting, and

c. Management Accounting.

The branches of accounting are briefly explained as under:

a. Cost Accounting

Cost accounting measures, analyses and reports financial and non-financial information relating to the cost of acquiring or using resources in the organisation. Cost accounting provides information for financial and management accounting. For example, calculating cost of producing goods or providing a service is a function of cost accounting. This cost is then used in financial accounting as the cost of inventory or cost of goods sold. The management accounting may use this information to make a decision on alternative method of production or improving the quality of goods or services.

b. Financial Accounting

The financial accounting measures and records business transactions and prepares financial statements that are based on accounting principles and standards. The financial statements are mainly prepared for external parties such as investors, government, banks, suppliers, and other stakeholders as information for making decisions. The financial statements comprise statement of income, statement of financial position, statement of cash flows and statement of changes in equity.

c. Management Accounting

Management accounting measures, analyses and prepares reports that provide accurate and timely financial and non-financial information required by managers to make organisational decisions. Management accounting uses information provided by cost and financial accounting. Financial accounting presents essentially the historic or past performance of business whereas management accounting presents both past results as well as future planning.

Read the information given in the following box understand the evolution of accounting and its development.

Branches of Accounting: A Brief History

The financial accounting system has evolved way back in the 15th century when Fra Luca Bartolomeo de Pacioli, an Italian mathematician developed the double entry bookkeeping system where every business transaction will have corresponding and opposite entry which is called debit and credit. However, the development of cost and management accounting system is quite recent phenomenon.

Initially, cost accounting system was used to record and report costs to management in manufacturing industries with the objective of determining product costs and to manage costs. The cost accounting system was also used for management accounting in particular for score-keeping (reporting results), directing management attention (focusing management to issues) and problem solving (analysing for decision making). Since then the nature of management accounting has changed significantly whereby there is a need for a management accounting system. Considering the information need for strategic planning, the scope for management accounting system has expanded to information provision to strategic planning and control.

Management accounting system uses non-financial as well as financial information and information from external as well as internal sources. This is explained in the previous section specifically under branches of accounting.

The rapid change in the accounting system is largely attributed to the revolution of ICT and its application in business functions.

Learning Activity 5

From the following list of activities given, state whether it is Cost Accounting, Financial Accounting or Management Accounting and justify your answer.

1. A restaurant using cost to determine the cost of ingredients, labour, and overhead associated with each menu item.
2. Recording daily sales by an accountant in a business firm.
3. Prepare and present financial statements and other reports to various stakeholders, including investors, creditors, regulatory bodies, and management.
4. Hospitals track costs associated with various departments, procedures, and patient treatments to identify areas for cost reduction, improve resource allocation, and negotiate better rates with insurance companies.
5. Understanding the relationship amongst costs, volume, and profit to determine break-even points, optimal pricing strategies, and the impact of production changes on profitability.
6. The school management preparing budgetary performance report to be forwarded to the District Education Officer.
7. The management of a central school developing the school mess management plans on the basis of students' nutritional needs, budget and students' feedback.
8. The Accountancy teacher estimating cost for students' industry visit and reporting to the management.
9. District Education Officer preparing monthly financial reports to be submitted to the Department of Public Accounts.
10. Bhutan National Bank Limited preparing statement of income for shareholders.
11. The accounts officer preparing a report to be forwarded to the senior management on the loss of sales due to introduction of a new tax rule in India.
12. The project manager of a renewal energy department reporting on the financial feasibility of a new bio-gas plant in Zhemgang.

Which of the following statements are true or false? Justify.

1. Management accounting reports follow legal guidelines.
2. The frequency and format of management accounting reports are determined by law.
3. The financial accounting reports follow accounting standards for preparation and presentation of financial statements.
4. The management accounting uses only historical cost data.

1.6 Process of Accounting

The importance of financial information provided in the form of financial statements to the users was discussed in the previous section. These financial statements are an outcome of a series of accounting processes. Irrespective of the nature and the purpose of financial information, accounting uses a system to generate such reports. Imagine how a business organisation can handle the volume of transactions and maintain the related data for a long period of time. The amount of information to be processed on a daily basis and a need for highly selective and competent information, require business organisation to have an accounting system where transactions and events are reliably processed and summarised into useful financial statements and reports.

The accounting information can be processed by a combination of manual and an automated system. In a small grocery shop, it may not be possible to use automated system, while in the bigger firms a combination of manual and automated system will help the firm to manage its financial transactions and resources. The business transactions are processed to generate various types of information that are required to make all sorts of business decisions. These decisions would include how to improve product quality, how to increase customer satisfaction and how to improve financial performance of the firm.

Data and Information

Data refers to facts, transactions or events that require further processing before it is used as information for decision making. Examples: sales, purchases, number of repeat purchase, number of employees retiring after 10 years and tax payable.

Information refers to data that has been processed so as to be meaningful or capable of influencing individual and organisational decision making.

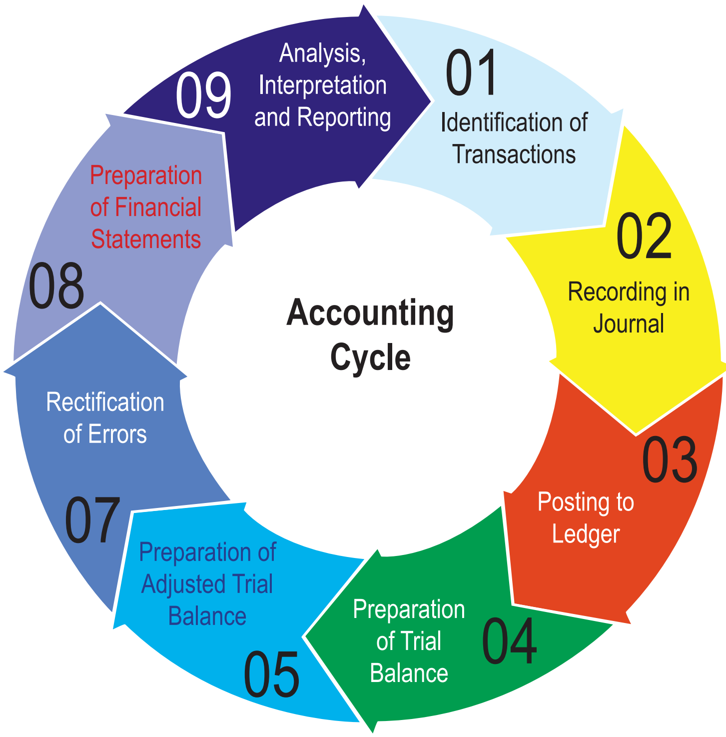


Figure 1.3 *Financial accounting cycle*

The financial accounting system is well captured in the definition and process of accounting. Accounting involves recording, classifying, and summarizing financial transactions and events and interpreting the results of such transactions to inform the users. The accounting process closely follows the business operation cycle.

1.7 Accounting Process in Practice

a. Identifying and analysing transactions and events

Accounting process begins with identification of business transactions which are measured in monetary value. For example, rent of Nu. 10,000 is paid to the building owner at the end of the month. The existence of transaction is evidenced by source documents (e.g. money receipt, bank statement etc.) indicating that a transaction has actually taken place. This is a case of an explicit transaction where the occurrence of transaction is substantiated by the existence of document. However, there are also transactions and events where it is difficult to understand

that transaction or events have actually taken place. Examples: depreciation, closing entries and adjustments which need to be carefully considered for record.
Once identified, transaction must be analysed to assess its implication on company's financial statements. One of the reasons to analyse transaction is to ensure that the data to be recorded in the accounting system is valid and correct in terms of its measurement and recognition.

b. Recording transactions and events

The accounting process involves recording the transactions and events using the principle of double entry system which is also referred to as dual system. According to the dual system, every transaction has two aspects 'the giver' and 'the receiver'. The two aspects are further known by the name 'debit' and 'credit'. In addition, all transactions are recorded in an 'account' and a transaction can have at least two accounts. Considering the nature of transactions, these accounts are group into three categories:

a. **Personal account:** Accounts related to individuals, organisations and body corporates such as companies, departments, corporative societies etc.

b. **Real account:** Accounts related to tangible and intangible things such as cash, property, plant and equipment.

c. **Nominal account:** Accounts related to income and expenses.

Based on the categories of three accounts a accounting rule has been developed which is applied during the recording of business transactions. These rules are commonly known as the 'golden rules' of accounting.

Personal Account Rule	Real Account Rule	Nominal Account Rule
Debit the receiver, credit the giver	Debit what comes in, credit what goes out	Debit all expenses and losses, credit all incomes and gains

Figure 1.4 *Golden rules of accounting*

Recording is done in the book called Journal. The art of recording transactions and events in a chronological manner in a journal with the intention to prepare financial statements is called 'bookkeeping.' The detailed conceptual knowledge and technical skills of recording is covered in chapter 4.

c. Classifying similar nature of accounts into a common group

This process involves categorising various accounts of similar nature under a common group heading. This involves posting of accounts from journal into a book called ledger. Ledger is a T-shaped presentation of accounts where all accounts of similar nature are brought to a common place under a common heading. The ledger presents a status of each class of accounts (showing either a debit or credit balance). The technical skills of preparing ledger are covered in chapter 3.

Figure 1.5 *'T' Account*

d. Summarising the transactions

The business organisation may have a number of ledger accounts that are actively used to update accounts and assess position of each account. These ledger accounts are aggregated and balances transferred to the financial statements. Each type of financial statement represent numerous transactions and events recorded and posted in the ledger accounts. All nominal accounts of income and expense are transferred to statement of income to show the performance of business during the financial year. Likewise, all real and personal accounts are brought to the statement of financial position to reveal financial status of business. Real accounts of cash and cash equivalents are transferred to statement of cash flows to show the net cash inflows and cash outflows.

e. Reporting

Perhaps the most important process of financial accounting is the reporting part. In the reporting part, company management prepares financial statements in accordance with the prevailing accounting standards such as the Generally Accepted Accounting Principles (GAAP) or in the Bhutanese context, Bhutanese Accounting Standards (BAS) under which the business is to report, and present these statements along with other parts of report such as management commentary and directors review of performance, to the shareholders and general public. The companies act and other legislations may require the business to report certain information which may not be required by the accounting standards. For example, the company may need to report on directors' remunerations and related party transactions in their financial statements. It may be necessary that the entity, particularly the large companies, and also entities whose business are quite seasonal may also be required to provide an interim financial reports for the period shorter than the full financial year.

f. Analysing and interpreting financial statements

The financial statements or the reports may not be capable of presenting the valuable information by itself. There is a need to apply another set of knowledge and skills, i.e. the financial analysis and interpretation. Financial analysis and interpretation involves use of analytical tools such as accounting ratios, common size analysis and time series analysis. The proprietary information derived from financial statement analysis is used to make investment and other economic decisions.

1.8 Operating Cycle

An Operating Cycle (OC) refers to the days required for a business to receive inventory, sell the inventory, and collect cash from the sale of the inventory. This cycle plays a major role in determining the efficiency of a business.

a. Net Operating Cycle (Cash Cycle) vs Operating Cycle

The operating cycle (OC) is often confused with the net operating cycle (NOC). The NOC is also known as the cash conversion cycle or cash cycle and indicates how long it takes a company to collect cash from the sale of inventory. To differentiate the two:

Operating Cycle: The length of time between the purchase of inventory and the cash collected from the sale of inventory.

Net Operating Cycle: The length of time between paying for inventory and the cash collected from the sale of inventory.
The following image illustrates difference between the cycles:

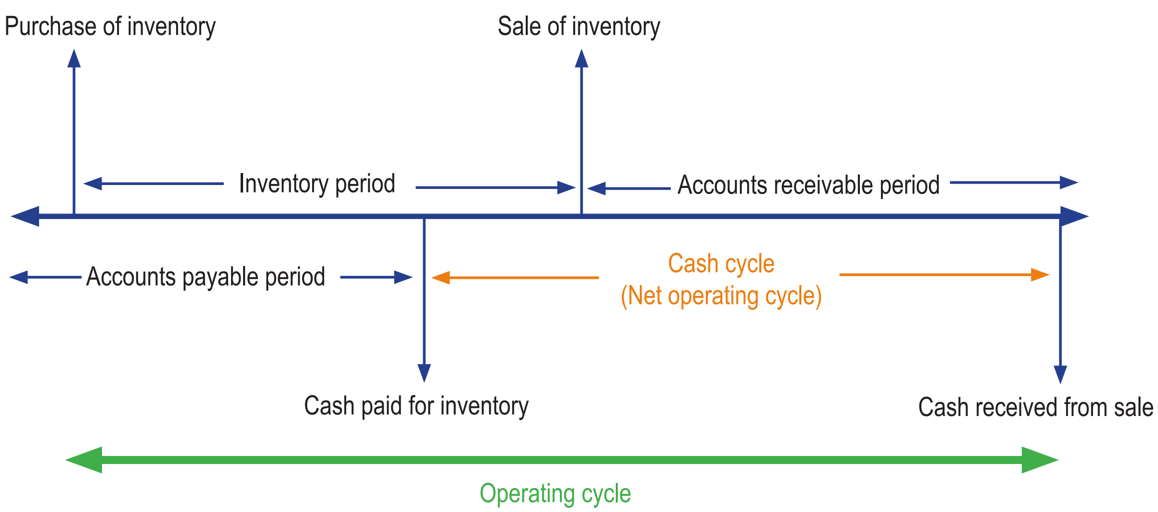


Figure 1.6 *Operating cycle*

1.9 Users of Accounting Information

Accounting information helps users to make better financial decisions. Users of financial information may be both internal and external to the organization.

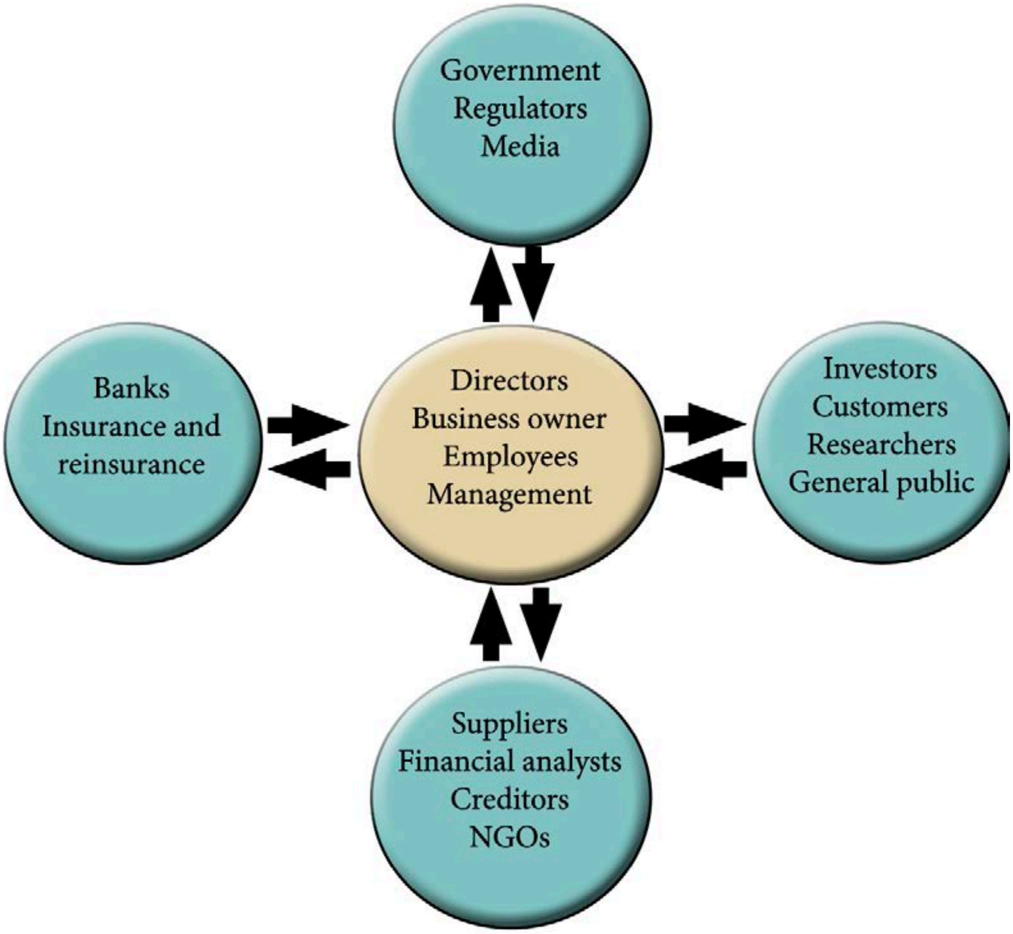


Figure 1.7 *Internal and external users of accounting information*

Internal users: It consists of management, employees, and directors within the organisation. Internal users need accounting information to make operational and strategic decisions related to the business. Internal users are the internal stakeholders.

External users: It refers to those users outside the business organisation who depend on the financial reporting of the business to make various investment and business decisions. These include investors, customers, suppliers, government and banks. External users of accounting information are the external stakeholders.

1.10 Main areas of stakeholder's interest in business entities

The key areas of interest among wide range of stakeholders may be summarised as follows:

a. Discharge of directors fiduciary duties

Particularly in a limited company, there is a separation of ownership and management of a company. The separation of owners from management places management in a fiduciary relationship with the owners and hence a responsibility to account or report to the owners for:

- proper application or effective use of company's resources,
- protection of company resources from misappropriation, and
- achieving returns on investment at the rate acceptable to the investors.

b. Profitability of business

The motive of every business is to earn sufficient return on investment and ensure continuity of its operation. Profitability depends on the nature of industry and business models. For example, in a business in tourism and hospitality industry there might be an expectation of steady growth while business in agriculture might take some time to earn sufficient returns on investment. A continuous loss over several years might jeopardize sustainability of business. Since profitability is one of the main motives of business, it is used as one of the measures to assess performance of management.

c. Liquidity position of business

Liquidity position of business reflects business entity's ability to meet its daily expenses such as payment of utility bills, settlement of its debts as and when they fall due. The strong liquidity position enables firms to seek business opportunities and overcome competition and other threats in the market. Firms with liquidity problems face higher cost of borrowing as the risk of defaulting loan services increases. The firm will also miss business opportunities and stagger growth.

d. Solvency

Solvency is the ability of the business entity to meet all its debts or claims in the event it is wound up. In case of a limited liability company, the shareholders and creditors may not realize all their claims if the resources available for distribution is insufficient to pay off their full claims. The reason being that members' have obligations only to the extent of what they have subscribed to the shares.

e. Employee welfare

Employee welfare scheme determines employee morale and productivity. This includes fair remuneration and training and development opportunities, work ethics, staff motivation and participation in decision making process.

f. GNH business goals

Business in Bhutan is now guided by the principles of GNH. The prospect of GNH based business and its performance measures are widely accepted among stakeholders. This means that the business entities must embrace GNH values and align their strategies and goals with GNH principles. It is expected that financial reporting framework will need to be extended to incorporate social and environmental performance of business during the reporting year. The report which captures financial, social and environment performance of business is called triple bottom line report. This is also called 3Ps: profit, people and planet. The stakeholders such as investors, customers and suppliers alike would account not only financial performance but also social and environment performance of business when they assess investment and business opportunities.

Learning Activity 6

Carefully study the information need of each of the users listed in the table. Fill in the table by analysing the users and their information need. The first one is done as an example.

Information User	Type of information required	How the information will be used?	Who can generate the information?
Government	Income earned by the business	Government is interested in the profitability of business for tax calculation.	Financial accountant
Customers			
Suppliers			
Management			

1.11 Bookkeeping

Bookkeeping is the basis of accounting and is concerned with the recording of financial transactions in the books of accounts. It is the process by which a record of financial transaction is maintained in proper set of books. Thus, it is concerned with identifying, measuring, recording and classifying recorded transactions and events in a systematic manner.

» Definitions of bookkeeping

A number of definitions of bookkeeping have been provided by various writers.

"Bookkeeping is the art of recording business transactions in a systematic manner."

-A. N. Rosen Kampff

"Bookkeeping is the science and art of recording correctly in the books of accounts all those business transactions that result in the transfer of money or money's worth."

-R. N. Carter

Learning Activity 7

Explore the difference between bookkeeping and accounting and present the information in the following table.

Basis	Bookkeeping	Accounting
Objective		
Relationship		
Skills required		
Purpose		

Learning Activity 8

From the following statements, identify whether it is bookkeeping or accounting function.
Dechen maintaining a record of all stationery items purchased by the school.

1. Tally-ERP performing an analysis of sales report to aid sales manager to project next year's sales.
2. An accounts executive writing a sales day book where she also does casting of the sales day book and post them to the sales ledger.
3. The school accountant entering school bus fuel expenses incurred in the last month.
4. The school accountant preparing payroll for staff salary.
5. Checking your bank statement and ensuring it matches your recorded transactions, identifying and resolving any discrepancies.
6. Creating invoices for customers and ensuring timely payments, as well as paying your own bills accurately and on time.
7. Preparing reports like income statements, balance sheets, and cash flow statements that summarize your financial performance and position.
8. Using the generated reports to understand your financial health, identify trends, and make informed business decisions.

9. Calculating and filing your taxes accurately based on your financial records, ensuring compliance with legal regulations.

1.12 Financial statements

The financial statements consist of:

a. Statement of financial position

Statement of financial position, otherwise called balance sheet presents information related to financial conditions of the business as of a particular point of time. In other words, statement of financial position provides a snap shot of financial position of a business at specific point of time. The items presented in the statement of financial position are assets, liabilities and equity.

b. Statement of income

The income statement, otherwise called statement of profit or loss account presents performance or results of operating activities of the business for a period of time. The performance of business is often measured by the amount of profit earned during the accounting period. The profit is calculated as the difference between income and expenses when matching concept is applied.

Profit = Income - Expenses

c. Statement of cash flows

Statement of cash flows provides details of cash received and cash paid out during the accounting period to which other financial statements relate. It classifies and presents cash flows from operating, investing and financing activities of the business. Statement of cash flows provides basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

d. Statement of changes in equity

Statement of changes in equity presents movement in the owners' equity during the period of time. It traces all the changes resulting from transactions with shareholders (such as share capital, share premium, and different classes of reserves) during the accounting period.

e. Notes

Notes present information about the basis of preparation of the financial statements and the specific accounting policies used in the preparation of financial statements. Notes also disclose the information required by accounting standards that is not presented elsewhere in the financial

statements. For example, contingent liabilities are disclosed in the form of notes.
The format and contents of these financial statements are specified in company law. The amount of information to be disclosed in these financial statements has grown over the years due to changes in legislations and the demand of the information users. For example, disclosures on company director's remunerations, political donations, transactions between company and its related parties are increasingly becoming important.

1.13 Conceptual Framework for Financial Reporting

It is essentially a set of guiding principles that define the objective and essential qualities of financial reporting, allowing for consistent and informative financial statements.

A financial statement is a snapshot of an entity's financial health at a specific point in time. It is a financial report that shows how well the entity is doing financially. Financial statements are often audited by government agencies and accountants to ensure accuracy and for tax, financing, or investing purposes. The concept will discussed later in depth in a independent chapter.

The framework identifies five financial statements:

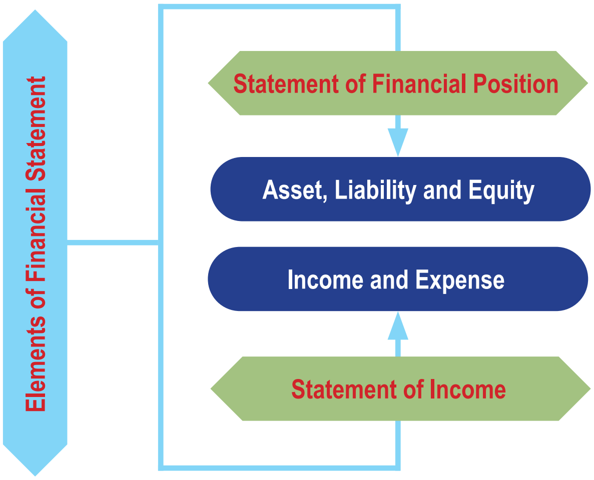


Figure 1.8 *Elements of financial statement*

a. Statement of financial position

Statement of financial position, otherwise called balance sheet presents information related to financial conditions of the business as of a particular point of time. In other words, statement of financial position provides a snap shot of financial position of a business at specific point of time. The items presented in the statement of financial position are assets, liabilities and equity.

» Asset

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

Assets are used to produce goods or services capable of satisfying the wants or needs of customers, and customers are prepared to pay for goods or services. Therefore, assets contribute to the cash flow or earnings of the entity.

The assets of an entity result from past transactions or events. This means, entities normally acquire assets by purchasing or producing them. However, there are also transactions or events which may generate assets. For example, entity receiving a property from government as part of a programme to encourage economic growth in an area is an asset.

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

- used singly or in combination with other assets in the production of goods or services to be sold by the entity,
- exchanged for other assets,
- used to settle a liability, or
- distributed to the owners of the entity.

Many assets such as property, plant and equipment, have a physical form. There are also assets which do not have a physical form such as patents, copyrights, goodwill and franchise rights. All these meet the definition of assets so long as future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

Types of Assets

In accounting, assets are classified into current and noncurrent assets based on their liquidity and the time frame within which they can be converted into cash.

Current Assets

Current assets are assets that are: [BAS 1.66]

- expected to be realised in the entity's normal operating cycle;
- held primarily for the purpose of trading;

- expected to be realised within 12 months after the reporting period; or
- cash and cash equivalents (unless restricted).

Noncurrent Assets
All other assets which are not current assets are non-current.

» Liability

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract (e.g. amounts payable for goods and services received) or statutory requirement (e.g. tax payable).

Liabilities result from past transactions or events. For example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance) and the receipt of a bank loan results in an obligation to repay the loan.
Settlement of a present obligation may occur in a number of ways, for example, by:

- payment of cash,
- transfer of other assets,
- provision of services,
- replacement of that obligation with another obligation, or
- conversion of the obligation to equity.

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

Type of Liabilities:
Liabilities are classified into current and non-current (or long-term) liabilities based on the time frame in which they are due.

Current Liabilities
Current liabilities are those: [BAS 1.69]

- expected to be settled within the entity's normal operating cycle;
- held for purpose of trading;
- due to be settled within 12 months; or
- for which the entity does not have the right at the end of the reporting period to defer settlement beyond 12 months.

Noncurrent (or Long-Term) Liabilities
Other liabilities which are not current liabilities are non-current.

» Equity

Equity is the residual interest in the assets of the entity after deducting all its liabilities. Equity is sub-classified into capital, retained earnings, reserves representing appropriations of retained earnings. Each of this part of equity is reported separately in the statement of financial position.

Business may create reserves for various future purposes. The creation of reserves may also be a requirement of law in order to give the entity and its creditors an added measure of protection from the effects of losses. Transfers to reserves are treated as appropriations of retained earnings rather than expenses.

However, the framework restricts excessive creation of reserves without sufficient justifications.

b. Statement of income

The income statement, otherwise called statement of profit or loss account presents performance or results of operating activities of the business for a period of time. The performance of business is often measured by the amount of profit earned during the accounting period. The profit is calculated as the difference between income and expenses when matching concept is applied.

Profit = Income - Expenses

» Income

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

Profit is used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share.

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including:

- sales – e.g. sale of goods
- fees – e.g. sale of service
- interest – e.g. banks and fund management companies
- royalties –e.g. mining and legal rights
- rent – e.g. investment properties

Gains represent other items that meet the definition of income, and may or may not arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. For example, gain arising on the disposal of non-current assets is an income and is reported in the income statement as ‘other income’.

The definition of income also includes unrealised gains such as those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long-term assets. When gains are recognised in the income statement, they are reported as separate items because knowledge of them is useful for the purpose of making economic decisions.

» **Expense**

Expenses decreases economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants

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

Losses include those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses. For example, losses that arise on the revaluation of marketable securities and those resulting from the decrease in the carrying amount of long-term assets. When losses are recognised in the income statement, they are usually reported as separate items because knowledge of them is useful for the purpose of making economic decisions.

c. Statement of cash flows

Statement of cash flows provides details of cash received and cash paid out during the accounting period to which other financial statements relate. It classifies and presents cash flows from operating, investing and financing activities of the business. Statement of cash flows provides basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

d. Statement of changes in equity

Statement of changes in equity presents movement in the owners' equity during the period of time. It traces all the changes resulting from transactions with shareholders (such as share capital, share premium, and different classes of reserves) during the accounting period.

e. Notes

Notes present information about the basis of preparation of the financial statements and the specific accounting policies used in the preparation of financial statements. Notes also disclose the information required by accounting standards that is not presented elsewhere in the financial statements. For example, contingent liabilities are disclosed in the form of notes.

The format and contents of these financial statements are specified in company law. The amount of information to be disclosed in these financial statements has grown over the years due to changes in legislations and the demand of the information users. For example, disclosures on company director's remunerations, political donations, transactions between company and its related parties are increasingly becoming important.

1.14 Capital and Revenue Items

It is customary to differentiate expenditure in business as capital or revenue.

a. Capital Expenditure

Those expenditures incurred in the purchase of non-current assets, the benefits of which will be derived for more than one accounting period. These expenditures are 'non-recurring' in nature. All the expenses incurred till the asset is ready for use are also treated as capital expenditure. Further, any expenditure incurred for the purpose of increasing profit earning capacity or reducing cost of production is a capital expenditure. All the capital expenditure incurred on an asset forms a part of cost of that asset, and is shown in the statement of financial position.

b. Revenue Expenditure

Those expenditures which are incurred by business in the day to day conduct and administration of its activities. Such expenditure generates benefits within the current accounting period. These expenditures are recurring in nature. They are sometimes called as expired costs. Example: purchase of goods, payment of salaries to staffs, payment of rent for building, traveling expenses, etc. Revenue expenditures are expensed, and are shown in the income statement.

It is also appropriate to distinguish between capital receipts and revenue receipts from conceptual point of view as well as for presentation of such items in the financial statements.

a. Capital Receipt

Those receipts, which are non-recurring in nature, and are not generated by the sale of goods or services in the ordinary course of the business. Such receipts are shown under liabilities in statement of financial position. For example, Cash and kind contributed by the proprietor/owner into the business, loan taken from financial institutions, proceeds from sale of non-current/fixed assets etc.

b. Revenue Receipt

It refers to those receipts which are recurring in nature and are also available for meeting the day to day expenses of a business. For example, sale proceeds of goods and services, interest received from banks, trading commission on sale of goods, rent received from tenants, etc. These receipts are shown in Income Statement.

Read the case study and answer the questions that follow:

Case Study

Sonam Trading Company has been in imports business for the past fifteen years. It purchases electronic goods from Nepal and Thailand, and distributes in Thimphu and other parts of the country. Items like I-phone, I-pad and LCD screen dominated the recent import bills. As usual, Sonam Trading Company filed its tax returns for the financial year 2017 with DRC Phuntsholing. However, the officials of DRC found out that the amount of tax calculated by the company needed some correction. For this the company was asked to provide the financial records and the accompanying documents. Later, it was found that some of the transactions of revenue nature were treated as capital and vice versa. Due to such errors, the financial statements of the business were found to be misleading.

These are the transactions:

a. Purchase of CCTV for Nu.500,000, of which worth of Nu.50,000 was installed in the business counter.

b. Salary advance of Nu.10,000 to salesman in the month of December 2019 was recorded as Salary of December.

c. Purchase of Pick-up Utility Van costing Nu.800,000 from Zimdra Automobiles was recorded in Purchase book.

d. Wages of Nu.30,000 paid to the carpenter for making shelves was debited in the Wages account

e. LCD worth of Nu.65,000 sold to Wangbama Central School was wrongly debited to purchase account.

f. f) Printer costing Nu.30,000 was recorded in printing and stationery account.

Complete the Table by using the information from the case study.

Table 10.2 Classification of capital and revenue expenditure

Sl.No.	Transaction	Nature of expenditure	Justification
a			

b			
c			
d			
e			
f			

Questions:

1. List down any four differences between capital expenditure and revenue expenditure.
2. Describe the significance of identifying capital and revenue items.
3. Examine how would each of these transactions affect the financial information in the financial statement.

1.15 Recognition of the Elements of Financial Statements

Recognition is the process of incorporating in the statement of financial position or income statement an item that meets the definition of an element and satisfies the criteria for recognition. If an item meets the definition of an element but does not qualify for recognition criteria it should be disclosed as a note.

a. Recognition of assets

An asset is recognised in the statement of financial position when:

- it is probable that the future economic benefits will flow to the entity,
- the asset has a cost or value that can be measured reliably and
- the resource is controlled by the business entity.

b. Recognition of liabilities

A liability is recognised in the statement of financial position when:

- it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation, and
- the amount at which the settlement will take place can be measured reliably.

c. Recognition of income

Income is recognised in the income statement when:

- an increase in future economic benefits related to an increase in an asset (e.g. sales) or a decrease of a liability (e.g. waiver of a debt payable) has arisen, and

- the amount can be measured reliably.

In practice, business entities normally recognise income when:

- the revenue is earned,
- the item can be measured reliably, and
- there is a sufficient degree of certainty of receiving the revenue.

d. Recognition of expenses

Expenses are recognised in the income statement when:

- a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen, and
- the amount can be measured reliably.

In practice, expenses are recognised when:

- the expense is incurred, and
- the item can be measured reliably.

1.16 Measurement of the Elements of Financial Statement

The elements of the financial statements are assigned a measurement basis for accounting purpose. This determines the monetary amounts at which the elements of financial statements are recognised in the statement of financial position and income statement. A number of different measurement bases are developed and applied in accounting. In practice, a combination of these measurements are used. For example, the business entity may use historical cost basis to account for property, plant and equipment, and present value basis to account for employee benefits and lease transactions. In the following section, we discuss some the popular measurement basis used in accounting. These include:

a. Historical cost

Assets are recognized or recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recognized or recorded at the amount of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business. The non-current assets after initial recognition are measured as carrying amount less depreciation and impairment loss (if any).

b. Current cost

Assets are recorded or carried at the amount of cash or cash equivalents that would have to be paid if the similar asset was acquired currently.

Liabilities are recorded or carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

» **Realisable (settlement) value.**

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

» **Present value**

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

c. Conceptual Framework for Financial Reporting Summary

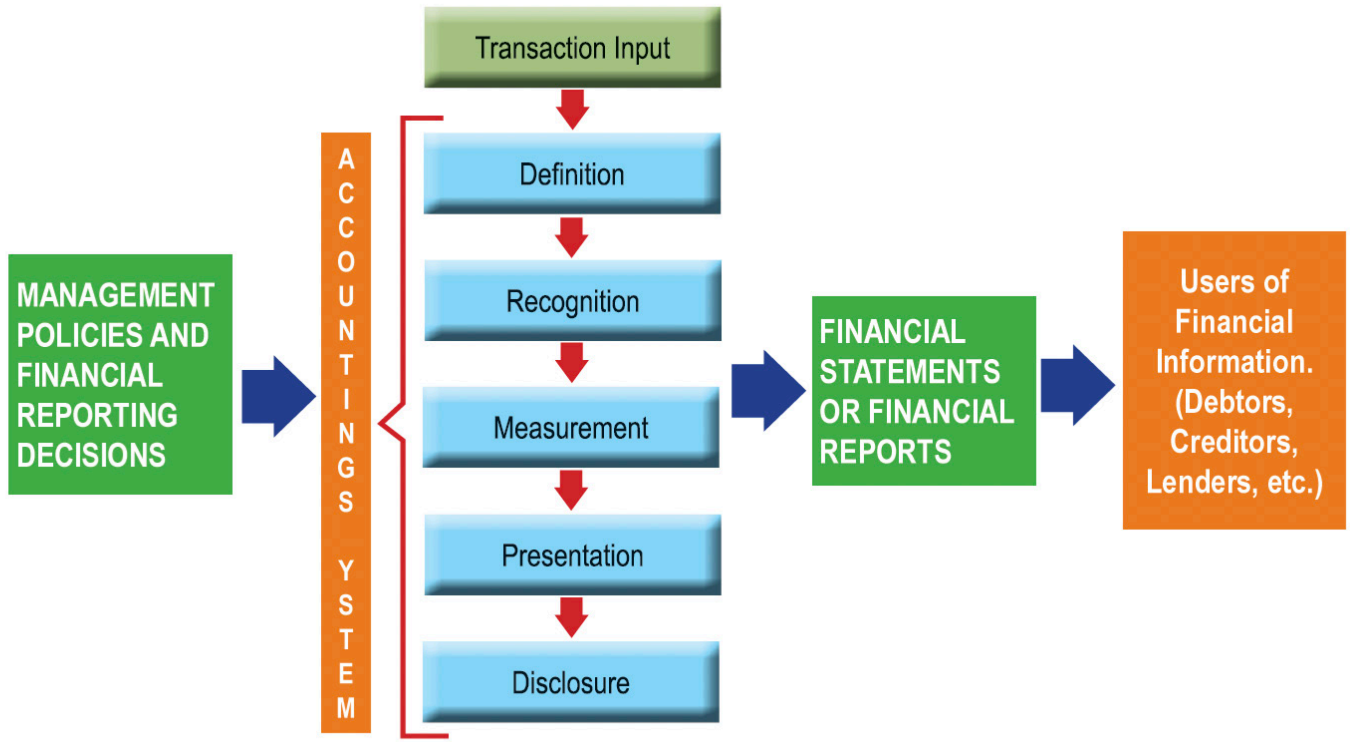


Figure 1.9 *Summary conceptual framework for financial reporting*

1.17 Accounting Standards

Accounting standards are set of codified written rules or guidelines for financial accounting to be followed by business entities expecting to have their financial information used by a wide range of stakeholders. Accounting standards guide preparation and presentation of financial statements of business entities through appropriate recognition, measurement and classification of business transactions.

Unlike the generally accepted accounting principles (GAAP), accounting standards are more prescriptive, precise and therefore enforceable. Accounting standards reduce differences in accounting practices among business entities in the country and thus achieve greater comparability of business performance across the industry. Since accounting standards are sector neutral and adopted widely by different industries, the development of accounting standards are usually entrusted to independent professional bodies. Accounting standards draw legal backing and enforcement from the Companies Act.

The current scenario in the world, indicate, that different countries have their own accounting standards and carry different names. Few examples of accounting standards are given below:

United Kingdom- FRS103 Insurance Contracts

- FRS is a generic alpha code for all UK accounting standards
- 103 is a numeric code assigned to this specific accounting standards for insurance contracts

India – Ind AS 16 Property, plant and equipment

- Ind AS is a generic alpha code for all Indian accounting standards
- 16 is a numeric code assigned to this specific accounting standards for property, plant and equipment

Bhutan – BAS16 Property, plant and equipment

- BAS is a generic alpha code for all Bhutanese accounting standards
- 16 is a numeric code assigned to this specific accounting standards for property, plant and equipment

Australia – AASB 116 Property, plant and equipment

- AASB is a generic alpha code for all Australian accounting standards
- 116 is a numeric code assigned to this specific accounting standards for property, plant and equipment

a. Development of Accounting Standards in Bhutan

The development of accounting standards in Bhutan is a recent phenomenon which is regarded as a measure to reform financial and capital markets. This aspiration was projected in the Public Finance Act 2007. Later in April 2010, the 69th session of the Lhengye Zhungtshog approved establishment of the Accounting and Auditing Standards Board of Bhutan (AASBB). Pursuing this direction, the cabinet issued an executive order to establish AASBB in May 2010 which eventually resulted in the establishment of the first accounting and audit- ing standards board in the country.

A nine member Accounting and Auditing Standards Board of Bhutan led by the First Chairman of the Board, the Auditor General of the Royal Audit Authority of Bhutan with the officials from the AASBB Secretariat spearheaded the development and adoption of the accounting standards in the country. The AASBB Secretariat has been formed under the Ministry of Finance. The first set of Bhutanese Accounting Standards (BASs) was launched and issued on April 6, 2012 for adoption by listed companies, financial institutions and DHI group of companies effective from 1 January2013. The first BAS financial statements was produced in December 2013. Issued BAS for Small and Medium Enterprise to be adopted mostly by incorporated companies was also issued.

b. Nature of Bhutanese Accounting Standards

The Bhutanese Accounting Standards in essence is the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), UK. In the era of globalisation where most countries of the world choose to adopt IFRS or converge local standards with IFRS, Bhutan had a natural inclination toward adopting IFRS rather than developing its own set of accounting standards. However, AASBB could not adopt full set of IFRS in the first time launching of the standards because of several constraints. Consequently, AASBB chose to adopt IFRS in phase-wise. Since the full set of IFRS was not implemented, the accounting standards are termed as BASs, rather than IFRS.

The Phase –I project undertook to implement 18 standards (2013-2015). Similarly, Phase-II project implemented 9 standards (2016-2017) and Phase- III project implement 10 standards (2018-2019). The Phase-wise adoption of IFRS provides some time for preparation to adopt new sets of standards of the subsequent project. In 2015, AASBB issued all set of standards equivalent BASs as part of implementation of Phase-II project and to encourage early adoption of Phase-III standards. Whether AASBB will retain the standards current name after implementation of Phase-III project will warrant further discussion and assessment of AASBB future strategic goals.

c. Bhutanese Accounting Standards issued up to January 2024

BAS1 Presentation of Financial Statements
BAS2 Inventories
BAS7 Statement of Cash Flows
BAS8 Accounting Policies, Changes in Accounting Estimates and Errors
BAS10 Events After the Reporting Period
BAS11 Construction Contracts
BAS12 Income Taxes
BAS16 Property, Plant and Equipment
BAS17 Leases
BAS18 Revenue
BAS19 Employee Benefits
BAS20 Accounting for Government Grants and disclosure of Government Assistance
BAS21 The Effects of Changes in Foreign Exchange Rates
BAS23 Borrowing Costs
BAS24 Related Party Disclosures
BAS26 Accounting Reporting by Retirement Benefit Plans
BAS21 Separate Financial Statements
BAS28 investments in Associates and Joint Ventures
BAS32 Financial Instruments: Presentations
BAS33 Earnings per share
BAS34 Interim Financial Reporting
BAS36 Impairment of Assets
BAS37 Provisions, Contingent Liabilities and Contingent Assets
BAS38 Intangible Assets
BAS39 Financial Instruments: Recognition & Measurement
BAS40 Investment Property
BAS41 Agriculture
BFRS1 First Time Adoption of BAS
BFRS2 Share-based Payment
BFRS3 Business Combinations
BFRS4 Insurance Contracts
BFRS5 Non-current Assets Held for Sale and Discontinued Operations
BFRS6 Exploration for and Evaluation of Mineral Resources
BFRS7 Financial Instruments: Disclosures

BFRS8 Operating Segments
BFRS9 Financial Instruments
BFRS10 Consolidated Financial Statements
BFRS11 Joint Arrangements
BFRS12 Disclosure of Interest in Other Entities
BFRS13 Fair Value Measurement
BFRS14 Regulatory Deferral Accounts
BFRS15 Revenue from Contracts with Customers

Exercises:

Choose the most appropriate answer from the choices given.

1. Financial statement that measures business financial conditions at a specific point of time is
   a. income statement.
   b. statement of changes in equity.
   c. statement of financial position.
   d. statement of receipt and payment.

2. The following entities normally use accrual accounting EXCEPT
   a. Druk Green Power Corporation.
   b. Wangbama Central school.
   c. Royal Insurance Corporation of Bhutan Limited.
   d. Food Corporation of Bhutan.

3. Which of the following measures of accounting provides more relevant information on assets and liabilities of a business?
   a. Historical cost
   b. Current value
   c. Present value
   d. Net realizable

4. Case Study

M/s SW Automobiles procures and sales second hand cars in the capital city Thimphu. The business of second hand car has picked up quite rapidly in the country particularly in the last couple of years. This rapid growth of second hand automobile business can be attributed to a number of reasons.

In 2016 alone, the industry had sold more than 200 second hand cars. M/s SW Automobiles adopted a policy of refunding the customers should there be any defects after the goods were sold. The past trend showed that at least 10 percent of the cars sold had some defects where customers had returned them and claimed for refund. During the financial year 2017, M/s SW Automobiles sold 50 cars at Nu. 300,000 each.

Required:

1. Explain the revenue recognition principle.
2. Outline a policy on revenue recognition for M/s SW Automobiles.
3. Calculate the amount of revenue which will be recognized in the income statement of M/s SW Automobiles for the year ending 31 December 2017.

5. Case Study

Druk Air Corporation hired an airbus A319 from Air India to meet its increasing demand for short haul passengers making holidays in Bhutan, India and Nepal. The flight first time began to fly under dragon flag with 100 passengers from Paro to Delhi on 26.10.2017. The airbus A319 branded as dream liner was known for its safety, comfort and swiftness. It carries up to 160 passengers and has a maximum range of 6,900 km.

Druk Air management intends to account this airbus as an asset in its statement of financial position. The aircraft was hired for three years and Druk Air had no intention to buy this aircraft after its hiring charges were fully paid. A hiring charges of Nu. 900,000 ($14,516) were paid to Air India on a monthly basis.

Required:

1. Bring out the general rules accountants apply when deciding when to recognize assets.
2. Assess whether the hired airbus A319 can be accounted as asset in the books of Druk Air Corporation.
3. Calculate the amount of hire charges for 2017 year ending. Explain how hiring charges can be treated in the books of Druk Air Corporation Ltd.

6. Case study

Pema and Tashi are cousins who decided to start a small vegetable shop in Mongar after their class XII exams in 2017. They obtained a trade license from the Ministry of Economic Affairs and named their business as ‘PT Organic Vegee’. They thought that by being an entrepreneur, it would help them realise their potential to innovate new ideas and develop entrepreneurship culture in the country particularly among youths and school leavers.

PT Organic Vegee constructed a small vendor shop in Mongar town at a cost of Nu. 213, 500 of which 70 percent was funded with the help of a bank loan. They also bought a new Mahindra Bolero Camper at Nu. 613,000. They wanted to develop a good supply chain in the locality by developing a good networking with farmers growing vegetables. They had a noble intention to help those farmers who could never achieve fair price for their produces otherwise.

They ran their pick up vehicle around vegetable growers and collected all varieties of vegetables and brought to their shop where the vegetables were then packed and stored for sale. In order to prevent their goods from theft, they purchased and installed a set of CCTV cameras worth Nu. 150,000. It was estimated that a cost of Nu. 1,200 per month could be saved for security charges and abnormal loss of goods.

PT Organic Vegee is also considering the adoption of accounting standards for small and medium enterprises issued by Accounting and Auditing Standards Board of Bhutan to improve accountability to its stakeholders.

Required:

1. Discuss whether a cost on CCTV can be capitalized. Apply the definition of asset.
2. Considering the nature of Nu. 1,200 as cost-saving, develop a case argument justifying whether this should be recognized as an asset or income.
3. Assess whether the construction of a shop should be treated as an asset by applying the asset recognition criteria. Note that construction is largely funded by a bank loan.
4. Develop an accounting policy for revenue for PT Organic Vegee with close reference to revenue recognition criteria.
5. Explain some of the benefits PT Organic Vegee will derive from adopting accounting standards in their business.

7. Answer briefly

a. What is Capital Receipts?

b. Distinguish Capital Receipts from Revenue Receipts.

c. If the financial statements are prepare semiannually, does it complete accounting cycle?

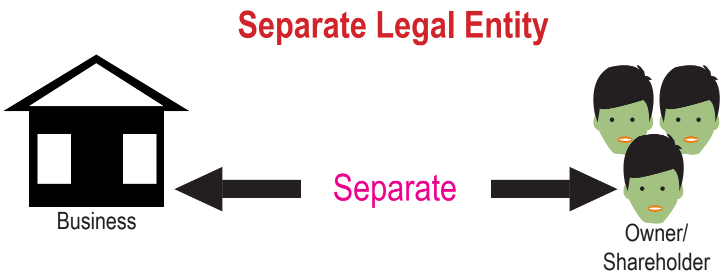
d. Why there is need for Bhutan to adopt International Accounting Standards?

e. Name any three internal and external stakeholders for a business entity and their need for type of information.

Chapter 2
Accounting Equation

Learning objectives:

- Explain the concept and the basis of accounting equation
- Identify and assess business transactions and events that affect accounting equation under double entry system of bookkeeping
- Relate accounting equation with the statement of financial position of a business entity



One of the key features of a business organisation is 'separate legal entity'. It is appropriate to begin with separate entity concept to learn the principles of financial accounting and reporting system.

The separate entity concept assumes that a business is a different entity from the owner. This is because, generally we assume that the owner and the business are same entity and that there is no reason to keep a record for business transactions. Of course this concept is more pronounced in sole proprietorship and partnership than in the corporate bodies. That is, legally, only for companies that separate entity is recognised. However, in accounting, separate entity assumption must be held to enable performance measurement of business and to facilitate business growth. Thus, the owner or the equity holder of the business must maintain a separate books of accounts for the business to record the business transactions.

Considering the separate entity concept, the business organisation owns large amount of economic resources called 'asset' and corresponding claims against these resources are called 'liabilities'. The claims are categorised into two- claims of creditors and owners (equity).

The chapter discusses how these economic resources and claims are related to each other by using the 'accounting equation' and the separate entity concept. It is appropriate to begin with how to account for business transactions with some capital introduction from the owner to start the business. First let us understand the meaning of accounting equation.

2.1 Accounting Equation

Accounting equation is a mathematical expression that shows the relationship of financial activities of a business. The equation illustrates that at any point of time, the assets of a firm always equal the sum of liabilities and owner's equity. Figure 3.1 shows an equation that represents relationship amongst assets, liabilities and owner's equity. This relationship is understood as accounting equation. The equation is also known as the statement of financial position equation or the dual aspect concept i.e., for every **Debit (Dr.)** there must be a **Credit (Cr.)**, and vice versa.

Figure 2.1 *Accounting equation*

Learning Activity 1
To explain accounting equation further, collect as many examples as you can and present it in the class. Make a common list of examples for each category and record it for reference.

Remember to apply the definition of assets, liabilities and equity every time activities are carried out on accounting equation.

2.2 Effects of Transactions on Assets, Liabilities and Owner's Equity (Capital)

Whenever a business transaction takes place, it will have an effect on the accounting equation. This would also mean that the statement of business financial position will change when there is a business transaction, i.e. the increase or decrease in the assets, liabilities or owner's equity. Let us see the steps in finding out the changes in accounting equation along with some examples of how the transactions cause an effect on accounting equation.

a. Steps to find out the changes in accounting equation:

2. Analyse the transactions in terms of assets, liabilities and owners' equity.
3. Find out the effect of the transaction in terms of increase or decrease in variables.
4. Record the effect of change in accounting equation.

Example transactions to explain accounting equation:

Transaction 1: Karma starts a coffee shop with the capital contribution of Nu. 250,000.

Analysis: The transaction consists of economic resource or asset 'cash' and the owner's claim 'equity'.

Effect: The effect of this transaction is that:

- firm's asset (cash) increases by Nu. 250,000
- owner's equity (capital) of Nu. 250,000.

Recording:

Sl.No	Transaction	Assets =	Liabilities+	Owner's equity
1.	Started a coffee shop	Cash = 250,000	Nil	Capital = 250,000

Transaction 2: Karma purchases a Dell laptop for Nu.30,000

Analysis: The transaction has economic resources or assets 'cash' and 'laptop' are identified.

Effect: The effect of transaction is that:

- Cash decreases by Nu. 30,000
- asset increases by Nu. 30,000 in the form of a Dell Laptop

In this case there is no effect on the liabilities or equity side of the equation'

Recording:

Sl.No.	Transaction	Assets=	Liabilities+	Owner's equity
2	Purchased Laptop	Cash + Laptop (220,000+30000)	Nil	250,000

Transaction 3: Karma purchases goods for Nu.10,000 on credit.

Analysis: The transaction has economic resource 'assets' in the form of 'inventory' and a liability 'Trade Payable' for credit purchases.

Effect: The effect of this transaction is that:

- assets increases by Nu. 10,000 and
- since the goods is purchased on credit, this gives rise to a liability 'trade payables' of Nu. 10,000.

Recording

Sl. No.	Transaction	Assets =	Liabilities +	Owner's equity
3	Purchased goods on credit	Cash+Laptop + Inventories (220,000+30,000+10,000)	Account payables = 10,000	Capital= 250,000

Note: Any increase or decrease in assets of the business will have corresponding effect on liabilities and owner's equity.

Learning Activity 2

Dawa Dema commenced a business by making an investment of Nu. 200,000 in cash. Make an analysis on the effect of accounting equation by the following transactions:

1. Purchased goods in cash Nu.10,000
2. Purchased goods on credit for Nu. 5,000
3. Purchased plant for Nu.20,000
4. Sold goods purchased on cash for Nu. 15,000.

2.3 Extension of Equation to Include Revenue and Expenses

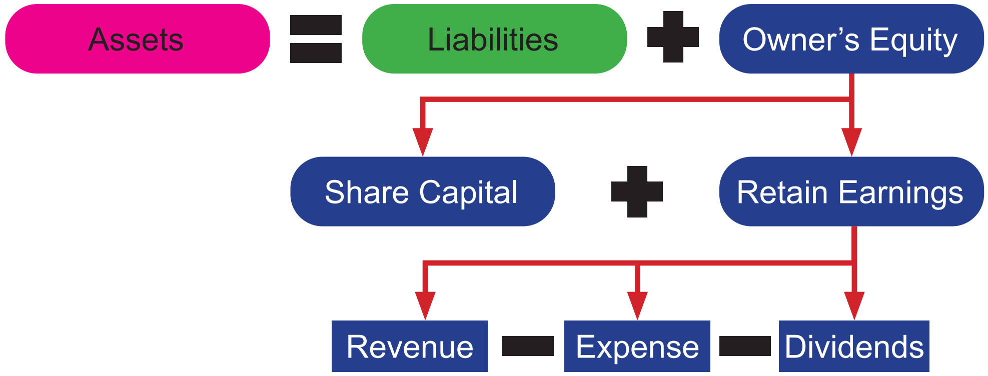


Figure 2.2 *Expansion of accounting equation*

Business revenues and expenses also change the owner's equity. Revenues are amount of money received or to be received from the sale of goods and services. Example: rent receivable, interest receivable, commission receivable etc. Expenses are amounts that have been paid or payable for costs that have been incurred to earn revenue. Examples: salary, wages, advertisement, interest on borrowing, commission on sales and house rent.
Revenue increases the owner's claim while expenses decrease it.

Let us continue with the previous example of Karma's coffee shop with additional transactions involving sales.
Transaction 4: Karma pays a salary of Nu. 7,000 to his staff for the month of April
Analysis: In this transaction, we identify economic resource (asset) 'cash' and 'salary' 'expense'.
Effect: The effect of this transaction is that:

1. asset (cash) decreases by Nu. 7,000 and
2. equity decreases due to expense (salary) by Nu. 7,000

The principle that explains the effect of expense on equity is stated below.

Revenue – expenses = profit or loss.

Profit increases the owner's claim while loss decreases it.

Recording:

Sl. No.	Transaction	Assets =	Liabilities +	Owner's equity
3	Purchased goods on credit	Cash+Laptop + Inventories (220,000+30,000+10,000-7000)	Account payables = 10,000	Capital= 250,000-7,000

Case Study

The twin brothers Tashi and Pema took a loan of Nu. 100,000 from Bank of Bhutan to start a grocery shop. They both made a cash contribution of Nu, 120,000 each. The first trading started one week after obtaining a trade license from the Ministry of Industry, Commerce and Entrepreneurship (MICE) where they purchased inventories of sorted grocery items of Nu. 70,000. The inventories were sold quickly and they recorded Nu. 95,000 as sales.

After a month, they refilled their shop with second lot of purchases for Nu. 115,000 basically to meet the demand for local tshechu. The sales forecast wasn't done so well this time that they had to clear the inventories at 12% loss on the purchase price. Tashi and Pema made a decision to attend a training course on marketing and sales promotion at the Institute of Management Studies to develop marketing skills. They paid Nu. 25,000 as course fees.

Required:

1. State the changes in assets, liabilities and owner's equity with the use of accounting equation for all transactions that took place at Karma and Pema's shop.
2. Explain how the cost of training and development of Nu. 25,000 paid to IMS will affect the statement of financial position of the business.

Learning Activity 3

Prepare an accounting equation from the following transactions.

1. Started business with cash Nu.50,000 of which Nu.20,000 was borrowed from BOBL
2. Purchased goods for Nu.7,000 (Nu.2,000 on credit)
3. Paid commission to manager Nu.3,500
4. Received interest Nu.500
5. Sold goods worth Nu.4,000 (Nu.1,500 on credit)
6. Settled account payable in full.

2.4 Treatment of Accrued and Deferred Expenses in Accounting Equation

Accrued expenses are liabilities. It will increase the liability and decrease the claim of the owner. For example, salary due for the month will be added to liability and subtracted from capital in accounting equation i.e.

Assets = Liabilities (accrued salary) + Capital – Accrued Salary.

In contrast, any expenses paid in advance is an asset. It would increase the Deferred expenses (asset) while it will decrease the cash which is also an asset. This transaction will impact only the asset side of the equation. For example, rent paid for the next month will decrease cash (asset) and increase Deferred rent (asset) i.e.

Assets - Cash + Deferred Rent = Liabilities + Capital

2.5 Treatment of Accrued Income and Income Received in Advance in Accounting Equation

Accrued income is an asset. It will increase asset and owner's claim. For example, rent earned but not received will increase asset (accrued rent) and increase owner's claim (capital) i.e.

Assets + accrued rent = liabilities + capital + Accrued Rent.

In contrast, income received in advance will increase asset (cash) and also increase liability (rent received in advance). For example, rent received for next month will be added to asset (cash) and liability (advance rent) i.e.

Asset (cash) = Liabilities (advance rent) + Capital.

Illustration 1

Show the treatment of the following transactions using the accounting equation.

1. Commenced business with cash Nu.75,000
2. Wages due but not yet paid Nu.1,000
3. Salary paid for next month Nu.500
4. Interest earned but not received Nu.750
5. Received rent for the next month Nu.3,500

Solution

Sl. No.	Transaction	Assets =	Liabilities +	Owner's equity
1	Started business	Cash = 75,000	0	Capital = 75,000
2	Wages due	Cash = 75,000	Accrued wages=1000	Capital=74,000 (75,000-1,000)

3	Deferred salary	Cash = 74,500 (75,000-500) Deferred salary=500	Accrued wages=1000	Capital=74,000
4	Accrued interest	Cash = 74,500 Deferred salary=500 Accrued interest=750	Accrued wages=1000	Capital=74,750 (74,000 +750)
5	Rent received in advance	Cash = 78,000 (74,500+3,500) Deferred salary=500 Accrued interest =750	Accrued wages=1000 Advance rent=3,500	Capital=74,750

2.6 Accounting Equation & Statement of Financial Position

The two sides of the accounting equation mirror the format of the financial statement position. The statement of financial position shows the net worth of the business. It summarizes company's assets, liabilities and equity at a specific point of time. In order to check how the balance of assets and liabilities equal, like it does in accounting equation, we can prepare a financial statement position.

Under this topic, we shall develop an accounting equation and see how business transactions affect the financial position.

For an example:

Commencement of business: Dechen starts a new business on 1st December by contributing Nu.45,000

Asset (cash) = Liability + owner's equity (capital) (45,000 = 0 + 45,000)

Effect of this transaction on statement of financial position

Particular	Amount (Nu.)
Asset:	
Cash	45,000
Total	**45,000**
Liabilities:	
Capital	45,000
Total	**45,000**

Purchase of equipment for Nu. 25,000:

Asset (cash + equipment) = Liabilities + Owner's equity (Capital) (20,000 + 25,000 = 0 + 45,000)

Effect of this transaction on financial statement position

Particular	Amount (Nu.)
Asset:	
Cash	20,000
Equipment	25,000
Total	**45,000**
Liabilities:	
Capital	45,000
Total	**45,000**

Loan taken from BNBL Nu.50,000:

Asset (Cash + Equipment) = Liabilities (bank loan) + Owner's equity (Capital) (95,000 = 50,000 + 45,000)

Effect of this transaction on financial statement position

Particular	Amount (Nu.)
Asset:	
Cash	70,000
Equipment	25,000
Total	**95,000**
Liabilities:	
Capital	45,000
Bank Loan	50,000
Total	**95,000**

Learning Activity 4

From the transactions given below, state how each transaction will affect the statement of financial position of the business.

1. The business proprietor introduced capital of Nu. 340,000 in cash, land & buildings valued at Nu. 560,000, logistics trucks currently sold in the market at Nu. 700,000 and computer equipment of Nu. 120,000 to start his construction business.
2. Receives a bank loan of Nu. 600,000 at 8% interest (payable at the end of each month).
3. The business bids for a construction work of government contract at Nu. 550,000.
4. The business purchases construction materials of Nu. 200,000
5. Pays employee expenses of Nu. 50,000.
6. Incurs cash expense of Nu. 35,000 on account of purchases of loose tools.
7. Makes advance payment of Nu. 60,000 to its construction engine.
8. Incurs another Nu. 200,000 for construction materials.

9. At the end of three months, business receives payment of bills of Nu. 580,000 from the government office.

Exercises:

1. Find the missing amount from the given data.

Sl.No	Assets	Liabilities	Owner's equity	Justification
1.	35,000	?	15,000	
2.	?	50,000	100,000	
3.	120,000	75,000	?	

2. Analyse the given transactions and show its effects in accounting equation. Justify your answer. The first one is done as an example.

Sl.No	Transactions	Assets	Liabilities	Owners' equity	Justify
1	Started business with cash Nu. 100,000	Cash 100,000	0	Capital 100,000	Since the owner has invested capital, it increases the capital and assets of the business.
2	Purchased goods on credit Nu. 5,000				
3	Received dividend on shares Nu. 1,000				
4	Sold goods for cash Nu. 4,000				
5	Paid to creditor Nu.3,000				
6	Cheque received from Pema Nu.10,000				
7	Drew cash for personal use Nu.10,000				

3. Denka, a store manager has the following assets and liabilities on 30th June 2018. Find out her capital.

Plant	Nu. 5,000	Trade payable	Nu. 300
Cash	Nu. 800	Trade receivables	Nu. 600
Bank	Nu. 6,000	Inventories	Nu.2,000

4. Study the statement of financial position of M/s Tobgyel's trading business as at 31st December 2019 and answer the questions that follow:

Particular	Amount (Nu.)
Asset:	
Cash	60,000
Equipment	40,000
Trade receivables (Dema)	20,000
Total	**120,000**
Liabilities:	
Capital	100,000
Trade payable (Kezang)	20,000
Total	**120,000**

1. Is the proprietor the only person who has share in the assets?
2. Who owes money to the business?
3. To whom does the business owe money and how much?
4. Show the accounting equation using the financial statement position.

5. Prepare accounting equation from the following transactions to calculate assets, liabilities and owner's equity.
   1. Singye commenced business with cash Nu.300,000 and Furniture Nu.50,000
   2. Borrowed Nu. 100,000 from BDBL
   3. Bought goods for Nu.35,000 from Dorji for cash
   4. Rent due but not yet paid Nu.6,500
   5. Sold goods costing Nu.5,000 for Nu.6,000
   6. Depreciate furniture by 10% for 6 months
   7. Commission earned but not yet received Nu.4,000
   8. Interest paid Nu.1000

6. Gaki was a high school graduate. She always dreamt of starting a business of her own. After completing class XII, she went back to her village to start the business. She decided to use her parent's house for the business and borrowed Nu.50,000 from her parents and Nu.100,000 from BDBL. She bought groceries for Nu.75,000 and hired two labourers with salaries of Nu.5000 each. She sold groceries costing Nu.60,000 for Nu.100,000 and purchased a second hand car for Nu. 50,000. She then paid Nu.3000 as rent. She sold groceries costing Nu.10,000 for Nu.18,000 and could repay Nu.10,000 to BDBL. Show the accounting equation for the aforementioned transactions.

7. Record the following transactions in accounting equation and show the effect of these transactions on Statement of Financial Position.
   1. Dolay commenced business with capital of Nu.500,000
   2. Deposited into bank Nu.100,000
   3. Bought printer for Nu.50,000
   4. Purchased goods from Kinzang for Nu.25,000 on credit
   5. Sold goods for cash Nu.15,000
   6. Sold to Penjore goods on credit for Nu.5,000
   7. Purchased goods for cash Nu.40,000
   8. Withdrew from bank Nu.10,000
   9. Paid salary to office assistant Nu.5,000
   10. Paid to Kinzang by cash Nu.15,000

8. Use accounting equation to show the effect of the following transactions on assets, liabilities and owner's equity:
   1. Sherab started business with cash Nu.150,000
   2. Paid wages Nu.7,500 and wages due is Nu.2,500
   3. Bought car for Nu.80,000
   4. Paid rent in advance Nu.5,000
   5. Purchased goods for Nu.12,000 out of which Nu.7,000 was paid in cash
   6. Paid 10% interest on capital for 3 months
   7. Sold goods costing Nu.10,000 for Nu.9,500
   8. Depreciate car by 5%
   9. Paid rent for next month Nu.500

10. Paid life insurance Nu.500
11. Purchased bicycle for proprietor's son Nu.1,500

9. Phuntsho was living with his grandmother in the village. With time his grandmother became very old to work. Phuntsho had to start a business to generate income to look after his grandmother. He started business with cash 40,000 and building 30,000. He purchased inventories for Nu.25,000 and sold the same for Nu. 35,000. He paid Nu. 1000 as wages out of which Nu. 500 was the wage for the next month. He received an interest of Nu. 500 (250 for the next month). He purchased a laptop for Nu.5,000 and furniture for Nu. 2,000. Generate an accounting equation to show the effect on assets, liabilities and owner's equity.

10. Create an accounting equation on the basis of the following transactions
    1. Commenced business with cash Nu. 50,000, goods Nu. 30,000 and plant Nu. 20,000
    2. Sold goods to Tshering on credit costing Nu. 4,000 for Nu. 5,000
    3. Sold goods for cash costing Nu. 12,000 for Nu. 16,000
    4. Purchased goods for cash Nu. 30,000
    5. Purchased goods on credit for Nu.20,000
    6. Paid rent Nu. 3000 including Nu.1,500 in advance
    7. Paid salaries to staff Nu.2,000
    8. Sold goods costing Nu. 8,000 for Nu. 10,000
    9. Salaries accrued Nu. 1,000
    10. Depreciation on plant Nu.200

Chapter 3
Recording of Business Transactions

Learning objectives:

- Explain the importance of source documents in accounting
- Prepare vouchers
- Explain the rules of debit and credit
- State the usefulness of journal
- Explain the meaning and purpose of subsidiary books
- Journalise the business transactions
- Explain the features, utility and format of ledger
- Explain the purposes of preparing trial balance
- Prepare journal, ledger and trial balance

By now you must be familiar with business transactions and explain how each transaction is likely to affect the statement of financial position. The statement of financial position and other financial statements such as income statements, statement of cash flows and statement of changes in equity are an outcome of business transactions which are recorded and processed through accounting system.

Accounting equation is a simple model to show the principle of double entry system and the separate entity concept. In practice, business transactions must be recorded systematically, properly classified and summarised in the form of financial statements. However, the statement of financial position must hold correct that the total of assets must be equal to the total of liabilities.

This chapter introduces the first phase of accounting cycle, i.e. recording of transactions in the primary books of entry. In the classroom setting, we may not be required to use documentary evidences to record transactions. However, in practice, business transactions must be recorded only when there is a documentary evidence to support that transaction. Documents show that transactions actually took place and were duly authorized for recognition. For example, when the payment voucher for the utility bill is prepared by the accounts executive and the same is signed by the manager, the transaction is ready for recording in the books of account. In the next section, you will learn the meaning and examples of common documents used in the business.

3.1 Source Document

Each time a business makes a financial transaction, a supporting document called Source Document is prepared or referred to by the accountant to authenticate business transaction. These source documents provide a basis for verification of financial statements assertions later by the auditors to provide an opinion whether financial statements are free from material misstatements.

The source document contains the following information:

- a description of business transaction (say whether it is a purchase or sale or payments).
- discounts allowed/received in case of sales invoice.
- the date of the transaction and also the due date for payment, if the payment is made some time later.
- a specific amount of money, exchange rate, if applicable, and interest chargeable for late payments.
- an authorising signature of the manager or an authority responsible for the transaction.

Source documents are prepared by the business firm pertaining to sales, purchases, payment of expenses and amount received. It also includes management policies, minutes of meeting, insurance policies, tax returns etc. These documents are prepared by employees of business and must be authorised by the head of organisation or the department or divisions as part of internal control system.

The source documents can also be prepared and issued by external sources such as suppliers, customers, banks and insurance companies, underwriters, government and other concerned authorities pertaining to transactions with business or as authoritative guidelines and policies. Some of these documents are listed in Table 4.1

Table 4.1 Supporting documents and their origins

Source of Document	Nature of transaction	Example of Source Document
INTERNALLY GENERATED	For purchase of goods	Purchase Order and Goods Received Note (GRN)
	For purchase returns	Debit note
	For sale of goods	Sales Invoice
	For sales returns	Credit note
	For payment of cash	Disbursement vouchers and Cheque
	For purchase of land and other properties other properties.	Sale Sales deeds, certificates of registration (e.g. RSTA)
	For adjustments and estimates, e.g. depreciation	Management policies and minutes of meeting
	For deposits and withdrawals of cash from bank	Bank statements
EXTERNALLY GENERATED	Purchase of goods	Invoice
	Import of goods	Customs duties Freight bills
	Deposit and withdrawals from banks	Bank Statements
	Payment of insurance premiums and claims made	Insurance policies and cheque receipts
	Government regulations	Policy documents Rules and regulations

The management must put in place an internal control system to ensure that accounting transactions and information system are reliable and effective. The control system encompasses all activities related to internal check and balances including authorisation of transactions and processing accounting records.

3.2 Vouchers

It is a document prepared on the basis of other source documents. It is prepared for the purpose of recording business transactions in the books of accounts. For recording, source documents are analysed and a conclusion drawn as to which account is to be debited and which one to be credited.

The document on which this conclusion is written is called voucher or accounting voucher.

a. The essential features of vouchers are as under.

- It is a document.
- It is prepared by analysing the source documents.
- It contains decision regarding the accounts to be debited or credited.
- It helps in recording an accounting entry in the books of accounts.
- It is prepared and signed by an accountant and also counter signed by an authorised signatory of the business enterprise.

b. Preparation of vouchers

After deciding the head of accounts to be debited and credited, vouchers are prepared.

Accounting vouchers are of two types:

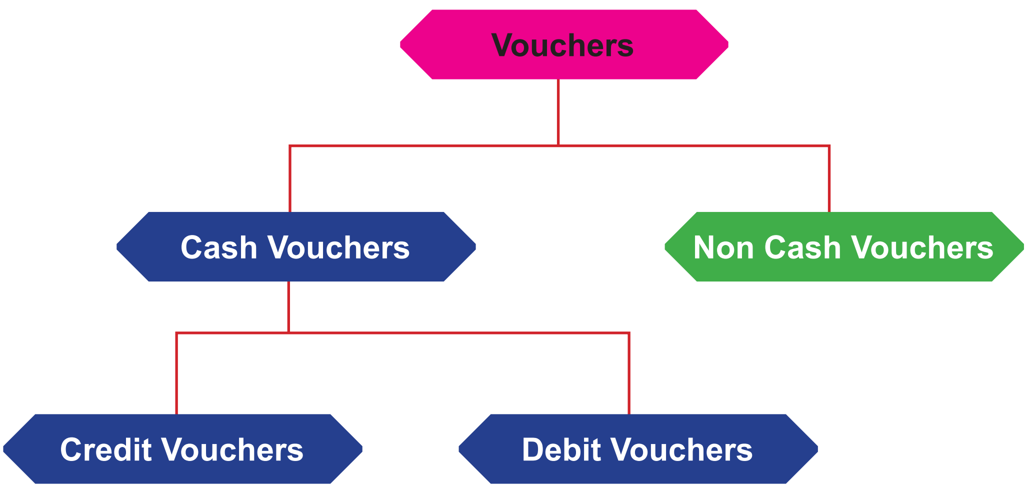


Figure 3.1 *Types of vouchers*

a. Cash vouchers

Cash vouchers are vouchers prepared at the time of receipt or payment of cash. It also includes receipt and payment through cheque. The cash vouchers can be classified as, credit voucher and debit voucher. Credit vouchers are prepared when cash is received and Debit vouchers are prepared when payment is made. For example, when goods are sold or when there is sale of assets or investments, credit vouchers prepare.

INSERT NAME OF FIRM/INSTITUTION

CREDIT VOUCHER

Bank Account No :

Voucher No:
Date:
Voucher Status

Received From:
GRN/Bill No.:
Particulars

Particular	Exp./ Recovery	Detailed Account	Object Code	Debit	Credit
	Broad head	Code & Name		(Nu)	(Nu)

Received a sum of Nu. ………………….. (Nu..) only

Prepared by:

Approving Officer

(Name & Seal of Designation)

Head of Finance

(Name & Seal of Designation)

Date

Figure 3.2 *Credit voucher*

INSERT NAME OF FIRM/INSTITUTION

DEDIT VOUCHER

Bank CD Account No :

Voucher No:

Date:

Voucher Status

Name of Payee :

CID/EID:

TPN NO.

Address:

Particular	Exp./Recovery	Detailed Account	Debit	Credit
	Broad head	Code & Name	(Nu)	(Nu)

Passed for Nu.

Net Payment for

Prepared by:

Head of Finance
(Name & Seal of Designation)

Approving Officer
(Name & Seal of Designation)

Figure 3.3 *Debit voucher*

Illustration 1

On September 21, 2018 M/S Rukubji Chemicals received Nu.40,000 in Cash and balance amount of Nu.160,000 by Banker's Cheque from Bajo Chemicals Ltd for the sale of inventories. Prepare a credit voucher.

Solution:

M/S Rukubji Chemicals

CREDIT VOUCHER

Bank Account No : **111222000**

Voucher No: **0001**

Date: **21/9/2019**

Voucher Status

Received From: **Bajo Chemicals Limited**

GRN/Bill No.: **2110**

Particulars

Particular	Exp./ Recovery	Detailed Account	Object Code	Debit	Credit
	Broad head	Code & Name		(Nu)	(Nu)
Sale of chemicals					
					200,000

Received a sum of Nu. …200,000.00….. (Nu....Two Hundred Thousand)only

Prepared by:

Approving Officer

(Name & Seal of Designation)

Head of Finance

(Name & Seal of Designation)

Date

Learning Activity 1
Kinley runs a restaurant in Phuntsholing. He purchases vegetables for Nu.5,000 and grocery items for Nu.4,000 from Loden super market. His sale for the week amounted to Nu. 15,000. Prepare a debit and a credit voucher.

b. Non-cash vouchers (Transfer voucher):

Non- cash voucher are vouchers prepared for the transactions that do not involve inflow or out flow of cash. It is prepared when credit sales and purchase are to be recorded. For an example, sales invoice, debit note, credit note, bills etc.

Dorji & Co. Ltd Khasadrapchu, Thimphu	Date 30.1. 2017 Amount (Nu.)
Voucher No. 801	
Debit: Furniture A/c	52,000
Total	**52,000**
Credit: Druk Furniture (Being furniture purchased vide memo No. 909)	52,000
Total	**52,000**
Sd/- Manager	Sd/- Accountant

Learning activity 2
Office furniture worth Nu. 25,000 was purchased from Modern Furniture on July 4, 2018 and Nu.15,000 are paid by cash immediately and Nu.10,000 is still payable. Prepare a transfer voucher.

Learning activity 3
On 24/2/19, Sangay company Ltd. based in Thimphu purchased goods for Nu. 70,000 from DK Enterprise, Paro on credit. Within a month the company sold all the goods for Nu. 110,000. With the money, he purchased office stationery amounting to Nu. 15,000 from DSB Enterprise on credit. Prepare a transfer voucher to help the business record the transactions.

3.3 Journal

Once a voucher confirms the occurrence of business transactions, it is used to make entries in the journal. A journal is a book of primary entry where transactions are recorded for the first time. These transactions are recorded in order by date, showing the sequence of all transactions.

The synonymous term used for journal is bookkeeping. Let us further understand the concept of bookkeeping that will help to develop the skills of journalising business transactions correctly.

"A journal is a chronological record of accounting transactions showing the names of the accounts that are to be debited or credited, the amounts of debits and credits, and any useful supplementary information about the transactions. It is analogue to a diary".

Robert Anthony

a. Double entry system of bookkeeping

An Italian mathematician named Fra Luca Bartolomeo de Pacioli (1447– 1517) developed a system called 'Double Entry System' of bookkeeping that recognised two aspects in a transaction and applied 'debit' and 'credit' rules to record transactions and events in Journal. 'Debit' and 'Credit' are terms used to denote the two aspects of transactions which are either asset or liability, income or expense and which are flowing in or flowing out of the business. These aspects of transactions are named as accounts. Accounts are units of economic activities and in aggregate they represent business value. The accounts are broadly classified into three types:

a. Real account:

It includes an account related to assets and properties such as, land, building, plant, equipment, goodwill, patent, inventories, investments, cash etc.

b. Personal account:

It includes an account related to a person. A person can be natural, artificial or representative. A natural person is an individual like, Sonam, Pema, Jigme Dechen etc. An artificial person is the corporate bodies or institutions which organises as person in business dealings. Example, BOBL, BPCL, BFAL etc. A representative person is an individual who represents certain person or group of persons, like rent due to land lord, interest accrued etc.

c. Nominal account:

It includes an account related to expenses, losses, incomes and gains of the business

Based on the above three accounts, a set of rules often called 'Golden Rules of Account' is used to record transactions under double entry bookkeeping system.

Real account rule: Debit what comes in, credit what goes out
Personal account rule: Debit the receiver, credit the giver
Nominal account rule: Debit all expenses, credit all incomes

Some illustrations are provided below showing how 'debit' and 'credit' rules can be applied in recording business transactions.

Transaction 1: A business purchases goods of Nu. 10,000 from a supplier Ex Plaza on 25 January 2019 for three months credit.
Accounting equation:

Assets	=	Liabilities	+	Capital
Goods (10,000)		Trade Payables (10,000)		

Analysis of transaction:
This is a credit purchase from ExPlaza, the supplier. [Documents used: purchase order, and GRN]

Two aspects of transactions:

1. Purchases of goods – purchases account
2. Ex Plaza the supplier – ExPlaza's account

What type of accounts are involved?
Real account
Personal account
Apply 'real' and 'personal' account rules
Purchases a/c Dr 10,000 (Read as debit purchase account)
To Ex Plaza a/c Cr 10,000 (Read as credit Ex Plaza account)

The same transaction can also be written as:
Inventory a/c Dr (Real account)
To Ex Plaza a/c (Personal Account)
Transaction 2: Business paid Nu. 30,000 as salary for its employees for the month of February 2019

Transaction analysis:

This is an expense related to payment of employee salaries. [Documents used- salary disbursement vouchers and cash vouchers)

Assets	=	Liabilities	+	Capital
Cash (-30,000)				Salary expense (-30,000)

Two aspects of transactions:

Payment of salary – expense account
Outflow of cash – cash account

What type of accounts are involved?

Nominal account
Real account

Apply 'nominal' and 'real' account rules

Salary expense a/c Dr 30,000 (Read as debit expense account)
To cash a/c Cr 30,000 (Read as credit cash account)

Transaction 3: Business sold goods for Nu. 13,000 which cost them Nu. 10,000.

Transaction analysis:

Goods were purchased at Nu.10,000 (refer transaction 1) and it is being sold at Nu. 13,000 with the profit of Nu. 3,000. Profit increase the equity and vice versa.
Accounting equation:

Assets	=	Liabilities	+	Capital
Cash 13,000		Trade Payables (10,000)		Profit 3,000

Two aspects of transactions: [Documents used- cash receipt/bank deposit note and sales invoice]
Receipt of cash – cash account
Sale of goods – sales account

What type of accounts are involved?

Real account
Nominal account
Apply 'nominal' and 'real' account rules
Cash a/c Dr 13,000 (Read as debit cash account)
To sales a/c Cr 13,000 (Read as credit sales account)

Transaction 4: Business purchases machinery for Nu. 120,000 on cash.
Two aspects of transactions:
Purchase of machinery – Machinery account [Documents used- purchase order, GRN and cash payment vouchers]
Cash outflow –cash account

What type of accounts are involved?
Real account
Real account
Apply 'nominal' and 'real' account rules
Machinery a/c Dr 120,000 (Read as debit machinery account)
To cash a/c Cr 120,000(Read as credit cash account)

b. Essential features of Journal

- It is a book of original entry.
- It is also called as day book.
- It keeps chronological record of all business transactions.
- It provides account to be debited or credited with debit and credit amount.
- All entries are followed by supplementary note called narration.

c. Advantages of journal

- There is no possibility of omitting the transaction from the books of accounts since it is recorded as soon as it takes place.
- Transactions can be easily ascertained as to when and why it has taken place as it is recorded in journal chronologically with a corresponding narration.
- It shows the complete story of a transaction in one entry.
- It ensures that the double entry rules have been followed.
- It is considered as reliable evidence.

d. Disadvantages of journal

- It is time consuming since transactions are recorded on a daily basis.
- It makes the recording difficult and bulky since business has to keep record of all the transactions.
- It does not provide the balance of accounts at a glance.

3.4 Classification of Accounts

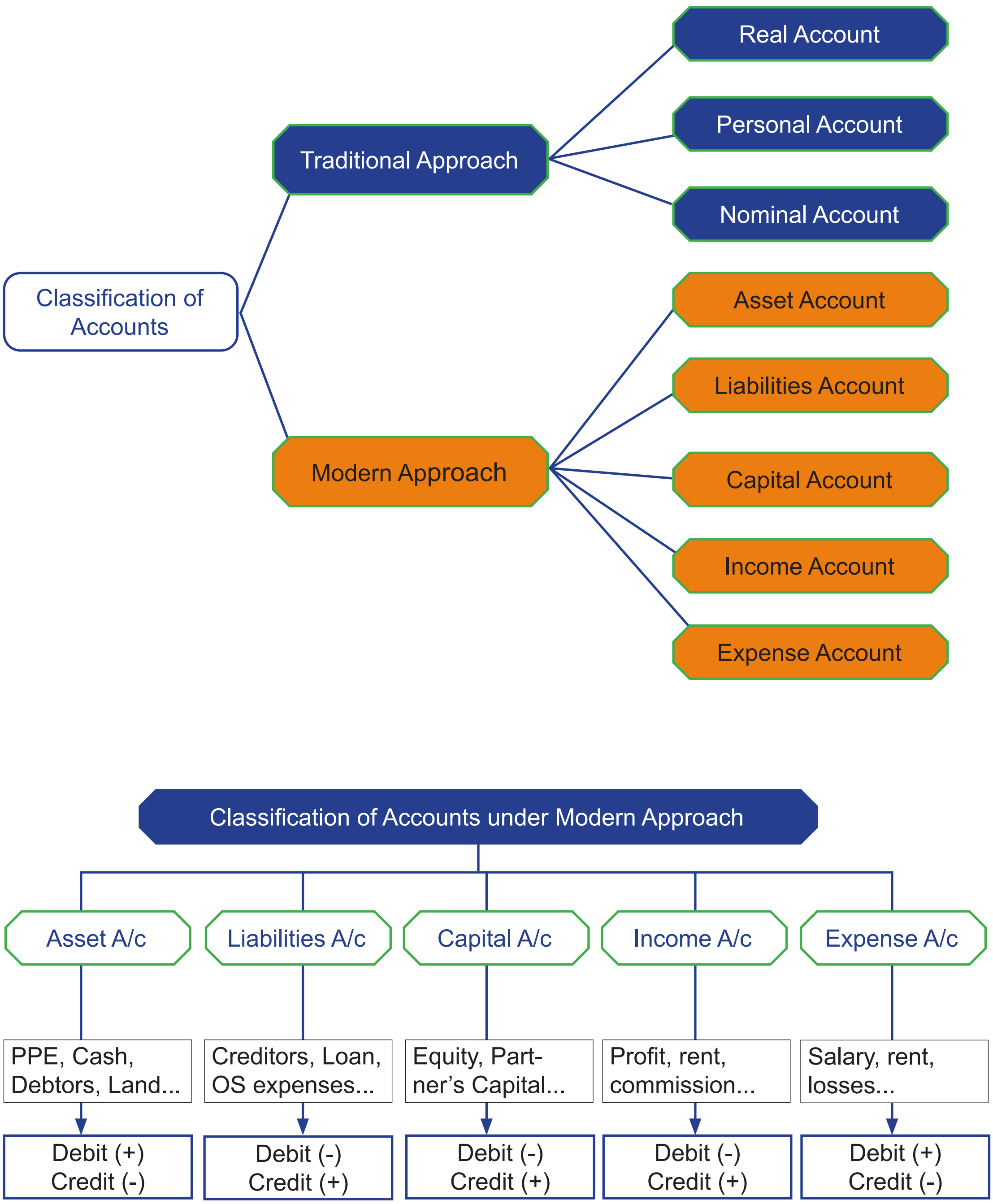


Figure 3.4 *Classification of accounts*

Figure 3.4 shows the accounts classified into traditional and modern approach. The traditional approach is further classified as, real, personal and nominal account, whereas modern approach as, asset, liability, capital, revenue and expenses.

Illustration 2

Classify the following into real, personal and nominal accounts.

a. Capital
b. Accrued salaries
c. Interest paid
d. Plant
e. Drawings
f. Patent
g. Cash
h. Purchases
i. Inventories
j. Sales

Solution (traditional approach)

Real account:	Cash, Inventories, Plant, Patent, purchases and Sales
Personal account:	Capital, Drawings, Accrued salaries
Nominal account:	Interest paid

a. Classification of accounts under modern approach

The elements of financial statements were discussed in the previous chapters. These elements are asset, liability, income, expense and equity. Assets represent resources of the entity and liabilities represent claims of the owners and other creditors against the entity. What we do in accounting is that we maintain a systematic record of transactions related to these financial resources and claims, and periodically report these in the form of financial statements to the management and investors of the entity. The day to day transactions including sales and purchases of goods and services will lead to either:

- increase of assets or
- decrease of liabilities or
- decrease of assets or
- increase of assets.

In the next section, we present some examples of assets, liabilities, income and expenses which will help you to work out the accounting equation and present these items correctly in the financial statements of an entity towards the end of the chapter.

a. Assets:

It includes accounts of assets such as property, plant, equipment, furniture & fixtures, patents, copy right, inventories etc.

b. Liabilities:

It includes account of lenders, trade payables etc.

c. Capital:

It includes the account of proprietor who invested money in the business.

d. Revenue:

It includes accounts of incomes and gains such as, sales, interest received etc.

e. Expenses:

It includes the accounts which show the amount spent or amount lost in carrying out the business. For example, purchases, rent paid, depreciation charge etc.

Table 4.2. *Debit and Credit rule*

Sl.No.	Types of account	Rules
1	Assets	Increase in assets- Debit
		Decrease in assets- Credit
2	Liabilities	Increase in liabilities- Credit
		Decrease in liabilities- Debit
3	Capital	Increase in capital- Credit
		Decrease in Capital- Debit
4	Revenue	Increase in revenue- Credit
		Decrease in revenue- Debit
5	Expenses	Increase in expenses- Debit
		Decrease in Expenses- Credit

Illustration 3

On which side will the increase in the following accounts be recorded? Also mention the nature of account on the basis of Modern Approach.

a. Machinery account	b. Receivables account
c. Payables account	d. Sale account
e. Cash account	f. Rent account
g. Capital account	h. Rent received account

Solution:

a. Debit- asset

b. Debit- Asset

c. Credit- liability
d. Credit- Revenue
e. Debit- asset
f. Debit- expenses
g. Credit- capital
h. Credit- Revenue

Learning activity 4
From the list of items given, classify them into different head of accounts under both the approaches.
Land, Rent due, Commission received, Salary paid, Capital, Cash in hand, Cash at bank, Furniture, Purchases and Sales.

Format of journal

Date	Particulars	Ledger folio	Debit Amount	Credit Amount

3.5 Accounting for Transactions

The section presents the type and nature of transactions which occur regularly in the business and the related accounting entries. These are explicit transactions, the occurrence of which is evidenced through production of supporting documents. This enables verification of financial statements through vouching and tracing methods.

a. Sales transaction

The following terms are useful to understand and record the sales transactions.

i. **Sales:** is providing of goods or services of value in exchange of consideration which is normally in the form of cash or cash equivalent. Sales can be made either on cash or on credit term. The consideration received is called revenue or an income.

ii. **Revenue:** is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. The amount of revenue arising on a sales transaction is determined by agreement between the business entity and the buyer. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity. In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. Remember that the definition of income includes revenue. However, revenue is a type of income earned from the principal activity that determines gross profit of the entity. Thus, revenue meets the definition of an income. Revenue is presented as a separate item in the statement of income.

The sources of revenue for business entity depend on the nature of product or service provided by the entity to its customers in the market. For example, a manufacturing company may generate its revenue through sale of physical goods or inventories, while banks and other financing companies generate revenue from the interests and other charges on landings and other banking services. To say the same, the car washing service company will generate revenue through provisions of washing and cleaning services. All other incomes are classified as 'income from other sources' in the financial statements.

iii. **Fair value:** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Revenue from the sale of goods can be recognized and recorded only when all the following conditions have been satisfied:

- the entity has transferred to the buyer the significant risks and rewards of ownership of the goods,
- retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold,
- the amount of revenue can be measured reliably,
- it is probable that the economic benefits associated with the transaction will flow to the entity, and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales.

b. Revenue recognition of services

When the business entity is involved in rendering a service instead of goods, revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.

However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

Revenue from service can be recognised only when the amount of revenue can be measured reliably and when all the following conditions are fulfilled:

i. it is probable that the economic benefits associated with the transaction will flow to the entity;

ii. the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

iii. the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Cash sales – is a sale of goods or service where the consideration (say in the form of cash) is received on the date of sale transaction.

Credit sales- is a sale of goods or service where the consideration is received after the date of transaction. The credit term is determined by agreement between the buyer and the seller.

3.6 General Approach to Recording Transactions Using Double Entry Bookkeeping Principle

Take note of the following steps for recording transactions in the journal.

a. Analyse the transaction

- See whether the transaction (say, sales) meet the definition of income and revenue and recognition criteria of revenue/income (remember all five conditions must be fulfilled). This applies to all transactions since the basis of transaction is either asset, liability, equity, income or expense which must fulfill the recognition criteria set for each element before the account is recorded in the books of account (journal).
- Likewise, the measurement of transactions (say, fair value for sales income) should be assessed and must fulfill the requirement as outlined in accounting standards.
- Identify whether the account is a real, personal or nominal account.
- Further, when doing transaction analysis, you must assess the impact of transaction on the assets, liabilities, income, expense and equity, and on the overall financial position of the business. (This may not be required always unless it is asked to do so for recording transactions in the Journal. However, student should know that each transaction affects the financial position of the business).

b. Apply the golden rules of accounts or the elements based journal entry principles

- Debit what comes in, credit what goes out
- Debit the receiver, credit the giver
- Debit expenses, credit income
- Debit increase of assets, credit decrease of assets

- Debit decrease in liabilities, credit increase in liabilities
- Debit increase in expense, credit increase in income

c. **Write a narration for each journal entry specifying what the entry is for.**

Generally, the narration begins with the words 'Being the…'.

Illustration 4: Recording of sales transactions

Transaction: On January 3, 2019, LHP Pvt. Ltd. sold goods worth Nu. 105,000 to M/s Edu.Com for 60 days of credit term. Sales invoice has been drawn and dispatched to M/s Edu.Com. Can LHP Pvt. Ltd. record sales income?

Solution

i. Analysis of transaction

LHP Pvt. Ltd. has dispatched the goods along with sales invoice to M/s Edu.Com. This reflects that the significant risk and rewards associated with ownership of goods have been transferred to M/s Edu.Com. There is no indication that LHP Pvt. Ltd. has management and control interest in the goods sold to M/s Edu. Com. The amount of Nu. 105,000 revenue is measured reliably and represents fair value of goods sold. This amount also represents the economic benefit that is expected to flow to LHP Pvt. Ltd. after 60 days. There is no issue with the sales transaction costs which is also expected to be measured reliably if there is cost at all. Further, there is no indication that M/s Edu.Com would default payment or consideration on any ground when it falls due. Therefore, sales revenue of Nu. 105,000 can be recognised as income and thus can be recorded in the company's book.

The credit sale transaction gives rise to an asset of trade receivables to the amount of Nu. 105,000. The transaction generates an income of Nu. 105,000 which raises the equity level to that extent.

ii. Identify the type of accounts –real, personal or nominal

The transaction gives rise to two aspects or accounts:

a. M/s Edu.Com account -Personal account

b. Sales income account -Nominal account

iii. Apply golden rule

<u>In Customer's ledger (03.01.2019)</u>

M/s Edu.Com A/c Dr 105,000[Debit the receiver]

To sales income A/c Cr 105,000 [Credit all gains and income]

(Being the goods sold to M/s Edu.Com on credit)

NOTE: This entry is shown simply to explain the concept of double entry system of journal entries using 'debit' and 'credit' concept. Otherwise, in the accounting system, sales made to individual customer are directly recorded in the sales day book. The total of individual sales are then brought to General Journal where the entry is passed using the control accounts 'Trade Receivables Account' as given below.

In General Journal

Trade Receivables A/c Dr 105,000 [Debit asset account]
 To Sales income A/c Cr 105,000[Credit income account]
 (Being the credit sales made to M/s Edu.Com)

In a computerised accounting system, all these accounting entries and the production of the invoice would take place simultaneously.

Further, these entries show that:

- Trade receivables which are an asset account meet the definition and recognition criteria of asset so it is recognised as an asset. This will be reported in the statement of financial position as current-asset. The current asset will therefore increase by Nu. 105,000.
- Sales meet the definition of income and income recognition criteria. An amount of Nu.105, 000, therefore will be reported as income in the statement of income.

On receiving payment (04.03.2019)

In Customer's ledger

Cash A/c Dr 105,000[Debit what comes in]
 To M/s Edu.Com A/c Cr 105,000[Credit the giver]

In General Ledger

Cash a/c Dr 105,000[Debit asset account]
 To Trade Receivables Cr 105,000 [Credit asset account]

Cash sales

Cash sales are directly recognized and recorded as income unless there is an indication that management intends to retain the management and control of the goods sold and that risk and rewards of ownership is not transferred to the buyer. Cash sales are recorded in cash book.

Cash a/c Dr [Debit what comes in]
 To sales income Cr [Credit income and gains]

3.7 The Need and Issues in Credit Sales

What if M/s Edu.Com turns out to default the payment on due date and even after series of reminders LHP Pvt. Ltd. was not able to collect the debt. This is not unusual in business. There are many cases where business has to write-off debts which are uncollectable from their customers. This affects the profit and the financial condition of the business. The business laws and industry practices covering such cases might differ from one country to another. However, the prudential norms of financial management generally are the same across industries and countries. Let us look into the basics of credit sales and management of credit before we learn how to account for irrecoverable debts.

Credit sales are essential for a business to increase its sales revenue and increase its profit. A large number of customers prefer to accept goods or services on credit terms. In fact, a credit sale provides a cost free loan facilities or a gift to customer when the payment is deferred to future.

In our example, M/s Edu.Com is given 2 months credit term for Nu. 105,000 credit sales. This means, M/s Edu.Com is saving around Nu. 1,784 interest cost to buy this good. The saving of this interest cost is a loss of interest income for LHP Pvt. Ltd. Thus, we see that a credit sale actually is a cost to the business, and this must be carefully considered as part of effective working capital management.

A caution must be raised here that a mere increase of sales revenue does not guarantee that business will be profitable as well as have a good cash resources to maintain its liquidity. In fact, you will be surprised to learn that many profitable business firms actually undergo insolvency administration. Therefore, there is a need to balance between credit sales and liquidity objectives of business.

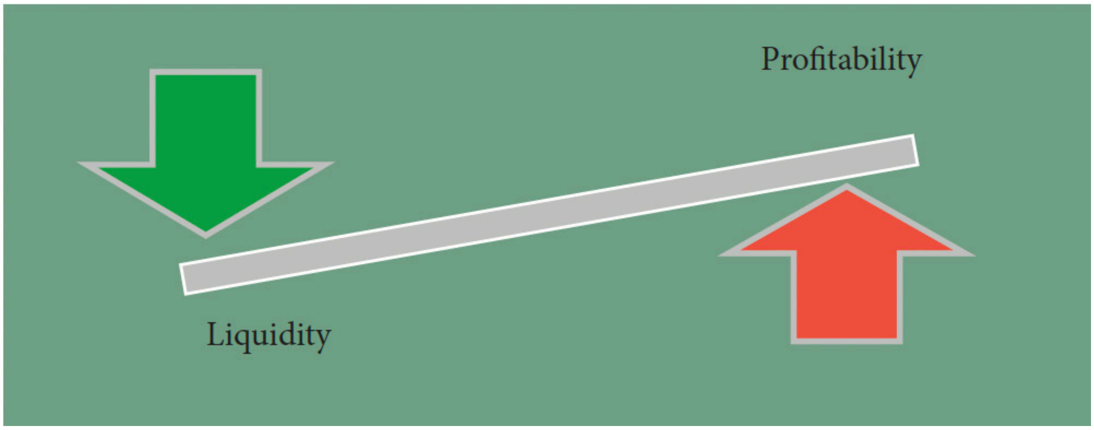


Figure 4.4 *Trade off between profitability and liquidity*

Irrecoverable debts will severely affect profitability and cash flows of business. This requires business to manage its credit sales effectively. Many business firms use a strict credit control policy.

a. Who gets credit?

The business must screen potential customers to whom credit facilities should be given. There is no use making a credit sale to a questionable customer just to achieve the sale. In practice, business firms use different methods of screening customers. This includes customer referencing and analysis of customer's financial position and debt capacity.

Terms of credit

Terms of credit should be carefully worked out and agreed in advance before the sales.

These will include:

i. the credit limit - the maximum amount the customer can owe at any point in time,

ii. the credit period –the maximum time the customer can take to make the payment,

iii. whether discount can be claimed for quick payment, and

iv. if interest is chargeable if the payment terms are not met, and so on. The terms of credit need not be the same for each customer.

b. Administration of billing and collection

In order to receive the payment on timely basis, the business must issue invoices quickly and should be accurate. Customers generally will not pay until and unless they receive the invoice, so delays in invoicing will result in delays in payment. Errors in invoices also contribute to delaying payments.

The collection of overdue payment must be done with utmost care and diligence. There must be a systematic approach to follow customers and pursue them to make payment. It is equally important to be aware of the law if there is any related to the debt payment and collection.

The business might either send email reminders, call customer's purchase department, and visit customer's premises or if required put a caution note that next time credit term is likely to be changed, etc. While these approaches would push customers to pay their debt, threatening a customer might lead to loss of customer relationship and in the extreme cases a court case.

c. Accounting for irrecoverable debts and allowance for irrecoverable debt

In our example, M/s Edu.Com fails to make the payment and now we need to account this as irrecoverable debt and write it off from the books. Writing off an account balance is a cancelling of the account without having balanced with the effect of other transactions. The irrecoverable debt written off is treated as an expense and will affect the income for the year. See the entry below:

In customer's ledger

Irrecoverable Debt a/c Dr 105,000[Debit expense/loss]
To M/s Edu.Com a/c Cr 105,000 [writing off customer's account]
(Being the amount of irrecoverable debt written off)

In General Ledger

Irrecoverable Debt a/c Dr 105,000[Debit expense/loss]
To Trade Receivables a/c Cr 105,000[writing off customer's account]
(Being the amount of irrecoverable debt written off)

Year-end closing

Receivables expense a/c Dr 105,000 [Income statement]
To Irrecoverable debt Cr 105,000

d. Allowance for receivables (bad debts)

Let us assume that some customers are likely to default payment in future. Based on their previous experience LHP Pvt. Ltd estimates 3 percent of debt as uncollectable. An allowance must be made in this regard to the extent of the doubtful debt estimate. An allowance is a measure of prudence to consider future losses in advance. An allowance is different from provision. Provision is a present obligation whose amount and timing of payment is not known at the reporting date. Allowance for irrecoverable debt is not a present obligation and thus it is not a provision. The entry for the allowance of irrecoverable debt is written as follows:

Irrecoverable debt a/c Dr 3,150
To Allowance for receivables Cr 3,150
(Being the allowance for irrecoverable debt)

The amount reported in the current asset with allowance for irrecoverable debt is now:

Current assets		
Trade Receivables	105,000	
Less: Allowance for receivables	(3,150)	101,850

e. Recovery of irrecoverable debt

It can happen that the customer may pay a part or whole of the irrecoverable debt which was previously written off. Example, if M/s Edu.Com pays 60 percent of the irrecoverable debt previously written off, this can be recorded as:

Cash/bank a/c Dr 63,000
To Irrecoverable debt Cr 63,000
(Being the 60 percent payment of written off debt)

f. Trade discount

Trade discount is allowed for placing a bulk order of goods purchased by the customer. The amount is directly deducted from the list price of goods before calculation of invoice price. Since it is deducted already before the invoice price, no recording is required.

Illustration 5

LHP Pvt Ltd allows 5% trade discount on the sales made to M/s Edu.Com. This amounts to Nu. 5,250. The invoice price will be the list price less trade discount. i.e. Nu.105, 000 – Nu. 5,250 = Nu. 99,750.

Note that the list price may be called by any name as per the business practice. The focus of this discussion is not the name of the list price but the approach of accounting for trade discount.

g. Cash discount

Cash discount is allowed for making a prompt payment by a customer. Remember we discussed in the previous section about the cost of credit sales. It is calculated on the invoice price and therefore the amount is deducted from the invoice price and treated as expense.

Illustration 6

LHP Pvt. Ltd allows 5% cash discount on the sales made to M/s Edu.Com. This amounts to Nu. 4,988 (calculated on the invoice price of Nu. 99, 750). It is recorded as follows:

Cash A/c Dr 94,762
Discount expense A/c Dr 4988 [Debit expense and loss]
To M/s Edu.Com Cr 99,750
(Being cash received from M/s Edu.Com after allowing 5% cash discount)

Cash a/c Dr 94, 762
Discount expense a/c Dr 4988
To Trade Receivables 99,750
(Being cash received from M/s Edu.Com after allowing 5% cash discount)

h. Accounting for sales returns

It is usual that customers may for any reason return the goods once sold to them and request the business to have their debt cancelled. Many established business firms also have a policy of accepting return of goods within certain time period if goods sold have any defect or proved to be not fit for purpose. In that case, business prepares a 'credit note' indicating that customer's debt has been credited to that extent of the value of goods returned. The same amount can be recorded in the **Sales Return Day Book.**

Assume M/s Edu.Com returns 10 percent of goods purchased due to damage after 15 days of dispatch of goods. M/s Edu.Com immediately communicated the matter to LHP Pvt Ltd on receiving the goods. LHP marketing department prepared a credit note and dispatched a copy to M/s Edu.Com. The copy of the same credit note was sent to accountant to update customer's account on the accounting system. The following entry will be passed.

In customer's ledger

Sales returns A/c Dr 10,500 [reducing future economic befits)
To M/s Edu.Com A/c Cr 10,500
(Being the customer account adjusted for sales returns)

In General Ledger

Sales returns a/c Dr 10,500
To Trade Receivables a/c Cr 10,500
(Being the customer account adjusted for sales returns)

3.8 Accounting for credit purchases

Purchases account for a significant portion of expense in the business. For the manufacturing company, purchases would include all transactions related to procurement of direct and indirect materials, and consumable items such as spare parts, loose tools and stationery items. The expenses related to procurement of raw materials and other items used in the production of goods are included in cost of goods sold or cost of sales in the financial statements, i.e. cost of sales = opening inventory + purchases + direct labour + overheads – closing inventory. The cost of materials consumed can be calculated as opening inventory plus purchases less closing inventory. The purchases can be that of goods procured within the domestic market and an import from the foreign countries (if there is any import). In the service business, purchases can include the procurement of services such as consultancy or advisory services on taxation, business valuation and forensic accounting. Similarly, in trading business, purchase consists of procurement of inventories which are held for sale in the ordinary course of business.

Business entity may purchase goods and services either on cash or credit. When purchase transaction takes place on cash, it requires the entity to settle the consideration for goods or a service on the date of purchase. There are several reasons why entities make a cash purchase. Some of these reasons are;

i. an entity may have surplus cash, which represents a balance of cash after meeting all cash expenses and the capital costs of the entity,

ii. credit purchases of items of small value and low volume may not be adding much value to the entity unlike trading of high volumes or high

iii. margins that come with heavy trade and cash discounts,

iv. an entity may have past practice of buying goods and services on cash, and

v. an entity may not have much strategic plans and financial management capacity to take advantage of credit facilities.

Total expense related to purchase include both cash and credit purchases. Credit purchase offers a kind of interest free short term credit facilities to the entity. That way, credit purchase is an advantage to the business entity, and it can improve the short term liquidity position of the entity by decreasing the cash operating cycle.

Illustration 7

Starbucks makes the following purchases of coffee beans in the month of August 2019.

2.9.2019 City Tea and Coffee Co. Nu. 100,000
4.9.2019 Nilgiri Food and Beverages Nu. 200,500
10.9.2019 Kisan Tea Co. Nu. 230,000

Record the above purchases in the appropriate journal and post the entry in the ledgers.

Solutions

Purchases Day Book				
Date	Voucher No	Suppliers name	L/F	Amount (Nu.)
2.9.2019 4.9.2019 10.9.2019	Inv12345 Inv12346 Inv12347	City Tea and Coffee Co Nilgiri Food and Beverages Kisan Tea Co		100,000 200,500 230,000
		Purchase A/c		530,500

In Suppliers ledger

Purchases a/c Dr 530,500
To City Tea and Coffee Co a/c Cr 100,000
To Nilgiri Food and Beverages Cr 200,500
To Kisan Tea Co a/c Cr 230,000

(Being the purchases of coffee beans on credit)

In General Ledger

Purchases a/c Dr 530,500

To Trade payables a/c Cr 530,000

(Being the purchases of coffee beans on credit)

a. Accounting for purchases returns

Goods once purchased may be returned to suppliers due to several reasons such as damage and change in specification. When that is the case, the business prepares a 'debit note' and a copy is sent to the supplier along with goods returned. The transaction is recorded in the Purchase Returns Day Book and the entry is passed. Assuming goods purchased from Kisan Tea and Co. to the extent of Nu. 30,000 is returned due to damage.

In Suppliers ledger

Kisan Tea Co a/c Dr 30,000

To Purchases Cr 30,000

(Being the returns of purchases)

In General Ledger

Trade Payables a/c Dr 30,000

To Purchases a/c Cr 30,000

(Being the returns of purchases)

Discount received

Supplier's a/c Dr

To Discount income a/c Cr

To cash a/c Cr

(Being the discount received from suppliers)

3.9 Journal Entries for Various Transactions

a. Accounting for purchase and sale of property, plant and equipment on cash

i. Purchase of asset for cash (, Property, Plant and Equipment)

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Assets a/c Dr. To cash a/c (Being the assets purchased for cash)		-----	-----

ii. Sale of Assets for cash (Property, Plant and Equipment)

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Cash a/cDr. To Assets a/c (Being the assets sold for cash)		-----	-----

Note: *For receipts and payment through cheque, bank account is opened instead of cash account.*

b. Purchase of asset (Property, Plant and Equipment) on credit

i. Purchase of assets

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Assets a/c Dr. To Accounts payable a/c (Being the asset purchased on credit)		-----	-----

ii. Sale of assets on credit (Property , Plant and Equipment)

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Accounts receivable a/c Dr. To asset a/c (Being the asset sold on credit)		-----	-----

c. Expenses and revenues

i. Payment of expenses

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Expenses a/c Dr. To Cash a/c (Being the expenses paid in cash)		-----	-----

Note: On payment of any expense, the concerned expense account is debited and not the recipient's personal account.

ii. Receipt of income

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Cash a/c Dr. To income a/c *(Being the income received in cash)*		-----	-----

Note: *On any income received, the concerned income account is credited.*

d. Accrued, Deferred expenses and accrued, income received in advance

i. Accrued expenses

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Expenses a/c Dr. To accrued expenses a/c *(Being the expenses due)*		-----	-----

ii. Deferred expense

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Deferred expenses a/c Dr. To cash a/c *(Being the expenses paid in advance)*		-----	-----

iii. Accrued income

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Accrued income a/c Dr. To income a/c *(Being the income earned but not yet received)*		-----	-----

iv. Income received in advance

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Cash a/cDr. To deferred income a/c *(Being the income received in advance)*		-----	-----

e. Depreciation

Depreciation is a reduction in the value of assets due to wear and tear. It is an expense for the business, and therefore depreciation account is debited and particular asset account is credited.

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Depreciation a/c Dr. To asset a/c *(Being the asset depreciated)*		-----	 -----

f. Drawings

If the proprietor has withdrawn cash of inventories from the business for his personal use; drawings account is debited and cash or purchase account is credited.

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Drawings a/c Dr. To cash/purchases a/c *(Being the cash or goods withdrawn or personal use)*		-----	 -----

g. Interest on capital and drawings

i. Interest on capital

Interest on capital is allowed for using the owner's capital in the business thus, it is considered as an expense for the business. It is debited and capital account is credited.

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Interest on capital a/c Dr. To capital a/c *(Being the interest allowed on capital)*		-----	 -----

ii. Interest on drawings

Interest on drawings is charged by business for drawing the money or money's worth for personal use. Drawings account is debited and interest on drawings account is credited.

Journal entries in the books of……for the year ……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Drawings a/c Dr. To Interest on drawings a/c *(Being the interest charged on drawings)*		-----	 -----

h. Personal expenses of owners

For personal expenses of the proprietor such as life insurance premium, income tax, and rent drawings account is debited to cash account.

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
----	Drawings a/c Dr. To cash a/c *(Being the personal expenses paid in cash)*		-----	-----

i. Loss of Goods by fire, theft and accident

When inventories are lost due to fire, theft and accident, it is a loss to the business. Hence, loss by fire/theft/accident account is debited and purchases account is credited. For an example, when inventories are lost due to fire, the entry is:

Loss of Goods by fire a/c Dr.
To Purchases a/c
(Being the inventories lost)

If in case, inventories were insured:
Insurance company a/c Dr
To Loss by fire a/c
(Being the inventories insured)
When full claim is received from insurance company:
Bank a/c Dr
To insurance company a/c
(Being the loss compensated fully)

When insurance company does not accept the full claim:
Bank a/c Dr (with amount compensated)
Profit/loss a/c Dr (with amount not compensated)
To Insurance company a/c
(Being the part of loss compensated)

j. Distribution of inventories as free samples

To increase the sale, the goods are distributed as free samples. It is a part of advertisement expense, thus it is debited to advertisement account and credited to purchases account.
Advertisement a/c Dr
To Purchases a/c

(Being the goods used as free sample)

k. Distributions of goods and cash as charity

To record the goods or cash given as charity, a charity account is opened. The charity account is classified as an expense, hence it is debited and purchases or cash account is credited.

Charity a/c Dr

To purchases/cash a/c

(Being the goods/cash given as charity)

l. Discount received and discount allowed

Discount received is an income for the business hence, credited and discount allowed is an expense hence, debited.

m. Loan and advances

Business often uses loans and credit facilities from banks and financial institutions as a source of debt financing. This debt financing carries a finance cost, otherwise called interest on loan. This finance cost must be expensed and reported in the income statement as finance cost. The portion of loan payable within the next accounting period is reported as current liability and other part as non-current liability.

Finance cost a/c Dr 1,674

To cash Cr 1,674

(Being the payment of interest on loan account)

3.10 Types of Journal Entries

a. Simple entry

Is an entry in which only two accounts are affected, one account is to be debited and another to be credited with an equal amount.

b. Compound entry

An entry in which, two or more accounts are debited and only one to be credited and vice versa. Suppose business pays cash for salary and rent of Nu.1,000 and Nu.500 respectively, the entry passed would be:

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)

----	Salaries a/c Dr Rent a/c Dr To Cash a/c *(Being the salary and rent paid in cash)*		1,000 500	 1,500

The compound journal entries are passed if:

- transactions takes place on the same date,
- there is a common account either on the debit or credit side of an entry, and
- number of accounts involved is more than two.

Opening entry

The entry passed to record the closing balances of the previous accounting year is called opening entry. While passing an opening entry, all asset accounts are debited and liability accounts are credited. For an example, the closing balance of ABC Ltd. for the year ended 31/12/2018 were; Cash Nu.10,000, Machinery Nu.50,000, Inventories Nu.5,000, Accounts payable Nu.6,000, Loan Nu.30,000 and Accounts receivable Nu.15,000 then, the compound journal entry is shown as stated:

Journal entries in the books of……for the year……

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
01/01/2019	Cash a/cDr Machinery a/c Dr Accounts receivable a/c Dr Inventories Dr To Accounts payable a/c To Loan a/c To capital a/c *(Being the closing balance of previous year brought forward)*		10,000 50,000 15,000 5,000	 6,000 30,000 44,000

Case study

On 1/1/2018, Jambay commenced business with Nu. 300,000. He purchased inventories from Ninda for Nu. 20,000 for cash on 10/1/2018. He further purchased inventories from Nidup Nu.10,000 on 19/1/2018. He realised that he needed furniture in his business and acquired it for Nu.15,000 on 11/1/2018. On 27/1/2018 he sold inventories for Nu.30,000 to Pema; receiving Nu.20,000 in cash and balance amount to be receivable after one month. On 31/1/2018 he paid Nu.12,500 and Nu.5,000 for salary and rent respectively.

Read the case study and answer the questions.

- "Jambay purchased inventories from Ninda for Nu.20,000 for cash on 10/1/2018", what accounts will you debit and credit if he Purchased the inventories on credit?
- Pass the journal entries for purchase of furniture on cash.
- Out of Nu.12,500 paid as salary, if Nu.2,500 is deffered, what would be the differences in the former and the later entry?

3.11 Types of Journals

Subsidiary books or special books of prime entry

Maintaining a subsidiary book is facilitation to journal entries. Practically, it is not possible to post each and every transaction through journal entries as there are transactions of repetitive nature and which occurs on regular basis. Therefore, to reduce the effort in recording these transactions, the subsidiary books are kept.

Meaning of subsidiary books

In a business, there are numerous transactions to be recorded on a daily basis and it becomes difficult to record all these transactions in a single Journal. So there is a need to maintain separate journals for different classes of transaction. Therefore, they are subdivided into various special journals known as Subsidiary Books.

Types of Subsidiary Books

The various subsidiary books include the following:

- **Cash Book:** to record all receipts and payments of cash including bank transactions.
- **Purchases Book:** to record all credit purchases of goods.
- **Sales Book:** to record all credit sales of goods
- **Purchases Returns Book:** to record goods returned to suppliers
- **Sales Returns Book:** to record goods returned by customers
- **Bill Receivable Book:** to record the receipts of bills of exchange
- **Bills Payable Book:** to record the issue of bills of exchange

General Journal: to record those transactions which cannot be recorded in any of the special journal books mentioned above.

Advantages of Subsidiary Books:

- It helps to save time.
- It increases the efficiency of accounting personnel.
- It facilitates easy access to accounting information.
- It enables division of work among different accounting personnel.

3.12 Control accounts

A control account maintains a total record of individual accounts of similar nature. It is an impersonal account which is part of the double entry system. Control accounts are maintained in the General Journal. Control accounts are mainly used for trade receivables and trade payables.

A receivables control account (Trade Receivables Account):
This records the sum of all receivables from individual customers at any time. It represents the total receivables from all the customers.

<u>In General Journal (Control account entry)</u>
Trade Receivables account Dr (current asset)
To sales income Cr
At any time the balance on the receivables control account should be equal to the sum of the individual balances on the personal accounts of customers in the sales day book.

A payables control account (Trade Payables Account):
This records the sum of all payables to individual suppliers at any time. It represents the total payables to all the suppliers.

<u>General Journal (Control account entry)</u>
Purchases account Dr (Current liability)
To Trade Payables account Cr
At any time the balance on the payables control account should be equal to the sum of the individual balances on the personal accounts of suppliers in the purchases day book.

Example:
Druk Eagles has three customers' accounts (trade receivable) in its sales day book:

- Ema Grocery Nu. 120,000
- Lhaden Shop Nu. Nu. 210,000
- Pinky General Trading Nu. 100,000

430,000

These three accounts are first recorded in the sales day book and then in the three personal accounts of customers in the receivables ledger. These is not part of the double entry system. It is a mere memorandum accounts of customers and will not go to the trial balance and financial statements.

In Individual customers' ledger

Ema Grocery A/c Dr 120,000 Lhaden Shop A/c Dr 210,000 Pinky General Trading A/c Dr 100,000

To sales income Cr 430,000

In General Journal

Trade Receivables account (Control) Dr 430,000

To sales income Cr 430,000

When cash payments are received from the Customers (General Journal) Cash A/c Dr 430,000

To Trade receivables a/c Cr 430,000

NOTE: *When the customer makes cash payments, this will be directly recorded in the cash book (subsidiary book) against the name of individual customer. However, the control entry is made in the general journal to record the total cash received from the customers.*

3.13 Ledger

Accounting involves recording, classifying and summarizing financial transactions. Recording is done in the journal chronologically. Classification of the recorded transaction is done in the book called ledger. Entries recorded in the journal need to be posted into the ledger to classify the nature of business transactions and study the details of respective accounts.

a. Meaning of Ledger

Ledger is a Principal Book where different accounts relating to a persons, assets, labilities, income and expenses are maintained. An account is a date-wise summary of business transactions of similar nature brought under particular head that has a debit and a credit side. The double entry bookkeeping concept is applied while preparing a ledger. This states that every aspect of transaction must be entered in ledger accounts and the sum of 'debit' should be equal to 'credit'. Remember we will use this idea when we close the books of accounts at the end of the year to prepare financial statements or when we have to make an interim report, in case of a large companies.

For example, when someone starts a business with the investment of Nu. 1000,000, this would mean that business will have two aspects or accounts to record. At the same time, there will be a set of ledger accounts 'capital account' and 'asset account'. That is:

Cash a/c Dr 1000,000
To owner's capital a/c Cr 1000,000

By classifying the transaction aspects into capital account and cash account, the business will be able to closely monitor the balances of these accounts and also explain the reasons why the balances have changed. Imagine the owner brings his car valued at Nu. 200,000 to his business, the financial position of the business will change. The total capital balance will be Nu. 1,200,000 and the business will have two types of assets, i.e. Cash Nu. 1000,000 and property (car) Nu. 200,000.

If we apply the concept of accounting equation or the statement of financial position equation, this will show that the asset is equal to the sum of capital and liabilities.

Asset (cash) =	Capital	+	Liabilities
Nu. 1000,000 =	1,000,000	+	0

Do not forget to use two sides of accounts 'Debit' and 'Credit' under double entry bookkeeping system when preparing the ledger account! Also, follow the simple rule we have learnt in the previous sections.

A debit entry will:
- Increase an asset
- Decrease a liability
- Increase an expense

A credit entry will:
- Decrease an asset
- Increase a liability
- Increase an income

b. Features of Ledger

Some important characteristics of ledger are listed below:
- Ledger is a book that contains various accounts related to business transactions which are posted from the journal. It is also known as the book of final entry.
- Ledger displays information about the balances of various accounts relating to assets, liabilities, capital, income and expenses.
- It is the important book which facilities the preparation of financial statements.

Learning activity 4
In groups of four, complete the table given below by providing explanation to the importance given.

Importance of Ledger	Explanation
Useful for management	
Business results	
Knowledge of financial position	
Reduced possibilities of error	
Instant information	
Preparation of trail balance	

3.4.1 Format of Ledger

Dr. **Name of Particular Account** Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount

a. Posting of Journal Entries into Ledger

Posting is the process of transferring the transactions recorded in the journal to the relevant accounts in the ledger. Following procedure is followed for posting of journal entries into the ledger:

Example

On 1st April 2017, a firm purchased machinery at Nu.10, 000 for cash from karma. Give Journal entry and prepare ledger accounts.

Journal

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
2017 April 1	Machinery a/c Dr. To cash a/c (Being the machinery purchased for cash)		10,000	10,000

In Ledger

Machinery Account

Dr Cr

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
2017 April 1	To Cash a/c		10,000				

Cash Account

Dr Cr

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
2017 April 1					By Machinery a/c		10,000

Illustration 8

Ngawang commenced a Dairy Farm business on 1st January 2018 with a capital of Nu. 750,000. On 5thJanuary, he purchased 10 Jersey cows worth Nu. 650,000 and on 7thJanuary, he incurred Nu. 2,500 as transportation cost. On 13th January 2018, he further paid Nu. 500 as a monthly charge for a pasture land. With all his investment, he could generate an income of Nu.30, 000 per month by selling his dairy products. The first income received was on 28th January 2018.

Date	Particular	L/F	Debit (Nu.)	Credit (Nu.)
1/01/2018	Cash A/C Dr To Nawang's Capital A/C *(Being the capital contributed)*		750,000	750,000

50/1/208	Livestock A/C. Dr To Cash A/C *(Being the purchase of Jersey Cow)*		650,000	650,000
7/01/2018	Transportation charges A/C. Dr To Cash A/C *(Being the transportation charges paid)*		2,500	2,500
13/01/2018	Pasture Land charges A/C.Dr To Cash A/C *(Being the pasture land charges paid)*		500	500
28/01/2018	Cash A/c. Dr To Sales A/c *(Being the cash received from sales of dairy product)*		30,000	30,000

Solution:

Dr. Cash Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
1/01/18	To Ngawang's A/c		750,000	5/1/18	By Livestock A/c		650,000
28/1/18	To Sales A/c		30,000	7/1/18	By Transportation Charges A/c		2,500
				13/1/18	By Pasture land charges A/c		500

Dr. Ngawang's Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
				1/01/18	By Cash A/c		750,000

Dr. Livestock Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/18	To cash A/c		650,000				

Dr. Transportation Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/18	To cash A/c		2,500				

Dr. Pasture Land Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
13/1/18	To cash A/c		2,500				

Dr. Sales Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
				28/1/18	By Cash A/c		30,000

b. Balancing of Account

Imagine the business owner wants to prepare a financial statements at the end of the financial year. He will need to close all ledger accounts and find out the balance of each account. The balances are then transferred to financial statements. It can also happen that the business owner may need to find out the balance of some accounts to update his or her knowledge about the accounts, then again the ledger accounts balance may need to be found out. The process of ascertaining and writing the balance of each account in the ledger is called balancing of an account. If debit side total is more than the credit side, the account shows a debit balance. Similarly, if the credit side total of an account is more than the debit side total, it is a credit balance.

Illustration 9

Following ledgers shows how respective account are balanced and closed.

Dr. Cash Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
1/01/18	To Ngawang's A/c		750,000	5/1/18	By livestock A/c		650,000
28/1/18	To sales A/c		30,000	7/1/18	By transportation Charges A/c		2,500
				13/1/18	By pasture land charges A/c		500
				31/1/18	By balance c/d		127,000
			780,000				**780,000**
1/2/18	To balance b/d		127,000				

Dr. Ngawang's Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
				1/01/18	By Cash A/c		750,000
31/1/18	To balance c/d		750,000				
				1/2/18	By balance b/d		750,000
			750,000				**750,000**

Dr. Livestock Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/18	To cash A/c		650,000	31/1/18	By balance c/d		650,000
1/2/18	To balance b/d						
			650,000				**650,000**

Dr. Transportation Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/18	To cash A/c		2,500	31/1/18	By balance c/d		2,500
1/2/18	To balance b/d		2,500				
			2,500				**2,500**

Dr. Sales Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
31/1/18	To balance c/d		30,000	28/1/18	By Cash A/c		30,000
				1/2/18	By balance b/d		30,000
			30,000				**30,000**

3.4.2 Types of Ledgers

Business entities usually maintain several ledger accounts to keep details of each type of accounts. The ledger accounts are broadly categorised in to two:

i. General ledger, and

ii. Personal accounts ledger

» The general ledger

As the name suggest, general ledger contains accounts of asset, liabilities, income and expenses. The general ledger is an impersonal account. The general ledger is an impersonal account. However, there is also a need to maintain personal accounts particularly for customers and suppliers with whom business entity do lot of sale and purchase transactions. The accounting system records these transactions first in the primary books of accounts i.e. subsidiary books 'sales day book' and 'purchase day book' which are not maintained on double entry system though it gives an impression that 'debit' and 'credit' concepts are used. The customers and suppliers accounts are maintained in the receivables ledger and payables ledger where transactions with customers and suppliers can be traced. The receivables and payables ledger contains personal accounts of customers and suppliers.

» Personal Accounts ledger (The Receivables and Payables ledger)

The receivables and payables ledgers are the personal accounts of individual customers and suppliers. They do not normally form part of the double entry system and the balances of these customers and suppliers accounts are totalled and transferred to the 'Trade Receivables' and 'Trade Payables' accounts. The balances of trade receivables and trade payables accounts are transferred to financial statements.

a. The Receivables ledger

The receivables ledger contains a number of personal accounts of customers to whom the business entity has sold goods on credit. These are separate individual accounts of customers, and it helps business entity to keep track of how much its customers owe to it at any point of time. This accounts is also called **debtor's account**.

Receivables ledger are written up as follows:

1. When entries are made in a sales day book after sending out the invoices, they are also simultaneously made in the debit side of the individual customer's accounts in the receivables ledger.
2. Likewise, when the entry is made in the cash book for payment received or when the entry is made in the sales returns day book (for any goods returned), a simultaneous entry is made on the credit side of the customer's account in the receivables ledger.

See how the receivables ledger is laid out in the following example. The business entity sales goods to its customer Karma and a ledger account is maintained to keep track of customer's account through receivables ledger. Whenever the sales transaction takes place, entry is made in the sales day book followed by the updates in the receivables ledger of customer's account. The total of sales day book from time to time (say daily, weekly, monthly, quarterly or at the year-end) is posted to the general ledger to show the amount of trade receivables which then will be taken to a trial balance and financial statements. As a matter of control to prevent errors or fraud, the general ledger balance of trade receivables can be reconciled with customers' accounts in the receivables ledger or the sales day book.

In the Receivables Ledger:

Dr. Karma's Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
1.1.18	Balance b/d		350,000	10.1.18	Cash		200,000
5.1.18	Sales		100,000	2.2.18	Sales return		50,000
31.1.18	Sales		200,000	31.12.18	Balance c/d		400,000
			650,000				**650,000**

b. The Payables Ledger

The payables ledger, like the receivables ledger, contains a number of personal accounts of suppliers to whom the business entity owes. These are separate individual accounts of suppliers, and it helps business entity to keep track of how much it owes to individual supplier at any point of time.

As we have seen in the receivables ledger how entries are made. Similarly, when the entry for purchases are made in the purchases day book, cash book and sales return day book (if there is sales returns), the supplier's account as a part of payables ledger is updated. Thus, it is easier to trace balances of individual supplier's account in the payables ledger. We will now look at the example to see how the payable ledger is updated after the entry is made in the purchases day book.

The business man Tshotsho purchases goods for his shop worth Nu. 10,000 on 10.1.2019 on cash. On 20.1.2019, he purchases machinery costing him Nu. 120,000 and on the same date goods value of Nu. 150,000 were purchased on credit from Remix company. Later on 23.1.2019, goods valuing Nu. 20,000 out of Nu. 150,000 purchase were returned to the suppliers due to defective in the specification of goods. In another purchase transaction on 15. 2.2019, they also purchased goods amounting to Nu. 110,000 from the D Mat company on credit. D Mat was paid 50% on 15.3.2019.

You must know that goods purchased on cash or goods returned to suppliers are not recorded in the purchases day book journal. The cash purchases are directly entered in the cash book while goods returned is entered in the purchases return day book or journal.

In the books of primary entry (Journal):

Purchases Day Book

Date	Particulars	Amount (in Nu)
20.1. 2019	Remix company code-1234	150,000
15.2.2019	D Mat company code -1356	110,000
		260,000

Cash Account

Date	Particulars	Amount	Date	Particulars	Amount
1.1.19	Balance b/d	145,000	10.1.19	Purchases	10,000
			15.3.19	Trade payables	55,000
			31.3.19	Balance c/d	80,000*
		145,000			**145,000**

** This amount is taken to Statement of Financial Position.*

Purchases Return Day Book

Date	Particulars	Amount (in Nu)
23.1.19	Remix Company	20,000

See how Remix Company and D Mat company's personal accounts are laid out in the payables ledger.

In the Payables Ledger:

Remix Company A/c

Date	Particulars	Amount	Date	Particulars	Amount
23.1.19	Purchase returns	20,000	1.1.19	Balance b/d	100,000
31.3.19	Balance c/d	230,000	10.1.19	Purchases	150,000
		250,000			**250,000**

D Mat Company A/c

Date	Particulars	Amount	Date	Particulars	Amount

15.3.19	Cash	55,000	1.1.19	Balance b/d	50,000
31.3.19	Balance c/d	105,000	15.2.19	Purchases	110,000
		160,000			**160,000**

In General Ledger:

Trade Payables A/c

Date	Particulars	Amount	Date	Particulars	Amount
31.3.19	Purchase returns	20,000	1.1.19	Balance b/d	150,000
15.3.19	Cash	55,000	31.3.19	Purchases	260,000
31.3.19	Balance c/d	335,000			
		410,000			**410,000**

Statement of Financial Position

Income Statement

Purchases A/c

Date	Particulars	Amount	Date	Particulars	Amount
31.3.19	Trade payables	**260,000**	31.3.19	Balance c/d	**260,000**

3.5 Trial Balance

It is usual for the investor owner to find out the financial position and the performance of business from time to time. This can be done only when balance of individual ledger account is known to us on the date when the statement of financial position is drawn. The purpose of accounting is to prepare financial statements which contain valuable financial information on income, expense, asset, liabilities and equity of business entity that information users rely on. This leads to the process of preparing financial statements.

The business entity generally prepares a trial balance before the financial statements are drawn, where balances of all individual ledger accounts are extracted and laid under two columns-debit and credit columns. It is prudent to ensure accuracy of double entry bookkeeping before balance of individual accounts are transferred to financial statements.

Because of the self-balancing nature of the system of double entry, the total of the debit balances will be exactly equal to the total of the credit balances. In very straightforward circumstances, where no complications arise and where the records are complete, it is possible to prepare accounts directly from a trial balance.

a. Meaning

A trial balance is a list of ledger account balances shown in debit and credit columns at any point of time. At this point of time, you should be able to recollect the nature of ledger balances of asset, liability, income and expense. Assets and expense accounts normally show debit balance and liability and income accounts show a credit balance. Assets and expenses ledger balances are put under debit column and liability and income ledger balances are put under credit column. If the basic principle of double entry system has been followed correctly in recording and posting entries into ledgers, the ledger balances of all accounts and transactions should show the debit total equal to credit total. Thus, if there is a difference in these totals we get an understanding that somewhere the process would have gone mistake.

However, trial balance is no full proof method, but a technique which shows up the more obvious mistakes. For example, if Dorji has been recording the sales transactions and one of the entries he recorded as Nu. 215,000 sales. However, when he posted the entry in the ledger, he hurriedly posted the amount of sales as Nu. 200,000 while the amount in the personal account of customer has been posted correctly. This will obviously not allow the totals of debit and credit balances of ledger agree.

Thus, the error of such nature can be detected through preparation of a trail balance before the preparation of financial statements. You should also recollect that financial statements of the business entity should be free from material misstatements in order that the financial statements is relevant and represent faithfully the business transactions and events. At this point of time, you can learn that trail balance basically checks the arithmetical accuracy of the process of ledger posting. In the next section, you will be able to understand purposes of preparing trial balance.

i. To check arithmetical accuracy

The main objective of preparing a trial balance is to check arithmetical accuracy of transactions while they are recorded in the journal and posted to the ledger. Arithmetical accuracy means writing correct figures, in the correct account and on its correct side while posting transactions from the journal. If total of debit column and credit column of trial balance is equal, then it is a general indication that no errors have been made in the journal and ledgers.

ii. To help in disclosing some accounting error

The objective of preparing a trial balance is to locate the accounting errors at an early stage. As soon as business transactions take place, it is recorded in the journal and then posted into the ledger. If errors are committed in posting from journal to ledger, the totals of the two columns of trial balance will not tally.

iii. To help in preparing Financial Statements

The objective of the trial balance is to help preparing financial statements of a business enterprise at the end of accounting year. The balances of income and expenses are placed in income statement and, balances of assets, liabilities and equity are used in preparing position statement. It acts as a link between ledger accounts and financial statements.

iv. To help management in taking decision

The trial balance helps in comparing the balances of assets, liabilities, capital, incomes, and expenses between two different accounting periods. Such comparison helps in making a proper judgment of different activities of the business and arriving at important decisions.

v. To provide a summary of ledger accounts

The Trial Balance provides summary of information of all the ledger accounts in one place. It presents the balances of assets, liabilities, capital, incomes and expenses relating to a particular date.

3.5.1 Preparing Trial Balance

Specimen of a Trial Balance

Trial Balance as at..........

SL	Ledger Accounts	L.F	Debit balance (Nu.)	Credit balance (Nu.)
	Total			

Steps for preparing trial balance

- **Step 1:** Balance all accounts of assets, liabilities, income and expenses in the general ledger. This may be called as extraction of account balances.
- **Step 2:** Transfer all ledger balances to the trial balance template as shown in the specimen above. Remember, you should be able to identify the nature of ledger balances as debit or credit and accordingly place them under debit or credit columns correctly.
- **Step 3:** Total the debit and credit columns of trial balance and see any difference. Generally, as said earlier, the total of debit and total of credit columns should agree unless there is an error in recording and positing of entries in the ledgers. Let's look at some illustrations.

Illustration 10

On 1st January 2017, Khotakpa Engineering Pvt Ltd. in Pemagatshel invested Nu. 1,000,000 mainly focusing on the construction business. The transactions on the commencement of the business included the following:

January 2017

1st, Purchased raw materials Nu. 300,000
2nd, Paid for transportation charges Nu. 50,000
7th, Paid wages for local labours Nu. 10,000
7th, Manager Salary Nu. 20,000
11th, Engineer's drawings fees Nu. 10,000
11th, Site supervisor's salary Nu. 15,000
13th, Purchased concrete mixture Nu. 100,000 20th, Hired a utility pick up Bolero and paid hiring charges Nu. 25,000 20th, Paid rent for office Nu. 7,500
22nd, Purchased cement and bricks from Choden Cement Agent Nu. 150,000 23rd, Paid insurance Nu. 30,000
27th, Paid to Choden Cement Agent Nu. 145,000 in full settlement
29th, Sold used materials for construction Nu. 13,000
Assuming that you are employed by Khotakpa Engineering as an accountant, prepare a trial balance for the company.

Solution:

Dr. Cash Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
1/1/17	To capital A/c		1,000,000	11/1/17	By Purchase A/c		300,000
29/1/17	To sales A/c		13,000	2/1/17 7/1/17	By transportation By wages		50,000 10,000
					By salaries		20,000
				11/1/17	By drawing Charges		10,000
					By salaries		15,000
				13/1/17	By concrete Mixture		100,000
				20/1/17	By Hiring charges		25,000
					By Rent		7,500
				23/1/17	By insurance		30,000
				27/1/17	By Choden Cement		145,000
				31/1/17	By balance c/d		300,500
			1,013,000				**1,013,000**
1/2/17	To balance b/d		300,500				

Dr. Capital Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
31/1/17	To balance c/d		1,000,000	1/1/17	By Cash a/c		1,000,000
			1,000,000				**1,000,000**
				1/2/17	By balance b/d		1,000,000

Dr. Purchase Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
1/1/17 22/1/17	To Cash A/c To Trade Payables A/c		300,000 150,000	31/1/7	By balance c/d		450,000
			450,000				**450,000**
1/2/17	To balance b/d		450,000				

Dr. Transportation Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
2/1/17	To cash A/c		50,000	31/1/7	By balance c/d		50,000
			50,000				**50,000**
1/2/17	To balance b/d		50,000				

Dr. Wages Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/17	To cash A/c		10,000	31/1/7	By balance c/d		10,000
			10,000				**10,000**
1/2/17	To balance b/d		10,000				

Dr. Salaries Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
7/1/17 15/1/17	To cash To cash		20,000 15,000	31/1/7	By balance c/d		35,000
			35,000				**35,000**
1/2/17	To balance b/d		35,000				

Dr. Drawings Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
11/1/17	To cash A/c		10,000	31/1/7	By balance c/d		10,000
			10,000				**10,000**
1/2/17	To balance b/d		10,000				

Dr. Concrete Mixture Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
13/1/17	To cash A/c		100,000	31/1/7	By balance c/d		100,000
			100,000				100,000
1/2/17	To balance b/d		100,000				

Dr. Hiring Charges Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
20/1/17	To cash		25,000	31/1/17	By balance c/d		25,000
			25,000				**25,000**
1/2/17	To balance b/d		25000				

Dr. Rent Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
22/1/17	To cash A/c		7,500	31/1/17	By balance c/d		7,500
			7,500				**7,500**
1/2/17	To balance b/d		7,500				

Dr. Choden Cement Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
27/1/17 27/1/17	To cash To Discount Received		145,000 5000	22/1/17	By purchases		150,000
			150,000				**150,000**

Dr. Insurance Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
23/1/17	To cash A/c		30,000	31/1/17	By balance c/d		30,000
			30,000				**30,000**
1/2/17	To balance b/d		30000				

Dr. Discount Received Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
31/1/17	To balance c/d		5,000	27/1/17	By Choden Cement A/c		5,000
			5,000				**5,000**
				1/2/17	By balance b/d		5000

Dr. Sales Account Cr.

Date	Particulars	J/F	Amount	Date	Particulars	J/F	Amount
31/1/17	To balance c/d		13,000	29/1/17	By cash A/c		13,000
			13,000				13,000
				1/2/17	By balance b/d		13,000

Trial Balance of Khotakpa Mines Ltd. as at 31st January 2017

SL	Accounts	L.F	Debit Balance Nu.	Credit Balance Nu.
1	Capital			1,000,000
2	Cash and Cash Equivalent		300,500	
3	Purchase		450,000	
4	Transportation		50,000	
5	Wages		10,000	
6	Salaries		35,000	
7	Drawing		10,000	
8	Concrete Mixer		100,000	
9	Hiring Charges		25,000	
10	Rent		7,500	
11	Insurance		30,000	
12	Discount Received			5,000
13	Sales			13,000
Total			1,018,000	1,018,000

Illustration 11

Ledger balances extracted from the books of a Karma Enterprise is provided below. Prepare Trial Balance as on 31st December, 2016.

Heads of Accounts	Nu.	Heads of Accounts	Nu.
Cash & Cash Equivalent	21,000	Sales	105,000
Bills Receivable	18,000	Purchases	75,000
Bills Payable	16,000	Carriage Inward	2,700
Trade Receivables	24,600	Salaries	12,000
Trade Payables	32,400	Advertisement	2,400
Capital	50,000	Insurance	1,600
Drawings	18,000	Furniture	7,500
Office Rent	2,000	Inventory	18,600

Solution:

Trial Balance of Karma Enterprise as at 31st December 2016

SL	Accounts	L.F	Debit Balance Nu.	Credit Balance Nu.
1	Cash and Cash Equivalent		21,000	
2	Bills Receivable		18,000	
3	Bills Payable			16,000
4	Trade Receivables		24,600	
5	Trade Payables			32,400
6	Capital			50,000
7	Drawings		18,000	
8	Sales			105,000
9	Purchases		75,000	
10	Carriage Inward		2,700	
11	Salaries		12,000	
12	Advertisement		2,400	
13	Insurance		1,600	
14	Furniture		7,500	
15	Inventory		18,600	
16	Office Rent		2,000	
Total			**203,400**	**203,400**

Illustration 12

The Himalayan Consortium, a private limited company presents you the following ledger balances as on 31.12.2019.

Accounts	Balance (Nu.)	Accounts	Balance (Nu.)
Bank loan	12,000	Other expenses	11,020
Cash at bank	11,700	Vehicles	2,020
Capital	13,000		
Business taxes	1,880		
Trade payables	11,200		
Purchases	12,400		
Sales	14,600		
Other payables	1,620		
Trade receivables	12,000		
Bank loan interest	1,400		

During the year the business made the following transactions.

i. Bought materials for Nu. 1,000, half for cash and half on credit.

ii. Made Nu. 1,040 sales, Nu. 800 of which was for credit .

iii. Paid wages to shop assistants of Nu. 260 in cash.

You are required to draw up a trial balance showing the balances as at the end of 31.12.2019.

Solution:

Let us first prepare the unadjusted trial balance. The trial balance should still agree (total debit=total credit) even if the adjustment entries are not made for three transactions unless there was a mistake in the double entry system of recording.

Sl. No.	Accounts	LF	Debit Balance Nu.	Credit Balance Nu.
1	Bank loan			12,000
2	Cash at bank		11,700	
3	Capital			13,000
4	Local taxes		1,880	
5	Trade payables			11,200
6	Purchases		12,400	
7	Sales			14,600
8	Other payables			1,620
9	Trade receivable		12,000	
10	Bank loan interest (expenses)		1,400	
11	Other expenses		11,020	
12	Vehicles		2,020	
Total			**52,420**	**52,420**

Now we must take account of the effects of the three transactions which took place during the year 2019.

i.	Purchases A/c	Dr	1,000		
	To Cash A/c	Cr			500
	To Trade Payables A/c Cr				500
ii.	Cash A/c	Dr	240		
	Trade receivablesA/c		Dr	800	
	To Sales		A/c	Cr	1,040

iii. Wages A/c Dr 260
To Cash A/c Cr 260

The adjusted trial balance can be prepared as follows after incorporating the effects of three transactions.

Sl. No.	Accounts	LF	Debit Balance Nu.	Credit Balance Nu.
1	Bank loan			12,000
2	Cash at bank (11,700-500+240-260)		11,180	
3	Capital			13,000
4	Local taxes		1,880	
5	Trade payables (11,200+500)			11,700
6	Purchases (12,400+1,000)		13,400	
7	Sales (14,600+1040)			15,640
8	Other payables			1,620
9	Trade receivable (12,000+800)		12,800	
10	Bank loan interest (expenses)		1,400	
11	Other expenses (11020+260)		11,280	
12	Vehicles		2,020	
	Total		**53,960**	**53,960**

Exercises:

1. Define the following terms:
   a. Source documents
   b. Voucher
   c. Journal

2. Classify the following accounts into real, personal and nominal account.
   a. Interest
   b. Cash
   c. Drawings
   d. DSB publishers
   e. Capital
   f. BDBL
   g. Bank loan
   h. Bank Overdraft
   i. Depreciation
   j. Commission receivable
   k. Motor vehicle
   l. Discount received

3. ABC Ltd. has the following balances in the beginning of the accounting year 2018. you are required to pass the opening journal entry.

Cash in hand	Nu. 5,000
Cash at bank	Nu. 6,000
Land	Nu. 50,000
Furniture	Nu. 18,000
Account payable	Nu. 9,000
Accrued rent	Nu. 15,000

4. On 1st January 2018, Damcho Lhendup started a Garment business named DAMCHO SHOP, with a capital of Nu. 1,500,000 importing high quality branded goods from Nepal. He decided that all sales are strictly affected through cash, while all purchases may be carried out immediately through cash or on a monthly credit basis. All payments are made by cheque unless otherwise stated. The transactions for his business for the month of January are as follows:

   Jan 1, Deposited in Bank of Bhutan Nu. 150,000

   Paid for shop premises Nu. 100,000

   Bought furniture Nu. 24,000

   Paid for fire insurance Nu. 5,000

   Jan 2, Received invoice for inventories purchased on credit from Lucky Cloth Pvt Ltd Nu. 250,000

   Jan 4, Paid Nima Enterprise for accrued dues Nu. 30,000

   Jan 6, A part of furniture which cost Nu. 10,000 purchased on 1st Jan were destroyed by fire. For that insurance claims received through cheque Nu. 7,000

   Jan 15, Bought replacement of furniture Nu. 9,000

   Jan 30, Sales for the entire period of month amounted to Nu.300,000 and the same was deposited into Bank of Bhutan on the same date.

   Drawings for personal trip Nu. 25,000

   Damcho Lhendrup got a Sales Executive who had all the required knowledge on bookkeeping and accounting as he previously worked in one of the famous companies in India.

   Imagining yourself as the Sales Executive, prepare journal, Ledger Accounts and Trial balance of the said business.

5. Following is the transaction of Bhutan Happiness Enterprise Ltd owned by Nima. He commenced his business on 1st July 2017 with a capital contribution of Nu. 500,000.

On 2nd July he deposited Nu. 130,000 in Bhutan National Bank Ltd.

2nd July, he purchased goods for cash from Shachok Enterprise Nu. 120,000

3rd July he bought furniture for office use Nu. 3,500

4th July Drew from BNBL for office use Nu. 8,000

10th July Sold goods to Dawa Nu. 55,000

13th July Bought goods from Karma Nu. 33,000

18th July Paid salaries to the assistance Nu. 6,000

18th July Paid trade Expenses Nu. 4,500

19th July Received cash from Dawa Nu. 50,000 Allowed him discount of Nu. 5,000

28thJuly Paid Karma in full settlement Nu. 3,000

30th July Paid rent for the shop Nu. 6600

31st July Interest on capital Nu. 1,350.

Since Nima lacked the idea on preparing the books of Accounts, so he hired you to record the above transactions and prepare all Journals, Ledger Accounts and Trial balance.

6. STAR Ltd. had the following closing balances brought forward for the accounting period 1/7/2018.

   Cash Nu.35,000, Bank Nu.7,000, Inventories Nu.70,000, Building Nu.100,000, Bank loan Nu.45,000, Accounts payable Nu.10,000 and Capital Nu 157,000. Transactions for the month were;

Date	Transactions
2/7/2018	Purchased inventories for Nu.5,000
5/7/2018	Purchased plant from Excellent Furniture trading house for Nu.50,000 (half paid in cash)
8/7/2018	Inventories lost due to fire Nu.7,500 and insurance company accepted a claim of Nu.2,500 only
12/7/2018	Sold inventories for Nu.3,000, received by cheque
15/7/2018	Paid to Excellent furniture trading house Nu.24,500 in full settlement of their account
17/7/2018	Rent due not paid Nu.500 and Insurance pair for the next month Nu.250
20/7/2018	Withdrew Nu.2,000 for office use and Nu.1,000 for domestic use
21/7/2018	Depreciate Building @10% for 3 months
22/7/2018	Allowed interest on capital @5% for 6 months
23/7/2018	Paid electricity charge for Nu.500 and telephone bill for Nu.250
25/7/2018	Received Nu.2,500 for commission.

Star Ltd. wished to find out the result of the business, so you are required to prepare Journal, Ledger Accounts and Trial balance for the above transactions

7. Answer the following questions.
   a. It is quite often found that preparing ledger is timing consuming, yet it is considered as the primary books of accounts by the business. Why do you think so?
   b. Can profit of the business and its financial position be known without maintaining ledger? Why?
   c. When both debit and credit amounts have been posted to an account, what determines debit or credit balance?
   d. Tshering Dema does not prepare journal in her business. She records the debits and credits for each transaction directly in Ledgers. Is Tshering Dema using the correct procedure? Justify?

8. The following Trial Balance is drawn from the books of Sherub traders;

Head of Accounts	L.F	Debit Balances Nu.	Credit Balances Nu.
Cash & Cash Equivalent		10,000	
Purchases returns		8,000	
Wages		8,000	
Establishment expenses		20,000	
Sales returns			7,000
Capital			100,000
Carriage outwards			2,000
Discount received		1,200	
Commission earned		800	
Machinery		64,000	
Inventory		10,000	
Trade Receivables		20,000	
Trade Payables			42,000
Sales			50,000
Purchases		155,000	
Bank overdraft			80,000
Manufacturing expenses		22,000	
Loan from Tashi			35,000

Carriage inward			1000
Interest on investments			2000
Total		**319,000**	**319,000**

Closely examine the trial balance given above. State whether it is correct or not. If it is not correct, redraw the correct one.

9. Answer the following questions
   a. Trial balance is not a conclusive proof of error free documentation of business transactions. Comment.
   b. Is trial balance an account or statement? Justify your answer.
   c. Trial balance is necessary to ensure reliability and accuracy of business transactions. Critique with appropriate justifications.

Chapter 4
Cash Book and Bank Reconciliation Statement

Learning objectives:

- Explain the nature and importance of cash transactions
- Discuss the importance of cash control in the business
- Prepare double column cash book and petty cash book.
- Explain the meaning, features and objectives of bank reconciliation statement
- Discuss the causes of differences in cash book and bank statement balance
- Prepare a bank reconciliation statement based on cash book and bank statement (favourable balance only)

Learning Activity1
List down at-least ten items you or family have purchased recently. You are required to classify them into cash and credit purchases in two separate columns and find the total amount of each column.

4.1 Nature of Cash

Cash is the life blood of business. It is the medium of exchange which provides the basis of accounting measurement. It is the most liquid current asset which helps the business to function on a continuous basis.

Cash does not simply mean cash in hand. It comprises cash in hand, cash at bank and cash equivalents. Cash equivalents are short term investments or marketable securities which can be easily converted into cash.

Sufficient cash is essential for the day to day operations of the business. It is required for buying and selling of goods and services and for discharging the business liabilities. Shortage of Cash would definitely affect the smooth functioning of the business. Excess cash, which does not contribute towards the profitability of the business, becomes dead money for the business. Therefore, efficient management of cash is very important for the successful functioning of the business

4.2 Importance of Cash

Cash is important for individuals, families and business concerns. Only through cash we can pay for our expenses and meet our obligations. “Cash is king” is an age-old saying often used to explain the importance of cash in our day to day life. Cash is important to meet the following needs of the business:

iv. Invest in fixed assets and to increase the earning capacity of the business,

v. Undertake the day to day transactions of the business such as purchase of materials, goods and payment of expenses,

vi. Make large purchases in order to avail trade discount,

vii. Make timely payment to creditors and avail cash discount,

viii. Take advantage of profitable opportunities such as fall in price of raw materials, decrease in price of fuel etc.,

ix. Ensure timely payment of dividend to shareholders,

x. Meet unforeseen events or contingencies,

xi. Make investment in outside profitable securities, and

xii. Cash is also essential for the survival of the business at times of depression.

4.3 Cash Control

Before learning about cash control, it is better to know the concept of 'cash flow'. Cash flows are inflows and outflows of cash and cash equivalents. Cash inflow represents the sources of cash and cash equivalents whereas cash outflow represents application of cash and cash equivalents.

A business may produce sufficient revenue by selling large volume of goods on credit but without the inflow of cash, it may even become bankrupt. Poor cash management is one of the main reasons for business failure. Therefore, every business must have effective cash control system. In case of a sole trading concern and partnership firms, the owner or manager will have a control over the cash transactions. Large organizations will have their own accounting system to have an effective control over cash inflow and cash outflow.

Accounting system should ensure proper control over the inflow and outflow of cash. As far as possible all receipts and payments of cash must be made through bank account. This will ensure the safety and control over cash flow. Employees dealing with cash must be made responsible for misappropriating funds by forging entries in the books of accounts. Preparation of Bank Reconciliation Statement helps the management to check the accuracy of entries made in the cash book and bank statement. It will bring out the errors committed by the staff and discourages them from embezzlement.

Case Study

Imagine that you are a business entrepreneur having a chain of resorts in different parts of the country. You also own a furniture shop in Thimphu. Purchases of furniture were always made on cash basis but sales were made on both cash and credit basis. Since you are on tour to visit the resorts most of the time, you appointed Mr. Dawjay as the manager of furniture shop who is also responsible for performing all the cash and bank transactions related to the shop. His monthly income is hardly enough to meet all his household expenses. In addition to his family members, he has to support two dependents who are studying in private schools in

Thimphu.
Recently you heard from your friends that Dawjay has become spendthrift in nature and found most of the time in Pubs and Drayangs. Having suspected about his source of income, you inspected the records of furniture shop and found many forged entries when compared with the bank statement. Entries were made in the office records for depositing money in the bank but Dawjay never deposited cash in the bank. It was found that he manipulated the accounts and used the fund for his personal purpose.

Required:

- Mention some of the measures you would like to recommend to prevent employees from such embezzlement in future

  OR

- Suggest some ways in order to have proper control over inflow and outflow of cash in your business. Your answer should be backed by strong justifications.

4.4 Cash Book

Cash Book is a special journal where all cash transactions are recorded. Bank transactions can also be recorded in a cash book with separate bank column. Cash book is a journalised ledger. It is a journal since all cash transactions are primarily recorded in the Cash Book. It is also a ledger as Cash Book serves the purpose of Cash Account and Bank Account. It shows the balance of cash and bank at any point of time. These balances are entered in the Trial Balance directly.

Features of cash book

- Only cash/bank transactions are recorded in Cash Book,
- Receipts are recorded on the debit side and payments on the credit side,
- Transactions are recorded in chronological order,
- It serves the purpose of both journal and ledger, and
- Cash book is balanced daily.

Types of cash book

Based on the need and uses there can be several cash books maintained by the business entities. The most popular are depicted in the following diagram and subsequent explanation.

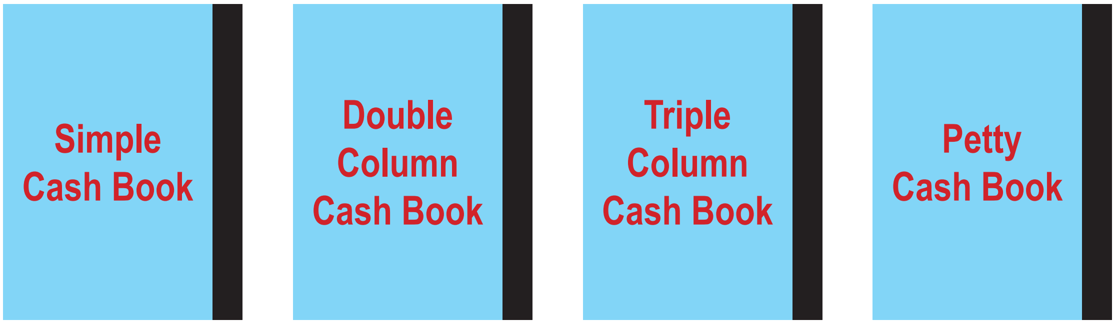


Figure 4.1 *Types of cash book*

a. **Simple Cash Book**

   A Simple Cash Book keeps the records of only cash transactions. It has only one column on each side for recording the amount. Therefore, a Simple Cash Book is also known as Single Column Cash Book. It is similar to that of cash account or cash ledger.

b. **Double Column Cash Book (Cash Book with Bank Column)**

   The cash book which records both cash and bank transactions is known as Double Column Cash Book. It has two columns on each side to record cash and bank transactions.

c. **Triple Column Cash Book (Cash book with bank and discount column)**

   It is a type of cash book that maintains columns to record discount in addition to bank transaction. As it is not that popular, exercises are not discussed under this topic.

Contra Entry: Some transactions affect both cash and bank at the same time and are entered on both the sides of cash book. Such entries are known as Contra Entry. These entries are made either for cash deposited into bank or cash withdrawn from bank for office use. Against contra entries the letter "C" is written in the J.F. column on both sides of Double Column Cash Book.

Bank Overdraft: Generally, bank may allow businesses to withdraw more than the balance available in the account. Such excess withdrawal is known as "Overdraft". Bank overdraft is the credit balance in the cash book.

Format of the Double Column Cash Book

In the Books of …………..
for the month of…………..

Dr. Cash Book Cr.

Date	Receipts	J/F	Cash	Bank	Date	Payments	J/F	Cash	Bank

Illustration: 3

Based on the information provided for Namgay Traders, Phuentsholing, you are required to prepare double column cash book.

April, 2018	Nu.
1/4/18 Cash in hand	250,000
Cash at Bank	300,000
2/4/18 Cash Sales	120,000
4/4/18 Paid to Yangchen by cheque	160,000
7/4/18 Cash Purchases	250,000
8/4/18 Paid into Bank	50,000
10/4/18 Goods purchased from Tenzin Manufacturing Company	80,000
11/4/18 Received Commission	15,000
14/4/18 Cheque Received from Pema	65,000
17/4/18 Issued cheque to Tenzin Manufacturing Company to settle the account	
20/4/18 Cash withdrawn from bank for office use	40,500
22/4/18 Sold goods to Sonam for Cash	100,000
25/4/18 Bought Furniture	45,750
27/4/18 Withdrew from Bank for personal use	10,000
29/4/18 Sold goods and cash sent to bank	25,000
30/4/18 Paid Rent	20,000
30/4/18 Paid Salaries by cheque	50,000

Solution: In the Books of Namgay Traders for the month of April,2019

Dr. **Double Column Cash Book** Cr.

Date	Receipts	J/F	Cash(Nu.)	Bank(Nu.)	Date	Payments	J/F	Cash(Nu.)	Bank(Nu.)
2018					2018				
1/4	To Balance B/d.		250,000	300,000	4/4	By Trade payables			160,000
2/4	To Sales a/c		120,000	-		Yangchen's Account			
8/4	To Cash a/c	C	-	50,000	7/4	By Purchases a/c		250,000	
11/4	To Commission a/c		15,000	-	8/4	By Bank a/c	C	50,000	
14/4	To Trade Receivables		-		17/4	By Trade Payables (Tenzin			80,000
	(Pema)			65,000		Manufacturing Co)			
20/4	To Bank a/c		40,500	-	20/4	By Cash a/c	C		40,500
22/4	To Sales a/c	C	100,000	-	25/4	By Furniture a/c		45,750	
29/4	To Sales a/c		-	25,000	27/4	By Drawings a/c			10,000
					30/4	By Rent a/c		20,000	
					30/4	By Salaries a/c			50,000
					30/4	By Balance C/d.		209,250	99,500
			525,000	**440,000**				**525,000**	**440,000**
1/5	To Balance b/d		209,250	99,500					

Learning Activity 3

Imagine that after the completion of your studies you got an opportunity to appear for an interview for the post of cashier at Ghasel Resorts, Paro. To check your proficiency in accounting, the manager of Ghasel Resorts asked you to prepare a Double Column Cash Book with at least ten transactions including two contra entries. Transactions must be related to the day to day activities of resorts. List down the transactions and prepare the aforementioned cash book.

Illustration: 4

Following are the transactions of Pema Enterprises for the month of December, 2018.

Transactions	Nu.
1/12/18 Cash	25,000
Bank Overdraft	40,000
2/12/18 Additional capital paid into bank	1,500,000
3/12/18 Goods purchased for cash	87,000
4/12/18 Paid carriage	5,400
6/12/18 Cash Sales	180,000
9/12/18 Deposited into bank	56,000
10/12/18 Received cheque from Nima	14,800
12/12/18 Bought goods by cheque	24,000
13/12/18 Drawn from bank	50,000
15/12/18 Good sold to Penjor	20,000
17/12/18 Bought laptop for personal use	54,000
19/12/18 Paid for office expenses	4,000
21/12/18 Received from Penjor (cash)	17,000
23/12/18 Commission paid by cheque	9,500
24/12/18 Cheque received for goods sold	55,000
25/12/18 Bought delivery van by cheque	1,150,000
27/12/18 Paid office Salaries	38,000
29/12/18 Paid Electricity Charges by cheque	4,850
30/12/18 Paid office Rent	15,500
31/12/18 Interest charged by bank	3,700

Required to record the above transactions in a Double Column Cash Book

Solution: In the Books of Pema Enterprises for the month of December,2018

Dr. **Double Column Cash Book** Cr

Date	Receipts	J/F	Cash(Nu.)	Bank(Nu.)	Date	Payments	J/F	Cash(Nu.)	Bank(Nu.)
1/12/18	To Balance B/d.		25,000	-	1/12/18	By Balance B/d. a/c		-	40,000
2/12/18	To Capital a/c		-	1,500,000	3/12/18	By Purchases a/c		87,000	
6/12/18 9/12/18	To Sales a/c To Cash a/c	 C	180,000 -	- 56,000	4/12/18 9/12/18	By Carriage By Bank a/c	 C	5,400 56,000	
10/12/18	To Trade Receivables (Nima)		-	14,800	12/12/18	By Purchases a/c		-	24,000
13/12/18	To Bank a/c	C	50000	-	13/12/18	By Cash a/c	C		50,000
21/12/18	To Trade Receivables (Penjor)		17,000		17/12/18	By Drawings a/c		54,000	
24/12/18	To Sales a/c			55,000	19/12/18 23/12/18	By Office Expenses a/c By Commission a/c		4000 -	 9,500
					25/12/18	By Delivery Van a/c		-	1,150,000
					28/12/18	By Office Salaries a/c		38,000	
					29/12/18	By Electricity Charges a/c		-	4,850
					30/12/18	By Office Rent		15,500	
					31/12/18	By Interest Charged		-	3,700
					31/12/18	By Balance C/d.		12,100	
			2,72,000	**1,625,800**				**2,72,000**	**1,625,800**
1/1/19	To Balance b/d		12,100	343,750					

Learning Activity 4

Chencho Traders, Samtse deals in complete sets of Gho and Kira. In the beginning of January, 2019, Chencho had cash balance of Nu.60,000 in the office and Nu.500,000 with Bhutan National Bank Ltd. On 1st January he purchased Ghos worth Nu.40,000 from Karma Traders in Phuntsholing which was sold to Nima for Nu.55,000 on the same date. On 2nd January, he received Nu.50,000 from Nima, out of which, Nu.40,000 was deposited into his bank account. On the next day, he issued a cheque of Nu.34,000 to Karma Traders and received Nu.4,500 from Nima in full- settlement. On 5th January, he withdrew Nu.25,000 from his bank account and bought a steel cupboard for Nu.20,000. On 7th January he recharged his office net connection for Nu.1,000.

Assume yourself as an Accountant of Chencho Traders, show the cash and bank balance at the end of first week of January.

d. Petty Cash Book

Every business organization has to make large number of small payments, such as telephone bills, internet charges, taxi fare, postage, wages, stationeries, refreshments and sundry expenses. If all these payments are recorded in the main cash book, it becomes bulky and the main cashier will be overburdened. Therefore, a Petty Cash Book is maintained to record all small payments. A petty cashier is appointed to make such payments and record them in the Petty Cash Book.

Imprest System of Petty Cash Book

Under this system, the petty cashier is advanced a fixed amount at the beginning of a period by the main cashier. He/she makes all payments out of this fund and submits the accounts at the end of the period to the main cashier for the reimbursement of the amount used. Thus in the beginning of each period, the petty cashier will have the same fixed amount.

Learning Activity 5

The Cashier of Nima Construction Company was dealing with volumes of transactions every day for the last couple of years. Of late, he is facing a lot of difficulty in maintaining the cash book. He had to work beyond office hours for verifying and balancing the cash book almost every day. Quite often, he started making errors in recoding the transactions in the cash book. Owing to such problem, he suggested the management to appoint one petty cashier to ease his burden in maintaining the cash book efficiently.

You are quired to study the advantages and disadvantages of appointing a petty cashier for the company.

Specimen of Petty Cash Book

Receipts (Nu.)	Date	Particulars	Total (Nu.)	Freight (Nu.)	Printing and stationery (Nu.)	Wages (Nu.)	Postage (Nu.)	Travelling expenses (Nu.)	Sundries (Nu.)

Note: Number of columns for expenditure depends on the nature of expenditure incurred.

Illustration: 5

You are required to prepare a Petty Cash Book based on the information provided below by Kinley, a Petty Cashier of Leki Traders who maintains cashbook on Imprest System.

On 1/1/18, Kinley is given imprest amount of Nu. 10,000 by the finance officer of the company.

2/1/18 Paid for stationeries	200
4/1/18 Paid freight	350
5/1/18 Bought postage stamp	65
7/1/18 Paid wages	450
9/1/18 Paid sundry expenses	260
11/1/18 Paid taxi fare	1200
12/1/18 Paid for note book	320
14/1/18 Paid wages	300
16/1/18 Bought curtains for office use	1250
19/1/18 Paid for freight	500
21/1/18 Paid for bus fare	235
22/1/18 Bought postage stamps	70
25/1/18 Refreshment served to customers	170
27/1/18 Bought envelopes	200
28/1/18 Electric charges paid	1400
31/1/18 Paid cleaning charges	500

Solution: In the Books of Leki Traders

Petty Cash Book for the month of January, 2018

Receipts	Date	Particulars	Total (Nu.)	Travelling Expenses	Freight	Stationery	Postage	Wages	Sundries
10,000	1/1/18	To Cash							
	2/1/18	By Stationery	200			200			
	3/1/18	By Freight	350		350				
	5/1/18	By Postage	65				65		
	7/1/18	By Wages	450					450	
	9/1/18	By Sundries	260						260
	11/1/18	By Taxi fare	1,200	1200					
	12/1/18	By Stationery	320			320			
	14/1/18	By Wages	300					300	
	16/1/18	By Curtains	1,250						1250
	19/1/18	By Freight	500		500				
	21/1/18	By Bus fare	235	235					
	22/1/18	By Postage	70				70		
	25/1/18	By Refreshment	170						170
	27/1/18	By Stationery	200			200			
	28/1/18	By Electric charges	1,400						1,400
	31/1/18	By Cleaning charges	500						500
			7,470	1,435	850	720	135	750	3,580
	31/1/18	By Balance C/d.	2,530						
10,000			10,000						
2,530	1/2/18	To Balance B/d.							
7,470	1/2/18	To Cash a/c							

Illustration: 6

Prepare the Petty Cash Book on imprest system in the books of Tashi Enterprises from the transactions given below:

2019 (Nu.)

Nov-1 Cash in Hand 1,325

Received cash from the chief cashier to make up the imprest amount, which is	12,000
Nov-2 Purchased paper, pen and glue	900
Nov-4 Purchased revenue and postage stamps	120
Nov -6 Paid telephone charges	765
Nov -8 Paid wages to sweepers	1,200
Nov -9 Paid postal charges	75
Nov -12 Paid carriages	490
Nov -13Paid repairing charges of office computer	1,700
Nov -15 Bought tea and snacks for refreshment	640
Nov -17 Paid travelling expenses	1,100
Nov -19 Bought books and registers	400
Nov -20 Paid mobile voucher allowance to office staff 250	
Nov -22 Paid wages to workers for shifting furniture	800
Nov -24Paid taxi fares	1,000
Nov-26 Paid carriages	600
Nov -29 Paid for mobile voucher for office	1,000

Solution:

In the Books of Tashi

Petty Cash Book for the month of November, 2019

Receipts	Date	Particulars	Total (Nu.)	Travelling Expenses	Telephone charges	Carriage	Stationery	Postage	Wages	Sundries
1,325	1/11	To Balance b/d								
10,675	1/11	To Cash								
	2/11	By Stationeries	900				900			
	4/11	By Postage	120					120		
	6/11	By Telephone charges	765		765					
	8/11	By Wages	1,200						1200	
	9/11	By Postage	75					75		
	12/11	By Carriage	490			490				
	13/11	By Repairing charges	1,700							1700
	15/11	By Refreshments	640							640
	17/11	By Travelling expenses	1,100	1100						
	19/11	By Stationeries	400				400			
	20/11	By Mobile Voucher	250		250					
	22/11	By Wages	800						800	
	24/11	By Taxi fare	1,000	1000						
	26/11	By Carriages	600			600				
	29/11	By Mobile Voucher	1,000		1000					
			11,040	2,100	2,015	1,090	1,300	195	2,000	2,340
	30/11	By Balance c/d	960							
12,000			**12,000**							
960	1/12	To Balance b/d								
11,040	1/12	To Cash								

Learning Activity 6

Phuntshok Company Limited, manufactures and sells cement on a large scale. Since there are numerous cash transactions, a petty cashier is appointed to record all the small payments. The imprest amount is fixed at Nu.15,000 and the company balances the Petty Cash Book on a weekly basis. On 15th May, 2018, Norbu, the petty cashier, had a cash balance of Nu.1, 600. He made the following payments in the third week of May, 2018.

Date	Particulars	Amount (Nu.)
15/5/18	Paid for pens, register and the stapler pins	1,500
16/5/18	Taxi hired for Sales Manager visiting the Agent at Phuntsholing Paid for fueling the Delivery Van	2,500 2,000
17/5/18	Postal charges paid for sending parcel Loading charges paid to labourers Paid for lunch served to field trip students	500 2,000 3,000
18/5/18	Paid for lock purchased for godown Paid for tea served in office	250 500
19/5/18	Subscription fees for Kuensel and Trade Journals Paid for toiletries bought for office washroom	300 650
20/5/18	Bought mobile voucher for manager for the use in the office Paid for soft drink served to customer	350 250

You are required to prepare the petty cash book based on the information presented in the table and the impress amount of the finance officer. Present the total expenditures of different heads in the form of a chart.

4.5 Bank Reconciliation Statement

Banks play a vital role in the smooth functioning of the business by providing facilities like accepting the deposits, withdrawal of cash; collecting interest and dividend, and making payment based on standing instructions. Business organizations maintain cash book (with bank column) to record cash transactions and similarly the bank maintains business account to record the transactions of the business entity carried out through the bank. Business entity can check cash balance with the bank anytime from the Bank Statement.

Sometimes, the cash balance shown in the Bank Statement may not match with the Cash Book balance. Therefore, the urgency and need arises to know the causes of discrepancy between the balances of Bank Statement and Cash Book. This is done through the preparation of a Bank Reconciliation Statement.

It must be noted that the bank reconciliation statement is not an account, therefore, double entry system of bookkeeping is not applicable. It is prepared to enable the accountant and any other users to understand the difference between bank balance in cash book and balance as per the bank statement.

The statement may be prepared weekly, monthly or quarterly based on the needs of the user. After preparing the BRS, it needs to be reviewed by a senior staff to ensure an effective control over cash inflows and outflows. Bank reconciliation statement is one of the effective methods of control over cash and cash equivalents so that the risk of misappropriation of cash resources is reduced.

A mere preparation of bank reconciliation statement may not be very useful unless it is appraised by supervisor or head of accounts. Having the knowledge of cash and cash equivalent balances would allow management to carry out effective cash budgeting.

Benefits of Bank Reconciliation Statement

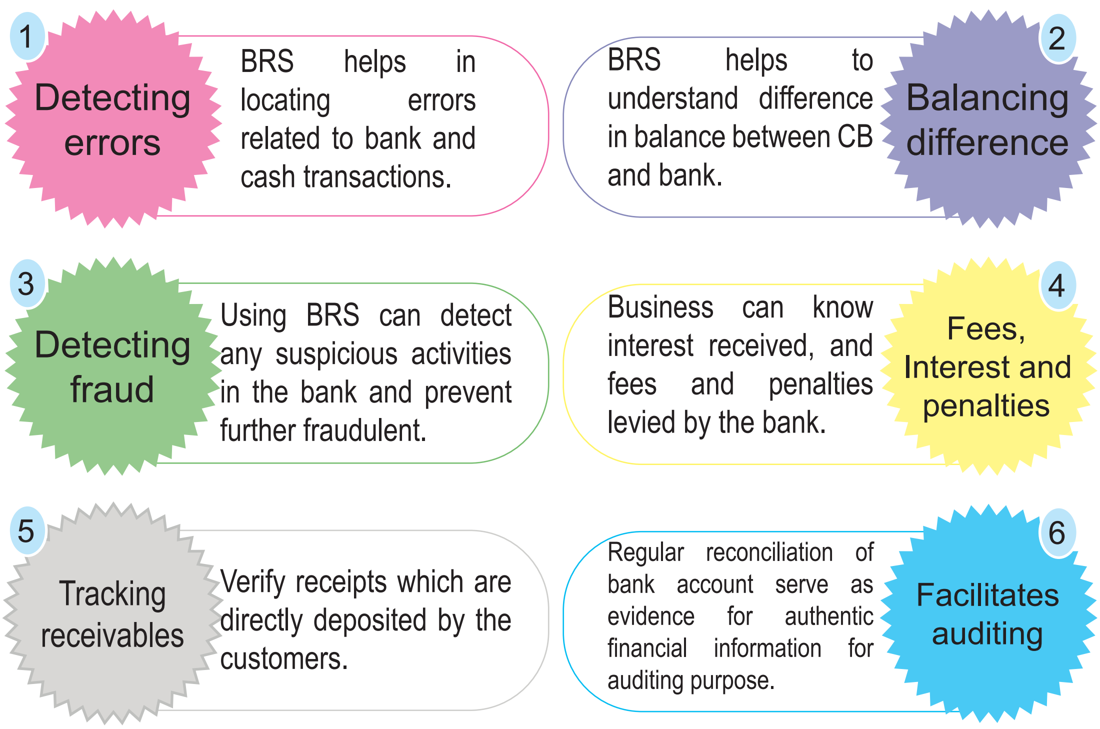


Figure 4.2 Benefits of BRS

Concept of Bank Statement

A Bank Statement is a summary of banking transactions which have occurred over a given period in a bank account held by a person, business or an agency with Bank or Financial Institution. In other words, it is a document that is issued by a bank on demand to its customers, listing the transactions relating to a bank account. Bank provides the bank statement both in print and electronic version- mBoB, B-Wallet, SMS Banking, Internet Banking and etc.

Activity 7: Fill in the missing details using only one or two sentences

Basis of difference	Bank statement	Bank Reconciliation Statement
Who prepares		
Objective		
Timing of Preparation		
Necessity		

Causes of Difference in the Balance of Cash Book and Bank Statement

There is a time gap in recording a transaction in cash book and actual bank transaction. Due to Such difference in timing, the balance in the cash book does not agree with the balance of the bank statement. For example, the cheques deposited into the bank are recorded immediately in the cash book but bank credit the amount in the Customer's Account only when the amount is actually realised after a few days of collection. There are several cases such as the one discussed in this example that causes difference in cash book and bank statement. The following section discusses some of these situations.

A: Transactions recorded only by the bank: *Sometimes, transactions are recorded by the bank but are NOT known to the customer until a notice is served. The following are some of the examples:*

Interest allowed by Bank: If the bank allows interest to the customer on deposits, balance in Bank Statement increases. The customer usually comes to know the amount of the interest by viewing the Bank Statement only.

Interest and expenses charged by the bank: If bank charges interest and expenses from the customer, such expenses and charges are debited to the Bank Account. The customer records such expenses and charges in cash book only after receiving the bank statement.

Interest and dividend collected by the bank: Customer gives standing instruction or authorization to the bank to collect dividends, interest etc. directly from the clients. The bank credits the amount received from clients in the bank statement as soon as it receives the amount. The customer will know such interest and dividend only when it receives or generates a bank statement.

Direct payments by the bank: Bank may receive standing order to pay insurance premium, electricity bill, telephone bill, water bill, house rent etc. from the customer. The bank will debit the Bank Statement on making the payment and this reduces the bank balance. But customer has no information and cannot record the payment until the bank statement is received.

Direct payment into the bank by the Customer: Customer may directly deposit the amount due in the account of the business. The bank credits customer's account immediately on receipts of such payments but the customer will make entry in the cash book only after receiving intimation from the bank.

Amount debited in Bank Statement but Cash not dispensed from the ATM. Customer withdraws the amount from the ATM but the cash is not dispensed, and the amount gets debited in the Bank Account. In such cases, cash is not received but same gets debited from the customer's bank account causing a difference in cash book and bank statement.

B: Transactions recorded only by the Customer: Sometimes, transactions are recorded by the customer and are not under the purview of the bank until it is executed. The following are some of the examples:

Cheques issued but not yet presented for payment: When a cheque is issued for payment, it is credited in the cash book immediately. But it is debited by the bank only when cheque is presented for payment. For an example, a customer issued a cheque of Nu.20, 000 on 24th December 2019 which is presented to the bank on 3rd January 2020. The customer will credit it in the Cash book on 24th December 2019 whereas Bank will debit it on 3rd January 2020. On 31st December 2019, the Cash book balance will be less by Nu. 20,000.

Cheque paid into the bank but not yet cleared: When a Cheque is deposited into bank, it is debited in the cash book immediately. But the same is credited in the bank statement only when bank collects cash from the concerned bank. For example, the customer deposited a cheque of Nu.5,000 in to the bank on 28th December 2019 which is collected by bank on 5th January 2020. If the balance on 28th December 2019 is compared, the Cash book balance will be more by Nu.5,000.

Cheque deposited in bank but not endorsed by bank due to insufficient balance. Cheque received from the customer is deposited into the bank by business and entry is debited in the cash book. But at times, such cheque deposited in the bank is not endorsed or accepted (dishonoured) by bank for insufficient balance. Ultimately, cash book shows more balance compared to the Bank Statement.

C: Errors committed: In the process of recording the transactions it may be possible that Nu. 1,000 deposited into the bank can be recorded as Nu.10, 000 in the cash book. Similarly, the bank may also make mistake while recording the transactions in the Bank Statement. Sometimes, error occurs while recording the correct amount in the wrong side of cash book. For example, instead of debit in the cash book, if it is credited, then payment will be more than receipts. The issue of misappropriation of cash may not be easily detected by a mere preparation of bank reconciliation statement unless the statement is analysed and assessed thoroughly by the supervisors.

Procedure of Preparing of Bank Reconciliation Statement

The difference in the balance of Bank Statement and Cash Book is determined when each item in the Bank Statement and that in the Cash Book is compared with one another. In practice, these differences are identified by following the given procedure.

i. Trace each of the item or transaction in the bank statements to the cash book to identify every item appearing in the bank statement but not in the cash book;

ii. Trace each item in the cash book to the bank statements to identify every item appearing in the cash book but not in the bank statement. These items normally consist of bank deposits awaiting for clearance, and cheques drawn or issued but not yet presented to the bank for payment, etc.

Illustration 7

Study the extract of Bank Statement and Bank Column of Cash Book given here for determining the exact causes of this difference.

Extract of Bank Statement (Account No. 1232132)

Date	Particulars	Cheque No.	Debit	Credit	Balance
24.12.2017	By Deposit	233977		100,000	100,000
27.12.2017	To Withdrawal from ATM		20,000		80,000
28.12.2017	By Fund transfer			50,000	130,000
29.12.2017	To Withdrawal	120090	30,000		100,000
31.12.2017	By Bank Interest			1,500	101,500
31.12.2017	To Bank Charges		500		101,000

Cash Book (with bank column)

Receipt			Payment		
Date	Particulars	Amount (Bank)	Date	Particular	Amount (Bank)
24.12.2017	To Cash	100,000	27.12.2017	By Cash	20,000
28.12.2017	To cash	50,000	31.12.2017	By Bal c/d	130,000
		150,000			**150,000**

Looking at the above statements, it is clear that Bank Statement shows the balance of Nu.101,000 and Cash Book shows the balance of Nu.130,000 indicating a difference of Nu.29,000 more in Cash Book (Nu.130,000 – Nu.101,000). So when we compare the two statements, difference arises because of Nu.30,000 withdrawn on 29.12.2017 and Bank charges of Nu.500 that were not credited in the Cash book till 31.12.2017. Also an amount of Nu.1, 500 as bank interest was not debited in the Cash Book till 31.12.2017.

Learning Activity 7

Work in pairs and study the causes in the first column of the Table 7.3. State whether it would increase, decrease or would have no effect in the balance of Cash Book and Bank Statement. The first one is done for you.

Table 7.3. Fill in the missing information in respective column

Cause Differences	Cash Book Balance	Bank Statement Balance
A: Transactions recorded by the bank only		
Interest allowed by Bank	No effect	Increase
Interest and expenses charged by the Bank		
Interest and dividend collected by the bank		
Direct payments by the bank		
Direct payment into the bank by the Receivables		
Amount debited in Bank Statement but Cash not received from the ATM machine		
B: Transactions recorded by the Customer only		
Cheques issued but not yet presented for Payment		
Cheque paid into the bank but not yet cleared		
Cheque deposited in Bank but not endorsed by Bank for insufficient balance.		

Specimen of Bank Reconciliation Statement

When favourable balance as per cash book is given

Bank Reconciliation Statement

Prepared by:………………………… Date when prepared:…………………………..
Reviewed by: ………………………..Date of review: ………………………………

Date	Particulars	Details (Nu.)	Amount (Nu.)
	Balance as per cash book		xxx
	Add:		
	Cheques issued but not presented for payment	xxx	
	Interest allowed, dividend collected, etc. Direct	xxx	
	deposited by Receivables in the bank	xxx	**XXX**
	Less:		
	Cheque deposited into bank but not cleared	(xxx)	
	Cheques recorded but not banked	(xxx)	
	Bank charges and interest charged by bank	(xxx)	**(XXX)**
	Balance as per pass book (bank statement)		**XXX**

Illustration 8

HTL Enterprise manufactures furniture and sells them through its own retail outlets and other sales agents. The company maintains a bank account with Tashi Bank and does all cash transactions through this bank account. It is December 2019 and the Accountant Ms. Zangmo need to ensure that her cash and cash equivalent balances in her cash book and bank should be correctly reported in the financial statements. You are required to prepare bank reconciliation on her behalf and explain the status of the bank balance. She provides you with the following information.

Particulars	Amount (Nu.)
Bank balance as per cash book	38,000
Cheques issued but not debited in the bank statement	5,000
Cheques deposited but not collected	1,500
Direct payment by customers into bank account	16,000
Direct payments by bank:	
• Insurance premium	2,000
• Employee health club subscription	2,500
Bank charges not entered in cash book	1,200
Cheque deposited into bank but dishonoured	4,000

Solution

Bank Reconciliation Statement

Prepared by: Date: 31.12.2019
Reviewed by: ………………………………………….. Date……………

Date	Particulars	Details (Nu.)	Amount (Nu.)
31.12.2019	Balance as per cash book Add:		38,000
	Cheques issued but not debited Direct	5,000	
	payment by customer into bank	16,000	21,000
	Less:		
	Cheque deposited but not collected Direct	(1,500)	
	payment by bank:	(2,000)	
	Insurance premium Club Subscription Bank	(2,500)	
	Charges Cheques deposited but dishonoured	(1,200)	
	Balance as per Bank Statement	(4,000)	(11,200)
			47,800

When Favourable Balance as per Pass Book(bank statement) is given

Prepared by: ………………… Date when prepared: …………………………..
Reviewed by: ………………… Date of review: ……………………………..

Date	Particulars	Details (Nu.)	Amount (Nu.)
	Balance as per pass book (bank Statement)		xxx
	Add:		
	Cheque deposited into bank but not cleared Cheques	xxx	
	recorded but not banked	xxx	
	Bank charges and interest charged by bank	xxx	xxx
	Less:		
	Cheques issued but not presented for payment	(xxx)	
	Interest allowed, dividend collected, etc. Direct	(xxx)	
	deposited by Receivables in the bank Balance as per	(xxx)	(xxx)
	cash book		XXX

Illustration 9

On 31st December, 2019, bank statement of Karma dairy firm maintained with Bhutan National Bank showed credit balance of Nu. 15,650 whereas cash book showed debit balance of Nu. 15,200. The accounts executive knew that several cash transactions that took place at different timing had actually caused this differences. Further analysis of transactions and queries revealed the following.

- Cheques issued to suppliers Pema and Choki for Nu. 6,000 and Nu. 3,840 were not presented for payment.
- Bank debited Nu. 350 as their charge for bills collection.
- A customer directly deposited Nu. 8,160 into the bank account using mobile application (transaction code BNM23232).
- Cheques issued by customers Karma for Nu. 5,150 and Jamtsho Nu. 12,500 were collected by bank in the first week of January, 2020 although they were banked on 25th December 2019.
- Bank credited interest amount of Nu. 450.

You are requested to prepare the bank reconciliation statement of the company which would be reviewed by the accounts officer later.

Solution

Prepared by: Date when prepared: 31.12.2019 Reviewed by: ………………… Date of review: ………………………………		
Particulars	Details (Nu.)	Amount (Nu.)
Balance as per Bank Statement		15,650
Add:		
Bank Charges	350	
Cheques deposited but not yet collected:		
Karma	5,150	
Jamtsho	12,500	18,000
Less:		
Cheques issued but not presented for payment:		
Pema	(6,000)	
Choki	(3,840)	
Cheque directly deposited in the bank	(8,160)	
Interest credited by bank	(450)	(18,450)
Balance as per the cash book		**15,200**

Illustration 10 (alternative method)

You are given the bank account and the bank statement of 7/24 Convenient Stores for reconciliation.

Cash Book (Bank column)

Receipt			Payment		
Date	Particulars	Amount (Nu)	Date	Particulars	Amount (Nu)
1.12.19	Balance	5,420	1.12.19	Kumar stores	92
1.12.19	M/s Phub enterprise	3,650	2.12.19	Transportation	110
2.12.19	Cash a/c	3,200	5.12.19	TD wholesale	249
7.12.19	Prakash stores	1,200	15.12.19	Bhutan Telecom	75
8.12.19	Cash a/c	4,225	18.12.19	Printing	4190
15.12.19	8 Heaven shop	3,200	19.12.19	Electric bill	46
18.12.19	Gautam Pvt. co	900			
25.12.19	Pema confeso	1,400	28.12.19	Balance c/d	18,433
		23,195			**23,195**

Bank Statement

Date	Particulars	Debit	Credit	Balance
1.12.19	Balance			5,420
2.12.19	Deposit		3,200	8,620
8.12.19	Deposit	145	4,225	12,845
10.12.19	Insurance premium	32	3,650	12,700
11.12.19	M/s Phub enterprise	92		16,350
18.12.19	Bank charges	249		16,318
19.12.19	Kumar stores	75		16,226
21.12.19	TD wholesale			15,977
27.12.19	Bhutan Telecom			15,902

Cash Book (bank column) - updated cash book

Balance b/d	18,433	Insurance premium	145
		Bank charges	32
		Balance c/d	18,256
	18,433		18,433

Bank Reconciliation (date)

Particulars	Amount
Balance as per bank statement	15,902
Cheques yet to be presented	(4,346)
Cheques deposits not collected	6,700
Balance as per cash book	**18,256**

Illustration 11

The cash book of Karma Central School shows a favourable balance of 130,000 on 30th June, 2019. The school accountant checked through the cash book entries and finds that:

i. Cheque amounting to Nu. 5,000 entered in the cash book have not been presented for payment.

ii. Cash deposit of Nu.10,000 entered in the cash book has not been deposited yet.

iii. An amount of Nu. 7,600 has been wrongly credited to the account.

iv. The bank has credited and then debited the bank statement with Nu 10,000 due to insufficient balance in the customer's account.

v. Interest of Nu. 1,200 has been credited by the bank.

vi. A cheque received from a customer has been correctly entered by the bank as Nu. 8,500 which was entered in the cash book as Nu. 850.

You are requested to prepare the bank reconciliation statement after updating the cash book with any items which are recorded in bank statements but not entered in the cash book.

Solution

Cash Book (updated)

Balance b/f	130,000	Cash not yet deposited	10,000
Error in cashbook	7,650	Interest not entered in CB	1,200
		Dishonoured cheque	10,000
		Balance c/f	116,450
	137,650		**137,650**

Bank Reconciliation Statement

Actual balance at bank as per the new CB balance Add:	116,450
Cheques not presented for payment	5,000
Wrong credit	7,600
Balance shown by bank statement	129,050

Exercises:

1. **Short Answer Questions**
   a. How does maintaining cash book help business?
   b. 'Cash Book serves the purpose of both Journal and Ledger'. Justify.
   c. Distinguish between cash book and cash account.
   d. What are some of the reasons for maintaining Petty Cash Book by the business?
   e. Explain the imprest system of petty cash book.

2. **State True or False:**
   a. Double column cash book records both cash and credit transactions.
   b. Contra entry is the entry which is recorded only in one side of the cash book.
   c. Petty cash book covers both small incomes and expenditures.

3. Rabten Academy maintains a Double Column Cash Book. In the beginning of the month they had Nu.50,000 and Nu.500,000 as the cash and bank balances respectively. Following are transactions for the month of February, 2018.

Date	Transactions	Amount (Nu.)
1/2/18	Bought Office Equipment- Printer and Photocopier and paid by cheque	160,000
2/2/18	Purchased mess items and paid by cheque	300,000
3/2/18	Purchased Curtains for hostel use	40,000
5/2/18	Collected students' fee	8,000,000
7/2/18 ,,	Bought additional library books Paid for fueling school bus	250,000 6,000
10/2/18	Deposited cash in the bank	7,200,000
12/2/18	Placed order for one truck load of fire wood	15,000
15/2/18	Collected students' fee and deposited in the bank	12,000,000
17/2/18	Purchased mess items	370,000

20/2/18	Bought T.V. set and projector for conference room	100,000
21/2/18	Purchased additional plastics chairs for classrooms and paid by cheque	25,000
23/2/18	Withdrew cash from bank	700,000
25/2/18	Paid staff salary by cheque	725,000
26/2/18	Collected students' fee and deposited in the bank	11,000,000
27/2/18	Cash used by proprietor to visit Bangkok for personal purpose	200,000
27/2/18	Paid internet charges	6,000
28/2/18	Paid monthly electricity charges Nu.18,500 and telephone charges Nu.3,000 through internet banking	
28/2/18	Purchased mess items	400,000

You are required to prepare

a. Prepare a double column cash book.

b. Estimate the total amount of salary for the year, 2018, taking salary for the month of February as the base.

c. Collect some transactions involving cash and bank, incurred by your school and prepare Double Column Cash Book.

4. Sumitra, a retailer in Gelephu, deals in household appliances. She has a separate current account for business purposes. On 1st June, 2019, she had a balance of Nu.129,500 at hand and Nu.310,000 with the bank. Goods sold on this date amounted to Nu.120,000 which was deposited in the bank account. On 3rd June, she sold a refrigerator to Prakash for Nu.35,000. On 5th June she bought goods worth Nu.46,000 for cash and sold goods on credit to Deki for Nu.75,000. On the next day she bought a ceiling fan for Nu.4,500 by cheque for using in her shop. Cash purchases and cash sales made on 8th June were Nu.130,000 and Nu.120,000 respectively. The amount due from Prakash was received on 9th June after allowing a cash discount of 2%. The shop was closed from 11th June to 18th July as Sumitra had to go to Bhangtar, S/Jongkhar to visit her parents. On 19th June, she sold goods worth Nu.34,000 for cash and bought goods worth Nu.115,000 from Kuenga Enterprises. After two days she withdrew Nu.10,000 from ATM for business use. On 22nd June, she received the amount due from Deki, which was used for paying her children's' school fee. On the next day she paid the amount due to Kuenga Enterprises after availing a discount of Nu.500. She sold a micro oven on 23rd June to Kinley for Nu.11,000. On 25th June she issued cheque for paying electricity charges Nu.1,350 and shop rent Nu.18,000. Total sales made on 27th June amounted to Nu.86,000 including Nu.12,000 for credit sales.

On the next day Kinley directly deposited Nu.10,600 to Sumitra's bank account in final settlement of the amount due. On 30th June she deposited the cash Nu.50,000 into bank account.

Prepare a Double Column Cash Book in the books of Sumitra.

5. Subba Restaurant, Tashicholing had the following transactions incurred during the first fortnight of November, 2018.

Date	Particulars	Amount (Nu.)
1/11/17 ,,	Cash in hand Bank overdraft	20,000 30,000
2//11/17 ,,	Made purchases Sold to customer on cash	15,000 8,000
3/11/17 ,,	Cash sales Credit Sales to customers	7,000 5,000
4/11/17 ,,	Paid miscellaneous expenses Cash sales	2200 10,000
5/11/17 ,,	Made purchases Sales for the day	20,000 12,000
6/11/17 ,, ,,	Deposited into Bank Cater to schools for general staff meeting Cash collected from customers	15,000 6,000
7/11/17 ,,	Made purchases Cash sales of the day	10,000 7,250
8/11/17 ,,	Paid for mobile voucher Sales for the day	500 5,900
9/11/17 ,,	Paid sundry expenses Cash sales	1,780 6,250
10/11/17 ,,	Made purchases Sale for the day	7,200 4,560
11/11/17 ,,	Cash sales Wages paid for helpers and dishwashers for the day since more people have come to celebrate the 11th November in the Dungkhag.	15,000 1,250
12/11/17 ,,	Deposited in the bank Sales for the day	16,000 4,820
13/11/17 ,,	Made purchases Cash sales	8,100 3,500
14/11/17	Sale for the day	4,000

15/11/17 ,,	Lunch catered to Dungkhag for meeting Cash sales	2,500 2,200
16/11/17 ,,	Deposited into bank Sales for the day	7,500 3750

Based on the information you are required to prepare:

a. Prepare Double Column Cash Book for Subba Restaurant.

b. Represent the sales date-wise in a column graph.

6. Lhawang InfoTech, Thimphu supplies you the following transactions:
On 25th December, 2018 it had balance in hand Nu.2, 350. The imprest for the week is Nu.15,000.

Date	Expenses	Amount (Nu.)
26/12/18	Paid for stationeries	2,000
27/12/18	Paid travelling expenses for Technician	1,700
28/12/18	Refreshment served to customer	650
29/12/18	Paid carriage Paid telephone bill	700 1,300
30/12/18	Wages paid for unloading computers	1,100
31/12/18	Paid electricity charges Bought computer table from BPPL	850 3,800

Prepare the petty cash book to ascertain the cash balance to be presented to the head cashier.

7. From the following particulars of Karma Group of Industries, prepare Bank Reconciliation Statement as on 31.12.2019
   - Balance as per Cash Book Nu.65,000
   - Cheques deposited into Druk PNB but not credited till 31.12.2019 Nu.17,800
   - Cheques issued but not presented for payment Nu.25,000
   - Druk PNB credited Nu.10,000 for receiving dividend through Internet Banking
   - Bank charges debited by Druk PNB Nu.800

8. The Cash Book and Bank Statement of Reed Book Store are given below. Carefully observe the items in each of the Cash Book and Bank Statement and identify items which are not found in either of the Cash Book or Bank Statement and prepare Bank Reconciliation Statement.

Cash Book

Date	Particulars	Amount	Date	Particulars	Amount
1.1.2019	To balance b/d	55,000	4.1.2019	By Namgay Hotel	8,000
5.1.2019	To Kinley Store	10,000	16.1.2019	By Purna Exports (cheque)	20,000
8.1.2019	To Pelki Export	12,000			
15.1.2019 27.1.2019	To Bhutan Books To Nado enterprise (Cheque)	13,000 11,000	28.1.2019	By Laxmi Imports (cheque) By balance b/d	5,000 68,000
		101,000			**101,000**

Bank Statement for the Month of January 2019

Date	Particulars	Amount Withdrawn	Amount Deposited	Balance
1.1.2019	By balance b/d			55,000
5.1.2019	By Kinley Store		10,000	65,000
8.1.2019	To Namgay Hotel	8,000		57,000
10.1.2019	To Pelki Exports		12,000	69,000
17.1.2019	By BDBL interest		50,000	119,000
18.1.2019	By Bhutan Books		13000	132,000
27.1.2019	To Bank charges	2000		130,000

9. Cash book balance of Duptho Ltd. on 31st December, 2019 maintained with BNB Ltd. was Nu. 90,000. On comparing it with bank statement, following difference were identified:
   - Cheques sent for collection amounting to Nu. 9,500 have not been cleared by the bank.
   - Cheques issued but not presented for payment Nu 5,000. Bank charges Nu 500 not entered in the cash book.
   - There was a credit of Nu. 2,200 in the bank statement of interest which was not recorded in the cash book.

A customer deposited Nu 2,500 directly in the bank account. Duptho Ltd. gives the following standing orders:

- BPC electricity bill Nu. 1,500
- Office rent Nu. 3,000

You are required to prepare a bank reconciliation statement as on 31st December, 2019.
Briefly, explain why it is necessary to prepare bank reconciliation statement at the end of every month?

10. Pema Enterprise located in Gelephu maintains its Bank Account with Bhutan National Bank. It also keeps records in Cash Book. Every month, Pema Enterprise gets copy of Bank

Statement and reconciles Bank Statement with Cash Book. It received Bank Statement for the month of October and found some difficulties to prepare Bank Reconciliation Statement. You, as an accountant is instructed to prepare Bank Reconciliation Statement based on the information presented in the cashbook and bank statement.

Bank Statement –BNBL

Opening Balance on 1.10.2017: Nu.14, 680

Date	Particulars	Cheque No.	Debit	Credit	Balance
5.10.2017	To Rinzin	2822	6,040		8,640
11.10.2017	By Fund transfer			11,650	20,290
13.10.2017	By dividend			2,400	22,690
18.10.2017	To ABC Ltd	2824	13,020		9,670
20.10.2017	To Cash withdrawal		2,000		7,670
24.10.2017	By Deposit			6,000	13,670
27.10.2017	By Bhim			12,730	26,400
28.10.2017	To RRCO	2825	10,000		16,400
31.10.2017	To Bank charges		300		16,100
			31,360	**32,780**	

Cash Book

Date	Particulars	Amount (Bank)	Date	Particular	Amou nt (bank)
1.10.2017	To Bal b/d	14,680	3.10.2017	By Sangay	6,040
5.10.2017	To Fund T/F	11,650	7.10.2017	By ABC ltd.	13,020
15.10.2017	To Minjur	3,120	12.10.2017	By Purchase A/C	5,000
18.10.2017	To Sales	9,260	17.10.2017	By Norbu Bros.	8,080
24.10.2017	To Cash	6,000	20.10.2017	By Cash A/C	2,000
26.10.2017	To Bhim	12,730	25.10.2017	By Electricity charges	5,600
26.10.2017	To Interest	2,200	27.10.2017	By RRCO	10,000
			31.10.2017	By Balance c/d	9,900
		59,640			**59,640**

11. RRCO Thimphu instructed M/s Peljor Enterprise located in Babesa to prepare bank reconciliation statement and submit to complete tax filing process. The work was outsourced to Nima Financial Consultancy. Upon comparing the Cash Book and Bank Statement,

following facts were discovered:

i. On 1st January 2017, the balance in the cash book was Nu. 16,500 and balance in the Current Account maintained with T. Bank Ltd. was Nu. 22,860.

ii. Two cheques amounting to Nu.11,600 and Nu. 4,400 were issued to Lhamo Enterprise and Kelzang Enterprise on 15th January 2017 but former presented the cheque for payment before 31st January 2017.

iii. Two cheques were received from Dorji Tour and Treks worth of Nu. 8,200 and Nu 3,800 respectively and sent it for collection. An accountant lost one cheque worth Nu.3,800 and never informed the Proprietor.

iv. On 28th January 2017, a customer directly transferred Nu. 7,000 through internet Banking.

v. It was also found that no entry has been made in Cash Book for the rent of Nu.1,600 paid by Bank on the standing order.

vi. Bank Statement also showed a credit of Nu. 640 for interest and a debit of Nu. 280 for bank charge.

Imagine yourself as one of the accountants working in the Nima Financial Consultancy and prepare Bank Reconciliation Statement.

12. Karma Sonam, a BBA graduate was one entrepreneur who just hit the market when many graduates hung around the two commercial hubs of Bhutan looking for some gainful employment. Karma started a retail shop of assorted grocery items with all modern facilities. Karma took charge of himself and garnered sufficient courage to break the monotonous retail market in Phuntsholing and bring a new era of retail sales with cashpoints located within his cash counter to facilitate seamless transactions for his customers. Many customers simply enjoy shopping at Karma's shop because of free parking and a coffee to relax. As his business was growing rapidly, Karma recruited a lady accountant to maintain the records of transactions. At the end of the day, all cash receipts were deposited into Druk PNB. Since his business was expanding beyond Bhutan, Karma often has to move to neighboring states of India for business trip. However, on one occasion he went to the bank to check the details of his account. Surprisingly, he found the monthly credit balance was less compared to the earlier months. So immediately, he went back to check his Cash Book and Sales Day Book and located the following discrepancies:

i. Out of the total cash of Nu. 350,000, only Nu.120, 000 was deposited.

ii. There were total sales of Nu. 150,000, of which credit sales was Nu.20, 000 and for the balance amount Cheque worth of only Nu.90, 000 was deposited in the account.

iii. In Cash memo book, he found cash memo of Nu.5,000 was issued but the same was not recorded in the cash book.

Karma questioned integrity of his accountant and felt the need of someone to help him what is going on with his cash transactions. You are requested to:

a. advise Karma on this matter by performing a bank reconciliation.
b. calculate the actual amount of cash not deposited in the bank.
c. describe your moral ethics to be an accountant.

13. Fill in the blanks with a suitable word/words:
   i. The cheques deposited are entered on the ....of the bank column of Cash Book.
   ii. Bank Reconciliation Statement is prepared to reconcile the balance shown by the....................... and the.................................
   iii. Favourable balance means....................... balance in Cash Book.
   iv. When a customer directly pays into bank, the entry is...................... in Bank Statement.
   v. The Bank Statement is sent by.................. to the.......................

14. State whether the following statements are true or false and give reasons.
   i. A Bank Reconciliation Statement is a part of the Double Entry system.
   ii. Bank Reconciliation Statement is prepared at any particular date of the year.
   iii. Cash book is similar to Bank Statement in context of recording the entry.
   iv. The purpose of preparing bank reconciliation statement is to curb fraudulent activities done by the banker.
   v. ATM card is not always required to withdraw money from the bank.
   vi. The necessity of installing CCTV in ATM compartment is to find out that a person does not withdraw money more than his deposits in the account.
   vii. Favourable balance as per cash book means having sufficient balance in the bank statement.
   viii. Electricity bill paid is debited in bank statement
   ix. It is the duty of the bank to collect interest and dividend on behalf of its customers.
   x. Bank charges are charges allowed by bank to their customer.

15. Answer the following questions
   i. Explain the meaning of Bank Statement.
   ii. Discuss the importance of preparing a Bank Reconciliation Statement.
   iii. Explain how does preparation of a Bank Reconciliation Statement help to curtail embezzlement and fraudulent practices?

Chapter 5
Accounting for Property Plant and Equipment

Learning objectives:

- Explain the meaning and recognition criteria of Property, Plant and Equipment (PP&E)
- Discuss the meaning and causes of depreciation
- Describe the methods of deprecation with focus on straight line and written down value methods
- Calculate the amount of depreciation by preparing asset account and depreciation schedule

5.1 Concept of Property, Plant and Equipment (PP&E)

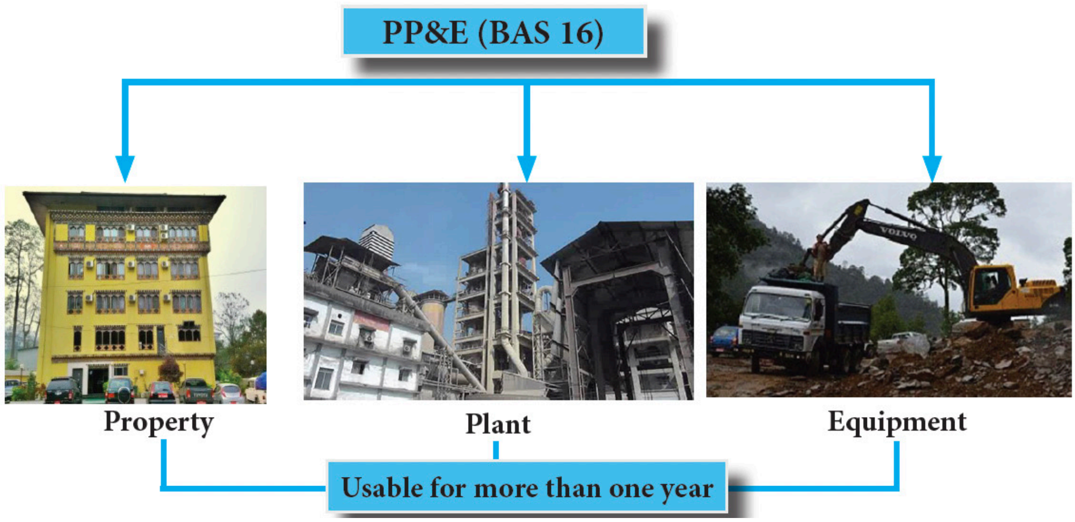


Figure 8.1 *Concept of PP&E*

In reality, there is no organization functioning without the physical resources such as property, plant and equipment (PP&E). In business organizations, on an average, 60 percent of the total assets is made up of property, plant and equipment with exceptions of service business. Therefore, it is important to account properly the property, plant and equipment so that the statement of financial position presents true and fair view of the business' financial condition. This also means that the information users will be able to assess true worth of the business at any point of time. The incorrect accounting of property, plant and equipment also affects the profit figure of business due to depreciation expenses. Property, plant and equipment as an asset generate cash flows and income for the business. For example, buses used by the transportation service companies generate cash flows and thus contribute to earning income for the business.

Definition

Property, plant and equipment, otherwise called fixed assets is defined as tangible items that:

a. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

b. are expected to be used during more than one period.

Recognition of property, plant and equipment

The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

a. it is probable that future economic benefits associated with the item will flow to the entity; and

b. the cost of the item can be measured reliably.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft.

The cost of an item of property, plant and equipment consist of the followings:

- Purchase price, including import duties and non-refundable purchases taxes, after deducting trade discount and rebate.
- Any costs directly attributable to bringing the asset to the location and condition.
- The initial estimate of the costs of dismantling and removing the item and restoring the site on which is located.
- Finance cost such as interest on construction loans.

Directly attributable costs are

- costs of employee benefits;
- costs of site preparation;
- initial delivery and handling cost;
- installation and assembly cost.

Land, buildings, machines, vehicles, aircraft, computer, furniture and fixtures, office equipment etc are the common items which fall under the property, plant and equipment.

All direct costs which are incurred on the acquisition of an item of property, plant and equipment are also called capital expenditures. On the other hand, expenditures whose benefits expire within the accounting period are called revenue expenditures.

The general rule is that capital expenditures are capitalized and form part of the cost of property, plant and equipment whereas the revenue expenditures are expensed in the income statement.

5.2 Finance cost

Finance cost is the borrowing cost normally the interests and other costs that an entity incurs in connection with the borrowing of funds.
An entity is allowed to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.
A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

For example, if a company obtains a construction loan of Nu. 3,000,000 to construct a building for a period of 3 years. Assuming construction of a building lasted 2 years and an interest expense of Nu. 900,000 was paid for 3 years. The borrowing costs (finance costs) for 2 years during the construction period will be capitalized and form part of construction cost or the cost of a building. Other 1 year borrowing costs are expensed. Assets that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets. The effective interest rate is used and not the simple or other interest calculation of bank.

[The calculation of effective interest rate is not required for this syllabus].
Property, plant and equipment-building a/c Dr 600,000
To cash/bank Cr 600,000
(Being 2 years borrowing costs capitalized)

Finance costs a/c Dr 300,000
To cash/bank 300,000
(Being borrowing costs of 1 year expensed)

5.3 Measurement of property, plant and equipment

All items of PP&E are initially measured at historical cost, i.e. the cost paid when the item of property, plant and equipment was acquired. The current accounting standards (BAS16) allow revaluation method in the subsequent years. By cost it meant not only the purchase price but also all costs directly related to acquisition of the item of PP&E, until the point of time when the asset is ready for use.

Illustration 1
A company purchases a land that is to be used for the construction of a building for the company office. There is an old building on the land that will need to be demolished. The following costs were incurred related to the purchase of the land.

- Purchase price Nu. 900,000
- Legal fees Nu. 15,000
- Transfer prices Nu. 10,000
- Costs of demolition of old building Nu. 8,000
- Costs of clearing, grading and filling Nu. 20,000
- Assumption of unpaid property taxes Nu.5, 000
- Proceeds from the sale of materials salvaged from the old building Nu. 11,000

Required:
Calculate the acquisition cost of the land at which it will be recognized in the books of the company. Provide journal entry to record the transaction.

Solution:

Purchase price	Nu. 900,000
Legal fees	Nu. 15,000
Transfer prices	Nu. 10,000
Costs of demolition of old building	Nu. 8,000
Costs of clearing, grading and filling	Nu. 20,000
Assumption of unpaid property taxes	Nu.5, 000
Proceeds from the sale of materials salvaged from the old building	(Nu. 11,000)
Total cost of Land	Nu. 947,000

Property, plant and equipment	Dr	947,000	
To Cash/Bank/Common stock			947,000

(Being the purchase of land)

Illustration 2

A construction company purchased an excavating machine and incurred the following expenses:

- invoice price Nu. 1,000,000
- transportation cost Nu. 12,000
- installation costs Nu. 9,000
- repair cost prior to use Nu.35, 000
- import duties Nu. 15,000

The vendor offered 5% cash discount on invoice price for 30 days credit term. The company also paid 10% sales tax.

Required:
Calculate the cost of acquisition of the item of property, plant and equipment which must be recognized in the company's accounting system.

Solution:

Invoice price	Nu. 1,000,000
5% cash discount	(Nu. 50,000)
Net invoice price	Nu. 950,000
10% sales tax	Nu.95, 000
Transportation cost	Nu. 12,000
Import duties	Nu. 15,000
Repair cost prior to use	Nu.35, 000
Installation costs	Nu. 9,000
	Nu. 1,116,000

Property, plant and equipment Dr 1,116,000
To cash/bank/accounts payable 1,116,000
(Being the purchase of excavating machine)

Illustration 3

On 1 January 2019, Menjong manufacturing company began the construction of a new factory. Costs relating to the factory construction, incurred in the year ending 31 December 2019, are as follows:

- Purchase of the land Nu. 1,000,000
- Costs of dismantling existing structures on the site Nu. 50,000
- Purchase of materials to construct the factory Nu. 160,000
- Employment costs Nu. 18,000 (Total cost in 12 months was Nu. 24,000)
- Production overheads directly related to the construction Nu. 12,000
- General administrative overheads Nu. 6,000
- Architects' and consultants' fees directly related to the construction Nu. 4,000
- Costs relating to the formal opening of the factory Nu. 2,000
- Interest on loan to partly finance the construction of the factory Nu. 12,000 (Nu. 16,000 per annum interest was incurred).

Required:

Compute the initial carrying value or historical cost of the factory which need to be recorded in the books of account of the company.

Solution:

Purchase of the land	Nu.1,000,000
Costs of dismantling existing structures on the site	Nu.50,000
Purchase of materials to construct the factory	Nu. 160,000
Employment costs	Nu. 18,000
Production overheads directly related to the construction	Nu. 12,000

Architects' and consultants' fees directly related to the Construction	Nu. 4,000
Costs relating to the formal opening of the factory	Nu. 2,000
Interest on loan to partly finance the construction of the factory	Nu. 12,000
	Nu. 1,258,000

Property, plant and equipment	Dr	1,258,000	
To cash/bank/accounts payable			1,258,000
(Being the cost of factory construction)			

5.4 Depreciation- Definition and Meaning

All items of property, plant and equipment are subject to depreciation. This means that the value of PP&E gradually decreases over its estimated useful life.

> *Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.*
> *Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.*

There are several factors that cause reduction in the useful life of property, plant and equipment and depreciation of asset. These factors include:

- the daily usage of item of property, plant and equipment (this represents the consumption of asset's economic benefits) causing wear and tear in the asset,
- obsolescence of the asset, where the use of asset is no longer economical due to lack of demand for product or service, and
- legal restrictions such as expiry of right to use the asset.

5.4.1 Factors involved in calculating depreciation expense

Cost of an asset - Refer definition of cost discussed under recognition of PP&E.
Residual or salvage value - The residual or salvage value of an asset is the probable amount that business entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal.
Useful life of an asset: The useful life of the asset is defined as:

- the period over which an asset is used by entity or
- the number of production or similar units expected to be obtained from the asset by an entity.

The useful life and residual value of a depreciable asset are estimated based on the pattern of usage of the asset. These estimates should be reviewed at the end of each reporting period.

If either changes significantly, then that change should be accounted for over the remaining estimated useful economic life.

Depreciable amount= (Cost of asset-Residual value or salvage value)

$$\text{Depreciation expense for the period} = \frac{\text{Depreciable amount}}{\text{Useful life of asset}}$$

5.4.2 Recognition of depreciation

Depreciation is recognized as an expense in the income statement. Depreciation is recognised even if the fair value of the asset exceeds its carrying amount (if the entity adopts revaluation model), as long as the asset's residual value does not exceed its carrying amount.

Important features of Depreciation

1. Depreciation is decrease in the book value of PP&E.
2. It decreases the book value (BV) of the asset but NOT its market value.
3. The reduction in the BV of an asset is permanent, gradual and continuous.
4. It is expense like any other expenses in the financial statements.
5. It is a process of allocation of cost of asset over the period of its useful life.

5.4.3 Need for Providing Depreciation

a. **To ascertain the correct income statement-matching concept**

   Depreciation is an expense incurred for business entity for using the property, plant and equipment and therefore, it is considered as charge or expense against income. If an expense is omitted, the profit for the period is overstated.

b. **To show a true and fair view of financial position**

   If depreciation is not charged, the asset value declared in the financial statement would give higher value.

c. **To show the asset at its proper value**

   When depreciation is charged against the asset in the financial statement, it gives business the actual value of asset for the particular period although this may not be correct at all the time since the carrying amount of the asset need not necessarily be same as the market value of the asset.

d. **To retain, out of profits, funds for replacement**

Imagine a situation where no depreciation is charged on property, plant and equipment. In that case, profit earned in the business would have been distributed to the owners and no fund is retained to replace the asset after its useful life. Through depreciation an amount equal to accumulated depreciation expenses over the useful life of the asset is retained in the business that would enable the business to replace the asset.

e. **Compliance with legal provisions**

Depreciation should be charged in order to accord with the Companies Act and the Income Tax Act.

5.4.4 Methods of Allocating Depreciation

A number of methods can be used to allocate depreciation to specific accounting periods. Two of the more common methods are:

a. **Straight Line Method (SLM)**

This method assumes that the asset will contribute to the earning of revenues equally each time period. Therefore, equal amounts of depreciation are charged during each year of the asset's useful life.

$$\text{Depreciation expense for each year} = \frac{\text{Acquisition cost - Estimated residual value}}{\text{Estimated useful life of asset}}$$

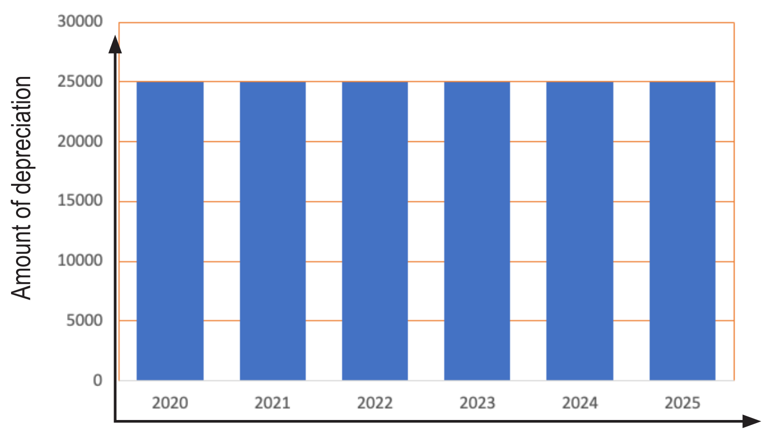


Figure 5.1 *Straight line graph*

Illustration 4

ABC limited company purchased a plant and machinery costing Nu. 120,000 on 1.1.2019 and incurs additional costs of Nu. 20,000 on account of import duties and installation charges. All PPE items are measured at historical cost. Company uses straight line method to allocate depreciation. The expected residual value after 5 years is Nu. 10,000.

Required:

Calculate the amount of depreciation expense to be charged for each year accounting period.

Solution:

Acquisition cost of plant and machinery

Purchase price	= Nu. 120,000
Add: Import duties and installation	= Nu. 20,000
	= Nu.140,000

Useful life of asset = 5 years

Scrap value after 5 years =Nu. 10,000

Depreciable amount = 140,000- 10,000 = 130,000

Annual depreciation expense = 130,000/(5 years) = Nu. 26,000

b. Written Down Value Method (WDV)

This method assumes that the consumption of asset's economic benefits is higher in the beginning of the useful life of asset. As such, depreciation is allocated higher in the beginning of the estimated useful life of asset. A fixed rate of depreciation is charged annually on the diminishing balance of asset. The amount of depreciation gradually decreases over the years with decrease in value of asset.

Rate of depreciation can be calculated on the basis of cost, residual value and useful life of the asset using the following formula.

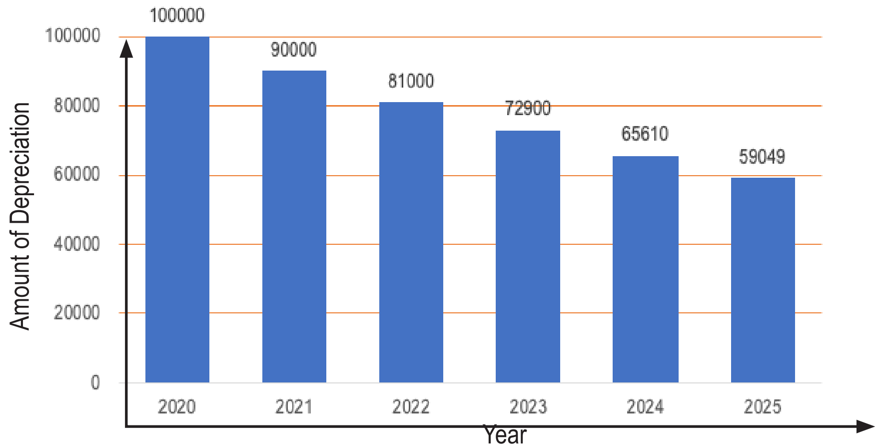


Figure 5.2 *Written down value graph*

5.5 Carrying Amount

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses. It is also called Book Value (BV) of asset.

Carrying amount = Cost of asset – (Accumulated Depreciation + impairment losses, if any)

Illustration 5

On 1.1.2019, a dairy farming company purchased a plant and machinery costing Nu. 120,000. It incurs additional costs of Nu. 25,000 on account of import duties and installation charges. All items of property, plant and equipment are initially measured at cost. Company uses written down value method of depreciation. The expected residual value after 5 years is Nu. 10,000.

Required:

Calculate the carrying amount of plant and machinery for the next 3 years.

Solution

Year	Opening balance	Depreciation rate	Depreciation expense for the year (Nu.)	Carrying amount (Book value)(Nu.)
1	145,000	41%	59,450	85,550
2	85,550	41%	35,076	50,474
3	50,474	41%	20,695	29,780

5.6 Methods of recording depreciation expense

There are two approaches of maintaining property, plant and equipment and recording depreciation expense i.e.

a. **When depreciation is charged to the Asset Account**

In this method, depreciation is directly charged against the asset account resulting in the decrease of asset value. The item of property, plant and equipment is reported in the financial statements at cost less depreciation expense for the year.

Depreciation expense a/c Dr
    To Property, plant and equipment Cr

Income statement Dr
    To Depreciation expense Cr

Carrying amount of asset = Cost of asset – Depreciation expense

b. When accumulated depreciation account is maintained

In this method, yearly depreciation expense is charged to an accumulated depreciation account which is a contra asset account. When an accumulated depreciation account is used, property, plant and equipment is reported in the statement of financial position at its cost. This allows users of financial statements assess the original cost of the asset. The asset's carrying amount is calculated by deducting accumulated depreciation from the cost of the asset.

Depreciation expense Dr
    To accumulated depreciation Cr

Income statement Dr
    To Depreciation expense Cr

Accumulated depreciation Dr [on disposal of asset]
    To property, plant and equipment Cr

5.7 Change in Useful Life and Residual Value of Asset

It can happen that after the initial estimates of useful life and residual value of asset, for variety of reasons, these estimates may change. For example, major repair and maintenance work on a building can increase its estimated useful life. In that cases, depreciation expense is recalculated from the date of the change in the accounting estimate and applied with prospective effect. No change is made to depreciation expense already recorded.

$$\text{New depreciation expense} = \frac{\text{Remaining carrying amount - Revised residual value}}{\text{Remaining useful life of asset}}$$

Illustration 5

A company on 1 January 2019 acquired an item of property, plant and equipment worth Nu. 220,000. Following the past trend, company management estimated five years useful life of the asset. It was also estimated that the asset on its disposal after its useful life would fetch a residual value of Nu. 20,000. All property, plant and equipment at the company are depreciated on a straight line basis.

On 31 December 2019 company management reviewed useful life of the asset to three years, with an estimated residual value of Nu. 12,000.

Required:

Calculate the amount of depreciation expense for 2020, 2021 and 2022.

Solution

Plant's original Cost = Nu. 220,000

Depreciation for 2019 = Nu. 40,000 (Nu. 220,000 – Nu. 20,000 = 200,000/5)

Carrying amount of the asset = **Nu. 180,000**

Given the reassessment of the useful life and RV, the depreciable amount at the end of 2019 is Nu.168,000 (Nu. 180,000 – Nu.12, 000) over three years.

Depreciation charges in 2020, 2021 and 2022 = Nu. 56,000 (Nu.168,000/3) unless there are future changes in estimates.

5.8 Revaluation of Property, Plant and Equipment

As discussed under section 8.3, after the initial recognition of an asset, the accounting standards allow business entities to measure the asset either by using the cost model or the revaluation model from the subsequent years. The following section, presents the method of revaluation accounting for PP&E.

a. Cost model

After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

b. Revaluation model

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount of the asset does not differ materially from the fair value at the end of the reporting period.

In business entities, some items of property, plant and equipment experience volatility with significant change in fair value (e.g. investment in securities such as shares and bonds), thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued. A class of PP&E is a grouping of assets of a similar nature and use in an entity's operations. For example, buildings, furniture and fixtures, machinery, motor vehicles, office equipment are separate classes of PP&E. Therefore, when revaluation accounting is applied on machinery, all similar machinery within that class must be revalued.

Revaluation gains are recognised in equity unless they reverse revaluation losses on the same asset that were previously recognised in the income statement.

Property, plant and equipment Dr
To Revaluation surplus Cr

Illustration 6

On 1 January 2013, a soft drinks company acquired a building costing Nu. 600,000. The company estimated a useful life of 30 years. Accumulated depreciation of this building amounted to Nu. 100,000 as of 31-12-2017. Company followed straight-line depreciation method to allocate cost over its useful life. Because of the volatile property market, company decided to apply revaluation model to account all land and buildings from the beginning of 2018. On 1.1.2018, building was revalued at Nu. 550,000. What would be accounting treatment if the same building is revalued at Nu. 450,000.

Required

Explain how the company would treat this revaluation in its financial statements as of 31-12-2018.

Solution

Calculating revaluation surplus

Carrying amount of building before revaluation = Nu. 600,000 – Nu. 100,000 = Nu. 500,000

1.1.2018 Fair value of building =Nu. 550,000

Revaluation surplus = Nu. 50,000

Journal entry

Property, plant and equipment Dr 50,000
To revaluation surplus Cr 50,000 (equity)

Depreciation on revalued carrying amount:

Revalued carrying amount as on 1.1.2018 = Nu. 550,000

Remaining useful life of asset = Nu. 25 years

Depreciation expense for remaining each year = Nu. 22,000 (550,000/25)

31.12.2018

Depreciation expense Dr 22,000
To accumulated depreciation Cr 22,000

If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. Thus, in the above illustration, if the fair value of the buildings is calculated as 450,000 on 1.1.2018, the amount

Statement of Income A/c Dr 50,000
To property, plant and equipment 50,000

5.9 Subsequent Expenditures After Acquisition

An item of property, plant and equipment, once acquired and put to use, must be maintained properly throughout their useful life. This entails other costs which were not included in the acquisition costs. These subsequent costs by and large go in the form of repair and maintenance costs of the item of property, plant and equipment. Generally these ongoing expenditures like repairs and maintenance to maintain asset in operating conditions are accumulated and expensed. However, in practice, this single rule of thumb may not be appropriate as some of these costs may result in increase of the estimated useful life of asset or improve performance of asset. In that situation, the nature of expenditure is more of capital than revenue, the expenditures must be capitalised. Thus, an expenditure that increases the future economic benefits of the asset by decreasing the operating cost, increasing productivity, improving its safety, reducing pollution and prolonging its useful life must be treated as capital expenditure and so form part of the cost of the asset.

Figure 5.3 *Example of subsequent cost*

Illustration 7

DHL Company has a delivery truck costing Nu. 1,600,000 with a 5 years useful life and Nu. 200,000 salvage value. At the start of the third year the company undertakes a major overhaul costing Nu. 250,000. Company depreciated the truck using SLM method during the first 2 years. The overhauling is expected to increase the life of the asset from 5 to 6 years.

Required:

Prepare a revised depreciation schedule after overhauling the truck.

Solution

Year	Opening balance	Depreciation expense	Carrying amount (Closing balance)
1	1,600,000	280,000	1,320,000
2	1,320,000	280,000	1,040,000
3	1,290,000	272,500	1,017,500
4	1,017,500	272,500	745,000

5	745,000	272,500	472,500
6	473,000	272,500	200,000

Year 3

Property Plant and Equipment Account Dr. 250,000 (overhauling cost)
To Cash Account 250,000

Depreciation Expense Account Dr. 272,500
To Accumulated deprecation Account 272,500

Depreciation Schedule

Depreciation Expense	Accumulated Depreciation	Book Value
280,000	280,000	1,320,000
280,000	560,000	1,040,000
272,500	832,500	1,017,500
272,500	1,105,000	745,000
272,500	1,377,500	472,500
272,500	1,650,000	200,000

5.10 Impairment of Property, Plant and Equipment (BAS36)

Entities must ensure that carrying amount of their property, plant and equipment should not exceed the recoverable amount.
The recoverable amount of property, plant and equipment asset is the value higher than its fair value less costs of disposal and its value in use.
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
Value in use is the present value of the future cash flows expected to be derived from an item of property, plant and equipment.

Recoverable amount = Higher of (FV-disposal cost) and Value in use

$$Value\ in\ use\ (PV) = \frac{C_1}{(1+r)^N};\ \text{where,}$$

C_1 - represents series of cash flows generated by asset in future
r - represents discount rate (usually entity's own weighted average cost of capital or entity's borrowing rate or other market borrowing rates)
N - represents number of years

An item of PP& E is said to be impaired, if carrying amount of the item exceeds recoverable amount.

The entity should assess at each reporting date whether there is any indication that an item of property, plant and equipment may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. Impairment losses are recognized not only for property, plant and equipment but also for other assets such as intangible assets, investment property (measured at cost), investment in subsidiaries and goodwill.

There are several factors that can cause impairment of asset, and thus it becomes important for management to obtain such information that sufficiently indicate impairment of its asset. These information is classified either as external or internal sources.

a. **External sources:**

iv. Decline in the market value of asset

v. Changes in technology and the entity has been negatively affected by such changes

vi. Changes in government policies and laws such as restriction on import of assets

vii. The decrease in entity's stock price below book value (the carrying amount of the net assets of the entity is more than its market capitalization).

b. **Internal sources:**

i. Evidence is available of obsolescence or physical damage of an asset.

ii. Asset is part of a restructuring or held for disposal or becoming idle

iii. Deterioration in the economic performance of asset

Calculation of value in use

The calculation of value in use should at minimum consider the following.

i. an estimate of the future cash flows the entity expects to derive from the asset;

ii. expectations about possible variations in the amount or timing of those future cash flows and

iii. the time value of money, represented by the current market risk-free rate of interest.

Time value of money

Nu. 1,000 received today is worth more than the same sum received in the future. This is called time value of money. But what is that makes Nu. 1,000 received today is more than the same

amount received in the future? The explanation is found in the concept of interest or return we get if this amount is invested at some borrowing rate.
Value in use of an asset is calculated as the present value of the future cash flows expected to be derived from the asset. This can be calculated by using the following formula.

$$PV = \frac{FV}{(1+r)^N}$$ (In case of single sum of money)

Illustration 8

An entity needs Nu. 5 million to finance its new investment project after 5 years of time. How much does it require to save today if the commercial borrowing rate is 8% p.a.?

Solution

PV= FV/(1+r) ^{5}
PV: Present value (amount you need to save today)
FV: Future value (Nu. 5 million)
r: Interest rate (as a decimal) - Convert 8% p.a. to decimal: 8% / 100% = 0.08
n: Number of time periods (years) - 5 years

= 5,000,000/1.469 or 5,000,000 * 0.681(PV table)
= Nu.3, 405,000
It is much easier and convenient to use present value table or discount factor table rather than a calculator. For example, 8% discount rate for 5 years, the corresponding discount factor is 0.681. Multiply the discount factor with the future value to get the present value. If a series of same or different amount of cash flows over a period of time is given, use the following formula to calculate present value.

$$PV = \frac{C1}{(1+r)^n}$$

Note: Students will be provided with the same present value table in the examination if there is a question which requires students to calculate present value. In the present value table, there is discount rates given on the top row and the number of years on the first column.

Illustration 9

An entity purchases an item of property, plant and equipment at Nu. 400,000 and estimates cash flows over its useful as follows.

Year 1	Year 2	Year 3	Year 4	Year 5
Nu. 80,000	Nu. 90,000	Nu. 100,000	Nu 60,000	Nu. 55,000

If cost of capital of the entity is 9%, calculate the present value of the future cash flows of the asset.

Solution

Year	Cash Flow	Discount Factor (9%)	Present Value
0	(400,000)	1.000	(400,000)
1	80,000	0.917	73,360
2	90,000	0.842	75,780
3	100,000	0.772	77,200
4	60,000	0.706	42,360
5	55,000	0.650	35,750
	385,000		304,450

Illustration 10

TT & Associates run a consultancy firm in the capital city. They have a building which cost Nu.1.5 million. On 1 January 2019 the accumulated depreciation showed Nu 550,000. The property market was constantly heading low for the last couple of years. TT & Associates accounted their asset on straight line method depreciation and the building's remaining useful life was estimated as 25 years. On 31 December 2020 at the reporting date, fair value of the building was found at Nu. 810,000 and its value in use was calculated at Nu. 905,000.

Required:

Determine the recoverable amount of the asset and impairment loss to be recognized in the income statement for 2020. Also calculate the carrying amount of the building as on 1 January 2021.

Solution

The carrying amount as on 1 January 2019 = Nu. 950,000

Fair value on the date = Nu. 810,000

Value in use = Nu. 905,000

Recoverable amount = Higher of FV and VIU = Nu.905, 000 (810,000 < 905,000)

Carrying amount of asset exceeds its recoverable amount. Therefore, impairment loss of Nu. 45,000 must be recognized in the income statement of year 2020.

Income statement (impairment loss) Dr 45,000

To PP&E (buildings) 45,000

Depreciation Dr 38,000 [calculated on the carrying amount as on 1.1.20]

To Accumulated depreciation 38,000

The carrying amount of building as on 31 December 2020 is Nu. 905,000.

5.11. Disposal and De Recognition of Property, Plant and Equipment

The business entity may dispose of its old items of property, plant and equipment due to obsolescence, discontinuation of production, legal restriction and other reasons. On disposal, the asset may fetch some value which is called disposal value. When the item of property, plant and equipment is disposed off, that item needs to be derecognised and removed from asset register. An item of property, plant and equipment should be derecognised when no future economic benefits are expected from the asset, i.e. when it is effectively scrapped.

Any gain realised on disposal of an item of property, plant and equipment must be included in Income statement as income from 'other sources'.

Gain or Loss on disposal of PPE = Net disposal proceeds - Carrying amount of asset

Illustration 11

A manufacturing company disposed one of its old plants on 1 July 2019 to replace with a new plant with enhanced quality control system. The accounting system revealed the following information:

- Acquisition cost when initially recognised Nu.1, 200, 000
- Accumulated depreciation up to 1 July 2019 Nu. 400,000
- The plant was purchased by another company paying Nu. 925,000 on 3 months credit term.

Required:

Calculate the amount of gain or loss on disposal of plant and pass journal entries to record the transactions.

Solution

<u>Calculation of gain or loss on disposal of plant</u>

Initial cost	Nu. 1,200,000	
Accumulated depreciation up to date		Nu. 400,000
Carrying amount on 1.7.2017		Nu. 800,000
Disposal value		Nu. 925,000
Gain on disposal of plant		**Nu. 125,000**

Journal entries

Accumulated depreciation	Dr	400,000	
To property, plant and equipment	Cr		400,000
Accounts receivables	Dr	925,000	
To property, plant and equipment	Cr		800,000
To gain on disposal of PPE item	Cr		125,000 (I/S)

Note:

If the asset is bought in between the year, the depreciation is charged for the part of the year for which the asset is used. Correspondingly, if an asset is sold within the financial year, depreciation is charged up to the part of the year it has remained in use, i.e., up to date of sale.

Useful life of asset can also be expressed in terms of percentage. For example, if the life of an asset is 10 years, this means the depreciation of asset is 10 % of cost every year. Say the cost of an asset is Nu. 100,000 the depreciation will be Nu. 10,000 p.a. Suppose in the above case, if the asset is purchased on 1 July and the accounts are closed on 31 December, 2020. Then the depreciation will be charged for six months and not for the full year. Depreciation on asset for the year will be Nu.5000 i.e., Nu. 100000x10/100 x 6/12.

Exercises:

1. On 1 January 2019, Gaduen Academy began the construction of a new school. Costs relating to the factory construction, incurred in the year ending 31 December 2019, are as follows:
   - Purchase of the land Nu. 7,000,000
   - Costs of dismantling existing structures on the site Nu. 500000
   - Purchase of materials to construct the Nu. 16,00,000
   - Employment costs Nu. 160000 (Total cost in 12 months was Nu. 240000)
   - Production overheads directly related to the construction Nu. 12,0000
   - General administrative overheads Nu. 65000
   - Architects' and consultants' fees directly related to the construction Nu. 10000
   - Costs relating to the formal opening of the factory Nu. 5000
   - Interest on loan to partly finance the construction of the factory Nu. 24000 (Nu. 28,000 per annum interest was incurred).

Required:

Compute the initial carrying value or historical cost of the factory which need to be recorded in the books of account of the company.

2. NDK Company has acquired a new equipment and is unclear about how to calculate on the cost associated with the acquisition. If you are a private accounting consultancy, what are some of the advises would you give to NDK Company on the cost recognition as per BAS-16.

3. Happiness Engineering Private Company Ltd. purchased a plant and machinery costing Nu.

8, 00,000 on 1.1.2019 and incurs extra costs of Nu.75, 000 on import duties and installation charges. All PPE are initially measured at cost and Company uses straight-line method. The expected residual value after 5 years is Nu. 10,000. Calculate the amount of depreciation of plant and machinery for each year for the next 3 years.

4. Bayul Construction Company procured a building on 31st July,2010 for Nu. 100 Million. The building was depreciated at the rate of 5% per annum. On 31st October, 2019. Bayul Construction vacated the building and let it to a third party tenant. At that date, an independent valuer assessed the value of the building to be at Nu. 150 Million. As the year ended on 31st December, 2019, the building was reexamined at Nu. 170 Million with no change in estimated remaining useful life. Bayul construction has adopted fair value model for its investing properties.

Required

Analyse and evaluate for the revaluation reserve on building that will be credited to Bayul construction for the year ending 31st December,2019.

Comprehensive question for practice

5. Construction Development Corporation Limited (CDCL) is the first Bhutanese company to be engaged in the construction of hydro power projects. As of now, the company is involved in executing exploratory tunneling works at Gomdar, Martshala and Thrimshing. The company also proposes to engage in HRT works for Kholongchu Hydroelectric project and many other similar civil works. In 2009 immediately after its incorporation as a separate entity, CDCL started construction of office buildings on the company land. The company management took a construction loan of Nu. 4.5 million from Bank of Bhutan @ 11 % for 5 years. On 31 December 2013, the construction site engineer and the project management submitted the completion certificate and the financial Bills as follows:
   - Materials Nu. 155.5 million
   - Labour cost Nu. 15.5 million (which include 10% cost incurred on general administration staff)
   - Ground clearance and labelling Nu. 0.750 Million Drawings Nu.1.2 million
   - Site engineer and supervision fees Nu. 3.15 million

The building was put to use a month after receiving a completion certificate and the company followed a straight line deprecation method to allocate the cost of the building over its useful life. The UL of the building was estimated as 50 years. The management adopted revaluation model as appropriate method of accounting.

- In 2016 July, CDCL purchased a plant and machinery. The costs associated with the purchase and installation of the plant and machinery were provided as follows:

- Purchase price Nu. 15.00 million
- Import duties Nu. 0.2 million
- Transportation Nu. 0.03 million
- Labour charges Nu.0.02 million
- Installation and test Nu. 0.06 million

The plant and machinery has a UL estimated as 20 years over which it will be depreciated. No salvage value has been estimated. The company management used WDV method of depreciation @10% p.a. and further management decided that all property, plant and equipment will be reported at its historical cost in the financial statements.

In 2016 at the year end, the building was revalued at 2% above its book value. Assume a borrowing costs of Nu. 0.6 million has been incurred during the construction period.

Required:

Account for the above transactions and show how each of the items will be presented in the financial statements of CDCL for the year ended 31 December 2019.

Prepare the necessary entry for the revaluation of the property, plant and equipment.

Solution:

Calculation of cost of construction of a building

Construction materials	155,500,000
Labour costs	13,500,000
Ground clearance and labelling	750,000
Drawings	1,200,000
Site engineer and supervision fees	3,150,000
Borrowing /finance costs	600,000
Total Cost of the building	**Nu. 174,700,000**

Journal entry -2014

Property, plant and equipment-building	Dr	174,700,000	
To capital work in progress	Cr		174,700,000

(Being the recognition of PPE-building at cost)

Depreciation schedule of PPE- Building from 2014-2019

Date	Cost of Building	Yearly Depreciation	Carrying amount (Nu)
1.1.2014	174,700,000	3,494,000	171,206,000
1.1.2015	171,206,000	3,494,000	167,712,000
1.1.2016	167,712,000	3,494,000	164,218,000

			167,502,360
1.1.2017	167,502,360	3,563,880	163,938,480
1.1.2018	163,938,480	3,563,880	160,374,600
1.1.2019	160,374,600	3,563,880	156,810,720

Journal entries 2016

Property, plant and equipment- Building Dr 3,284,360
To Revaluation surplus-equity Cr 3,284,360
(Being the revaluation surplus of a building)

Depreciation expense Dr 3,563,880
To Property, plant and equipment-building 3,563,880
(Being depreciation charge after revaluation of asset)

Debit Equity - revaluation surplus Dr 69,880
To Equity - retained earnings Cr 69,880
(Being use of revaluation surplus to absorb additional depreciation)

Journal entries 2019

Depreciation expense Dr 3,563,880
To Property, plant and equipment-building 3,563,880
(Being depreciation charged on property, plant and equipment-building)

Calculation of cost of property, plant and equipment-machinery

Purchase price	Nu.15,000,000
Import duties	Nu. 200,000
Transportation	Nu. 30,000
Labour charges	Nu. 20,000
Installation charges	Nu. 60,000
	Nu. 15,310,000

Journal entry 1-1-2016

Property, plant and equipment-machineryDr 15,310,000
To cash/bank Cr 15,310,000
(Being the initial cost of PPE-Machinery)

Journal entry 31-12-2016

Depreciation expense Dr 765,500
To PPE-machinery 765,500
(Being depreciation expense on PPE-machinery)

Depreciation schedule of PPE-Machinery 2016-2019

Date	Cost	Depreciation Rate (Given)	Yearly Depreciation	Carrying amount (Nu)
1.7.2016	15,310,000	0.1	765,500	14,544,500
1.1.2017	14,544,500	0.1	1,454,450	13,090,050
1.1.2018	13,090,050	0.1	1,309,005	11,781,045
1.1.2019	11,781,045	0.1	1,178,105	10,602,941

Statement of financial position of CDCL as at 31 December 2019

Non-current assets	**Note**	
Property, plant and equipment	1	167,413,661
Non-current liabilities		
Equity capital -		
Revaluation surplus		3,214,480
Retained earnings		69,880

Note 1:

PPE- Building	156,810,720
PPE-Machinery	10,602,941
	167,413,661

Chapter 6
Accounting for Biological Assets

Learning objectives:

- Explain the concept of biological assets
- Differentiate between bearer and consumable biological assets
- Account biological assets as per BAS 41
- Present biological assets in the financial statement

6.1 Concepts of Biological Assets

Figure 6.1 *Biological assets*

Although the standard BAS 41 is developed for agriculture accounting, this chapter deals only on biological assets. Biological assets are living plants or animals that are owned by a business and are expected to be used in the production of agricultural products such as crops, trees, livestock, poultry, and fish. Biological assets are a unique type of asset because they are constantly undergoing biological transformation. This means that they are growing, maturing, reproducing, or otherwise changing in a way that affects their value. As a result, biological assets must be accounted for differently than other types of assets. The biological assets are accounted under the IAS 41 (BAS 41).

Learning Activity 1

List at least six biological assets from your locality and discuss whether the assets are used for reproduction or directly consumed.

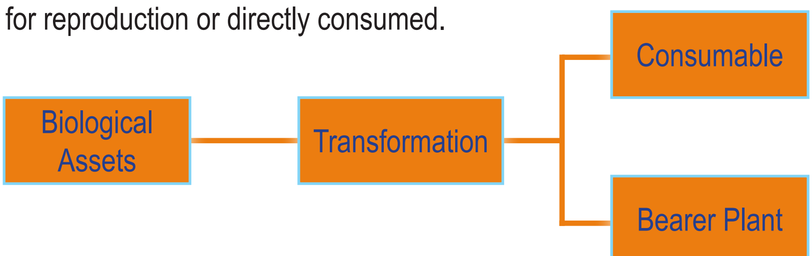


Figure 6.2 *Purposes of biological assets*

Table 1: Types of agricultural activities

Biological assets	Agriculture Produce	Products that are the result of processing after harvesting
Trees in a timber plantation	Felled (cut down)trees	Logs, lumber(wooden blocks)
Fruits trees	Picked fruits	Processed fruit
Dairy cattle	Milk	Cheese, Butter
Pigs	Pork(Meat)	Sausages, cured hams (sikam)
Poultry	Egg	Processed food (egg pasta, baked food etc...)

6.2 Accounting for Biological Assets

The BAS 41 outlines the accounting treatment for biological assets during the period of biological transformation until the point of harvest. This period covers the transformation of plants and animals into consumable or saleable products, excluding bearer plants.

Bearer plants are those cultivated and maintained by a business for the purpose of producing fruits. Due to their similar nature to property, plant, and equipment, they are accounted for under BAS 16. However, if trees, including bearer plants, are grown with the intent of harvesting them, they fall under the scope of BAS 41. For instance, a walnut tree may be cultivated either for its fruit or for harvesting to produce furniture. The timeline for accounting for biological assets is illustrated in Figure 3.6.

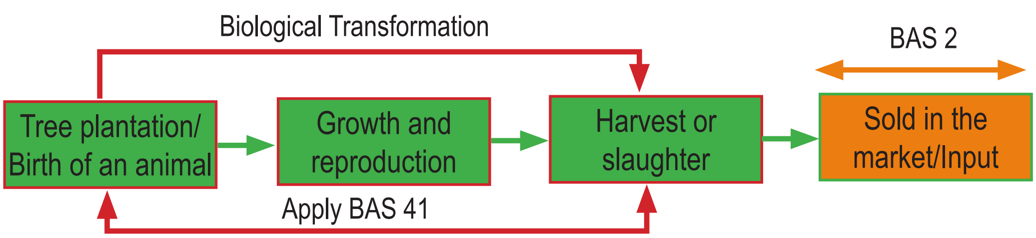


Figure 6.3: *Timeline for accounting for biological assets*

BAS 41 does not cover the processing of agricultural produce after harvest. For instance, when a vintner processes grapes into wine, even though this process is a logical continuation of agricultural activity and resembles biological transformation, it is not classified as agricultural activity under this Standard.

Presentation

XYZ Limited

Balance Sheet as at March 31 2017

All amounts are in Rs. Lakhs unless otherwise stated

		Particulars	Note No.	As at March 31, 2017	As at March 31, 2016	As at April 01, 2015
A		**Assets**				
	1	**Non-Current Assets**				
		(a) Property, Plant and Equipment				
		(b) Capital work-in-progress				
		(c) Investment Property				
		(d) Goodwill				
		(e) Other Intangible assets				
		(f) Intangible assets under development				
		(g) Biological Assets other than bearer plants				
		(h) Financial Assets				
		(i) Investments				
		(ii) Trade receivables				
		(iii) Loans				
		(iv) Finance lease receivables				
		(v) Other financial assets				
		(i) Deferred tax assets (net)				
		(j) Other non-current assets				
		Total Non-Current Assets				
	2	**Current assets**				
		(a) Biological Assets other than bearer plants				
		(b) Inventories				
		(c) Financial Assets				
		(i) Other Investments				
		(ii) Trade receivables				
		(iii) Cash and cash equivalents				
		(iv) Bank balances other than (iii) above				
		(v) Loans				

Bearer Plants to be disclosed as one of the blocks under Property, Plant and Equipment. (For eg: Tea bushes, coffee bushes, shade trees and so on)

To include:
(a) Produce growing on a plant that is yet to be harvested which requires more than 12 months from reporting date to be ready for harvest.
(b) Livestock held for breeding purposes only, with a remote likelihood that it will ever be sold.
(c) Trees cultivated both for their lumber and their fruit (For eg: Rubber trees are grown for both the latex and also their wood)

To include:
(a) Produce growing on a plant that is yet to be harvested which requires less than 12 months from reporting date to be ready for harvest (for eg: Tea leaves, coffee seeds).
(b) Livestock held for slaughter purposes
(c) Annual crops such as rice, maize and wheat

To include inventories that are produced from the agricultural produce (for eg: Black tea or made tea produced from tea leaves)

Figure 6.4: *Sample financial statement - biological assets*

Note: Apply the rule of current and non current asset to differentiate between current and non current biological assets.

Learning Activity 2

Using the information from the learning activity 1, complete the table given below

Consumable biological assets	Bearer biological assets

6.3 Recognition of Biological Assets

An entity shall recognise a biological asset when, and only when:

iv. the entity controls the asset as a result of past events;

v. it is probable that future economic benefits associated with the asset will flow to the entity;and

vi. the fair value or cost of the asset can be measured reliably.

Illustration 1

Sonam a farmer raise a poultry farm and makes living from earning by selling the meat and egg to the local meat market. Which of these activities are in the scope of BAS 41?

Solution:

The living poultries (chickens) are treated as biological assets and will be accounted under BAS 41, whereas meat and egg sold to the market is agricultural produce so it is accounted under BAS 2.

Learning Activity 3: Case study

Dechen and Dorji embarked on a hydroponics farming venture following the completion of their Deesup skilling program in 2022, establishing their business as “DD Modern Farm.” DD Modern Farm acquired one acre of land in Mongar for Nu. 4 million, incurring an additional Nu. 50,000 for land development and Nu. 100,000 for hiring workers and setting up the greenhouse.

Throughout the year, DD Modern Farm expended Nu. 5,000 on water culture, Nu. 20,000 on chemicals, and Nu. 3,000 on hybrid seeds for cultivating various vegetables. The firm also allocated Nu. 15,000 per month as a salary for the chemist.

After one year, recognizing a local demand for milk, DD Modern Farm invested Nu. 150,000 in three Jersey cows to enhance business sustainability. Additionally, the farm incurred Nu. 10,000 in legal and transportation fees and generated Nu. 210,000 in revenue from milk sales.

Required:

i. Recognize the biological Asset from above case.

ii. Calculate the cost of biological assets. [Nu.160,000]

iii. Which of the above biological assets can be classified as bearer biological assets, justify?

6.4 Measurement of Biological Assets

» **Initial Measurement:**

Biological assets are initially measured at cost. This includes all costs directly attributable to bringing the biological asset to a condition where it is capable of being sold or used.

» **Subsequent Measurement:**

After initial recognition, biological assets are measured at fair value less costs to sell. Fair value is determined based on active market prices, if available. If there is no active market, valuation techniques are used to estimate fair value. A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in profit or loss for the period in which it arises. A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

Illustration.2

ABC Company plant maize on its farm costing Nu. 200,000, during the year additional cost incurred Nu. 50,000. Pass the necessary accounting entries and present in the financial statement.

Solution:

Biological asset (consumable plants) Account	Dr.	250,000	
To cash/Bank/ Trade payable			250,000
(Being recognition of biological assets)			

Statement of Financial Position as on……

Particulars	Note	Amount (Nu.)
Asset: **Current Asset** Biological asset (consumable)		 250,000

6.5 Disclosure of Biological Assets

While the biological assets are reported as separate line items under non-current assets, or under current assets if they are expected to be harvested or sold within one year in the statement of financial position, the changes in the fair value of biological assets, less estimated point-of-sale costs, are included in profit or loss for the period in the income statement. The detailed disclosures about the biological assets should be supported by notes to the Financial Statements.

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.

Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of income or expense, the nature and amount of that item are disclosed in accordance with BAS 1 Presentation of Financial Statements. Examples of such an event include an outbreak of a virulent disease, a flood, a severe drought or frost, and a plague of insects.

Illustration 3.

Entity A purchased 100 jersey cows at an auction for Nu. 300,000 on December 31st 2022. Entity A also incurred Nu. 5000 on veterinary expenses.

On June 30 2023, the fair value of the cattle in the most relevant market increases to Nu. 330,000. The cost to sell is Nu. 3,000 in relation to the fair value ascertained above. On 31st December 2023 Entity A sold 80 jersey cows for Nu. 250,000.

Solution:

Initial Recognition of Biological assets (Jersey cows) at 31st December 2021.

Biological assets (Jersey cows) Account	Dr	300,000	
To Cash/bank/trade payable account			300,000
(Being biological assets recognized at cost)			

Veterinary Expenses Account	Dr	5,000	
To Cash Account			5,000

(Being expenses paid)

On 30th June

Biological assets (Jersey cows) account Dr	27,000*	
To gain on changes in fair value (IS)		27,000

(Being the gain due to change in fair value in the market)

***Calculation:**

Fair value on 30th June	330,000
Less: cost to sell	3,000
	327,000
Less: initial cost	300,000
Gain in changes in fair value	**27,000**

31st December

Cash/bank/Bills Receivable account	Dr	250,000	
To Revenue			250,000

(Being revenue from 80 jersey cows sold)

Cost of Sale account	Dr. 250,000	
To Biological asset		250,000

Loss on sale of biological assets account	Dr 11,600	
To Biological assets account		11,600

Calculation for cost of sale of 80 jersey cows:

100 jersey cows at fair value:	327,000
80 jersey cows at fair value:	327,000/100*80= 261,600
Selling price	250,000
Loss on sale	**1,600**

Exercises:

1. Answer the following questions briefly.
   i. What is the key difference between accounting for biological assets and traditional assets?
   ii. According to BAS 41, at what point does a harvested agricultural product transition from being a biological asset? And why?
   iii. What is a Bearer plants? Is the bearer plants accounted under BAS 41?
   iv. Why is fair value more appropriate valuation method for biological assets than the historical cost?
   v. How are biological assets measured after initial recognition?
   vi. Explain how fair value is determined if there is no active market for a biological asset.
   vii. What is included in the profit or loss when recognizing a biological asset at fair value less costs to sell?

2. KKC Company provided the following assets in a forest plantation and farm:

Freestanding trees	5,000,000
Land under trees	600,000
Roads in forest	300,000
Animals related to recreational activities	1,000,000
Bearer plants	1,500,000
Bearer animals	2,000,000
Agricultural produce growing on bearer plants	800,000
Agricultural produce harvested	1,200,000
Plants with dual use	1,400,000

Based on the information, you are required to answer the following questions:
   i. What total amount should be reported as biological assets?
   ii. What total amount should be included in property, plant, and equipment?

3. XYZ Company started fishery costing Nu. 400,000. The cost of fishing operation amounts to Nu. 120,000 during the year. At the end of the year the fair value of the harvested fish amounted to Nu.1 million. Pass the necessary accounting entries and present in the financial statement.

4. Dophu a farmer in Paro hired power tiller @ Nu.65,000 from FMCL to plough his field for paddy cultivation, Nu.15,000 for irrigation cost and Nu.20,000 for quality seeds. At the end he harvest 4,500 kgs of paddy and sold at Nu.100. Pass the necessary accounting entries and report in the financial statement under BAS 41.

5. GreenFields Ltd. is an agricultural company that cultivates apple orchards. On January 1, 2023, the company acquired 500 young apple trees for Nu. 50,000. The fair value of these apple trees on the acquisition date is reliably measured at Nu. 52,000. The company incurs additional costs of Nu.5,000 for planting and nurturing the trees. By December 31, 2023, the fair value of the apple trees increased to Nu.60,000, and the estimated point-of-sale costs are Nu.2,000.

Requirements:

i. Determine the initial recognition and measurement of the apple trees on January 1, 2023.

ii. Calculate the fair value change of the apple trees as of December 31, 2023.

iii. Prepare the journal entries for initial recognition and subsequent fair value adjustment on December 31, 2023. [Gain Nu. 6,000]

6. HappyFarm Ltd. specializes in breeding livestock. On January 1, 2023, the company acquired 100 sheep for breeding purposes at a total cost of Nu. 40,000. The fair value of these sheep was determined to be Nu. 42,000 at acquisition. During the year, the company incurred Nu. 8,000 in feeding costs and veterinary care. On December 31, 2023, the fair value of the sheep was assessed to be Nu. 50,000, with estimated point-of-sale costs of Nu. 1,000.

Requirements:

Provide how HappyFarm Ltd. should disclose the biological assets in its financial statements for the year ended December 31, 2023 including the notes.

[Gain Nu. 7,000]

Chapter 7
Financial Statements

Learning objectives:

- Explain the nature of capital and revenue expenditure
- Explain the purposes of financial statements
- Identify various elements (assets, liabilities, income and expense) of financial statements
- Draw the formats of income statement, statement of cash flows and statement of changes in equity, statement of financial position

7.1 Meaning of Financial Statements

Financial statements are summaries of the accounts of a business entity, prepared at the end of an accounting year. Generally, accounting standards require the preparation of an income statement, statement of financial position, statement of cash flows, statement of changes in equity, and accompanying notes. The statement of financial position reflects the value of assets, liabilities, and equity; the income statement shows the results of operations; the cash flow statement details the inflows and outflows of cash and cash equivalents; and the statement of changes in equity indicates changes in owners' equity. The notes to financial statements provide detailed explanations, additional information, and context to the figures in the financial statements, enhancing transparency and aiding users in making informed economic decisions.

Definition

BAS1/IAS1 defines financial statements as those "general purpose financial statements which are prepared to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs".

The Conceptual Framework for Financial Reporting (2018) defines financial statements as "a particular form of financial reports that provide information about the reporting entity's assets, liabilities, income and expenses".

Financial reporting is a terminology closely related to financial statements and often the two terms are used interchangeably, although they are different concepts. Financial reporting is a broad concept that includes financial statements and other information such as management commentary and financial highlights of the reporting entity presented outside the financial statements.

7.2 Purpose of Financial Statements

The main objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet this objective, entity's management prepare financial statements which contain information about the entity's

c. Assets,
d. Liabilities,
e. Equity,
f. Income and expenses, including gains and losses,
g. Contributions by and distributions to owners in their capacity as owners, and
h. Cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows, distribution of future profit and the ability of the entity in meeting its financial commitment as and when it is due. Further, financial statements are used by users to assess potential changes in the economic resources the entity is likely to control in future. The financial statements prepared by the business entity may not be able to meet all these users' needs, but financial statements which meet the needs of investors (providers of risk capital) will meet most of the needs of other users. These financial statements are called General Purpose Financial Statements.

Due to the importance of financial statements for users, their preparation and presentation are necessary and a very important mandate for the business entity. This process is guided by the financial reporting framework and accounting standards.

A complete set of financial statements comprises:

a. a statement of financial position as at the end of the period;

b. a statement of income for the period;

c. a statement of changes in equity for the period;

d. a statement of cash flows for the period;

e. notes, comprising significant accounting policies and other explanatory information; and

f. a comparative information

7.3 Characteristics of Good Financial Statements

The preparer of financial statements should be guided by these qualitative characteristics of a useful information while preparing the set of financial statements.

» Relevance

The financial information is relevant if the information can make difference in the decisions made by users. This means, the users of information should be able to predict the future performance or cash flows of the entity by using the current available information. Also, the users should be able to validate or confirm the information that was expected. Most of these knowledge can be obtained through financial statement analysis and interpretations.

» Materiality

Materiality is an entity specific aspect of relevance based on the nature and magnitude of items presented in the financial statements. Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. To decide whether information is material, the preparer of the financial statements should consider both the nature and the magnitude of the item presented in the financial statements and evaluate whether omission or misstatements of such information could affect decision of the information users. All material items of similar nature should be presented as a separate line item and items of dissimilar nature which are immaterial could be presented in aggregate in the financial statements. For example, the finance costs (commonly known as interest costs) on the borrowed fund are presented as a separate line item in the income statement.

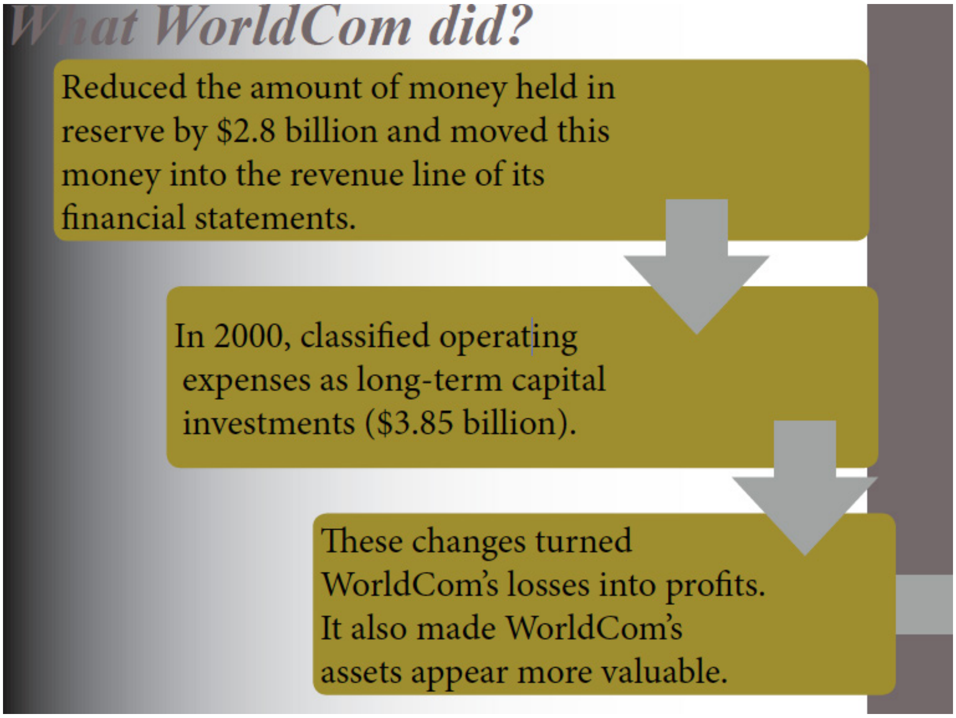
» Faithful representation

Literally, faithful means being true or not altering any of the facts. Financial statements represent economic phenomena or business transactions and events expressed in numbers and words. The financial reporting requires financial statements to present not only the relevant financial information, but the information must also faithfully represent the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses. In other words, financial statements should present fairly the financial position, financial performance and cash flows of a reporting entity. The financial statements that provide a true and fair representation of the effects of business transactions and events must bear the following:

i. **Completeness** – all necessary information for a user to understand the economic phenomena of the business must be presented. This means, for example, all assets and liabilities that exist at the balance sheet date must be recorded in the correct period or all revenue and expense transactions that occurred during the period must be recorded in the correct period. The incomplete presentation of financial information would result in financial statement items being understated. For some items, a complete presentation may also require explanations of the process used to determine the numerical presentation. Completeness is more relevant in case of presenting liability items and expenses in the statement of financial position.

ii. **Neutral-** the financial statements should be prepared without bias. This means, the preparer of financial statements should not be under any influence or affected by any user's or management interest in the selection of accounting policies or preparation of financial statements. The neutrality of financial statements may be put under question if management overrides the control activities that yield to manipulation of events and transactions. The failure to prepare financial statements without bias would mislead the information users in making their economic decision.

iii. **Free from error**- the financial statements should be free from material misstatements due to error. Error can occur due to several reasons such as incorrect application of accounting principles, mathematical mistakes and overlooking of the process of preparing financial statements. When the preparer of financial statements deliberately avoid using the required accounting standards or framework, it would lead to fraudulent financial reporting. Through trail balance some of the errors can be detected and corrected by the preparer of financial statements so that financial statements can be prepared without material misstatement.



Source: www.google/world.com/fraud

In addition following are some of the qualitative characteristics that enhance the usefulness of information. These include:

i. **Comparability**

Comparability means the information presented in the financial statements is carefully identified and measured so that it is comparable over time or with other similar entities. This is achieved through:

- having consistency in accounting of transactions over a period of time,
- disclosing accounting policies so that any changes or discrepancies in treatment of transactions is informed to the users, and
- the Bhutanese Accounting Standards and other similar accounting standards can contribute to comparability by reducing the options available to different entities

when accounting for similar transactions and requiring the disclosure of accounting policies and changes in accounting policies in the financial statements.

ii. Verifiability

Verifiability means that accounting data can be objectively verified by any knowledgeable person to arrive at convincing conclusion. The accounting process requires all transactions and events to be recorded by using double-entry system and that all accounting records should be supported by documentary evidences. This system allows external verifications of accounting data and validates its usefulness.

iii. Timeliness

The timeliness qualitative characteristic expects that information should be provided on timely basis to the users in order to improve relevancy of the information. In this regard, the decision to approve issue of annual reports to the shareholders and other stakeholders is critical as the information will be priced by the market and affect value of the business. Generally, the older the information is the less useful it is. However, some information may continue to be relevant and timely even long after the end of a reporting period. For example, some users may need to identify and assess trends.

iv. Understandability

Understandability means whether the information presented in the financial statements is understandable to the information users. The framework suggests that financial statements are prepared in a way that assists understanding. Understandability can be increased through proper classification of items and presenting information in the financial statements clearly and concisely. Some transactions such as lease and employee benefits are inherently complex and cannot be made easy to understand. Any attempt to make these transactions less complex may potentially distort the information. The framework, therefore, expects that users should have a reasonable knowledge of business and economic activities and seek the aid of those who can review and analyse the information diligently.

v. Consistency

This means accounting policies and methods should be applied consistently over the period of time unless it is reasonable to change and such changes provide a better measurement of transactions and information to the users.

7.4 Underlying Assumptions in Preparing Financial Statements

The preparation and presentation of financial statements is based on the following assumptions:

a. Separate business entity

When recording transactions, we assume that the business entity in respect of which accounting records are maintained is separate from the business owner and other entities owned by the same person or group of people. For example, a person invests Nu. 15 million in a start-up business. Looking from the point of view of business, Nu.15 million is a liability whereas for the owner this is an investment asset. For business, all resources required are provided by either business owner or creditors. This represents claims against the economic resources (assets) of the business. This relationship between business and its suppliers of financial resources can be learnt through accounting equation in chapter 2.

b. Going concern

This is one of the most fundamental assumptions made when preparing the financial statements. Here we assume that the business entity will continue in operation for the foreseeable future and that there is no intention or necessity to close down the business or significantly cut down the scale of its operation.

It is because of this assumption that:

- non-current assets are reported at net depreciated historical cost, even if its realizable value is lower, since we expect that the asset will continue to be in use in future, and
- assets and liabilities are categorized as current and non-current and that the business entity will continue to trade.

The preparers of financial statements must assess the going concern of the business entity and satisfy themselves that there are no indications suggesting going concern issue of the business. There could be several reasons or conditions that the business entity may be considered having going concern issue. This condition may include the following.

- The business entity incurs loss over several years.
- There is inadequate working capital and long term capital, and there is a barrier to raise additional capital.

When there is a going concern issue, the financial statements are prepared under realisation method where it is expected that assets are disposed-off and the sale proceeds used to settle debts and other liabilities.

c. Money measurement

It is assumed that every item that needs to be accounted can be measured in terms of money or money's worth. This facilitates the business entity to aggregate the value of assets and liabilities and ascertain the wealth or financial position of the entity. Other physical units of measurement, say acres, tons, gallons, etc. may not provide the same value as money.

Every country has its own national currency which can be used as a unit for measuring transactions and events for accounting purpose. In Bhutan, we use our national currency Ngultrum (Nu.) as the unit of measurement of transactions and events throughout the country. Although, Indian currency and other foreign currencies are seen in the market, these currencies are not used when reporting the results of business entities. The ngultrum is also used as a unit of accounting and for financial reporting of government.

The particular currency which is used to account for business transactions and events is called functional currency, and the currency which is used to prepare financial statements and reporting of the entity's financial results is called reporting currency. It is possible that functional and reporting currencies may be different especially in case of multinational companies having operations in different countries and having a wide spread of investors across the world.

7.5 Accounting Conventions in Preparing Financial Statements

In addition to assumptions we discussed in the previous section, accountant use certain working rules known as conventions when preparing financial statements. These conventions are:

a. Accounting period

You may be aware that in the ancient period in the barter economy, the accounts for traders, particularly when unit of measurement of accounting was not so defined as today, accounting was based on venture concept and the result of trading was known only when the venture was completed i.e. when all merchandise had been sold. This means the trader had to wait until the venture was completed to know the results of the business. This also means that there was no need to make estimates such as how long the non-current assets will last and value the inventory to be carried forward.

However, in the modern economy, stakeholders need not only reliable and relevant information but also need such information with greater frequency. This requires business entities to use some sort of time intervals to provide information to its stakeholders on a regular basis. Many business entities use 12 months period to provide accounting information to their stakeholders. This is called accounting period or reporting period or financial year. In many countries, the Companies Act specifies the accounting period. As specified by Companies Act of Bhutan 2016, companies in Bhutan use calendar year as their financial year (i.e. 1 Janurary-31 December). However, the government financial year is July- June.

b. Accruals and matching

When business entities use financial year to report their results, it becomes necessary to ensure that in each financial year the income accounted for in that year must be matched with the expenses incurred in the earning process. This means that:

- income must be accounted for in the year in which it is earned irrespective of whether the related cash is received in that year or not, and

- expenses must be accounted for in the year in which it is incurred irrespective of whether the related cash is paid in that year or not.

Later, you will learn that when we prepare financial statements, some accounting adjustments need to be made because of this accrual and matching principle. For example, at the end of the financial year the entity made an advance payment of Nu. 100,000 to its suppliers. This is a form of Deferred expense which will be deferred to next year for its recognition. This expense will be matched with the income earned next year when the business receives goods from its suppler and sells them to customers. That is why, Deferred expense is reported as an asset.

In case of non-current asset such as property, plant and equipment, the accrual and matching rule is achieved by charging depreciation expense using the concept of useful life of the asset and its scrap value. This means, income earned during the life of the asset is matched with the depreciation expense charged against the asset over the useful life of that asset.

Accrual and matching rule is the key in determining the accurate performance result of the business entity as it is possible for business to improve their reported profit by delaying payments. Similarly, business may also use such techniques to reduce reported profit by expediting payments. An unethical practice of business often leads to such manipulations of earnings affecting the government tax revenue as well as deceiving the stakeholders.

While accrual and matching rule makes sense in most of the business entities, small entities may not find this necessary and instead adopt cash basis of accounting. In that case, income and expense will be recognised only when the actual related to cash is received or paid. Currently, the government and many civil society organisations follow cash basis of accounting.

c. Historical cost

This represents the measurement of the value of resources in accounting. The value is based on the actual amount paid to acquire an asset or expenses paid. It is considered objective and verifiable that is why most business entities use this as the basis of accounting and reporting. However, the historical cost accounting suffers from the following limitations.

- **Resources are not reported at their current value**

The financial statements prepared under historical cost accounting fails to reflect the current value of the resources owned by the business entity. For example, a company acquires an item of property, say, a building worth Nu. 85 million on 1 January 2015 and depreciates the property over its useful life of 50 years. By the end of three years, the building would have a carrying amount of Nu.79.9 million. In the bullish market situation where property price is on rise, the value of the property will be much higher than what is reported by the business.

- **Mismatching of the income earned and expenses incurred**

This occurs when the income earned today is matched with the expense incurred in the past, when money may have had a different value, at the time when the property was first acquired. The extent of this mismatch will depend on the level of inflation and the time gap between payment and the use of assets. This distorts the reported profit and performance results of the business.

Companies use revaluation model of accounting to overcome the limitations of historical cost method. In revaluation method, companies are allowed to revalue their non-current assets on a regular basis and report the assets at re-valued amounts. However, revaluation method has its own practical limitation. Many business entities do not have the capacity to perform valuation of their assets regularly. Also, the current property and capital market in Bhutan lack buyers and suppliers to set competitive market price. Therefore, most businesses continue to use historical cost method of accounting.

7.6 Qualitative Characteristics of Useful Information in Financial Statements

The Companies Act and the corporate governance rules prevent company directors from approving financial statements for public declaration unless they are satisfied that the financial statements present true and fair picture of the economic activities of the business. Further, statutory auditors under Companies Act require auditors to provide opinions on whether financial statements are prepared and presented in true and fair manner. The conceptual framework of financial reporting suggests that the financial statements provide true and fair picture of business activities if they are prepared and presented in accordance with accounting standards and if the information presented contain certain qualitative features which make the information useful for stakeholders.

If financial information is to be useful, it must be relevant and faithfully represent what it ought to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. These qualitative characteristics of financial information can be discussed under two categories.

7.7 Fundamental Qualitative Characteristics

The fundamental qualitative characteristics are relevance and faithful representation.

a. Relevance

Relevance is the usefulness of financial information for making economic decisions. This is possible when the financial information presented in the financial statements can be used for:

- evaluating current business performance,
- predicting the future prospect, and
- confirming past evaluation.

b. Materiality

In accounting, materiality is a threshold set to determine whether in the judgement of the preparer of financial statements the misstatements of which could influence decision of the stakeholder. This means that there is a minimum amount of which the stakeholders may treat the misstatement as significant and cannot be tolerated. In other words, information is said to be material, if by nature or amount, is significant to those information users.

Materiality is an entity-specific aspect based on the nature or magnitude of misstatement, or both. For example, a company purchases a CCTV of Nu. 200,000. The decision whether to capitalize this item as an asset or write it off as an expense depends on the size of the entity. If the buying entity is a large size limited company, this cost could be expensed, whereas, if it is a small entity or an individual household, it is reasonable to be capitalized.

Materiality also plays a significant role when deciding whether to report an item as a separate item in the financial statements. For example, when an entity decides whether to disclose an irrecoverable debt of Nu.50,000 as a separate item or this to be included in the selling and distribution expenses depends on the materiality level. Generally, business entities set their own accounting policies to determine materiality level for different items of assets, liabilities, income and expenses when preparing financial statements. For example, the business entity may use threshold value of Nu. 120,000 where all items of asset, liability, income and expense of value equal to or greater than Nu. 120,000 may be treated as material and thus reported as separate line item in the financial statements.

c. Faithful representation

Financial reports represent economic activities undertaken by business entity and communicate these realities to the stakeholders. To be useful, financial information in financial statements must not only be relevant but it must also faithfully represent the economic activities that it ought to represent. To achieve this faithful representation, the financial information in financial statements must have three characteristics. These are:

i. Completeness

Completeness requires financial statements to disclose all information including all necessary descriptions and explanations for a user to understand the nature and value of item presented in the financial statements. For example, in accounting of an asset, the entity must include at a minimum, a description of the nature of assets in the group, value of asset in the group, description of what the numbers represent such as original cost and adjustment costs. The omission of information can cause the information presented in the financial statements to be biased and mislead the information users.

ii. Neutrality

Neutrality is achieved when the information presented is objective and free from bias. This helps entity to gain credibility in their financial reporting and improve stakeholders' confidence. Lack of credibility could have an adverse effect on investment. We have discussed under historical cost rule that by reporting non-current assets at the actual amount paid reduces subjective judgement of business. There are occasions such as:

- determining depreciation for tangible assets when the useful life of tangible asset is to be estimated,
- making allowance for doubtful debts when the recoverability of the debt is to be assessed, and
- determining the net realizable value of inventory , which involve making subjective judgment in accounting.

Business makes these estimates by using certain assumptions or financial models which may be biased. A neutral financial information is not slanted, emphasised or de-emphasized or manipulated to improve its value to certain group of users.

iii. Free from error

Free from error does not mean perfectly accurate in all respects. It all means there are no errors or omissions in the description of the item including its nature and the related amounts. For example, an estimate of depreciation cannot be determined with cent percent accuracy. However, a representation of that estimate can be faithful if the amount and the estimating process is described clearly in the financial statements. Practically, these qualities may not be achieved fully. However, management of the entity must enhance those qualities as much as possible.

7.8 Enhancing Qualitative Characteristics

These are qualitative characteristics that enhance the usefulness of information. These include:

a. Comparability

Comparability means the information presented in the financial statements is carefully identified and measured so that it is comparable over time or with other similar entities.
This is achieved through:

- having consistency in accounting of transactions over a period of time,
- disclosing accounting policies so that any changes or discrepancies in treatment of transactions is informed to the users, and

- the Bhutanese Accounting Standards and other similar accounting standards can contribute to comparability by reducing the options available to different entities when accounting for similar transactions and requiring the disclosure of accounting policies and changes in accounting policies in the financial statements.

b. Verifiability

Verifiability means that accounting data can be objectively verified by any knowledgeable person to arrive at convincing conclusion. The accounting process requires all transactions and events to be recorded by using double-entry system and that all accounting records should be supported by documentary evidences. This system allows external verifications of accounting data and validates its usefulness.

c. Timeliness

The timeliness qualitative characteristic expects that information should be provided on timely basis to the users in order to improve relevancy of the information. In this regard, the decision to approve issue of annual reports to the shareholders and other stakeholders is critical as the information will be priced by the market and affect value of the business. Generally, the older the information is the less useful it is. However, some information may continue to be relevant and timely even long after the end of a reporting period. For example, some users may need to identify and assess trends.

d. Understandability

Understandability means whether the information presented in the financial statements is understandable to the information users. The framework suggests that financial statements are prepared in a way that assists understanding. Understandability can be increased through proper classification of items and presenting information in the financial statements clearly and concisely. Some transactions such as lease and employee benefits are inherently complex and cannot be made easy to understand. Any attempt to make these transactions less complex may potentially distort the information. The framework, therefore, expects that users should have a reasonable knowledge of business and economic activities and seek the aid of those who can review and analyse the information diligently.

e. Consistency

This means accounting policies and methods should be applied consistently over the period of time unless it is reasonable to change and such changes provide a better measurement of transactions and information to the users.

7.9 Elements of Financial Statements

The framework identifies five elements of financial statements:

7.9.1 Statement of Financial Position

a. Asset

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

Assets are used to produce goods or services capable of satisfying the wants or needs of customers, and customers are prepared to pay for goods or services. Therefore, assets contribute to the cash flow or earnings of the entity.

The assets of an entity result from past transactions or events. This means, entities normally acquire assets by purchasing or producing them. However, there are also transactions or events which may generate assets. For example, entity receiving a property from government as part of a programme to encourage economic growth in an area is an asset.

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

- used singly or in combination with other assets in the production of goods or services to be sold by the entity,
- exchanged for other assets,
- used to settle a liability, or
- distributed to the owners of the entity.

Many assets such as property, plant and equipment, have a physical form. There are also assets which do not have a physical form such as patents, copyrights, goodwill and franchise rights. All these meet the definition of assets so long as future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

b. Liability

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

An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract (e.g. amounts payable for goods and services received) or statutory requirement (e.g. tax payable).

Liabilities result from past transactions or events. For example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance) and the receipt of a bank loan results in an obligation to repay the loan.

Settlement of a present obligation may occur in a number of ways, for example, by:

- payment of cash,
- transfer of other assets,
- provision of services,
- replacement of that obligation with another obligation, or
- conversion of the obligation to equity.

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

c. Equity

Equity is the residual interest in the assets of the entity after deducting all its liabilities. Equity is sub-classified into capital, retained earnings, reserves representing appropriations of retained earnings. Each of this part of equity is reported separately in the statement of financial position. Business may create reserves for various future purposes. The creation of reserves may also be a requirement of law in order to give the entity and its creditors an added measure of protection from the effects of losses. Transfers to reserves are treated as appropriations of retained earnings rather than expenses.

However, the framework restricts excessive creation of reserves without sufficient justifications.

7.9.2 Statement of Income

a. Income

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

Profit is used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share.

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including:

- sales – e.g. sale of goods
- fees – e.g. sale of service
- interest – e.g. banks and fund management companies
- royalties –e.g. mining and legal rights
- rent – e.g. investment properties

Gains represent other items that meet the definition of income, and may or may not arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. For example, gain arising on the disposal of non-current assets is an income and is reported in the income statement as 'other income'. The definition of income also includes unrealised gains such as those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long-term assets. When gains are recognised in the income statement, they are reported as separate items because knowledge of them is useful for the purpose of making economic decisions.

b. Expense

Expenses decreases economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

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

Losses include those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses. For example, losses that arise on the revaluation of marketable securities and those resulting from the decrease in the carrying amount of long-term assets. When losses are recognised in the income statement, they are usually reported as separate items because knowledge of them is useful for the purpose of making economic decisions.

7.10 Other Requirements of Financial Statements

» Frequency of reporting

An entity should present a complete set of financial statements (including comparative information) at least annually. The entity may also provide an interim financial statements if it is necessary for the information users. Some of the Companies Act requires large companies to prepare and present interim financial statements for the stakeholders. The interim financial statements are prepared for a period less than the full financial year.

» Comparative information

An entity should present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. It should present, as a minimum, two statements of financial position, two income statements, two statements of cash flows and two statements of changes in equity, and related notes.

Financial Statements of Druk Green Power Corporation Limited is given as sample of different financial statements.

i. Income Statement

Statement of Comprehensive Income for the year ended on December 31, 2022

(Amount in Nu.)

Particulars	Note No.	31-Dec-22	31-Dec-21
INCOME			
Electricity revenue	17	11,511,032,946.51	12,004,425,244.27
Interest earned	18	191,842,628.49	199,444,532.71
Other income	19	323,413,731.71	305,204,016.95
		12,026,289,306.71	12,509,073,793.93
EXPENDITURE			
Wheeling charges		786,649,983.27	991,276,852.19
Insurance		127,541,192.69	151,135,299.49
Running and maintenance expenses	20	246,950,627.18	346,839,709.74
Employees' remuneration and benefits	21	1,051,362,690.43	875,653,307.66
Finance cost	22	246,021,560.24	245,754,101.56
Depreciation/amortization		2,295,333,544.98	2,251,991,228.96
Other expenses	23	729,484,252.47	317,167,349.58
		5,483,343,851.26	5,179,817,849.18
Operating profit		6,542,945,455.45	7,329,255,944.75
Profit before tax		6,542,945,455.45	7,329,255,944.75
Tax expense	24		
Current tax		2,139,120,066.23	2,159,106,359.94
Deferred tax (Income)/Expenses		(220,580,391.36)	73,035,964.38
Income Tax for earlier years			
		1,918,539,674.87	2,232,142,324.32
Profit for the year		4,624,405,780.58	5,097,113,620.43
Other comprehensive income:			
Remeasurements of post-employment benefit obligations gain/(loss)		1,556,734.58	21,561,711.24
Income tax relating to these items			
Total other comprehensive income for the year		1,556,734.58	21,561,711.24
Comprehensive income for the year		4,625,962,515.16	5,118,675,331.67

ii. Statement of financial position

Statement of Financial Position as at December 31, 2022

(Amount in Nu.)

Particulars	Note No.	31-Dec-22	31-Dec-21	1-Jan-21
ASSETS:				
Non- current assets				
Property, plant & equipment	3	33,974,394,032.43	35,172,220,670.97	36,615,380,626.46
Intangible assets	3	31,364,727.75	36,829,862.94	28,736,779.98
Right of Use Assets/Leasehold Properties	3	22,248,325.94	-	-
Investment property	4	-	-	32,000,000.00
Deferred tax asset	5	211,933,146.63	-	64,388,719.65
Investments in subsidiaries and joint ventures	6	12,204,836,989.76	10,066,492,500.14	8,787,347,385.44
Long-Term Investments	7a	4,170,090,795.45	4,207,248,139.43	2,769,370,399.12
Other assets	7b	-	-	1,880,572.38
Total non - current assets		**50,614,868,017.96**	**49,482,791,173.48**	**48,299,104,483.03**
Current assets				
Cash and cash equivalents	11c	2,259,144,540.19	1,840,555,671.45	759,358,887.64
Inventories	8	528,743,485.04	474,387,621.85	389,388,320.62
Short Term Investments	11a	-	1,312,035,068.49	3,395,053,100.34
Trade and other receivables	11b	2,602,201,167.23	2,904,316,290.85	3,014,839,387.24
Prepayments and advances	9	207,710,528.11	124,137,520.94	36,081,893.25
		5,597,799,720.57	**6,655,432,173.58**	**7,594,721,589.09**
Assets classified as held for sale	10	140,478,096.80	134,930,791.28	134,484,949.28
Total current assets		**5,738,277,817.37**	**6,790,362,964.86**	**7,729,206,538.37**
Total assets		**56,353,145,835.33**	**56,273,154,138.34**	**56,028,311,021.40**

(Amount in Nu.)

Particulars	Note No.	31-Dec-22	31-Dec-21	1-Jan-21
EQUITY AND LIABILITIES:				
Equity				
Share capital	12	32,465,093,407.26	32,465,093,407.26	32,131,958,441.49
General reserves		8,868,573,935.56	8,859,898,603.89	9,402,159,518.99
Retained earnings		4,753,277,646.70	5,249,132,840.01	5,188,196,593.23
Total shareholders' equity		**46,086,944,989.52**	**46,574,124,851.15**	**46,722,314,553.71**
Non-current liabilities				
Long-Term Borrowings	7c	6,113,946,011.82	6,317,879,953.89	5,899,015,821.98
Deferred tax liability	5	-	8,647,244.73	-
Employee benefit obligation	13	610,826,449.58	561,966,150.23	529,629,710.92
Lease liability	7d	23,519,000.62	516,968.82	286,021.22
Total non-current liabilities		**6,748,291,462.02**	**6,889,010,317.67**	**6,428,931,554.12**
Current liabilities				
Trade and other payables	11d	1,303,533,875.67	565,995,256.48	458,072,922.13
Other financial liabilities	11e	442,059,348.03	447,996,706.68	398,456,850.98
Other current liabilities	14	51,919,354.74	68,342,184.33	65,007,859.75
Current tax liabilities	15	1,597,636,500.78	1,628,348,421.16	1,857,074,824.57
Employee benefit obligation	16	122,760,304.58	99,336,400.87	98,452,456.14
Total current liabilities		**3,517,909,383.80**	**2,810,018,969.52**	**2,877,064,913.57**
Total liabilities		**10,266,200,845.82**	**9,699,029,287.19**	**9,305,996,467.69**
Total shareholders' equity & liabilities		**56,353,145,835.33**	**56,273,154,138.34**	**56,028,311,021.40**

iii. Statement of cash flows

Statement of Cash flows for the year ended on December 31, 2022

(Amount in Nu.)

Particulars	31-Dec-22	31-Dec-21
Cash flows from operating activities		
Profit before taxation	6,542,945,455.45	7,329,255,944.75
Adjustment for:		
Actuarial gains (losses)	1,556,734.58	21,561,711.24
Depreciation / amortisation	2,295,333,544.98	2,251,991,228.96
Foreign exchange loss	369,658,248.45	54,596,057.11
Loss/(gain) on sale of property plant & equipment	-	-
Investment income	-191,842,628.49	-199,444,532.71
Dividend income	-49,841,162.49	-8,956,096.04
Interest expenses	246,021,560.24	245,754,101.56
(Increase)/decrease in trade receivables and other receivables	302,115,123.62	110,523,096.39
(Increase)/decrease in inventories	-54,355,863.19	-84,999,301.23
(Increase)/decrease in prepayments and advances	-83,573,007.17	-88,055,627.69
(Increase)/decrease in assets classified as held for sale	-5,547,305.52	-445,842.00
Increase/(decrease) in trade and other payables	43,081,007.17	107,922,334.35
Increase/(decrease) in other current liabilities	-20,247,103.48	3,334,324.58
Increase/(decrease) in other Non-current liabilities	-516,968.82	230,947.60
Increase/(decrease) in employee benefit obligation	72,284,203.06	33,220,384.04
(Increase)/Decrease in Other asset	-	1,880,572.38
Cash generated from Operation	**9,467,072,558.33**	**9,778,369,303.29**
Income tax paid	-2,169,831,986.61	-2,387,832,763.34
Net cash from operating activities	**7,297,240,571.72**	**7,390,536,539.95**

(Amount in Nu.)

Particulars	31-Dec-22	31-Dec-21
Cash flows from investing activities		
Purchase of PPE & intangibles assets	-1,087,538,154.91	-818,245,390.66
Acquisition of PPE-ROU Asset	591,332.33	
Payment for investments in subsidiaries and joint ventures	-2,138,344,489.62	-1,279,145,114.70
Proceeds from held-to-maturity investments	1,466,168,800.00	700,000,000.00
Interest received	74,866,240.96	144,584,824.25
Dividend received	49,841,162.49	8,956,096.04
Net cash used in investing activities	**-1,634,415,108.75**	**-1,243,849,585.07**
Cash flows from financing activities		
Issue of share capital		366,456,000.00
Increase/(Decrease) in Reserve		
Proceeds/(Repayment) of loan	125,151,337.30	368,210,205.93
Adjustment RoU opening to Retained earning	-3,142,376.80	
Cash payment for interest portion of Lease Liability	-8,061,693.56	
Interest paid	-248,183,861.07	-200,156,376.99
Dividend paid	-5,110,000,000.00	-5,600,000,000.00
Net cash used in financing activities	**-5,244,236,594.21**	**-5,065,490,171.06**
Net increase/(decrease) in cash and cash equivalents	**418,588,868.85**	**1,081,196,783.82**
Cash and cash equivalents at the beginning of the period	**1,840,555,671.45**	**759,358,887.64**
Cash and cash equivalents at the end of the period	**2,259,144,540.30**	**1,840,555,671.46**
Component of cash and cash equivalents:-		
Cash in hand	**285,363.99**	**392,483.78**
Balances in current accounts with banks	**2,258,859,176.20**	**1,840,163,187.67**
Total	**2,259,144,540.19**	**1,840,555,671.45**

iv. Statement of Changes in equity

Statement of Changes in Equity for the year ended on December 31, 2022

(Amount in Nu.)

	Number of Shares	Equity Share Capital	General Reserve	Retained Earnings	Total Equity
Balance at December 31, 2020	32,131,958.44	32,131,958,441.49	9,402,159,518.99	5,188,196,593.23	46,722,314,553.71
Net profit for the year 2021					
Net Profit/(Loss) for the year		-	-	5,097,113,620.43	5,097,113,620.43
Transfer to reserves					-
Transfer to/(from) General Reserve		-	-542,260,915.10	542,260,915.10	-
Other Comprehensive Income for the Period		-		21,561,711.24	21,561,711.24
Transaction with the owners					-
Book value of Land transferred is adjusted from reserve	-33,321.03	-33,321,034.23			-33,321,034.23
Issue of Additional Shares	366,456.00	366,456,000.00	-	-	366,456,000.00
Payment of Dividends		-	-	-5,600,000,000.00	-5,600,000,000.00
Balance at December 31, 2021	32,465,093.41	32,465,093,407.26	8,859,898,603.89	5,249,132,840.01	46,574,124,851.15
Adjustment of IFRS 16 Lease				-3,142,376.80	-3,142,376.80
As at January 01, 2022	32,465,093.41	32,465,093,407.26	8,859,898,603.89	5,245,990,463.21	46,570,982,474.35
Net profit for the year 2022					
Net Profit/(Loss) for the year			-	4,624,405,780.58	4,624,405,780.58
Transfer to reserves					-
Transfer to/(from) General Reserve			8,675,331.67	-8,675,331.67	-
Other Comprehensive Income for the Period				1,556,734.58	1,556,734.58
Transaction with the owners					-
Issue of Additional Shares				-	-
Payment of Dividends			-	-5,110,000,000.00	-5,110,000,000.00
Balance at December 31, 2022	32,465,093.41	32,465,093,407.26	8,868,573,935.56	4,753,277,646.70	46,086,944,989.52

v. Accounting policies and Notes

ACCOUNTING POLICIES & NOTES TO ACCOUNTS

SCHEDULES FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2020

NOTE 1: GENERAL CORPORATE INFORMATION

A Nature of Operations

Druk Green Power Corporation Limited ("DGPC" or "the Company") - the public sector generation utility with the vision of " harnessing and sustaining Bhutan's renewable energy resources"- was established in 2008 for the effective and optimal utilization of the scarce water and human resources, to develop the water to wire expertise amongst the Bhutanese, and to lead in accelerating hydropower development on its own or through joint ventures in keeping with the Sustainable Hydropower Development Policy, which was also approved in 2008.

The company is a wholly owned subsidiary of Druk Holding & Investments (DHI), the holding company for government owned companies. The company has been incorporated and registered under the Companies Act of the Kingdom of Bhutan, 2000 and has registered office located at Thimphu, Bhutan

Comprehensive Income when, and only when, the entity has a legal right and is allowed by the standard to offset the amounts and intends either to settle on a net basis or to realize the assets and settle the liability simultaneously. The legally enforceable right must not be contingent on future evets and must be enforceable in the normal course of business and in the event of default, insolvency, or bankruptcy of the entity or the counterparty.

iii. Functional and Presentation Currency

Items included in the financial statements of the company are measured using the currency of the primary economic environment in which the company operates. The functional currency of DGPC is Bhutanese Ngultrum (Nu) which is also the presentation currency.

iv. Use of Estimates

The preparation of Financial Statements in conformity

Source: DGPC Annual Report 2018

» Consistency of presentation

An entity should retain the presentation and classification of items in the financial statements from one period to the next, unless the new presentation and classification provides better information to users. Similarly, the entity must consistently follow the accounting policies over the given period of time, unless it is required by law or any changes in the current accounting standards or industry practices.

7.5 Capital and Revenue Items

It is customary to differentiate expenditure in business as capital or revenue.

» Capital Expenditure

Those expenditures incurred in the purchase of non-current assets, the benefits of which will be derived for more than one accounting period. These expenditures are 'non-recurring' in nature. All the expenses incurred till the asset is ready for use are treated as capital expenditure. Further, any expenditure incurred for the purpose of increasing profit earning capacity or reducing cost of production is also treated as capital expenditure. All the capital expenditure incurred on an asset forms a part of cost of that asset, and is shown in the statement of financial position.

» Revenue Expenditure

Those expenditures which are incurred by business in the day to day conduct and administration of its activities. Such expenditure generates benefits within the current accounting period. These expenditures are recurring in nature. They are sometimes called as expired costs. Example: purchase of goods, payment of salaries to staffs, payment of rent for building, traveling expenses, etc. Revenue expenditures are expensed, and are shown in the income statement.
It is also appropriate to distinguish between capital receipts and revenue receipts from conceptual point of view as well as for presentation of such items in the financial statements.

» Capital Receipt

Those receipts, which are non-recurring in nature, and are not generated by the sale of goods or services in the ordinary course of the business. Such receipts are shown under liabilities in statement of financial position. For example, Cash and kind contributed by the proprietor/owner into the business, loan taken from financial institutions, proceeds from sale of non-current/fixed assets etc.

» Revenue Receipt

It refers to those receipts which are recurring in nature and are also available for meeting the day to day expenses of a business. For example, sale proceeds of goods and services, interest received from banks, trading commission on sale of goods, rent received from tenants, etc. These receipts are shown in Income Statement.

Learning Activity 1: Read the case study and answer the questions that follow:

Sonam Trading Company has been in imports business for the past fifteen years. It purchases electronic goods from Nepal and Thailand, and distributes in Thimphu and other parts of the country. Items like I-phone, I-pad and LCD screen dominated the recent import bills. As usual, Sonam Trading Company filed its tax returns for the financial year 2017 with DRC Phuntsholing. However, the officials of DRC found out that the tax return of the company needed some correction. For this the company was asked to provide the financial records and the accompanying documents. Later, it was found that some of the transactions of revenue nature were treated as capital and vice versa. Due to such errors, the financial statements of the business were found to be misleading.
These are the transactions:

a. Purchase of CCTV for Nu.500,000, of which worth of Nu.50,000 was installed in the business counter.

b. Salary advance of Nu.10,000 to salesman in the month of December 2019 was recorded as Salary of December.

c. Purchase of Pick-up Utility Van costing Nu.800,000 from Zimdra Automobiles was recorded in Purchase book.

d. Wages of Nu.30,000 paid to the carpenter for making shelves was debited in the Wages account

e. LCD worth of Nu.65,000 sold to Wangbama Central School was wrongly debited to purchase account.

f. Printer costing Nu.30,000 was recorded in printing and stationery account.

Complete the Table 7.1 by using the information from the case study.

Table 7.1 Classification of capital and revenue expenditure

Sl.No.	Transaction	Nature of expenditure	Justification
a			
b			
c			
d			
e			
f			

Questions:

a. List any four differences between capital expenditure and revenue expenditure.

b. Describe the significance of identifying capital and revenue items.

c. Examine how would each of these transactions affect the financial information in the financial statements.

7.6 Types of Financial Statements

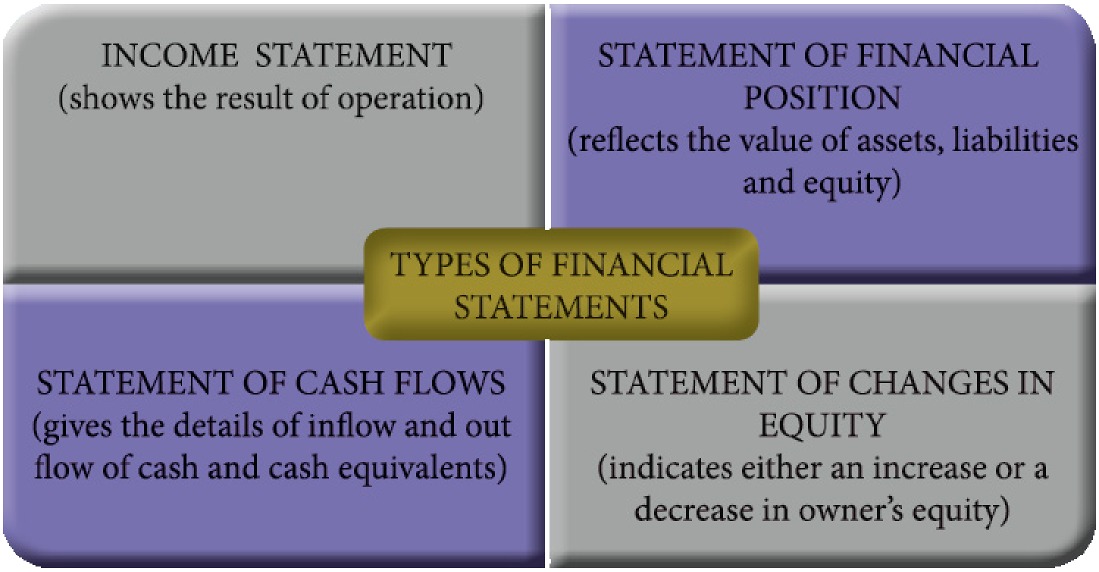


Figure 10.1 *Types of financial statements*

7.6.1 Income statement

Income Statement, otherwise called the Statement of Profit or Loss, reports the company's financial performance in terms of net profit or loss over a specified period. Income Statement comprises of the following items of income and expenses:

» **Revenue**

It refers to the income earned from the principal revenue producing activities, also known as operating activities of the enterprise. For example, a cement manufacturing company generate its revenue from sale of different grades of cement such as PC and PPC. The retail and wholesale companies in consumer goods generate revenue from the sale of inventories of consumable items. Similarly, an advertisement company may generate revenue from sale of advertisements. Think about banks and other financial institutions. For example, banks do not sell any physical goods, therefore, it cannot generate revenues from sale of physical goods as retail companies do. Instead banks make its revenue from the sale of loans and advances and other banking services such as credit cards, discounting of bills, e-banking, overdraft and bank guarantees. In the similar way, entities in airline industry generate revenue from sale of air tickets and freight charges rather than selling of a physical goods, though some airlines may also sell some consumable items in the flight to augment their main revenue.

The income generated from these principal activities or from the operating activities of the entity is also called 'income from operating activities' or simply put it as 'operating income'. Remember, the concept of operating income is very useful when financial statements users analyse the financial statements for decision making.

The income from sales or revenue is reported as a separate line item in the Statement of Income. All incomes generated from sources other than main revenue activities (sales) are reported as 'Income from Other Sources' or simply put it as 'Other income'.

Net Sales/Revenue = Total Sales – Sales returns

» Other Income

Those income earned by business entity from non- operating activities. Example of other income are: profit on sale of non-current assets, interest earned on fixed deposit, dividend etc.,

» Cost of Materials consumed

Cost of materials consumed means the cost of raw materials and other materials consumed in manufacturing the goods.

Cost of materials consumed = Opening inventory (stock) of materials + purchase of materials – closing inventory (stock) of materials

In the manufacturing entity, cost of sales is calculated as the sum of cost of material consumed, direct labour costs and manufacturing overheads..

» Purchases of inventory

It means goods purchased for resale in the business entity. It is current assets.

Net Purchase = Total purchases- Purchase returns

The cost of purchase is presented in the income statement as cost of sales which is cost of goods sold. The portion of inventory purchase which is not yet consumed or sold is presented as inventory and it is accounted for under BAS2. The inventory is presented as current asset in the statement of financial position. It is only the cost of purchases consumed or sold that forms the cost of goods sold or cost of sales that is presented in the income statement.

» Changes in inventories of goods:

It is the difference between the opening and closing inventories. The average inventory is calculated as:

$$\frac{\text{Open inventory} + \text{closing inventory}}{2}$$

» Employees benefit expenses

It is payments made to the services provided by employees, labourers, workers etc. For examples, wages, salaries, bonus etc., paid to the staffs. Employee benefits also include post-employment benefits such as gratuity, pension and provident funds payable at the time of retirement or separation of the employee. Employee benefit expenses are also called employee costs.

» Finance costs

These are costs associated with borrowing of funds or loans from banks and other financial institutions. It includes interest paid on term loan and bonds. Finance costs such as interest on loans are expensed but the finance costs incurred on borrowed funds used in construction of a qualifying assets must be capitalised. The borrowing costs deserve some attention of students since its treatment is quite tricky. Borrowing costs are interest and other costs incurred by the entity to raise finance for buying or construction of items of property, plant and equipment. Not all borrowing costs of purchases and construction of items of PPE qualify for capitalisation. The borrowing cost which relates to 'qualifying asset' only can be capitalised. Qualifying asset is defined as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. This means, if the purchase or construction of an asset is not going to take substantial time to put the asset into its use or sale, the costs incurred on borrowing that fund to purchase or construct the asset will not be capitalised. Further, the entity can capitalise interest expense only for the time when construction is taking place. Capitalisation starts from the date when the borrowing costs were incurred or the construction activity started, whichever is later. The capitalisation of interest costs ceases when substantially all work necessary to get the asset ready for its intended use or sale is complete. It excludes the time when construction activity was suspended.

Illustration1

Tenzin Construction Company started construction of a warehouse on 1st January 2018 after a stone foundation was laid. On 1st March 2018, the company raised Nu. 8 million 7% loan from Bank of Bhutan Limited to finance the construction work. Construction work was suspended in the month of June and July due to labour shortage. The construction was completed in December 2018 at a cost of Nu. 7 million.

The construction lasted 10 months but the interest capitalisation period is only 8 months since construction work was suspended for 2 months and the loan was obtained after 2 months

(March) of commencement of construction.

The interest expense to be capitalised would be calculated as follows: Nu. 7 million x 7 % x 8/12 = Nu. 326,667.

PPE- warehouse	a/c	Dr	326,667[interest cost capitalised]	
To Bank/Payables		Cr		326,667

The interest for June and July of Nu. 81,667 would be treated as an expense in the statement of income.

Finance cost	a/c	Dr	81,667	[7 million x 7% x 2/12]
To Bank		Cr		81,667

» Depreciation and amortisation expenses

Depreciation is an expired cost of assets. It is the fall in value of the non-current tangible asset due to its usage or efflux of time or obsolescence. Depreciation expense is the systematic allocation of cost of tangible assets over its useful life.

Amortisation is the process of allocating the cost of intangible asset over a period of time. Amortisation also refers to the repayment of loan principal amount over the loan period. Both depreciation and amortisation are treated as expenses and presented in the income statement.

» Other expenses:

Expenses that are not covered under any of the above expense are presented under the heading 'other expenses'. These are generally expense items which are individually not material to be presented as a separate line item in the income statement. Thus, they are aggregated and presented under other expenses.

Measurement of Business Performance

The performance in business entities is measured by its profit. Profit is the primary objective of the business and the basis to give investors the return they require. Profit also provides funds for reinvestment in the business. Profit in business can be interpreted in different ways and the user of information may like to use a particular type of profit figure to assess the performance of the business entity.

» Gross profit

Gross profit is revenue minus the cost of goods sold or cost of sales, which are the direct costs attributable to the production or acquisition of the goods sold by the entity. Gross profit focuses on the entity's trading (main revenue earning) activities. The higher gross profit indicates a healthy trading and a sustainability of the business entity.

» Operating Profit

Operating profit is gross profit minus all other fixed and variable expenses associated with operating the business, such as rent, utilities, and payroll. Interest on borrowings and business tax expenses are classified as non-operating expenses. Therefore, operating income is also called 'earnings before interest and tax' (EBIT).

» Profit before tax

Profit before tax (PBT) is earnings before interest and tax (EBIT) minus interest on borrowed funds.

» Profit after tax

Profit after tax (PAT) is the profit before tax minus tax expenses of the entity.

Specimen of Income Statement

A business entity preparing a statement of income shall present an analysis of expenses using a classification based on either:

i. their nature or

ii. their function

within the entity, whichever provides information that is reliable and more relevant.

Format of Income Statement - Nature of Expense Method

Particulars	Note No.	Current Year	Previous Year
Revenue		XXXX	XXXX
Other incomes		XXXX	XXXX
Total Revenue		**XXXXX**	**XXXXX**
Expenses:			
Changes in inventories of finished goods and work in progress		XXXX	XXXX
Raw materials and consumables used		XXXX	XXXX
Employee benefits expense		XXXX	XXXX
Depreciation and amortisation expense		XXXX	XXXX
Other expenses		XXXX	XXXX
Total expenses		**XXXXX**	**XXXXX**
Profit before tax		XXXX	XXXX

Statement of Comprehensive Income of PCAL for the year ended on 31st December 2022

PENDEN CEMENT AUTHORITY LIMITED

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER, 2022

(Amount in Nu.)

Particulars	Notes	For the year ended 31 December, 2022	For the year ended 31 December, 2021
Revenue			
Revenue from operations	21	499,794,235	909,219,120
Other income	22	46,574,784	33,574,407
Total Revenue		**546,369,019**	**942,793,527**
Expenditure			
Cost of materials consumed	23	168,751,977	294,950,168
Other manufacturing expenses	24	297,182,560	385,527,470
Changes in inventories of finished goods and work in progress	25	(26,497,343)	17,453,676
Employee benefit expenses	26	188,489,953	193,278,358
Finance costs	27	13,851,422	7,204,724
Depreciation and amortization expenses	4 & 5	69,267,648	71,448,677
Selling and transportation expenses	28	33,484,217	38,906,665
Other expenses	29	25,113,962	15,332,101
Total Expenditure		**769,644,396**	**1,024,101,839**
Loss before tax		**(223,275,377)**	**(81,308,312)**

Source: PCAL Annual Report 2022

Format of a Statement of Income - Function of Expense Method:

Particulars	Current Year	Current Year
Revenue	XXXX	XXXX
Cost of sales	(XXXX)	(XXXX)
Gross profit	XXXXX	XXXXX
Other income	XXXX	XXXX
Distribution costs	(XXXX)	(XXXX)
Administrative expenses	(XXXX)	(XXXX)
Other expenses	(XXXX)	(XXXX)
Profit before tax	**XXXX**	**XXXX**

Natural Resources Development Corporation Limited uses function of expenses method.

Statement of comprehensive income for the period ended 31 December 2017

Particulars	Note	Year Ended	
		31-12-2018	31-12-2017
		(Nu)	(Nu)
Continuing Operations Revenue	17	672,499,675	459,012,743
Total revenue Cost of Sales Gross Profit	 18	672,499,675 529,015,451 143,484,224	459,012,743 360,317,280 98,695,463
Operation Expenses: Selling & Marketing Expenses Administrative Expenses Provision for Compensation	 19 20	 1,639,430 84,408,210 -	 5,027,233 68,837,137 75,853,592
Total Operating expenses		86,047,640	149,717,961
Operating profit(loss) Profit(loss) before income tax		57,436,584 57,436,584	(51,901,028) (51,901,028)
Income tax expenses	21	17,628,795	9,926,456
profit (loss) for the year		39,807,789	(61,827,485)

Source: NRDCL, Annual report, 2017

*Cost of sales** = Opening inventory + purchases - closing inventory + direct labour cost + overhead costs*

*Cost of sales** = Cost of material consumed + direct labour cost + overhead costs*

Employee costs for labour engaged in production of goods is treated as direct labour cost. This employee cost forms part of cost of sales whereas the employee cost incurred on administrative and general staff is presented as administrative expenses.

Case Infocus

Karma Yoeten

Business: Greener Way

Country: Bhutan

Member: The Loden Entrepreneurship Programme

Karma (30) is Bhutan's first citizen to turn waste management and recycling into a business. He saw opportunity in the country's maligned, unsightly and toxic landfills, which posed a danger to people's health.

With the assistance of YBI member The Loden Entrepreneurship Programme (LEP), Karma launched his pioneering enterprise, Greener Way, with basic equipment and a waste collection van.

Today this burgeoning business – operating across 5 regions and praised for contributing towards Bhutan's gross national happiness philosophy – is tackling the country's growing waste problem head-on. It collects, separates and correctly disposes of domestic waste material; it manages over 1,000 tonnes of recyclable matter; it has launched ground-breaking education initiatives; and it turns organic waste into high-grade compost.

"To quit my job and take up the waste business, which is considered very low profile in Bhutan, was never welcomed," says Karma. "But I had a business dream and I was not going to let it go."

"The Loden Enterprise Programme believed in my business idea and in me, and their timely grant of capital enabled me to buy the necessary equipment and a van to collect waste," says Karma. "Furthermore, the LEP's encouragement, mentoring and support were the driving force behind my venture into this business."

Karma Yonten Business: Greener Way Country: Bhutan

Read the case given in the table and answer the following questions.

i. Discuss the benefits of starting a business as reported by Karma Yonten in the case.

ii. Analyse and explain how the capital money received from Loden Entrepreneurship Programme would be accounted in the books of Greener Way.

iii. Identify components of costs that would go in the calculation of cost of sales of Greener Way.

iv. If you are undertaking similar business, what are some of the ways through which you can earn and sustain the business.

7.6.2 Statement of Financial Position

Statement of Financial Position shows the financial position of an entity at a given point of time. It helps users of financial statements to evaluate the liquidity and solvency of an entity. The users can assess the financial leverage and the financial risk of the reporting entity by analysing the debt-equity ratio. Along with income statement, statement of financial position helps users to evaluate efficiency and effectiveness of management in generating returns on capital employed and the future expected growth of the entity. This can be possible only if the assets, liabilities and equity are presented at the fair value.

Recognition of assets, liabilities and equity

As discussed in chapter 1, assets, liabilities and equity must be recognised in the statement of financial position only if:

i. the item of asset, liability or equity meets the definition of asset, liability and equity and

ii. the item of asset, liability and equity fulfills the recognition criteria

All subsequent expenditures after acquisition of asset such as property, plant and equipment are capitalized and are recognized as part of the cost of the asset if such expenditure results into increase of the useful life of the asset or enhance the productivity of the asset.

» Information to be presented in the statement of financial position

The statement of financial position must include line items that present the following amounts:

- property, plant and equipment
- investment property
- intangible assets
- biological assets
- inventories
- trade and other receivables
- cash and cash equivalents
- the total of assets classified as held for sale
- trade and other payables
- provisions
- issued capital and reserves

» Classification of assets, liabilities and equity

The financial statements must be presented with various items of assets, liabilities and equity properly classified. Broadly, the assets and liabilities are presented by classifying them as current and non-current.

i. Current and Non-current assets

ii. Current and Non-current liabilities

a. Current asset

Short term used assets which are held not more than a year. Current assets can be tangible as well as intangible.

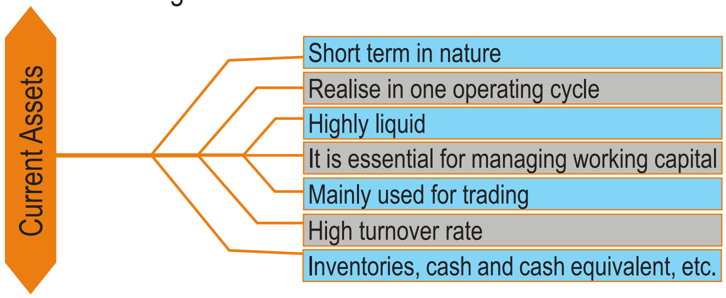


Figure 7.2 Characteristics of current assets

Types of current assets

- ***Cash and Cash Equivalents***

  The most liquid assets, including currency, bank balances, and short-term investments with maturities of less than three months. They are used for day-to-day transactions and meeting immediate obligations.

- ***Accounts Receivable***

  Amounts owed to the company by customers for sales made on credit. Effective collection policies are crucial to maintain liquidity.

- ***Inventory:***

  The inventory for a business are mainly constitutes raw materials, work-in-progress, and finished goods. Inventories are required to meet daily sales and production needs.

- ***Marketable Securities:***

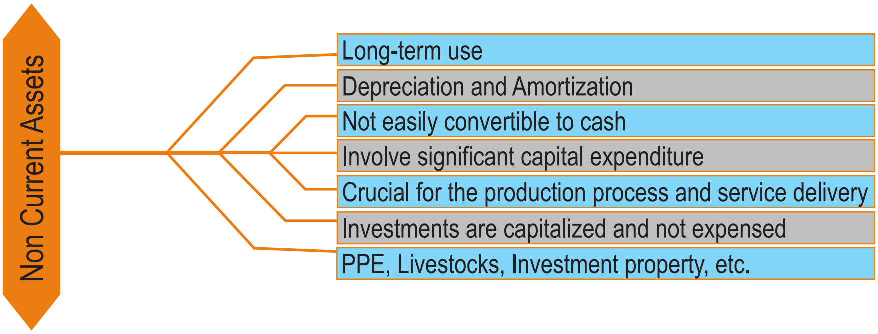
  Short-term investments that can be quickly converted into cash, such as treasury bills and other highly liquid instruments. While maintaining liquidity, it provides returns to the business.

- ***Prepaid Expenses:***

  Payments made in advance for goods or services to be received in the future, such as insurance premiums and rent. It is an intangible current assets recorded until the benefit is received, after which they are expensed.

b. Non current asset

Non-current assets, also known as long-term assets, are assets that a company expects to hold for more than one year or the operating cycle of the business. These assets are not readily convertible into cash within a short period and are used in the operations of a business over the long term. The term 'non-current' includes tangible and intangible assets of a long-term nature.



7.3 Characteristics of non current assets

Types of non current assets

- ***Property, Plant, and Equipment (PP&E)***
  PP&E are non current assets in the form of land, buildings, machinery, vehicles, furniture, and equipment. These assets are (except land) depreciated over their useful lives to account for wear and tear.

- ***Intangible Assets***
  Asset such as patents, trademarks, copyrights, goodwill, and software do not have physical existence but have legal value or intellectual properties. Intangible assets are amortized over their useful lives.

- ***Investment Property***
  It refers to building and land held for earning rental income or capital appreciation rather than for use in the business operations.

- ***Long-Term Investments***
  Investments in stocks, bonds, or other financial instruments including investments in subsidiaries, associates, or joint ventures that are intended to be held for more than one year.
- ***Bearer plants***
  Plants and trees that are grown for bearing fruits and not for harvesting the tree or plant.

Note: An entity shall classify all other assets as non-current

c. **Current Liability**

Current liabilities are obligations that a company needs to settle within one year or within its operating cycle, whichever is longer. These liabilities are crucial for understanding a company's short-term financial health and liquidity.

d. **Long Term Liability**

Long-term liabilities, also known as non-current liabilities, are financial obligations that a company is required to pay over a period longer than one year. These liabilities are crucial for financing major projects, capital expenditures, and long-term investments.

Learning Activity 2

Using a reliable source, list different types of current and non current liabilities and make a presentation to the class.

e. **Equity**

Equity is what the business owes to its owners. Equity is derived by deducting total liabilities from the total assets. Also, equity represents the net asset. Equity is presented in the statement of financial position under the following categories:

i. **Share capital:** Share capital represents the amount invested by the owners in the entity

ii. **Retained earnings:** Retained earnings comprises the total net profit retained in the business after distribution to the owners in the form of dividends.

iii. **Reserves:** Reserves is a part of equity other than the share capital. An entity may have different types of reserves under equity capital. Reserves are sometimes mistakenly used in the place of provision. Reserves are part of profit which is put back to the business for use in future whereas provision is a liability of uncertain timing or amount.

An entity must disclose the following, either in the statement of financial position or the statement of changes in equity, or in the notes:

a. **for each class of share capital**

i. the number of shares authorised

ii. the number of shares issued and fully paid, and issued but not fully paid

iii. par value per share, or that the shares have no par value

iv. a reconciliation of the number of shares accrued at the beginning and at the end of the period

v. the rights, preferences and restrictions attaching to that class including, and

vi. restrictions on the distribution of dividends and the repayment of capital

b. a description of the nature and purpose of each reserve within equity.

An entity without share capital, such as a partnership or sole trader, must disclose information equivalent to that of the corporate entity as discussed in the above section showing changes during the period in each category of equity interest.

Specimen of Statement of Financial Position as at............................

Particulars	Notes No.	Current Year	Previous Year
ASSETS			
Non-Current Assets			
Property, Plant and Equipment		xxxxxx	xxxxxx
Intangible assets		xxxxxx	xxxxxx
Investment property		xxxxxx	xxxxxx
Investment in Fixed Deposit		xxxxxx	xxxxxx
Total Non-Current Assets		xxxxxx	xxxxxx
Current Assets			
Inventories		xxxxxx	xxxxxx
Trade Receivables		xxxxxx	xxxxxx
Other Receivables		xxxxxx	xxxxxx
Cash and Cash Equivalents		xxxxxx	xxxxxx
Total Current Assets		xxxxxx	xxxxxx
Total Assets		xxxxxx	xxxxxx
EQUITY AND LIABILITIES			
Capital and Reserve			
Share Capital		xxxxxx	xxxxxx
Retained Earnings		xxxxxx	xxxxxx
Revaluation Reserve		xxxxxx	xxxxxx
Total Equity		xxxxxx	xxxxxx
Non-Current Liabilities			
Retirement Benefit Obligations		xxxxxx	xxxxxx
Amounts Due to Directors		xxxxxx	xxxxxx
Long Term Borrowings		xxxxxx	xxxxxx
Total Non-Current Liabilities		xxxxxx	xxxxxx
Current Liabilities			
Trade Payables		xxxxxx	xxxxxx

Other Payables		xxxxxx	xxxxxx
Current portion of long term borrowing		xxxxxx	xxxxxx
Current Tax Liability		xxxxxx	xxxxxx
Bank Overdrafts		xxxxxx	xxxxxx
Total Current Liabilities		xxxxxx	xxxxxx
Total Liabilities		xxxxxx	xxxxxx
Total Equity and Liabilities		xxxxxx	xxxxxx

Learning Activity 3

Visit the official websites of five companies in Bhutan and obtain the statement of financial position from their recent year annual report. Critique the format followed and make a class presentation.

7.6.3 Statement of changes in equity

Statement of Changes in Equity, also called the Statement of Retained Earnings, details the movement in owners' equity over a period. The movement in owners' equity is derived from the following components:

i. Net Profit or Loss during the period as reported in the income statement

ii. Share capital issued or repaid during the period

iii. Dividend paid to the shareholders

Following are the main elements of statement of changes in equity:

» **Opening Balance**

This represents the balance of shareholders' equity and reserves at the start of the comparative reporting period, as reflected in the prior period's statement of financial position. The opening balance is unadjusted in respect of the correction of prior period errors (if any) rectified in the current period, and also the effect of changes in accounting policy implemented during the year as these are presented separately in the statement of changes in equity.

» **Changes in Share Capital**

Issue of further share capital during the period must be added in the statement of changes in equity, whereas redemption of shares must be deducted therefrom. The effects of issue and redemption of shares must be presented separately for share capital reserve and share premium reserve.

» **Dividends or Drawings**

Dividend payments issued or announced during the period must be deducted from shareholder's equity as they represent distribution of wealth attributable to stockholders.

» **Income / Loss for the period**

This represents the profit or loss attributable to shareholders during the period as reported in the income statement.

» **Changes in Revaluation Reserve**

Revaluation gains and losses recognized during the period must be presented in the statement of changes in equity to the extent that they are recognized outside the income statement. Revaluation gains recognized in income statement due to reversal of previous impairment losses however shall not be presented separately in the statement of changes in equity as they would already be incorporated in the profit or loss for the period.

» **Other Gains & Losses**

Any other gains and losses not recognized in the income statement may be presented in the statement of changes in equity such as actuarial gains and losses arising from the application of Employee Benefit.

» **Closing Balance**

This represents the balance of shareholders' equity reserves at the end of the reporting period as reflected in the statement of financial position.

Statement of changes in Equities
For the year ended..........

Particulars	Share Capital	Retained Earning	Revaluation Surplus	Total Equity
Opening Balance	xxx	xx	xxx	xxx
Issue of share capital	xx			xx
Profit for the year		xx		xx
Revaluation gain/Reserve			xx	xx
Dividends				(xx)
Drawings				(xx)
Closing Balance	XX	XX	XX	XXX

7.6.4. Statement of cash flows

Statement of cash flows present the position of entity's cash and cash equivalents. Cash comprises of cash in hand and demand deposits. Cash equivalents are short- term, highly liquid investments that are readily convertible to known amounts of cash without a significant risk of change in their value. The short-term investments in government treasury bills and other similar instruments with maximum of 3 months and less maturity days are examples of cash equivalents.

The cash flows are categorised into:

i. **Cash flows from operating activities:** Operating activities are the principal revenue-producing activities of the entity. Example: purchase and sale of goods.

ii. **Cash flows from investing activities:** Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples: purchases and sales of property, plant and equipment.

iii. **Cash flows from financing activities:** Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. Example: issue of shares, bonds, obtaining bank loans, etc.

Statement of Cash Flow

Particulars	Notes	Current Year
I. Cash flows from operating activities		
Profit before tax		xxx
Adjustments for non-cash items of income and expenses:		
Depreciation		xxx
Amortization		xxx
Interest expense		xxx
Gain on revaluation of investments		(xxx)
Interest income		(xxx)
Dividend income		(xxx)
Gain on disposal of fixed assets		(xxx)
Operating Profit before working Capital Changes		xxx
Working Capital Changes:		
Movement in current assets:		
(Increase) / Decrease in inventory, trade receivables		xxx
Movement in current liabilities:		
Increase / (Decrease) in trade payables,		xxx
Cash generated from operations		xxx

Dividend paid		(xxx)
Income tax paid		(xxx)
Net cash from operating activities (A)		**xxx**
II. Cash flows from investing activities		
Capital expenditure		(xxx)
Purchase of investments		(xxx)
Dividend received		xxx
Interest received		xxx
Proceeds from disposal of fixed assets		xxx
Proceeds from disposal of investments		xxx
Net cash flow in investing activities (B)		**xxx**
III. Cash flows from financing activities		
Issue of share capital		xxx
Bank loan received		xxx
Repayment of bank loan		(xxx)
Interest expense		(xxx)
Net cash flow from financing activities (C)		**xxx**
Net increase in cash & cash equivalents (A+B+C)		**xxx**
Cash and cash equivalents at start of the year		**xxx**
Cash and cash equivalents at end of the year		**xxx**

7.6.5 Notes

The notes typically describe each item on the statement of financial position, income statement and cash flow statement in further detail. It provides additional information pertaining to a company's operations and financial position, and is considered to be an integral part of the financial statements.

The 'notes' should:

i. Present information about the basis of preparation of the financial statements and the specific accounting policies;

ii. Disclose the information required that is not presented elsewhere in the financial statements; and

iii. Provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

An entity should, as far as practicable, present notes in a systematic manner. In determining a systematic manner, the entity should consider the effect on the understandability and comparability of its financial statements. An entity should cross-reference each item in the statements of financial position and in the statement(s) of income and in the statements of changes in equity and of cash flows to any related information in the notes.

Exercises:

1. State whether the following statements are True or False
   a. Depreciation on machinery is an example of revenue expenditure.
   b. Inventory valuation affects only the statement of financial position.
   c. Income received in advance is considered as liability.
   d. Deferred expenditure is shown as an asset.
   e. Furniture sold by furniture house is capital expenditure.

2. Fill in the blanks with appropriate words:
   a. Unearned income means income received in ---------------------
   b. Deferred expenses are------------------- of the business.
   c. An expenditure which benefit current period is called --------------expenditure.
   d. An amount spent on painting a new factory building is ------------expenditure.

3. Answer the following questions
   a. Explain any four essential features of good financial statements.
   b. A fraudulent Financial Statement can impact not only one's business but also the country's exchequer. Comment.

4. The most important assumption we use when preparing financial statements of a business entity is
   a. separate entity.
   b. matching.
   c. going concern.
   d. money measurement.

5. The difference between fundamental and enhancing qualitative features of financial statement is

a. fundamental qualitative characteristics are more critical than enhancing qualitative features to provide relevant information to users.

b. the enhancing qualitative features are less useful to small business entities as their information may not be widely used.

c. enhancing qualitative features are covered by fundamental qualitative features.

d. fundamental and enhancing qualitative features are equally important when preparing financial statements.

6. ABC child care centre collected Nu. 120,000 in December 2018 as an advance fees from students. In which year this amount should be recognised as revenue?

   a. 2018
   b. 2019
   c. 2020
   d. 2021

7. At the end of December 2019, ABC child care centre owed Nu. 245,135 to its teachers as salaries accrued. In which year, should this be matched with income earned?

   a. 2018
   b. 2019
   c. 2020
   d. 2021

8. Triple bottom line reporting measures business performance in terms of

   a. profit earned by business during the financial year.
   b. promotion of employee welfare, training and development during the financial year.
   c. (a) only
   d. (a) and (b)

Chapter 8
Introduction to Management Accounting

Learning objectives:

- Define management accounting
- Explain the purposes of management accounting
- Examine the scope of management accounting
- Explain the tools of management accounting

8.1 Concepts of Management Accounting

A manager of a business is responsible for making decisions, planning for the future, coordinating activities both within and outside the business, motivating employees, explaining tasks, and setting goals for the business. To perform these duties effectively, the manager rely heavily on accounting information provided by financial accounting. While generally the financial accounting ends with the preparation of financial statements, the management accounting further process the financial information using various managerial tools, such as ratio analysis, cash flow statements, and comparative and common-size balance sheets and income statements. Thus, management accounting plays a crucial role in the day-to-day operations of the business.

Management accounting is a specialized branch of accounting developed to meet the specific needs of management. It provides essential information to aid in policy creation and daily business operations. By utilizing accounting information, management accounting supports the functions of planning, organizing, staffing, directing, and controlling, ensuring efficient business management.

Definition

According to the Chartered Institute of Management Accountants (CIMA), United Kingdom (UK), Management Accounting is "the process of identification, measurement, accumulation, analysis, preparation, interpretation and communication of information used by management to plan, evaluate and control within an entity and to assure appropriate use of and accountability for its resources. Management accounting also comprises the preparation of financial reports for non-management groups such as shareholders, creditors, regulatory agencies and tax authorities"

Learning Activity 1

The manager of a car dealer business found that the sales has decreased drastically recently. To boost the sales, manager thought that providing incentives to the salespersons would be a good strategy. The manager has decided to pay a bonus whenever sales exceeds a specified target. However, the salespersons see that the current month's sales would not reach the target. Therefore, they discouraged the customers to purchase in the current month stating that the company may offer better discount in the upcoming month to increase the sales volume.

Answer the following questions in reference to the above statement:

iv. Do you think the decision taken by the manager was right in the interest of the company?

v. If you were the manager, what could be your decision in the interest of the company?

vi. What are some of the basis of information on which the manager take decision?

Purposes of Management Accounting

Management accounting plays a crucial role in helping organisations achieve their financial and operational objectives through effective planning, decision-making, and control.

Some of the purposes of management accounting are:

- ***Planning and Budgeting***
  Management accounting helps in setting financial and operational goals for the organization by forecasting future financial performance and resource requirements.

- ***Performance Measurement and Control***
  Management accounting establishes performance benchmarks and measures actual performance against these standards. It helps in identifying variances between planned and actual performance. It designs information for corrective actions to improve performance and achieve organisational goals.

- ***Assists in Decision-making process***
  With the help of various modern techniques, management accounting makes decision-making process more scientific. Data provided by financial and cost accounting are collected and analysed as a basis for taking sound decisions.

Learning Activity 2

In Media Advertising Ltd., the manager of the company has a problem. The sales forecast was planned as 60 percent home and 40 percent export. The export sales have not met expectations because the home currency has become stronger during the year and overseas buyers now think the advertising charges are too high. The manager has two choices:

i. Reduce the price charged to overseas buyers and risk complaints from home customers.

j. Accept the lower volume of export sales and try to increase home sales by reducing the price charged to home customers.

Questions:

i. If you were the manager, which option would you like to choose in the interest of the company and why?

ii. How would you insure that collective decision is arrived at pertaining to the above case for the benefit of the company in future?

- ***Interprets accounting information***
  Financial information provided by Income Statement and the Statement of Financial Position is technical in nature and doesn't give required information to the users. Therefore, it must be presented in such a way that it is easily understood. It presents accounting information with the help of different tools used by management accounting.

- ***Reporting***
  Management accounting insures that the performance and the activities of the business are timely reported for the purpose of quick action. The performance of various departments is regularly reported to the top management.

- ***Provides Data, Not the Decision***
  Management accounting is not an end but means. It furnishes the data and the decision has to be made by the management. Quality of decision depends on the analytical capacity of the managers.

- ***Assist in Achieving Objectives***
  Unlike financial accounting, management accounting is not restricted to preparation and presentation of the facts and figures which has already taken place. It supplies the information to the management which is crucial for achieving the long term and short term goals of the business.

- ***Use of Special Tools***
  Management Accounting uses special tools like Ratio Analysis, cash flow statements and statement analysis to make accounting data more useful and relevant. The type of tools determined according to the situation and necessity.

8.2 Interrelationship between Management, Financial and Cost Accounting

Management accounting, cost accounting, and financial accounting are closely interrelated, but they serve different purposes and cater to different stakeholders. The financial accounting focuses on external reporting and compliance, cost accounting delves into the specifics of cost management, and management accounting uses information from both to support internal decision-making and strategic planning.

- ***Data***
  Financial accounting provides the foundational data (such as revenues, expenses, assets, and liabilities) which is used by management accounting for further analysis and internal reporting. Cost accounting generates detailed cost data, which is used in financial accounting for valuing inventory and determining the cost of goods sold.

- ***Integrated Reporting***
  Cost data from cost accounting is used to create financial statements in financial accounting. Management accounting uses data from both financial and cost accounting to prepare reports that aid in internal decision-making.

- ***Decision-Making***
  Financial accounting ensures compliance and provides a financial overview, while cost and management accounting provide the detailed information needed for day-to-day management decisions and strategic planning.
- **Compliance and Strategy:**
  Financial accounting ensures compliance with external standards and regulations. Cost accounting provides the detailed cost information necessary for financial reporting and internal cost control. Management accounting uses information from both to develop strategies, budgets, and forecasts that guide the organization.

8.3 Tools of Management Accounting

The management accounting uses various tools for analysis and decision making, the tools discussed under this section are:

a. Ratio Analysis

b. Common Size Statements

Ratio Analysis

Liquidity Ratios	Solvency Ratios	Activity Ratios	Profitability Ratios
Firm's ability to meet current obligations. a. Current ratio b. Quick ratio	Firm's ability to meet long term obligations. a. Debt equity ratio b. Debt to asset ratio c. Interest coverage ratio	Measure how effectively a business utilizes its assets and manages its operations. a. Inventory turnover ratio b. Debtors turnover ratio c. Creditors turnover ratio d. Working capital turnover ratio	Provide insights into the financial health and performance of a business, and ability to generate earnings. a. Gross profit ratio b. Operating profit ratio c. Net profit ratio d. Return on equity e. Earning per share

Ratio analysis is a widely used by management. It is a quantitative method of analyzing financial statements to evaluate a company's performance, financial health, and operational efficiency. By comparing different figures from the balance sheet, income statement, and cash flow statement, ratio analysis provides insights into various aspects of the business.

» Liquidity ratios

Liquidity ratios measure a company's ability to meet its short-term obligations using its most liquid assets. These ratios are crucial for assessing the financial health and operational efficiency of a business, especially in terms of its capacity to pay off current liabilities. The two most commonly used liquidity ratios are the current ratio and the quick ratio.

a. Current Ratio

The current ratio measures a company's ability to cover its short-term liabilities with its short-term assets. A higher ratio indicates a stronger liquidity position.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Illustration 1:

Suppose Company A has the following balance sheet items - Current Assets: Nu. 150,000 Current Liabilities: Nu. 100,000

$$\text{Current Ratio} = \frac{150{,}000}{100{,}000}$$

= 1.50

This means Company A has Nu. 1.50 in current assets for every Nu. 1.00 of current liabilities, indicating a healthy liquidity position.

b. Quick Ratio (Acid-Test Ratio)

The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets (excluding inventories). It provides a more stringent test of liquidity than the current ratio.

$$\text{Quick Ratio} = \frac{\text{Current Assets - Inventories}}{\text{Current Liabilities}}$$

Illustration 2:

Suppose Company A has Current Assets: Nu. 150,000, Inventories: Nu. 50,000 and Current Liabilities: Nu. 100,000

$$\text{Quick Ratio} = \frac{150{,}000 - 50{,}000}{100{,}000}$$

= 1.0

This means Company A has Nu,1.00 in liquid assets for every Nu. 1.00 of current liabilities, indicating that the company can meet its short-term obligations without relying on the sale of inventories.

Learning Activity 1:
You are a financial analyst at XYZ Corporation, and you have the following balance sheet information for two consecutive years:

Balance Sheet Items	Year 1 (Nu.)	Year 2 (Nu.)
Current Assets	200,000	250,000
Current Liabilities	120,000	130,000
Inventories	60,000	70,000

Questions:

i. Calculate the current ratio for Year 1 and Year 2.

ii. Calculate the quick ratio for Year 1 and Year 2.

iii. Analyze the liquidity position of XYZ Corporation based on the calculated ratios. Is the company's liquidity improving or deteriorating? Explain your reasoning.

» Solvency ratios

Solvency ratios are financial metrics used to assess a company's ability to meet its long-term debt obligations. These ratios provide insights into a company's financial stability and its ability to continue operations over the long term. Some common solvency ratios:

a. Debt Equity Ratio

The debt to equity ratio measures the relative proportion of shareholders' equity and debt used to finance a company's assets. A lower ratio indicates less reliance on debt and a stronger equity position and vice versa.

$$\text{Debt Equity Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

Illustration 3

Suppose Company A has Total Debt: Nu. 500,000 and Total Equity: Nu. 1,000,000, the debt to equity ratio is

$$\text{Debt Equity Ratio} = \frac{500,000}{1,000,000}$$

=0.5 This means Company A has Nu. 0.50 in debt for every Nu. 1.00 of equity.

Learning Activity 2

Company B has Total Debt: Nu. 600,000 and Total Equity: Nu. 900,000, you are required to:

i. Debt to equity ratio for the Company.

ii. If Company B increases its debt to Nu. 700,000 while keeping equity constant, what would be the new debt to equity ratio?

iii. Discuss the implications of a higher debt to equity ratio for Company B.

b. Debt to Asset Ratio

The ratio measures the proportion of a company's assets that are financed by debt. A higher ratio indicates higher financial leverage and more risk.

$$\text{Debt to Asset Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

Illustration 4

Suppose Company C has Total Liabilities: Nu. 400,000 and Total Assets: Nu. 800,000

$$\text{Debt to Asset Ratio} = \frac{400,000}{800,000}$$

=0.5 This means 50% of Company C's assets are financed by debt.

Learning Activity 3

Company D has total Liabilities: Nu. 300,000 and total Assets: Nu. 750,000, you are required to:

i. Calculate the debt to asset ratio for Company D.

ii. If Company D's total liabilities increase to $450,000, what would be the new debt ratio, assuming total assets remain the same?

iii. Analyze the impact of an increasing debt ratio on Company D's financial risk.

c. Interest Coverage Ratio

The interest coverage ratio measures a company's ability to pay interest on its outstanding debt. A higher ratio indicates a better ability to meet interest obligations.

$$\text{Interest coverage Ratio} = \frac{\text{EBIT}}{\text{Interest Expense}}$$

Illustration 5

Suppose Company E has earnings before Interest and Taxes (EBIT) Nu. 200,000 and Interest Expense Nu. 50,000.

$$\text{Interest coverage Ratio} = \frac{200{,}000}{50{,}000}$$

= 4 This means Company E can cover its interest expense 4 times with its EBIT.

Learning Activity 4

Company F has EBIT: Nu. 180,000 and Interest Expense: Nu. 60,000 you are required to

i. Calculate the interest coverage ratio for Company F.

ii. If Company F's EBIT decreases to $120,000, what would be the new interest coverage ratio?

iii. Discuss the implications of a lower interest coverage ratio for Company F's financial stability.

» Profitability ratios

Profitability ratios are financial metrics used to evaluate a company's ability to generate earnings relative to its revenue, operating costs, balance sheet assets, and shareholders' equity over time. They provide insights into a company's financial health and operational efficiency.

a. Gross Profit Ratio

The ratio measures the percentage of revenue that exceeds the cost of goods sold (COGS). It indicates how efficiently a company produces its goods.

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

b. Operating profit ratio

The ratio measures the percentage of revenue left after covering operating expenses (excluding interest and taxes). It indicates the efficiency of the company's core operations.

$$\text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Net Sales}}$$

c. Net profit ratio

The ratio measures the percentage of revenue that remains as profit after all expenses, including interest and taxes, have been deducted. It indicates the overall profitability of the company.

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}}$$

d. Return on equity

The ratio measures the return generated on shareholders' equity. A higher ROE indicates more efficient use of equity capital.

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Total Equity}}$$

e. Return on Investment

Return on investment (ROI) evaluate the efficiency or profitability of an investment. It measures the gain or loss generated relative to the amount of money invested.

$$\text{Return on Investment} = \frac{\text{Net profit}}{\text{Total initial Investments}}$$

f. Earning per share

Earnings per share (EPS) is a financial metric that indicates the portion of a company's profit attributable to each outstanding share of common stock. It is a key indicator of a company's profitability and is used by investors to evaluate the financial performance of a company.

$$\text{Earning per Share} = \frac{\text{Net profit - Preference Dividend}}{\text{Outstanding No. Equity Shares}}$$

Illustration 6

From the following financial statements of Karma Pvt. Ltd., compute the profitability ratios and provide analysis of it.

Income Statement as of 31 December 2023

Particulars	Amount
Revenue (Sales)	5,000,000
Cost of Goods Sold (COGS)	3,000,000
Gross Profit	**2,000,000**
Operating Expenses	800,000
Operating Profit (EBIT)	**1,200,000**
Interest Expense	100,000
Earnings Before Tax (EBT)	1,100,000
Taxes (30%)	330,000
Net Income	**770,000**
Preferred Dividends	50,000
Net Income available to common shareholders	**720,000**

Statement of Financial Statement (as of 31 December 2023)	
Particulars	Amount
Total Assets	**6,000,000**
Total Liabilities	**3,000,000**
Total Equity	**3,000,000**
Common Shares Outstanding	200,000
Initial Investment	4,500,000

$$\text{Gross Profit Ratio} = \frac{200{,}000}{5{,}000{,}000} \text{X}100 = 40\%$$

$$\text{Operating Profit Ratio} = \frac{1{,}200{,}000}{5{,}000{,}000} \text{X}100 = 24\%$$

$$\text{Net Profit Ratio} = \frac{770{,}000}{5{,}000{,}000} \text{X}100 = 15.4\%$$

$$\text{Return on Equity} = \frac{770{,}000}{3{,}000{,}000} \text{X}100 = 25.67\%$$

$$\text{Return on Investment} = \frac{770{,}000}{4{,}500{,}000} \text{X}100 = 17.11\%$$

$$\text{Earning Per Share} = \frac{770{,}000 - 50{,}000}{200{,}000} = \text{Nu.}3.60$$

Interpretation: The financial health of Karma Pvt. Ltd. is sound and operation is effective as indicated by the ratios. The Gross Profit Margin indicates that the company retains 40% of its revenue as gross profit, while the Operating Profit Margin shows that 24% of revenue remains after covering operating expenses. The Net Profit Margin reveals that 15.4% of revenue is converted into net income. ROE highlight the company's effectiveness in using its equity to generate profit, with returns of 25.67%. The EPS indicates that each share of common stock earns Nu. 3.60.

Learning Activity 5:
From the financial statements of Green Hills Textile and additional information, calculate profitability ratios.

Particulars	Current Year (Nu.)	Previous Year (Nu.)
Revenue	1,200,000	1,000,000
Cost of Goods Sold	600,000	500,000
Gross Profit	**600,000**	**500,000**
Operating Expenses:		
- Selling, General & Administrative (SG&A)	200,000	180,000
- Depreciation	50,000	40,000
Operating Profit	**350,000**	**280,000**
Other Income (Interest)	20,000	10,000
Profit Before Tax (PBT)	370,000	290,000
Income Tax (40%)	148,000	116,000
Net Profit	**222,000**	**174,000**

Additional Information:

i. Weighted Average Common Shares Outstanding: 100,000 (both years)

ii. Preferred Shares: None (no preferred dividends)

Learning Activity 6:
Obtain financial statements of any FIVE registered companies in Bhutan and calculate different ratios. Based on the ratios, provide analysis and make a presentation to the class.

Comparative Statement

Comparative Statement or Comparative Financial Statements means a comparative study of items or components of financial (statement of financial position and income statement) for two or more years or with that of other enterprises. Comparative Statement is a tool of financial analysis that shows change in each item or component of financial statement in absolute amount and in percentage, taking the amount for the previous accounting period as the base. A sample of comparative income statement is given in the following illustration. All the registered companies are required to present financial statements figures at least two years in their annual report, i.e., for current year and previous year.

Illustration 7

	2016	2017
Sales	120% of cost of goods sold	50% of cost of goods sold
Cost of goods sold	2,000,000	2,500,000
Indirect Expenses	10% of Gross Profit	
Rate of income tax	50% of Net Profit before tax	

Solution:

Comparative Income statement of Bhutan Agro Industry Ltd.				
Particulars	2016 (Nu.)	2017 (Nu.)	Absolute (Nu.)	Percentage change (%)
Sales	2,400,000	3,750,000	1,350,000	56.25
Less: Cost of goods sold	2,000,000	2,500,000	500,000	25
Gross Profit	400,000	12,50,000	850,000	212.5
Less: Indirect expenses	40,000	125,000	85,000	212.5
Profit before tax	360,000	1,125,000	765,000	212.5
Less: Income tax	180,000	562,500	382,500	212.5
Net Profit after tax	180,000	562,500	382,500	212.5

Common size statement

Common-size Financial Statement are the statement in which amounts of individual items of financial statements are converted into percentages to a common base. A sample of common-size balance sheet is given below:

Statement of financial position for Tenyang Traders Ltd. for the year ended 31st December, 2018		
Current Assets	**Nu.**	**%**
Cash	150000	1.77%
Accounts Receivable	984,563	11.63%
Inventories	1,345,230	15.89%
Total Current Assets	**2,479,793**	**29.29%**
Total Fixed Assets	5,987,345	70.71%
Total Assets	**8,467,138**	**100%**
Current Liabilities		
Accounts Payable	982,134	11.60%
Accrued Expenses	345,690	4.08%
Short-term Debt	12,983	0.15%
Total Current Liabilities	**1,340,807**	**15.84%**
Long-term Debt	4,387,632	51.82%
Total Liabilities	**5,728,439**	**67.65%**
Shareholders' Liability	2,738,699	32.35%
Total Liabilities and Equity	**8,467,138**	**100%**

Illustration 8

For the given financial statements of Kuenphen Pvt. Ltd., you are required to prepare common size financial statement and carry out analysis.

Income statement

Particulars	Current Year	%	Previous Year	%
otal Sales	600,000	100%	500,000	100%
Cost of Goods Sold	360,000	60%	300,000	60%
Gross Profit	240,000	40%	200,000	40%
Operating Expenses	120,000	20%	100,000	20%

Operating Income	120,000	20%	100,000	20%
Interest Expense	12,000	2%	10,000	2%
Net Income Before Taxes	108,000	18%	90,000	18%
Taxes	27,000	4.5%	22,500	4.5%
Net Income	81,000	13.5%	67,500	13.5%

Statement of Financial Position

Particulars	Current Year	%	Previous Year	%
Total Assets	1,000,000	100%	800,000	100%
Cash	70,000	7%	50,000	6.25%
Accounts Receivable	120,000	12%	100,000	12.50%
Inventory	200,000	20%	150,000	18.75%
Property, Plant, and Equipment	610,000	61%	500,000	62.50%
Total Liabilities	400,000	40%	300,000	37.50%
Accounts Payable	60,000	6%	50,000	6.25%
Long-term Debt	340,000	34%	250,000	31.25%
Total Equity	600,000	60%	500,000	62.50%
Common Stock	250,000	25%	200,000	25%
Retained Earnings	350,000	35%	300,000	37.50%

Analysis:

- **Revenue Growth:** Company XYZ experienced significant revenue growth of 20%, maintaining consistent profitability ratios.
- **Expense Management:** Costs and expenses were managed efficiently, as indicated by stable percentages relative to sales.
- **Asset Expansion:** The company expanded its asset base by 25%, potentially positioning itself for future growth.
- **Increased Liabilities:** Liabilities increased but were proportionate to the growth in assets.
- **Equity and Debt:** Both equity and debt financing increased, with a slight shift towards higher leverage.

Learning Activity 6:

From the following financial statements Lingsel Pvt. Ltd. provide analysis of company's performance in terms of real value and percentage change over the two years.

Income Statement

Item	2024 (Nu.)	2023 (Nu.)
Revenue	1,200,000	1,000,000
Cost of Goods Sold	720,000	600,000
Gross Profit	480,000	400,000
Operating Expenses	240,000	200,000
Operating Income	240,000	200,000
Interest Expense	25,000	20,000
Income Before Taxes	215,000	180,000
Income Tax Expense	64,500	54,000
Net Income	150,500	126,000

Statement of Financial Position

Item	2024 (Nu.)	2023 (Nu.)
Cash and Cash Equivalents	60,000	50,000
Accounts Receivable	90,000	80,000
Inventory	120,000	100,000
Total Current Assets	270,000	230,000
Property, Plant, Equipment	550,000	500,000
Total Assets	**820,000**	**730,000**
Accounts Payable	120,000	100,000
Short-Term Debt	70,000	50,000
Total Current Liabilities	190,000	150,000
Long-Term Debt	230,000	200,000
Total Liabilities	420,000	350,000
Common Stock	150,000	150,000
Retained Earnings	250,000	230,000
Total Equity	400,000	380,000
Total Liabilities and Equity	**820,000**	**730,000**

Assessment

Accountancy Assessment Matrix

	Continuous Formative Assessment (CFA)			Continuous Summative Assessment (CFA)			Summative Assessment (SA)	
Definition	It is a continuous process of assessing learner's problems and learning needs; provide feedbacks and to identify the needs for the remedial measures to improve learner's learning. It also enables teachers to understand what teaching methods and materials work best.			It is a continuous process of grading learner's performances and achievements. Based on their performance, teachers provide feedbacks for improvement. It also enables teachers to understand what teaching methods and materials work best.			Assesses learner's cumulative performances and achievements at the end of each term.	
Domains	Content knowledge (CK) (Cognitive)	Application of Concepts(AC) (Psychomotor)	Accounting Values and Attitudes (AVA) (Affective)	Content knowledge (CK) (Cognitive)	Application of Concepts(AC) (Psychomotor)	Accounting Values and Attitudes (AVA) (Affective)	CK, AC & AVA	CK, AC & AVA
Techniques	Observation, quiz & debate, self & peer assessment, class presentation, homework, class works.	Class work, home work, case studies, observation, problem solving.	Analysis and interpretation of financial data. Use of financial data for decision making.	Home work, class work, unit test	Project Work, case study, practical problem solving and presentation.	Analysis and interpretation of financial data. Use of financial data for decision making.	Term Exam I	Term Exam II
Tools	Q&A, rubrics, checklist and anecdotal records.	Checklist and anecdotal records.	Checklist, Q&A, rubrics and anecdotal records.	Rubrics (HW) and Q&A.	Check list, Scales, Rubrics	Check list and Rubrics	Paper pencil test: Part A: MCQ, Fill in the blanks, Matching, True and False and SAQ. Part B: EAQ	

Frequency	Continuous assessment to improve students' performance. Evidence such as assessment of student's works, assessment tools must be maintained throughout the academic year.	2 times in a term	1 time in a year	Practical/ interpretation of financial statements	First Term	Second Term
Weighting	No grading	T_1=2.5 T_2=2.5	T_1=2.5 T_2=2.5	T_1=5 T_2=5	T_1=40	T_2=40
Notes	1. Same assessment modality is followed in class XII examinations. 2. Continuous assessment is based on average marks obtained in class activities, assignments and presentations. 3. Term examinations papers are set out of 100 and converted to 40% in each term. 4. The question paper for the term: Part A - MCQ (20), Fill in the blanks (5), Matching (5), True or False (5) and Short answers questions (15) totaling 50 marks. Part B - Extended answer questions for 60 marks. One additional question is given as choice. 5. Ensure that questions are competency based - use/application of knowledge, context based/case based, solving real world problems, generation of new knowledge, etc. 6. Ensure that Blooms Levels are followed while setting the questions.					

Assessment Tools and Techniques

The following section describes the **suggestive techniques and tools** that are to be used to assess learner's tasks.

» Homework

Criteria	4	3	2	1
Completion	All the assigned tasks are completed	Most of the assigned tasks are completed	Some or part of the tasks are incomplete	Major part of the tasks are incomplete
Timeliness	Submitted on due date	Submitted one day late	Submitted two days late	Submitted three days late and beyond
Accuracy	All of the answers are correct	Most of the answers are correct	Some of the answers are correct	Few answers are correct and requires to redo the task
Neatness	All the answers are presented orderly manners and neatly	Most of the answers are presented in orderly and neatly	Answers are not presented orderly and lack neatness	Answers are presented haphazardly and no neatness at all

» Rubrics for assessing classwork

Grade	Descriptors
A	Demonstrated clear understanding of all the concepts studied and 100% of the work is complete and are correct.
B	Most of the concepts are understood clearly and 90% - 80% of the work is completed and are correct.
C	Some concepts are not understood properly and 80% - 70% of the works are completed and some are not correct.
D	Most of the answers are incorrect and only 70% to 60% of the works are only completed.
Redo	Concepts are not understood properly and less than 50% of the works are only completed. Required to redo the task.

» Rubrics for assessing case studies

Standards	Outstanding (4)	Very good (3)	Good (2)	Satisfactory (1)
Identification of the issues/ problems	Identifies and understands all of the main issues in the case study.	Identifies and understands most of the main issues in the case study	Identifies and understands some of the issues in the case study.	Identifies and understands few of the issues in the case study.
Analysis of the issues	Insightful and thorough analysis of all the issues.	Analysis of all the issues without thoughtful analysis.	Analysis of two or three issues.	Imperfect and incomplete analysis of the issues.
Comments on effective solutions/ strategies (The solution may be in the case already or proposed by you)	Well documented, reasoned and appropriate comments on solutions, or proposals for solutions, to all issues in the case study.	Appropriate with few thought out comments about solutions, or proposals for solutions, to some issues in the case study.	Artificial and inappropriate solutions to most of the issues in the case study.	Little or no action suggested and in appropriate solutions to all of the issues in the case study.
Research / Reference	Excellent research into issues and clearly documented reasons or arguments.	Good research into issues with some clearly documented links to material read.	Limited research and few documented links to readings.	Incomplete research and links to any readings.
Delivery/flow and enthusiasm	Very clear and concise flow of ideas. Demonstrates passionate interest in the topic.	Clear flow of ideas. Demonstrates interest in the topic.	Most ideas have a flow but focus is lost at times. Limited evidence of interest in the topic.	Hard to follow the flow of ideas. Lack of enthusiasm and interest.
Visuals	Visuals augmentation and extended conception of issues in unique ways.	Use of visuals related to the material.	Limited use of visuals loosely related to the material.	No use of visuals.

Rubrics for assessing project work

	4	3	2	1
Content	Content is new, relevant.	Content is not new but relevant.	Content is not new and not so relevant.	Content is not new and relevant.
Presentation and format	Excellent presentation. Correct format is followed and report is free of errors	Only one area of format is not correct. Report has a few errors.	Only two aspect of format is not correct. Report has some errors	Three or more aspect of format is incorrect. Report has many errors.
Finding	Finding is supported by the facts and figures. Explanation is made on each facts and figures.	Finding is supported by the facts and figures. Insufficient explanation on each facts and figures.	Finding is not supported by enough facts and figures.	Finding is not supported by facts and figures.
Research	Research done on the topic and all ideas are clear and explained.	Research done on the topic and most ideas are clear and explained.	Research done and a few ideas are clear and explained.	Research not done and ideas are not clear and not explained.
Reference	Five or more references are cited.	Three or four references are cited.	One or two references are cited.	No references.

Project Work shall include the following components:

1. Project file.
2. Title of the project work.
3. Acknowledgment.
4. Table of content.
5. Introduction.
6. Content/theory.
7. Case study.
8. Findings.
9. Conclusion.
10. Bibliography/references.

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Questions for Practice

Multiple Choice Questions

1. Kaka is working in procurement division; he is responsible for quotation of goods from the supplier. The type of accounting information used by him is related to
   a. Management Accounting
   b. Cost Accounting
   c. Financing Accounting
   d. Public accounting.

2. Which is the last step of accounting as a process of information.
   a. Recording the financial transactions and events
   b. Analysing and Interpreting data
   c. Communicating to the users
   d. Classifying of transaction

3. GNH's business goals is to have a report which captures;
   a. Financial performance
   b. Social performance
   c. Environmental performance
   d. Financial, social and environmental performance.

4. A worker at the Construction Development Corporation Limited (CDCL) suffers an injury at work and the CDCL decides to pay him Nu. 45,000 as compensation. Should the CDCL pass an entry even though it has not been paid.
   a. No, because it is not paid
   b. Yes, because of accrual concept
   c. No, because the employee has not accepted

5. As per the accounting standard, depreciation is identified as
   a. the process of valuation of asset.
   b. the decline in the market value of fixed asset.
   c. the systematic allocation of the depreciable amount of the property, plant and equipment.

6. The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if;
   a. it is probable that future economic benefits associated with the item will flow to the entity
   b. the carrying amount exceeds its recoverable amount.
   c. there is decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen.
   d. future economic benefit is not clearly known.

7. Mountain Café hired Yeshi, a B.Com graduate to oversee the cash collection procedures. When the cashier pays weekly wage, the transaction will
   a. increase an asset, increase a liability.
   b. decrease an asset, decrease a liability.
   c. increase an asset, increase owner's equity.
   d. decrease an asset, decrease owner's equity.

8. A firm purchased machinery worth Nu. 20,000. Of the total Nu. 12,000 financed through a borrowing. The capital of the firm will
   a. increase by Nu.32,000
   b. increase by Nu.8,000
   c. decrease by Nu.32,000
   d. decrease by Nu.8,000

9. Petty cash system is designed
   a. to meet the needs of small business
   b. to cover small and miscellaneous income
   c. to cover the small expenditure to be paid in cash
   d. to cover both small incomes and expenditures.

10. The balance on the debit side of the bank column in cash book indicates
    a. the total amount withdrawn from the bank
    b. the total amount deposited in the bank
    c. cash balance at bank
    d. cash in hand.

11. The correct journal entry for return of merchandise purchased from Mr. Pema on account is:
    a. Cash - debit; purchase - credit,
    b. Pema - debit; merchandise - credit,
    c. Pema - debit; purchase return - credit
    d. Purchase - debit; Pema - credit

12. Which of the following best describes the trade discount:
    a. It is different from cash discount
    b. It is a reduction in list (or retail) price
    c. It is not recorded in the books of accounts
    d. It is received during the sales and purchase of goods.

13. BRS is prepared:
    a. To ascertain cash balance only,
    b. To ascertain cash balance only,
    c. To reconcile the balance of two books,
    d. Equalize the Cash balance with Bank balance

14. When balance as per Cash Book is starting point, uncollected cheques are:
    a. Added to the BRS
    b. Subtracted in the BRS
    c. Not required to be adjusted in the BRS.

15. Favorable balance of cash book implies:
    a. Overdraft
    b. Credit balance of cash book
    c. Debit balance of cash book
    d. Adjusted balance of cash book

16. Due date of a bill of exchange drawn on 30th January, 2018 for one month will be:
    a. 29th February
    b. 3rd March
    c. 4th March
    d. 5th March

17. Encashing the bill before the date of its maturity is called
    a. Endorsement of bill
    b. Retirement of bill
    c. Discounting of bill
    d. Dishonoring of bill

True or False

State whether the statement is **"True"** or **"False"** and justify your answer.

i. Internal users of accounting information include a company's shareholders.
ii. Financial accounting information are used by management for decision-making purposes.
iii. As per the Accounting convention, financial year always starts from 1st January and ends on 31st December.
iv. A transaction between owner and business are recorded considering the separate business entity assumption.
v. The matching principle requires that the same accounting practices to be used from year to year consistently.
vi. Discarding the old machinery by substituting newly invented machinery is termed as innovation.
vii. Depreciation arises because of daily usage of the properties.

viii. Under the straight line method of charging depreciation, the amount of depreciation is progressive every year.

ix. If Rigzang withdraws cash from Bank of Bhutan Ltd. for business purposes, it will have no effect on her liabilities.

x. Assume assets total Nu. 24,000, liabilities total Nu.5,000, and owner's equity is Nu. 19,000. If assets increase by Nu.3,000 and equity decreases by Nu.1,000, then liabilities must increase by Nu. 4,000.

xi. Cash is inevitable for the business so the cash book always shows a debit balance.

xii. Maintaining of cash book removes the necessity of having cash and bank accounts in the ledger.

xiii. Computrised accounting system offer online facility to store and process transaction data.

xiv. The basic rule "debit what comes in, credit what goes out" is applicable to personal account.

xv. Wages of workmen employed for setting up of the new machinery is debited to machinery account.

xvi. A sale of goods to Sonam on cash should be debited to Sonam's personal account.

xvii. Preparation of BRS follows the rule of double entry system.

xviii. Cheque deposited to the bank but not collected leads to increase in the balance of cash book as compared to the bank statement.

xix. Bill of exchange is a conditional order to pay the bill amount.

xx. Drawer and payee can be the same person in case of a bill of exchange.

xxi. Where a bill is dishonored, the drawee is relieved of his liability.

Short Answer Questions

i. Accounting involves reporting and communicating business information. Justify the statement.

ii. "Management accounting measures, analyses and prepares reports that provide accurate and timely financial and non-financial information to the management". State how management Accounting helps mangers in taking the decision.

iii. Can the following transactions be recorded in the book of accounts? Justify each.

a. Quality of medical staff in a hospital

b. Profit of Nu. 26,000 on sale of plant and equipment.

iv. One of the pillars of GNH is Good Governance. If you are an accountant of a business organization, how would you work to attain this pillar ?.

v. Happiness Engineering Private Company Ltd. purchased a plant costing Nu.800,000 on 1.1.2023 and incurs extra costs of Nu.75,000 on import duties and installation charges. The PPEs are initially measured at cost and company uses straight-line method for depreciation. The expected residual value after 5 years is Nu. 10,000. Calculate the amount of depreciation chargeable for plant and machinery for the next 3 years.

vi. Discuss the significance of useful life while computing for depreciation on PPE.

vii. "Accounting Equation (A=L+C) always holds well under all circumstances". Justify.

viii. The owner of a Jangchub Traders invested Nu.1,000,000 to their business. After one year of operations, the business has assets of Nu. 850,000 and losses of Nu.300,000. What are the total liabilities at the end of the first year?

ix. "Cash book is a journalized ledger". Justify.

x. Why bank overdraft is usually considered as cheaper than bank loan?

xi. 'An accounting report is essential report which must be able to fulfil certain basic criteria'. Explain.

xii. "Computerised Accounting systems are best form of accounting system". Comment.

xiii. Cash Nu.950 received from Dorji in full settlement of his account of Nu. 1000. How would you record this transaction in journal?

xiv. Analyse the statement, "for every debit there is a credit".

xv. Explain how Compound entry differ from Contra entry?

xvi. Debit balance in the pass book indicates overdraft. Justify.

xvii. State the needs of preparing bank reconciliation statement.

xviii. Does the perpetual inventory method eliminate the needs of physical inventory count?

xix. Compare the FIFO and Weighted Average Method of stock valuation.

xx. Distinguish between a Bin Card and Store ledger. Give a Specimen of Bin Card with FOUR imaginary transactions.

Extended Answer Questions

1. Case Study

Researchers and economist have been trying to understand the reasons for successful entrepreneurship and its success factors. In contrast, the study put more emphasis on understanding the reason for business failure than finding the success factor. It is reviled that in many cases management do not take scientific decision indicating lack of knowledge on management accounting.

Management accounting uses the tools for analyzing the financial data that will help in enhancing the business decision and to improve their financial returns. However, there may be possibility of failure when business is conducted without the knowledge of management accounting.

i. Can business succeed without proper knowledge of management accounting? Justify.

ii. Can Management accounting alone fulfill the objective of business?

iii. "Management accounting has proven important for the success of the business yet many entrepreneur do not consider its importance" comment on this statement.

2. Case Study

Nado started a stationery business with Nu. 400,000 as an initial investment. He paid Nu. 70,000 for the purchase of furniture and Nu. 100,000 for buying stationery items. He employed a salesperson and a clerk, and paid monthly salary of Nu. 5,000 each. Out of the stationeries bought, he sold some part for Nu. 80,000 on cash and some items for Nu. 40,000 on credit to Kado in the first month. He bought additional stationery items of Nu. 60,000 from Serdo. A fire broke out in the first week of the second month and lost Nu. 30,000 worth of stationeries. He sold furniture worth 25,000 for Nu. 28,000. Based on the information given in the case, answer the following questions.

i. Analyse and compute the income earned by Mr. Nado.

ii. Explain the expenses recognition principle.

iii. Recommend some strategies to Nado to enhance his business profitability.

iv. Evaluate the need of Accounting Assumptions and Conventions while carrying out the accounting procedures.

3. Case Study

Deki is a petty contractor operating in Trashigang. The firm has one Excavator and Concrete Mixer purchased at the cost of Nu. 7 million and Nu. 0.3 million respectively. Although Ms. Deki the proprietor has studied up to class XII and has some knowledge of accounting, she lacks accounting skill of maintaining books of accounts in construction business. Most of her business is financed through Bhutan Development Bank Limited(BDBL). The company has successfully completed several road construction works. However, five years later her excavator met with a major accident and machine broke down permanently. As a result, M/s Deki Construction could not carry out any construction work further and the Construction Development Board (CDB) declared the business as not going concern. Based on the scenario answer the following questions.

i. What do you understand by not going concern in the business?

ii. If you were Ms. Deki, what would you have done from initially to avoid stoppage of the business?

iii. Can the excavator gain any value in the market?

iv. How would treat the excavator in the books?

4. Case Study

Dechen is recently recruited as a school Administration Assistant and given the task to maintain the records of the school financial activities. As she comes from a non-accounting background and has no knowledge of maintaining books of accounts, she listed all the cash and cash equivalent transactions in a MS excel sheet similar to manual record keeping including the petty cash items. When the Principal inquires about the cash balances available, she faces tough time ascertaining the balance amount manually and also does not tally with the bank balance.

i. If you were Dechen with bookkeeping and accounting knowledge, how would you improve the efficiency of her work?

ii. Which accounting or bookkeeping knowledge would you apply for Dechen's work?

5. Case Study

Damchoe Pvt. Ltd utilizes Bank Reconciliation software (Xero) to tame their monthly reconciliation process.

"Once upon a time, we spent a minimum of three days a month reconciling bank account for our company", said Dema. "Last month with 'Xero' I was able to print a final reconciliation report within 15 minutes of receiving a 50 page outline statement. This software is not intimidated by lengthy or volume of transactions." "It offers multiple levels of security, which means I no longer have to worry about unauthorized activity in our accounts." Said Dema. "I know it will alert me to any unauthorized activity in time for me to take the necessary steps to correct it before it reaches a critical level. 'Xero' has also given me increased confidence about information within our system. I do not hesitate to pull reports and provide information for salesman, etc. who come to my office with questions because I know our information is up-to-date and accurate."

Answer the following questions:

i. From the above statement, enumerate and illustrate the advantages of preparing Bank Reconciliation Statement?

ii. Discuss and evaluate on shift of method from manual to digitalized bank reconciliation System.

6. A company purchases a piece of machinery on January 1, 2022, for Nu. 50,000. The machinery has an estimated useful life of 10 years and a residual value of Nu. 5,000. Using the straight-line method of depreciation, calculate the annual depreciation expense and the book value of the machinery at the end of each year for the first three years. Show the accounting entries for accumulated depreciation. [BV after III year Nu.36,500]

7. A company purchases a piece of machinery on January 1, 2022, for Nu. 50,000. The machinery has an estimated useful life of 10 years and a residual value of Nu. 5,000. Using the straight-line method of depreciation, calculate the annual depreciation expense and the book value of the machinery at the end of each year for the first three years. On December 31, 2024, the company assesses the fair value of the machinery and determines it to be Nu. 30,000. The company also estimates that the machinery has a remaining useful life of 7 years with no change in the residual value. Calculate the impairment loss, if any, and provide the adjusted depreciation expense for the remaining useful life of the machinery. [Impairment loss Nu.6,500]

8. A company owns a vineyard with grapevines classified as biological assets. On January 1, 2023, the company purchases additional grapevines for Nu. 60,000. These grapevines are expected to have a productive life of 15 years with no residual value. The company uses the fair value model for measuring its biological assets. On December 31, 2023, the fair value of the grapevines is determined to be Nu. 65,000. On December 31, 2024, the fair value of the grapevines is determined to be Nu. 63,000. Calculate the initial recognition of the grapevines and the fair value adjustment for the years ending December 31, 2023, and December 31, 2024. Prepare the journal entries for the initial recognition and for the fair value adjustments at the end of 2023 and 2024. [Revaluation loss in 2024 Nu.2,000]

9. XYZ Corporation has provided the following financial information for the years ended December 31, 2022, and December 31, 2023. Prepare the comparative financial statements in both real figures and common size for the years 2022 and 2023.

Income Statement

Item	2022 (Nu)	2023 (Nu)
Revenue	500,000	600,000
Cost of Goods Sold (COGS)	300,000	350,000
Gross Profit	200,000	250,000
Operating Expenses	100,000	120,000
Operating Income	100,000	130,000
Interest Expense	20,000	25,000
Net Income Before Tax	80,000	105,000
Income Tax Expense	20,000	26,250
Net Income	60,000	78,750

Statement of financial position

Item	2022 (Nu)	2023 (Nu)
Assets:		
Cash	50,000	70,000
Accounts Receivable	40,000	60,000
Inventory	30,000	40,000
Property, Plant & Equipment	200,000	250,000
Total Assets	320,000	420,000
Liabilities and Equity:		
Accounts Payable	20,000	30,000
Long-term Debt	100,000	150,000
Common Stock	150,000	180,000
Retained Earnings	50,000	60,000
Total Liabilities and Equity	320,000	420,000

Instructions:

i. Prepare a comparative income statement and balance sheet for the years ended December 31, 2022, and December 31, 2023, using real figures.

ii. Prepare a common size income statement and balance sheet for the years ended December 31, 2022, and December 31, 2023. Use total revenue for the income statement and total assets for the balance sheet as the base for your common size calculations.

iii. Analyze the changes in the financial position and performance of XYZ Corporation from 2022 to 2023.

Present Value of Nu.1 $= \frac{1}{(1+r)^n}$

Period	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	21%	22%	23%	24%	25%
1	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	0.826	0.820	0.813	0.806	0.800
2	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	0.683	0.672	0.661	0.650	0.640
3	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	0.564	0.551	0.537	0.524	0.512
4	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	0.467	0.451	0.437	0.423	0.410
5	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	0.386	0.370	0.355	0.341	0.328
6	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	0.319	0.303	0.289	0.275	0.262
7	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	0.263	0.249	0.235	0.222	0.210
8	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	0.218	0.204	0.191	0.179	0.168
9	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	0.180	0.167	0.155	0.144	0.134
10	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	0.149	0.137	0.126	0.116	0.107
11	0.650	0.585	0.527	0.475	0.429	0.388	0.350	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	0.123	0.112	0.103	0.094	0.086
12	0.625	0.557	0.497	0.444	0.397	0.356	0.319	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	0.102	0.092	0.083	0.076	0.069
13	0.601	0.530	0.469	0.415	0.368	0.326	0.290	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	0.084	0.075	0.068	0.061	0.055
14	0.577	0.505	0.442	0.388	0.340	0.299	0.263	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	0.069	0.062	0.055	0.049	0.044
15	0.555	0.481	0.417	0.362	0.315	0.275	0.239	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	0.057	0.051	0.045	0.040	0.035
16	0.534	0.458	0.394	0.339	0.292	0.252	0.218	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054	0.047	0.042	0.036	0.032	0.028
17	0.513	0.436	0.371	0.317	0.270	0.231	0.198	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045	0.039	0.034	0.030	0.026	0.023
18	0.494	0.416	0.350	0.296	0.250	0.212	0.180	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038	0.032	0.028	0.024	0.021	0.018
19	0.475	0.396	0.331	0.277	0.232	0.194	0.164	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031	0.027	0.023	0.020	0.017	0.014
20	0.456	0.377	0.312	0.258	0.215	0.178	0.149	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026	0.022	0.019	0.016	0.014	0.012
21	0.439	0.359	0.294	0.242	0.199	0.164	0.135	0.112	0.093	0.077	0.064	0.053	0.044	0.037	0.031	0.026	0.022	0.018	0.015	0.013	0.011	0.009
22	0.422	0.342	0.278	0.226	0.184	0.150	0.123	0.101	0.083	0.068	0.056	0.046	0.038	0.032	0.026	0.022	0.018	0.015	0.013	0.011	0.009	0.007
23	0.406	0.326	0.262	0.211	0.170	0.138	0.112	0.091	0.074	0.060	0.049	0.040	0.033	0.027	0.022	0.018	0.015	0.012	0.010	0.009	0.007	0.006
24	0.390	0.310	0.247	0.197	0.158	0.126	0.102	0.082	0.066	0.053	0.043	0.035	0.028	0.023	0.019	0.015	0.013	0.010	0.008	0.007	0.006	0.005
25	0.375	0.295	0.233	0.184	0.146	0.116	0.092	0.074	0.059	0.047	0.038	0.030	0.024	0.020	0.016	0.013	0.010	0.009	0.007	0.006	0.005	0.004

Prd	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	21%	22%	23%	24%	25%
26	0.361	0.281	0.220	0.172	0.135	0.106	0.084	0.066	0.053	0.042	0.033	0.026	0.021	0.017	0.014	0.011	0.009	0.007	0.006	0.005	0.004	0.003
27	0.347	0.268	0.207	0.161	0.125	0.098	0.076	0.060	0.047	0.037	0.029	0.023	0.018	0.014	0.011	0.009	0.007	0.006	0.005	0.004	0.003	0.002
28	0.333	0.255	0.196	0.150	0.116	0.090	0.069	0.054	0.042	0.033	0.026	0.020	0.016	0.012	0.010	0.008	0.006	0.005	0.004	0.003	0.002	0.002
29	0.321	0.243	0.185	0.141	0.107	0.082	0.063	0.048	0.037	0.029	0.022	0.017	0.014	0.011	0.008	0.006	0.005	0.004	0.003	0.002	0.002	0.002
30	0.308	0.231	0.174	0.131	0.099	0.075	0.057	0.044	0.033	0.026	0.020	0.015	0.012	0.009	0.007	0.005	0.004	0.003	0.003	0.002	0.002	0.001
31	0.296	0.220	0.164	0.123	0.092	0.069	0.052	0.039	0.030	0.023	0.017	0.013	0.010	0.008	0.006	0.005	0.004	0.003	0.002	0.002	0.001	0.001
32	0.285	0.210	0.155	0.115	0.085	0.063	0.047	0.035	0.027	0.020	0.015	0.011	0.009	0.007	0.005	0.004	0.003	0.002	0.002	0.001	0.001	0.001
33	0.274	0.200	0.146	0.107	0.079	0.058	0.043	0.032	0.024	0.018	0.013	0.010	0.007	0.006	0.004	0.003	0.002	0.002	0.001	0.001	0.001	0.001
34	0.264	0.190	0.138	0.100	0.073	0.053	0.039	0.029	0.021	0.016	0.012	0.009	0.006	0.005	0.004	0.003	0.002	0.002	0.001	0.001	0.001	0.001
35	0.253	0.181	0.130	0.094	0.068	0.049	0.036	0.026	0.019	0.014	0.010	0.008	0.006	0.004	0.003	0.002	0.002	0.001	0.001	0.001	0.001	0.000
36	0.244	0.173	0.123	0.088	0.063	0.045	0.032	0.023	0.017	0.012	0.009	0.007	0.005	0.004	0.003	0.002	0.001	0.001	0.001	0.001	0.000	0.000
37	0.234	0.164	0.116	0.082	0.058	0.041	0.029	0.021	0.015	0.011	0.008	0.006	0.004	0.003	0.002	0.002	0.001	0.001	0.001	0.000	0.000	0.000
38	0.225	0.157	0.109	0.076	0.054	0.038	0.027	0.019	0.013	0.010	0.007	0.005	0.004	0.003	0.002	0.001	0.001	0.001	0.001	0.000	0.000	0.000
39	0.217	0.149	0.103	0.071	0.050	0.035	0.024	0.017	0.012	0.009	0.006	0.004	0.003	0.002	0.002	0.001	0.001	0.001	0.000	0.000	0.000	0.000
40	0.208	0.142	0.097	0.067	0.046	0.032	0.022	0.015	0.011	0.008	0.005	0.004	0.003	0.002	0.001	0.001	0.001	0.000	0.000	0.000	0.000	0.000