Financial Accounting & Reporting I
Course Code: ACC 201

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LECTURE ONE

INTRODUCTION TO PARTNERSHIP

Definition of Partnership

- Partnership is defined in accordance with Partnership ACT 1907 (of UK) as "the relation which subsists between persons carrying on a business in common with a view of profit``.
- In other words, partnership can be described as a type of business that exists when two or more people agree to carry on a business with the purpose of making profit.

Common Terminologies n Partnership Account

- Capital
- Interest on Capital
- Profit Sharing
- Drawings
- Interest on Drawings
- Partner’s Salary

Formation of Partnership

Contents of partnership registration form include:

- Name of the partnership;
- General nature of business;
- Principal place of business, and any other places where the business is carried on;
- Address and post office box number;
- Names of partners and their residential addresses
- Date of commencement of the partnership

Partnership Agreement or Partnership Deed

Contents of Partnership Agreement or Partnership Deed include:

- Name
- Capital
- Profit Sharing
- Interest on Capital
- Interest on Drawing
- Interest on Loan
- Limits to Partners’ Drawings
- Books of Accounts
- Settlement of Disputes
- Entitlement to Remuneration e.t.c.

Rules Applicable in Absence of Partnership Agreement

- Partners shall share profits or losses equally and shall contribute equally to capital.
- The firm shall indemnify every partner in respect of payments made and liabilities incurred by him/her in the ordinary and proper conduct of the business of the firm.
- Any advance or payment in excess of agreed share capital will attract an interest at the rate of 5%.
- Every partner may take part in the management of the firm.
- No partner shall be entitled to remuneration for acting in the firm’s business.

Bookkeeping Entries

1. Drawing of stocks for personal use:

- **Debit** Partner’s Current Account
- **Credit** Trading Account with the cost of the stocks

2. Payment of expenses of the Firm from personal resources:

- **Debit** Profit & Loss Account
- **Credit** Current Account with the interest

3. **Interest on loan advanced by a partner:**

- **Debit** Profit & Loss Account
- **Credit** Partner’s Current Account with the amount

Bookkeeping Entries (Contd.)

4. **Interest on drawings:**
- **Debit** Partner's Current Account
- **Credit** Appropriation Account with the amount

5. **Interest on Capital Account:**
- **Debit** Appropriation Account
- **Credit** Partners Current Account with the amount

6. **Partner's Salary:**
- **Debit** Appropriation Account
- **Credit** Partner's Current Account with the amount

Bookkeeping Entries (Contd.)

7. Share of Profit:

- **Debit** Appropriation Account
- **Credit** Partner's Current Account

8. Interest on loan taken by a partner

- **Debit** Partner's Current Account with the amount
- **Credit** Profit & Loss Account

LECTURE TWO

CHANGE IN THE STRUCTURE OF PARTNERSHIP – GOODWILL VALUATION

Reasons for Changes in the structure of partnership

Reasons for changes in the structure of partnership include:

- Admission of more partners
- Retirement of a partner
- Death of a partner

Issues on Changes of Structure of Partnership

- Two important issues that usually affect changes in structure of partnership are:
- Goodwill and
- Revaluation of Assets

Goodwill

- Goodwill is "that which enables business to earn super-normal profit, because of the reputation or special advantages which the business engages with the rest of the world".
- It is also defined as "the difference between the value of the business as a whole and the aggregate of a fair value of its separable net assets".
- It can also be described as the value that a business has because it is well established with good reputation.

Types of goodwill

- Inherent goodwill – A goodwill that is agreed upon internally.
- Purchased goodwill – This type of goodwill arises as a result of one company acquiring another. The goodwill is derived by deducting the book value of the assets taken over from the purchase price paid.

Conditions for introducing goodwill into partnership business

- Introduction or admission of a **new partner**
- Change in **profit or loss sharing ratio** between the partners
- **Retirement** of a partner
- **Death** of a partner
- **Purchase** of business
- **Dissolution** of business

Valuation of Goodwill

- Purchase of average profit
- Purchase of average gross fee income
- Purchase of average super profit
- Excess of purchase price of a business over value of intangible net assets taken over

Accounting for Goodwill

If the goodwill is to be retained in the books:

To record the goodwill in the books

- **Debit** Goodwill Account
- **Credit** Capital Accounts of partners
- With the value of goodwill due to the partners in the old firm in the existing/old profit sharing ratios

Where incoming partner pays for the goodwill

- **Debit** Bank/Cash account
- **Credit** Capital account of the old partners
- With the amount paid by the new partner in their old profit sharing ratio.

Accounting for Goodwill (Contd.)

If the goodwill is not to be retained in the books:

a. Debit Goodwill Account

- **Credit** Capital Accounts of ***partners in the old firm*** in the old profit sharing ratios with the value of the goodwill.
- To open the goodwill account

b. Debit Capital Accounts of ***partners in the new firm***in the new profit sharing ratio

- **Credit** Goodwill Account with the value of the goodwill.
- To close the goodwill account

LECTURE THREE

CHANGE IN THE STRUCTURE OF PARTNERSHIP – REVALUATION OF ASSETS

Admission of a new partner

A new partner may be invited to join a partnership for various reasons which include:

- Expansion of operations such that the existing partners feel the need for an additional person with some skills.
- More capital requirement to take advantage of opportunities to expand the business.
- Replacement of an outgoing partner, whether due to death or retirement.

Issues of importance on admission of a new partner

- Change in terms of the partnership agreement with particular reference to capital contribution and profit and loss sharing ratios.
- Revaluation of the assets of the firm in order to reflect the true value of the partnership business.
- Put a value on the goodwill the firm has acquired.

Revaluation of Partnership Assets

- Revaluation of asset signifies an upward or downward revision of the value of the assets in the accounts of the partnership to reflect their current market value.
- It involves opening of revaluation account to adjust for the increase or decrease in the value of the assets.
- If there is increase in the value of the asset, debit the asset account with the increase and credit the revaluation account.
- But if there is a decrease in the value of the asset, credit the asset account and debit the revaluation account.
- Revaluation gain or loss is then shared and transferred to capital account as earlier stated.

LECTURE FOUR

DISSOLUTION OF PARTNERSHIP

Reasons for Dissolution of Partnership

Reasons for dissolution of partnership include:

- The death of a partner
- Retirement of partner
- The bankruptcy of a partner
- The lunacy of a partner
- Amalgamation of partnership
- Conversion of partnership to Limited Liability Company

Accounting entries

Transfer all non-cash assets to the **Realization Account** by

- Dr. Realization Account with the book value of the assets
- Cr. the Assets Accounts with the same.

Relevant expenses

- Dr. Realization Account
- Cr. Cash or Bank Account with all relevant expenses

Proceeds of assets

- Dr. Bank or Cash
- Cr. Realization Account with proceeds of assets

Accounting Entries (Contd.)

Assets taken over by any partners

- Dr. Partners’ Capital Account
- Cr. Realization Account with the agreed price.

Paying off liabilities:

- Dr. Liability Account.
- Cr. Bank or Cash with the value of the liabilities

Discount allowed by creditors:

- Dr. Creditor’s Accounts
- Cr. Realization Account with the discount allowed

Accounting Entries (Contd.)

Close the Realization Account to the Partner's Capital Accounts.

Paying off the Partner's current accounts to their capital accounts:

- Dr. Current Accounts
- Cr. Partner's Capital Accounts.

Close off the Partner's Capital Accounts by paying the amount due to them or by receiving the amount due from them.

Deficiency in a partner's accounts (Rule in Garner V Murray)

- After dissolution, the capital account of a partner may have a debit balance.
- The rule in Garner V Murray (1904) – a case in UK - is that the deficiency (the balance that cannot be paid by the insolvent partner) should be shared by the remaining partners in the ratio or proportion of their last agreed balances in their capital account.
- That is, the credit balances on their capital accounts in the normal balance sheet drawn up at the end of their last accounting period.

LECTURE FIVE

JOINT VENTURE

Definitions

- A joint venture is simply a venture undertaken jointly by two or more persons with a view to making a profit.
- It differs from a partnership in that it is more temporary in nature and has more specific limited objective(s).
- A party to a joint venture may be called a co-venturer or simply a venturer.

Main Features of Joint Venture

- **Sharing of Profit or Loss** - The ratio in which business profits or losses are to be shared must be clearly stated and agreed by the venture.
- **The scope of the venture** – Usually joint venture has limited purpose and limited lifespan.
- **Responsibilityof venturers** - The respective responsibilities of each venturer must be agreed upon
- **Services rendered by each venturer** - The parties may agree to pay a venturer for services rendered, such payment is deducted from revenue before the profit (or loss) of the venture is ascertained.

Accounting Records

- **Joint venture Account –** The Joint venture account is similar to ***income and expenses account.***
- **Joint venture memorandum account –** The account is prepared by merging the joint venture accounts. It is ***a replica of Trading, profit and loss account.***

Book Keeping Entries

- If cash is paid out:
- **DR** Joint Venture A/C
- **CR** Cash A/C
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- (ii) If cash is received: (from sales or from co-venturer):
- **DR** Cash
- **CR** Joint Venture Account
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- (iii) Any charges agreed upon e.g. Sales Commission:
- **DR** Joint Venture Account
- **CR** Commissions Account in the books of the venturer who is to receive the Commission

Book Keeping Entries (Contd.)

When it is time to ascertain profit (or loss), the Joint Venture Account of each party (venture) are combined together in a Memorandum Joint Venture Account to ascertain profit (or loss) of the venture.

When profit (or loss) is found, each venture will:

- **DR** Joint Venture Account with his share
- **CR** Profit and Loss on Joint Venture Account with the same amount

Book Keeping Entries (Contd.)

In the event of a loss, each venturer must:

- **DR** Profit and Loss on Joint Venture Account with his share of the loss
- **CR** Joint Venture Account, with the same amount

When all these entries have been made correctly, the Joint Venture Account in the books of each venturer will now be found to show the same balance.

The balances will however appear on the opposite sides in the respective books.

LECTURE SIX

CONSIGNMENT ACCOUNT

Definitions

- **Consignment** - Where a trader (the consignor) sends goods to his agent (the consignee) to sell and collect the money from customers for him, the goods are said to be sent on consignment.
- **A consignor**- A consignor is a trader (the principal) who sends goods to another (the agent) to sell them on his behalf for a reward, that is for commission.
- **A consignee**- A consignee is the agent to whom goods are sent on consignment.

Definitions (Contd.)

- **The Agent's Commission**- The agent's commission is his reward for work done on behalf of his principal (the consignor) and is calculated on the basis of an agreed percentage on gross sales.
- **Del Credere Commission**- This is an additional commission given to a consignee (agent) who promises to pay bad debts arising from sales made on credit either by him or by his principal to customers introduced to his principal by him.
- **Pro Forma invoice**- A pro forma invoice is not a charge but only used to provide information on the goods and to indicate the price at which the consignee is expected to sell them.

Account Sales

On completion of consignment, or when requested by the consignor, the agent submits a document called Account Sales which sets out the following information:

- Gross proceeds of sales
- Expenses incurred by the agent and the agent’s commission(s) shown as a deduction from gross sales; and
- Balance to be settled by the agent

Accounts and Records

- **Consignment a/c** – It is a replica of **trading, profit or loss a/c.** Debit it with cost of goods on consignment, expenses paid by the consignor and consignee and consignee’s commission while it is credited with sales proceeds and closing stock.
- **Goods on consignment a/c** – It is used to transfer the goods sent to the agent to trading a/c by a debit entry.
- **Consignee’s account**. – It is like a **receipt and payment account**. It is debited with sales proceeds and credited with all expenses made by the agent including his/her commission while the balance is the amount of money due to the consignor.

Accounting Entries

- **For the goods sent:**
- Debit: Consignment Account
- Credit: Goods sent on Consignment Account
- Note: The cost to the consignor of the goods sent is used.

- **For expenses paid by the consignor:**
- Debit: Consignment Account
- Credit: Bank (or Cash, as appropriate) Account

Accounting Entries (Contd.)

To record sales

- Debit: Consignee Account
- Credit: Consignment Account
- With the gross proceeds from sales

To record expenses

- Debit: Consignment Account
- Credit: Consignee Account
- With expenses incurred by the Agent

Accounting Entries (Contd.)

To record agent's commission

- Debit: Consignment Account
- Credit: Consignee Account
- With the agent's commission

To record cash remittance

- Debit: Bank
- Credit: Consignee Account
- With the cash remittance for settlement received from the agent

LECTURE SEVEN

CONTAINERS ACCOUNT

Definitions

- A container can be described as any item in which goods are packaged for purpose of selling, preservation or conveyance to an agreed destination.
- This lecture focuses on the accounting treatments for returnable and non-returnable containers.

Types of Containers

- **Non-returnable Containers:** Some containers cannot be used again for packaging after the contents have been consumed. These kinds of containers are called non-returnable containers. Examples include tins of milk, cans of coke and boxes of matches.
- **Returnable Containers:** Some containers can be used again for packaging after consuming the contents. These kinds of containers are called returnable containers. Examples include gas cylinder, cartons of beer and crates of soft drinks.

Accounting Entries for Non-returnable Containers

- Debit **containers stock account** with **opening stock** and **purchases** during the period
- Credit **containers stock account** with unit and value of unused containers (closing stock of containers) as carried down.
- The difference between both sides of this account represents the containers consumed during the period and would be passed on to manufacturing account or profit or loss account as distribution cost.

Accounting Entries for Returnable Containers

- **Containers stock account** is used to record stock of containers **at their book value** .
- The account is **debited** with ***opening stock*** of containers in hand and with customers at book value and with ***purchases*** of container **at purchase price**.
- The account is **credited** with depreciation charge, scrap, loss on scrap, containers retained by customers and with closing stock of containers in hand and with customers.
- The balancing figure (if any) is the cost of containers consumed which is transferable to profit or loss account.

Accounting Entries for Returnable Containers (Contd.)

- **The containers trading account** is used for measuring profit or loss on containers and for monitoring the movement of containers in the hands of customers and recording is made **at refundable amount/price**.

Accounting Entries for Returnable Containers (Contd.)

- **Containers suspense account:** This is also used as an alternative approach to monitor the movement of containers in the hands of the customers and recorded **at refundable amount/price**. It records the refundable deposit, deposit receivable and forfeited (through non-return), sum written off in form of depreciation and repairs and maintenance expenses.

LECTURE EIGHT

CONTRACT ACCOUNT

Definitions

- **Construction contract** is a contract negotiated for the construction of an asset or combination of assets that are closely interrelated or independent in terms of their design technology, function or use.
- **Mobilisation Fee:-**It is the advance payment made to the contractor to enable the commencement of the contract.
- **Retention Fee:-**This is a part of the contract price withheld after the successful execution of contract and released after the expiration of a stated period subject to no adverse event on the contract.

Definitions (Contd.)

- **Contract Certification:-**This is the process by which the project Architect/Engineer issues a certificate as evidence of the value of work done on a construction contract as at a particular date.
- **(v) Deferred Costs:-**These are costs that relate to aspects of a contract which are not immediately certifiable.
- **(vi) Contract Work-In-Progress:-**These are accumulated certifiable costs relating to a contract that is yet to be completed.

Definitions (Contd.)

- **Progress Payments:-**These are settlements of fees for work already billed.
- **(viii) Under Billing:-**This arises where the rates used for progress billings for payment are lower than those used for revenue recognition.
- **(ix) Overbilling:-**This arises where the rates used for progress billings for payment are higher than those used for revenue recognition.

Types of Construction Contract

- Fixed sum Contract
- Cost plus a fixed rate
- Variable Price Contract
- Re-measured Contract

Contract Revenue

- Contract revenue is the amount of **revenue initially agreed upon with the customer** and the **amount on account of variations** from the agreed terms, claims made and the incentives claimed to the extent that is probable that they will result in revenue and they are capable of being reliably measured.

Contract Costs

- Material Costs
- Labour Costs
- Direct Expenses
- Depreciation
- Hiring Cost
- Transportation Cost
- Cost of Design
- Overhead

Methods of Recognizing Revenue and Expenses

- Percentage of Completion Method

- Completed Contract Method

Methods of Preparing Contract Accounts

- Architect Certificate Method
- Work-in-progress Method

Disclosure Requirements (IAS 11)

- The amount of contracts revenue recognized in the contract period
- (ii) The method used to determine the contracts revenue recognized in the period
- (iii) The methods used to determine the stage of completion of contracts in progress
- (iv) The total contracts costs incurred and recognized profits up to the reporting date

Disclosure Requirements (Contd.)

- Total advances received
- The total amount of retentions
- Cross amount due from customers for contract work as an asset
- Cross amounts due to customers for contract work, as a liability
- Contingent liabilities or contingent assets that may arise on warranties claims

LECTURE NINE

FARMERS ACCOUNTS

TERMINOLOGIES

- ***Agricultural Activities:*** It is the management by an enterprise of the biological transformation of biological assets for sale into agricultural produce, or into additional biological assets.
- ***Biological Asset:*** It is a living animal or plant.
- ***Biological transformation:*** It comprises the processes of growth, degeneration, production or procreation that causes qualitative or quantitative changes in a biological assets.

TERMINOLOGIES (CONTD.)

- ***Agricultural produce:*** It is the harvested products of the enterprise’s biological assets.
- ***Agricultural Inputs:*** These include cost of seeds, fertilizer, stems, suckers, seedlings, young animals, veterinary drugs, chemicals among others.

Farming Activities

- Farmers produce for sale and for their own consumptions. Hence, consumptions should be treated as drawings.
- Farmers may engage in different types of farming including:
- Livestock, Crop Farming, Horticulture and Plantations

Farmer's Accounts

- Farmer's account is covered by IAS 41 – Agriculture.
- Large farms prepare all the components of financial statements
- While smaller farms keep incomplete records or at best single entries to record receipts and payments.

Farmer’s Accounts (Contd.)

- Farmers prepare final accounts just like other enterprise or business

The final accounts include:

- Trading, Profit or Loss Accounts
- Statement of Financial Position
- Statement of Gross Output
- Notes to the Accounts

Peculiarities in Farmer's Account

- Valuation of inventory of arable crops or livestock (biological assets): IAS 41 provides that biological assets should be measured and included in the financial statements at their fair value less estimated point-of-sale cost.
- But where the fair value cannot be obtained or cannot be measured reliably, the biological assets should be measure at cost.
- Determination of the appropriate method of depreciation of farm land and other farm assets.

LECTURE TEN

HIRE PURCHASE

Definitions

- **Hire purchase transaction**: It involves financing acquisition of assets through credit facilities. The two parties involved in hire purchase transaction are ***the vendor (seller) and the buyer.***

- **Cost Price**: This is the price at which the vendor acquired the asset.

- **Cash Price:** This is the price at which the asset could have been purchased from the vendor if not on hire purchase.

- **Hire Purchase Price:** This is the total amount due from the buyer of the asset for acquiring the asset through hire purchase. Simply put, it is the cash price plus the hire purchase interest.

Definitions (Contd.)

- **Hire Purchase Interest:** This is also known as finance charge. It is the excess of the hire purchase price over the cash price.

- **Initial Deposit:** This is the initial amount payable by the buyer at the inception of the hire purchase transaction.

- **Installment:** This is the sum payable by the buyer at specific intervals to liquidate the balance of the purchase price after the payment of the initial deposit.

- **Unrealized Profit**: It is the profit element included in the outstanding hire purchase price.

Methods of Accounting for Hire Purchase Transaction

- **Hire Purchase Interest Account Method**
- Under this method, the hire purchase buyer will ***debit the asset account*** and ***credit vendor account with the cash price*** of the item. The ***interest element*** is only ***recognized as it falls due.***

Methods of Accounting for Hire Purchase Transaction (Contd.)

- **Hire Purchase Interest Suspense Method**
- This method involves ***debiting the*** **asset account** with ***'Cash Price'*** of the item and **hire purchase interest suspense account** ***is debited with*** the ***Total Hire Purchase Interest or Finance Charges*** while **the vendor** ***is credited*** with ***Total Hire Purchase Price***.
- When an installment falls due, the appropriate amount of the ***hire purchase interest that is due is charged to*** **Profit & Loss Account** ***from*** **Hire Purchase Interest Suspense Account**.

Basis of Allocating Hire Purchase Interest over Hire Purchase Period

- **Straight Line Method**
- **Actuarial Method**
- **Sum-of-the Years-Digit Method**

Accounting Entries under Hire Purchase Transaction

When accounting for hire purchase transactions, the accounting entries can be considered from two points of view:

- Buyer’s Point of view
- Vendor’s Point of view

LECTURE ELEVEN

BRANCH ACCOUNT

Branch Operation

- Many entities, especially those in retailing, find it convenient to operate from various locations.
- A manufacturer may want to sell its products from different spots in order to maximize sales and also attend promptly to its customers.
- In such cases, one option is to carry out its business from various branches.

Classification of Branches for Accounting Purposes

- Non-autonomous branches: These are branches for which all the financial records are kept at the Head Office
- Autonomous branch: These are branches which maintain separate accounting records
- Foreign Branches: These are branches established in another country.

Methods of Invoicing Goods to the Branches

- There are three basic methods of invoicing goods to the branches. These are:
- The Cost Price Method
- The Cost plus a Percentage Method; and
- The Selling Price Method.

LECTURE TWELVE

ROYALTY ACCOUNT

Definitions

- **Royalty:** It is the consideration paid to the owner of a legal right (a lessor) for allowing another party (a lessee) to use a legal right owned by him.
- **Minimum Rent:** It is a guaranteed minimum payment to the lessor irrespective of the level of output derived by the lessor. It is usual for the royalty arrangement to stipulate a minimum rent.
- **Short workings:**It is the shortfall or the amount needed to make up the minimum rent.

Accounting for Royalties in the Books of the Lessee/Tenant/Grantee

Accounts to be opened:

- Royalties Payable Account (*an expense account)*
- Land lord's Account (*a liability account)*
- Bank Account(*a current asset a/c)*
- Short workings Recoverable Account (*a current asset a/c)*
- Short workings Irrecoverable Account (*an expense account)*
- Profit or loss Account (Final a/c)

Accounting Entries in the Books of the Lessee

To record ascertained royalties based on actual production:

- Debit Royalties Payable A/C
- Credit Landlord’s A/C with the amount of royalty due.

To record ascertained short workings:

- Debit Short workings Recoverable
- Credit Landlord’s Account with the amount of short workings.

Accounting Entries in the Books of the Lessee (Contd.)

To close off Royalties payable account at the end of the period:

- Debit Manufacturing or Profit/Loss Account
- Credit Royalties Payable Account amount of royalty due.

When the royalty is paid to the Landlord

- Debit Landlord's Account
- Credit Bank Account

To record recoupment of past short workings:

- Debit Landlord's Account
- Credit Short workings Recoverable Account

Accounting Entries in the Books of the Lessee (Contd.)

- To record lapsed short workings:
- Debit Short workings Irrecoverable Account
- Credit Short workings recoverable Account with the amount of lapsed short workings.
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- If short workings become irrecoverable:
- Debit Profit or loss Account
- Credit Short workings Irrecoverable Account with the amount no longer recoverable

Accounting for Royalties in the Books of the Lessor/Landlord/Grantor

Accounts:

- Royalties Receivable Account (*an income account)*
- Tenant's Account (*a current asset account)*
- Bank Account(*a current asset a/c)*
- Short workings Allowable Account (*a liability a/c)*
- Profit or loss Account (Final a/c)

Accounting Entries in the Books of the Lessor

To record ascertained royalties based on actual production:

- Debit Tenant’s A/C
- Credit Royalties Receivable A/C with the amount of royalty due.

To record ascertained short workings:

- Debit Tenant’s A/C
- Credit Short workings Allowable Account with the amount of short workings.

Accounting Entries in the Books of the Lessor (Contd.)

To close off Royalties Receivable account at the end of the period:

- Debit Royalties Receivable account
- Credit Manufacturing or Profit/Loss Account with the amount of royalty due.

When the royalty is received by the Landlord

- Debit Bank's Account
- Credit Tenant's Account with the amount of royalty paid

Accounting Entries in the Books of the Lessor (Contd.)

To record recoupment of past short workings by tenant:

- Debit Short workings Allowable Account
- Credit Tenant’s Account

If short workings lapsed/become irrecoverable:

- Debit Short workings Allowable Account
- Credit Profit or loss Account with the amount no longer recoverable

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