Final Accounts.

2004 Question 1.

Adjustment 1.
Stock at 31/12/2003 at cost was €85,000. This figure includes old stock which cost €8,000 but has a net realisable value of 60% of cost.

Solution.
The old stock has lost 40% (€3,200) worth of its value – it has possibly gone off or been damaged in some way. So instead of recording closing stock as €85,000 in the Trading Account and Current Assets, we simply record it as €81,800 in both places instead.

Adjustment 2.
Patents, which incorporate 2 months investment income, are to be written off over a five year period commencing in 2003.

Solution.
This adjustment requires you to do a few different things. First of all we need to work out how much 2 months investment income is. To do this just look for investments figure in the trial balance. You'll see that it says '6% Investments' and the amount is €180,000. So a full year of investment income would be €180,000 x 6%. Since we only need 2 months of investment income, work out the answer to €180,000 then divide this by 12 and then multiply by 2. This gives you €1,800.

Now we know that the figure for patents (€58,200) includes €1,800 that shouldn't be in it. You would think that subtracting the €1,800 from the €58,200 would give us the correct figure for patents therefore. Unfortunately you'd be wrong! The real figure for patents is actually €58,200 + €1,800! The reason for this is best explained using the old accounting saying:

Debit Assets and Expenses,
Credit Liabilities and Gains.

In this case, we are told that patents include some amount of investment income. In other words we have an asset (patents) which includes some amount of a gain (investment income). So the €58,200 you see for patents on the debit (left) side of the trial balance includes €1,800 which should actually be on the credit (right) side of the trial balance. Now that we have realised that €1,800 needs to be put on the right side of the trial balance, it makes sense that the left hand side also needs to be increased by €1,800 to make everything balance. So the rule is:

If a figure includes another figure that should be on the opposite side of the trial balance – Add them. If a figure includes a figure that should be on the same side of the trial balance – Subtract them. (NB: I know this sounds confusing but it really does get easy once you've done a few of them!).

So now we know that patents are actually €60,000 (€58,200 + €1,800). We are told in the adjustment to write them off over 5 years. This just means that the value of the patents is to be reduced from €60,000 to zero in the next five years. The entries for this adjustment are therefore:

Patents (in the Fixed Assets) should be €48,000 (€60,000 - €12,000);
Patent Write-Off (an Expense) should be €12,000; and
Investment Income (a Gain) should be €1,800.

Simple!

<u>Adjustment 3.</u>
Provide for depreciation on delivery vans at the annual rate of 20% of cost from the date of purchase to the date of sale. NOTE: On 31/9/2003 a delivery van, which had cost €60,000 on 1/6/2001, was traded in against a new van which cost €84,000. An allowance of €22,000 was given on the old van. The cheque for the net amount of this transaction was incorrectly treated as a purchase of trading stock. This was the only entry made in the books in respect of this transaction.

<u>Solution.</u>
OK, here we go – This adjustment is essentially asking us to do three things. First of all we have to work out if we made a profit or a loss on the sale of the delivery van (anytime we sell a fixed asset we need to work this out). To do this we just calculate how much the van was worth at the time of the sale and compare this to how much we got for it. So if the van cost us €60,000 and was sold 2 years and 4 months later, it would have been worth €32,000 at the time we sold it (this is because 20% depreciation per year is €12,000 and we had 2 years and 3 months of this; i.e €28,000 of depreciation). Since we received a trade-in or allowance of €22,000 for this van, we made a loss of €10,000 on the sale. This €10,000 is therefore recorded as an Expense. If we had received *more* than we thought the van was worth, we would have recorded the amount as a Gain.

Secondly, we need to use the information in the adjustment to work out an overall figure of depreciation for all of our vans. This is made up of the following figures:

Depreciation to date:	€78,000 (given to us in the trial balance)
Depreciation Jan-Sep:	€25,800 (€172,000 x 20% x 9 months) *
Depreciation Oct-Dec	€9,800 (€196,000 x 20% x 3 months) *
Dep. on Van We Sold	-€28,000
Total Depreciation:	€85,600

* Hopefully these two lines make sense. Don't forget that for nine months of the year we owned vans which had cost us €172,000. For the last three months of the year however, we owned vans which had cost us €196,000 (because we sold a van which had cost €60,000 and bought one costing €84,000).

So what gets recorded where? Well in the Fixed Assets section we put in the cost of the vans we currently own (€196,000) and subtract the total depreciation (€85,600) from this to show the value of our vans. Meanwhile in the Expenses section we record the amount of depreciation that we incurred this year (€35,600 i.e €25,800 + €9,800).

Finally, the adjustment mentioned that "the cheque for the net amount of this transaction was incorrectly treated as a purchase of trading stock". Remember that we bought a van costing €84,000 but that we received an allowance or trade-in for our old van of €22,000. So we only actually *paid* €62,000 for the new van. The €62,000 cheque was unfortunately recorded incorrectly in our accounts. The problem was that we treated it as if we had bought some stock (that we might be re-selling to a customer) instead of as a fixed asset that we would be using ourselves. So all we have to do is to subtract €62,000 from the figure for purchases (€620,000) before we put purchases into the Trading Account.

Adjustment Four.

Buildings are to be depreciated at the rate of 2% of cost per annum (land at cost was €130,000). At the end of 2003 the company re-valued the Land and Buildings at €880,000.

Solution.

Having been through the tough issue of the van depreciation above, this one should seem a bit more straightforward. First of all we just need to work out the depreciation on buildings. We're told that the rate of depreciation is 2% and that land made up €130,000 of the

€780,000 Land and Buildings cost from the trial balance. So the depreciation on buildings this year is 2% of €650,000 (€13,000). This €13,000 is therefore recorded as an Expense.

So what about the second sentence in the adjustment? Well before we heard about this re-valuation, we would have thought that our land and buildings were worth:

Cost:	€780,000
Accumulated Depreciation:	-€39,000
Depreciation This Year:	-€13,000
Current Value:	€728,000

As a result of this, if the company has decided to revalue the land and buildings to €880,000 we have what's called a 'Revaluation Reserve' of €152,000 (€880,000 - €728,000). In the Fixed Assets section we simply record land and buildings as being worth €880,000 and in the Financed By section we include a 'Revaluation Reserve' of €152,000.

<u>Adjustment Five.</u>
The figure for bank in the trial balance has been taken from the firm's bank account. However, a bank statement dated 31/12/2003 has arrived showing a credit balance of €4,040. A comparison of the bank account and the bank statement has revealed the following discrepancies:
1. Investment income €2,700 had been paid direct to the firm's bank account.
2. A cheque for €780, issued to a supplier, had been entered in the books (cash book and ledger) as €870.
3. A credit transfer of €750 had been paid direct to the firm's bank account on behalf of a debtor who has recently been declared bankrupt. This represents a first and final payment of 30c in the €1.
4. A cheque for fees €6,000 issued to a director had not yet been presented for payment.

<u>Solution.</u>
This seems like a tough adjustment but it's really just a few short adjustments bunched together.

1. In the first part we simply need to record €2,700 as investment income in the Gains and also add €2,700 to the figure for bank in the trial balance.

2. In part two we paid a creditor €780 but recorded it as €870 (i.e €90 too much). So we need to increase our creditors in the Current

Liabilities by €90 (because we incorrectly subtracted €870 away from creditors instead of €780 when we made the payment) and we also need to increase our bank figure by €90 (again because we reduced it by €870 when we only should have reduced it by €780).

3. In this third part we firstly need to add the €750 to our bank figure. The debtor has only paid us 30% of what he owed and apparently we're not getting the rest, so there has been a bad debt of €1750 (which should be recorded as an Expense). The total of €2,500 should be subtracted from debtors in the Current Assets (since he has paid us €750 and no longer owes us the remaining €1750).

4. The fourth part is a bit of a trick because we don't need to do anything. As soon as we write a cheque we record it as being paid in our accounts. The fact that this director hasn't cashed the cheque yet is irrelevant as far as our accounts go.

So overall this adjustment caused changes to a couple of the figures from the trial balance (debtors and investment income) and also changed our bank figure as follows:

Bank Figure From Trial Balance:	-€5,500 *
Investment Income Received:	€2,700
Payment to Debtor Error:	€90
Payment From Debtor:	€750
	-€1,960

* Don't forget the accounting rule mentioned before:

Debit Assets and Expenses,
Credit Liabilities and Gains.

The bank figure is on the credit side of the trial balance, meaning that it is in fact a bank overdraft (Current Liability). The adjustments have improved the situation but our new bank figure of €1,960 is still a Current Liability.

<u>Adjustment Six.</u>
The directors recommend that:
1. The Preference dividend due be paid.
2. A final dividend on ordinary shares be provided bringing the total dividend up to 9c per share.
3. Provision be made for both Investment income and Debenture interest due.
4. Provision for bad debts to be adjusted to 4% of debtors.

Solution.
Just like the last adjustment, we have a few separate parts to deal with in this last section of the question.

1. The trial balance has told us that we have €200,000 worth of 7% preference shares. This means that we *must* pay out €14,000 to the preference shareholders each year (a preference shareholder gets exactly what they're entitled to – nothing more, nothing less). Now if we consider that the trial balance mentions 'Interim dividends for first six months' of €40,000 we know that €7,000 was for preference shareholders (because they have to get €14,000 a year and therefore would have received €7,000 at this six month period). Given that they are now owed the remaining €7,000 this amount should be recorded in the Appropriation Account and also as a Current Liability.

2. The ordinary shareholders on the other hand are never guaranteed any specific return and only find out for sure what they're getting at the end of the year. So if you remember that the interim dividends of €40,000 contained €7,000 for preference shareholders (and so €33,000 must have gone to ordinary shareholders) and bear in mind that the adjustment said these ordinary shareholders need to get a total of €49,500 (9% of the €550,000 ordinary shares), they are therefore still owed €16,500 (€49,500 - €33,000). This €16,500 is recorded in the Appropriation Account and as a Current Liability.

3. For both investment income (which is a Gain) and debenture interest (which is an Expense) we need to work out how much we *should have* paid or received during the year and compare this to how much we *actually* paid or received. In this way, we can then see how much is due for each of them.

If we look at investment income first, we should have received €7,200 this year (the investments of €180,000 carry a 6% return, but don't forget that we only made the investment on 1/5/2003 (so we've only had the investments for 8 months). Now we need to compare what we should have received (€7,200) with what we did receive. Hopefully you remember adjustment number two where we found out that we had received €1,800 of investment income (but by mistake had included it in our figure for patents). As well as this, adjustment number five mentioned that €2,700 of investment had been received that we weren't aware of at the time. So overall we *should* have received €7,200 this year and we *actually* received €4,500 (€1,800 + €2,700). The difference of €2,700 is therefore due to us. We have to record this €2,700 as a Gain and as a Current Asset.

The debenture interest requires a similar calculation. A debenture is a type of loan and so we need to know how much interest we should have paid this year. The trial balance tells us that we have €230,000 worth of debentures and that the interest rate if 9%. The slight confusion however is the bit of information in the brackets which tells us that we didn't have €230,000 of debentures for the whole year. So we need to work out 9% of interest on €150,000 for 3 months (€3,375) and add this to 9% of interest on €230,000 for 9 months (€15,525). Adding these two figures together tells us how much debenture interest we should have paid for the year (€18,900). The trial balance tells us that we actually paid €4,500 and there is no mention in any of the adjustments of any further payments of debenture interest. We therefore still owe €14,400 (€18,900 - €4,500) and this needs to be recorded as an Expense and as a Current Liability.

4. Finally, we are told to change the provision for bad debts from its current figure of €3,600 to 4% of debtors. This is pretty straightforward but we just need to remember that it should be 4% of the *up-to-date* debtors figure (not the €73,900 in the trial balance). Adjustment five part 3 led us to reduce the debtors figure by a total of €2,500. The new bad debt provision is therefore 4% of €71,400 (€2,856) and this is a decrease of €744 on the original bad debt provision in the trial balance. This €744 reduction is recorded as a Gain and the new provision of €2,856 is subtracted from debtors in the Current Assets.