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3-in-1

Accounting

CLASS TEXT & STUDY GUIDE

Ann Botha

GRADE

10

CAPS

Grade 10 Accounting 3-in-1 CAPS

CLASS TEXT & STUDY GUIDE

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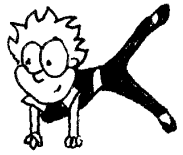

UNIT 5: LEDGERS, TRIAL BALANCES AND THE ACCOUNTING EQUATION

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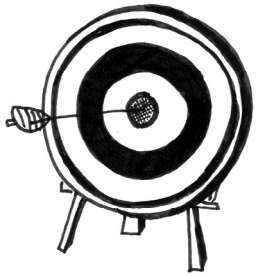


QUESTIONS

EXAM QUESTIONS

SUGGESTED ANSWERS

Final Accounts

These are the very last accounts prepared at the end of the financial period.
At this stage there are only two of them:

- the Trading account, which calculates the gross profit by comparing sales and cost of sales
- the Profit and loss account which calculates the net profit by comparing all the gains/incomes/profits with all the expenses/losses.

These two accounts give the same information as an Income Statement. (Unit 9)

A Post-closing Trial Balance

The only accounts in this trial balance are the assets, liabilities and equity i.e. the Capital account, as the Drawings account will have been closed to the capital account. This is the information shown in a Balance Sheet. (Unit 9)

ADJUSTMENTS

It is impossible for all the totals and balances of the accounts to be 100% correct on the last day of the accounting period because:

- consumables bought have not been used e.g. packing material, fuel, stationery
- expenses have been paid for the next accounting period e.g. insurance
- income has been earned, but not yet received e.g. interest on fixed deposit
- some expenses have not been paid by the year-end e.g. telephone
- payment has been received for a service, but the service has not been provided yet e.g. rent income
- trading stock is missing i.e. there is a deficit, or there is surplus stock on hand
- fixed assets must be depreciated

The accounts which are not correct must be changed to make them accurate for the financial period [**GAAP** – matching].

This will bring new accounts into being:

New Assets

- Consumable stores on hand — the business can use the product next year or get the money back
- Prepaid expenses — the business will receive the service in the future or get the money back
- Accrued Income — money is owing ***to*** the business

New Liabilities

- Accrued Expenses — money is owing ***by*** business
- Income Received in Advance — the business has received money, but has not earned it. It will have to do the work or pay the money back to the customer.

New Expenses [GAAP – prudence]

- Trading Stock Deficit — stock 'disappears' from the shelves, but as there was no break-in, the business cannot claim insurance.
  [If there was a Trading stock surplus, which is an income, it would mean that someone bought and paid for goods, but forgot to take them. There would be more stock on the shelves than there should be!]
- Depreciation — reduction of the value of fixed assets because of normal 'wear and tear'

HOW TO DO ADJUSTMENTS – STEP BY STEP

All adjustments are journalized. The method is the same as that used for other journal entries.

QUESTIONS TO ASK WHEN DOING ADJUSTMENTS

❶ **Which account** is wrong? – identify it
❷ What is wrong with it, i.e. is it too **big** or too **small**?
❸ What is the **other account**?

This process is easy because the options are limited.

For example: Assume the answer to ❶ is Rates = expense

if the answer to ❷ is too big ➔ PREPAID
OR
the answer to ❷ is too small ➔ ACCRUED
↘ ↗ ❸ EXPENSE

Another example: Assume the answer to ❶ is Rent income = income

if the answer to ❷ is too big ➔ RECEIVED IN ADVANCE
OR
the answer to ❷ is too small ➔ ACCRUED
↘ ↗ ❸ INCOME

Some examples of the thought process involved

(February Year-End)

Consumables stores on hand

The business had bought packing material for R15 000, but by the end of the year had only used half.

❶ Which account is wrong?	**Packing material (expense)**			
❷ Is it too big or too small?	Too big	= E	– R7 500	RHS
❸ The other account is?	**Consumables stores on hand**	= A	+ R7 500	LHS
Is it right? Does the LHS = RHS?, i.e. does the debit side = the credit side YES!				

Prepaid expenses

Insurance includes premium of R1 800 paid annually on 1 July.

❶ Which account is wrong?	**Insurance (expense)**			
❷ Is it too big or too small?	Too big because it is ***always*** paid in advance.			
*Be careful with the calculation. The most important word is **annual**, so work out the monthly amount first. R1 800/12 = a premium of R150 per month. Now count the number of months in advance i.e. from 28 February (always from the end of the financial year)* to 1 July *(when it has to be paid again)* = 4 months *(don't count February and don't count July as it says 1st.)*				
The amount prepaid is 4 × R150	Insurance	= E	– R600	RHS
❸ The other account is?	**Prepaid expenses**	= A	+ R600	LHS
Is it right?	Does the LHS = RHS	YES!		

Accrued income

No interest has been received on the fixed deposit of R6 000 invested on 1 January 2014. The rate of interest is 5% p.a.

❶ Which account is wrong?	**Interest on fixed deposit (income)**			
❷ Is it too big or too small?	Too small – nothing has been received yet.			
To calculate the figure: fixed deposit × interest % × no. of months invested *6 000 × 0,05 × 2/12 (or 1/6)* = R50				
Interest on fixed deposit		= G	+ R50	RHS
❸ The other account is?	**Accrued income**	= A	+ R50	LHS
Is it right?	Does the LHS = RHS?		YES!	

Accrued expenses

The telephone account for February, R750 was only received on 5 March.

❶ Which account is wrong?	**Telephone (expense)**			
❷ Is it too big or too small?	Too small by R750	= E	+ R750	LHS
❸ The other account is	**Accrued expenses**	= L	+ R750	RHS
Is it right?	Does the LHS = RHS?		YES!	

Income received in advance

The tenant pays the rent monthly in advance. The balance on the Rent income account is R26 000.

❶ Which account is wrong?	**Rent income**			
❷ Is it too big or too small?	Too big *(she has paid for 12 + 1 months)*			
To calculate the figure always divide amount given by the number of months actually received, i.e. 13 R26 000/13 = R2 000				
Subtract R2 000 from	Rent income	= G	– R2 000	LHS
❸ The other account is?	**Income received in advance**	= L	+ R2 000	RHS
Is it right?	Does the LHS = RHS?		YES!	

Trading stock deficit

A physical inventory showed trading stock on hand cost R125 000. The balance on the Trading stock account was R126 500.

❶ Which account is wrong?	**Trading stock (asset)**			
❷ Is it too big or too small?	Too big	= A	– R1 500	RHS
❸ The other account is?	**Trading stock deficit**	= E	+ R1 500	LHS
Is it right?	Does the LHS = RHS?	YES!		

Trading stock surplus

Imagine that the physical inventory in the above example showed the cost of the stock on hand was R127 500.

❶ Which account is wrong?	**Trading stock (asset)**			
❷ Is it too big or too small?	Too small	= A	+ R750	LHS
❸ The other account is?	**Trading stock surplus**	= I	+ R750	RHS
Is it right?	Does the LHS = RHS?			YES!

HOW TO DO THE ADJUSTMENTS IN THE LEDGER AND THE JOURNAL – STEP BY STEP

QUESTIONS TO ASK WHEN DOING ADJUSTMENTS

❶ **Which account** is wrong? – identify it
❷ What is wrong with it, i.e. is it too **big** or too **small**?
❸ What is the **other account**?

1. A physical inventory showed that stationery ❶ costing R500 had not been used.

   The stationery expense should not be R8 200. It is too big ❷.

GENERAL LEDGER OF TINY TOTS

+ STATIONERY (E) – N4

Balance	b/d	8 200	Consumable stores on	
			hand (adjustment)	500
			Profit and loss (Closing transfer)	7 700
		8 200		8 200

+ ❸ CONSUMABLE STORES ON HAND (A) – B7

Stationery	500		

GENERAL JOURNAL OF TINY TOTS

Consumable stores on hand (A+)	500	
Stationery (E–)		500
stationery not used		

2. Tiny Tots entered into an advertising ❶ contract with Southern Sun Newspapers for three months January to March.

   The account shows that they had paid R3 000. This is one month too much, ❷ R1 000 (3 000 / 3)

+ ADVERTISING (E) – N5

Total	b/f	3 000	Prepaid expenses	1 000
			Profit and loss (C/T)*	2 000
		3 000		3 000

+ ❸ PREPAID EXPENSE (A) – B8

Advertising	1 000		

GENERAL JOURNAL OF TINY TOTS

Prepaid expenses (A+)	1 000	
Advertising (E–)		1 000
advertising paid for March		

3. Tiny Tots had sold a total of R105 000 stock on behalf of Big Brother during this financial period. The agreement states that it will earn 10% commission ❶ on all sales.

   The account shows a total of only R9 600. This means it is too small ❷ by R900 as 10% of R105 000 = R10 500.

– COMMISSION INCOME (G) + N6

Profit and loss (C/T)*		10 500	Total	b/f 9 600
			Accrued income	900
		10 500		10 500

+ ❸ ACCRUED INCOME (A) – B9

Commission income	900		

GENERAL JOURNAL OF TINY TOTS

Accrued income (A+)	900	
Commission income (G +)		900
commission still owing on goods sold		

4. The water ❶ account for February R400, was only received on 3 March.

   The water has been used, but not paid for. The expense is too small ❷

+ WATER AND ELECTRICITY (E) – N7

Total	b/f	4 800	Profit and loss (C/T)*	5 200
Accrued expenses		400		
		5 200		5 200

– ❸ ACCRUED EXPENSES (E) + B10

		Water and electricity	400

GENERAL JOURNAL OF TINY TOTS

Water and electricity (E+)	400	
Accrued expenses (L+)		400
water account still owing for February		

*(C/T) refers to the closing transfers made in the General Journal to close the accounts. These Journal entries are shown on the next page.

5. The tenant pays her rent ❶ quarterly in advance.

   Instead of receiving 12 months' rent, Tiny Tots has received 15. This account is too big. ❷ To calculate the amount in advance: 15 000/15 × 3.

	RENT INCOME		(G) +	N8
Income received in advance	3 000	Total	b/f	15 000
Profit and loss (C/T)	12 000			
	15 000			15 000

–	❸ INCOME RECEIVED IN ADVANCE	(L) +	B11
		Rent income	3 000

GENERAL JOURNAL OF TINY TOTS

Rent income (G–)	3 000	
Income received in advance (L+)		3 000
rent received for three months in advance		

6. An inventory of trading stock ❶ on 28 February showed R100 000 on hand.

   The account shows that there should be R102 500 on hand. This means stock is R2 500 too small. ❷

+	TRADING STOCK		(A) –	B5
Balance b/d	102 500	Trading stock deficit		2 500
		Balance	c/d	100 000
	102 500			102 500
Balance b/d	100 000			

+	❸ TRADING STOCK DEFICIT	(E) –	N10
Trading stock	2 500	Profit and loss (C/T)	2 500

GENERAL JOURNAL OF TINY TOTS

Trading stock deficit (E+)	2 500	
Trading stock (A–)		2 500
deficit according to physical stocktaking		
authorised by **T Tots**		

HOW TO DO CLOSING TRANSFERS IN THE JOURNAL AND THE GENERAL LEDGER

Always follow the order given on page 42.

1. Close Debtors allowances to Sales

Keeping a record of Debtors allowances in a separate account is a very useful management tool as it shows how much of what was sold, was returned.
Now it has served its purpose, so close it by means of a General Journal entry.

GENERAL JOURNAL OF TINY TOTS **GJ12**

2014 Feb 28	Sales (G–)	N1	15 600	
	Debtors allowances ([G–] –)	N2		15 600
	closing transfer			

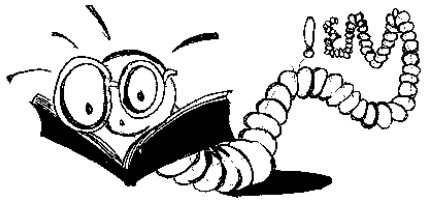
GENERAL LEDGER OF TINY TOTS

–	SALES			(G) or (I) +			N1
2014 Feb 28	Debtors			2014 Feb 28	Total	b/f	471 600
	allowances	GJ12	15 600				

+	DEBTORS ALLOWANCES		(G-)	–			N2
2014 Feb 28	Total	b/f	15 600	2014 Feb 28	Sales	GJ12	15 600

The 'b/f' means 'brought forward'.
It is used with 'Total' in an account where figures are on one side only during the year.

These big equal signs means the account is closed (both sides are equal).



2. Close Sales to Trading

It is important to remember that Sales has now changed, so the amount to be transferred out of the account is not R471 600, but only R456 000.

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Sales (G–) (471 600 – 15 600)	N1	456 000	
	Trading (G+)	F1		456 000
	closing transfer			

– SALES (G) + N1

Feb 28	Debtors			Feb 28	Total	b/f	471 600
	allowances	GJ12	15 600				
	Trading	GJ12	456 000				
			471 600				471 600

The F1 folio tells you that the Trading account is a Final account.

– TRADING (G) + F1

				Feb 28	Sales	GJ12	456 000

Some people prefer to write 'Trading account'. This is not necessary (but not wrong). Every word we write down refers to an account, but we do not write 'Sales account' or 'Profit and loss account'.

3. Close Cost of sales to Trading

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Trading (G–)	F1	240 000	
	Cost of sales (E+)	N3		240 000
	closing transfer			

+ COST OF SALES (E) – N3

Feb 28	Balance	b/d	240 000	Feb 28	Trading	GJ12	240 000

The 'b/d' means 'brought down'. It is used with 'Balance' in an account which has figures on both sides during the year.

– TRADING (G) + F1

Feb 28	Cost of sales	GJ12	240 000	Feb 28	Sales	GJ12	456 000

4. Close Trading to Profit and loss

The purpose of the Trading account is to tell how much gross profit was made this year. If we close it now, that is exactly what it will tell us, as the difference between sales and cost of sales is the gross profit.

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Trading (G–) (456 000 – 240 000)	F1	216 000	
	Profit and loss (G+)	F2		216 000
	transfer of gross profit			

– TRADING (G) + F1

Feb 28	Cost of sales	GJ12	240 000	Feb 28	Sales	GJ12	456 000
	Profit and loss	GJ12	216 000				
			456 600				456 600

– PROFIT AND LOSS (G) + F2

				2014 Feb 28	Trading	GJ12	216 000

5. Close other Income accounts to Profit and loss

We are now going to do what is called a 'combined' journal entry (where there are more than two accounts involved). There are two other income accounts - Commission income and Rent income. They both have credit balances and therefore need to be debited to close them. The entry will look like this:

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Commission income (G–)	N6	10 500	
	Rent income (G–)	N8	12 000	
	Profit and loss (G+)	F2		22 500
	closing transfers			

– PROFIT AND LOSS (G) + F2

				Feb 28	Trading	GJ12	216 000
					Commission		
					income	GJ12	10 500
					Rent income	GJ12	12 000

These have been posted to the income accounts on pages 45 and 46.

6. Close all Expenses to Profit and loss

A combined entry is needed again. There will always be many expense accounts to be closed and they all need to be credited. The Profit and loss account will be debited as the expenses decrease the profit.

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Profit and loss (G–) *(add all the credit figures)*	F2	138 500	
	Stationery (E–)	N4		7 700
	Advertising (E–)	N5		2 000
	Water and electricity (E–)	N7		5 200
	Sundry operating expenses (E–)	N9		121 100
	Trading stock deficit (E–)	N10		2 500
	closing transfer**S**			

There would be many more expenses than this. Sundry operating expenses has been used as a short cut to make the profit more realistic.

It is very important that you know how to do the Profit and loss account. It shows **all income and expenses separately.** At the moment it looks like this:

– PROFIT AND LOSS (G) + F2

Feb 28	Stationery	GJ12	7 700	Feb 28	Trading	GJ12	216 000
	Advertising	GJ12	2 000		Commission		
	Water and				income	GJ12	10 500
	electricity	GJ12	5 200		Rent income	GJ12	12 000
	Sundry						
	operating						
	expenses	GJ12	121 100				
	Trading stock						
	deficit	GJ12	2 500				

These have been posted to the expense accounts on pages 45 and 46.

7. Close Profit and loss to Capital

The Profit and loss account is now poised to tell what the owner is eager to know – the net profit. By closing the account to the capital account, we will find the figure.

ALWAYS add up the credit side first and put in the total [A], making sure to leave a line open on the debit side for the net profit [B]. Not all businesses in real life make a profit, but here, in theory, they usually do.

Add up the debit side and subtract this total from the credit total – that gives the net profit [C].

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Profit and loss (G–) (234 000 – 134 000)	F2	100 500	
	Capital (OE+)	B1		100 500
	transfer of net profit			

– CAPITAL (OE) + B1

				2013 Mar 1	Bank	CRJ12	360 000
				2014 Feb 28	Profit and loss	GJ12	100 000

– PROFIT AND LOSS (G) + F2

Feb 28	Stationery	GJ12	7 700	Feb 28	Trading	GJ12	216 000
	Advertising	GJ12	2 000		Commission		
	Water and				income	GJ12	10 500
	electricity	GJ12	5 200		Rent income	GJ12	12 000
	Trading stock						
	deficit	GJ12	2 500				
	Sundry						
	operating						
	expenses	GJ12	121 100				
[B]	**Capital**	**GJ12**	**100 000**	[C]			
			238 500	[A]		[A]	238 500

8. Close Drawings to Capital

The last entry for the year must be now be done.

GENERAL JOURNAL OF TINY TOTS **GJ12**

Feb 28	Capital (OE–)	B1	75 000	
	Drawings ([OE–] –)	B2		75 000
	closing transfer			

– CAPITAL (OE) + B1

2014 Feb 28	Drawings	GJ12	75 000	2013 Mar 1	Bank	CRJ12	360 000
	Balance	c/d	385 000	2014			
				Feb 28	Profit and loss	GJ12	100 000
			460 000				460 000
				Mar 1	Balance	b/d	385 000

+ DRAWINGS (OE–) – B2

Feb 28	Total	b/f	75 000	Feb 28	Capital	GJ12	75 000

A COMPARISON OF THE THREE TRIAL BALANCES

TINY TOTS

PRE-ADJUSTMENT TRIAL BALANCE ON 28 FEBRUARY 2014		
	DR	CR
BALANCE SHEET SECTION		
Capital		360 000
Drawings	75 000	
Vehicle	180 000	
Equipment	86 000	
Trading stock	102 500	
Bank	20 000	
NOMINAL SECTION		
Sales		471 600
Debtors allowances	15 600	
Cost of sales	240 000	
Stationery	8 200	
Advertising	3 000	
Commission income		9 600
Water and electricity	4 800	
Rent income		15 000
Sundry operating expenses	121 100	
	856 200	856 200

POST-ADJUSTMENT-TRIAL BALANCE ON 28 FEBRUARY 2014		
	DR	CR
BALANCE SHEET SECTION		
Capital		360 000
Drawings	75 000	
Vehicle	180 000	
Equipment	86 000	
Trading stock	100 000	
Bank	20 000	
Consumable stores on hand	500	
Prepaid expenses	1 000	
Accrued income	900	
Accrued expenses		400
Income received in advance		3 000
NOMINAL SECTION		
Sales		471 600
Debtors allowances	15 600	
Cost of sales	240 000	
Stationery	7 700	
Advertising	2 000	
Commission income		10 500
Water and electricity	5 200	
Rent income		12 000
Sundry operating expenses	121 100	
Trading stock deficit	2 500	
	875 500	875 500

POST-CLOSING TRIAL BALANCE ON 28 FEBRUARY 2014		
	DR	CR
BALANCE SHEET SECTION		
Capital		385 000
Vehicle	180 000	
Equipment	86 000	
Trading stock	100 000	
Bank	20 000	
Consumable stores on hand	500	
Prepaid expenses	1 000	
Accrued income	900	
Accrued expenses		400
Income received in advance		3 000
	388 400	388 400

NOTE

These Trial Balances are not realistic e.g. there is no depreciation because we have not studied the entries yet, and many expenses are hidden in Sundry operating expenses. The assumption is that Tiny Tots is a new business buying and selling on a cash basis only as there are no Debtors and Creditors.

THE PURPOSE is to show that:

1. the Pre-adjustment Trial Balance has many accounts, but not those created when adjusting the books.
2. the Post-adjustment Trial Balance is the longest Trial Balance as it shows all the accounts. It is used to draw up the final accounts and financial statements. *(Units 8 and 9)*
3. the Post-closing Trial Balance only has Balance Sheet items in it as all nominal accounts and drawings have now been closed (as the name implies). *(Unit 9)*

TRICKY ADJUSTMENTS – Interest on loan

Interest on loan as an accrued expense

When a business needs finance and the owner does not have more capital to invest, it will borrow money. The owner or the business will have to provide some security for this loan, which will be classified as a non-current liability.

If the interest is paid monthly or quarterly and it has not been paid for the full year, it requires a calculation to determine the amount owing. This will be a simple interest calculation.

EXAMPLES

- If the business borrowed R250 000 on 1 March 2013 at an interest rate of 12% p.a. it should have paid R30 000 by the end of the year, 28 February 2014 (250 000 × 0,12 or 250 000 × 12/100).
- If the Trial Balance on 28 February 2014 shows that the firm has a loan of R200 000 and you are told that R50 000 of the loan was repaid on 1 September 2013, how much interest should have been paid for the year ended 28 February 2014?

CALCULATION OF INTEREST

We always need to look for three things:

1. the **A**mount of the loan at the beginning and at the end of the year
2. the **R**ate (of interest)
3. the **D**ate, i.e. the date when either the amount or the rate changed.

CALCULATION: **amount** × **rate** × **date** (date = number of months the loan was that amount before or after it changed)

1. The amount of the loan at the end of the year was R200 000. At the beginning of the year it would have been R250 000 (R50 000 was repaid which made it less).
2. The rate of interest is 12% p.a. and it did not change.
3. The date the amount changed was 1 September 2013 which is exactly ½ way through the year.

   There are two calculations to do:

Loan now (at end)	200 000 × 0,12 × ½	=	R12 000
Loan at beginning	250 000 × 0,12 × ½	=	R15 000
		=	**R27 000**

Which account is wrong? Interest on loan account ❶.

What is wrong? Has the firm paid too much or too little? Too little ❷ so we need to **add** to this expense (E+).

The other account will be **Accrued** expenses ❸ which is a liability to the firm (L+) because this amount is still owing.

***ACCRUED:** add*

The question is - by how much is the amount too little?

Interest according to our calculation, ought to be	R27 000
but the account shows only (see below)	R25 000
It is therefore short by	**R 2 000**

The journal entry is:

GENERAL JOURNAL OF TINY TOTS

Feb 28	Interest on loan (E+)	B	2 000	
	Accrued expenses (L+)	N		2 000
	interest still owing on loan at 12% p.a.			

The ledger accounts will look like this:

GENERAL LEDGER OF TINY TOTS

+ INTEREST ON LOAN (E) –

Feb 28	Total	b/f	25 000	Feb 28	Profit and loss		**27 000**
	Accrued expenses	GJ	2 000				
			27 000				27 000

This must agree with the figure calculated.

– ACCRUED EXPENSES (L) +

				Feb 28	Interest on loan	GJ	2 000

Interest on the loan capitalised

In real life, interest is calculated monthly and **added to the loan** i.e. compound interest is used.

If the question states that interest is capitalised, the amount of interest for the year will be given. No calculation will be needed. For example, you are told that interest on the loan from ABC Bank capitalised for the year amounts to R15 700. Just work out by how much the Interest on loan account is short and add the difference to both the Interest on loan account and the Loan account.

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Feb 28	Interest on loan (E+)	B	1 500	
	Loan: ABC Bank (L+)	N		1 500
	interest still owing on loan			

+ INTEREST ON LOAN (E) –

Feb 28	Total	b/f	14 200	Feb 28	Profit and loss		**15 700**
	Loan: ABC Bank	GJ	1 500				
			15 700				15 700

This must agree with the figure given.

– LOAN: ABC BANK (L) +

				Feb 28	Balance	b/d	140 000
					Interest on loan	GJ	1 500
							141 500

TRICKY ADJUSTMENTS – Depreciation

Depreciation

Depreciation means the reduction in value of a fixed/tangible asset through normal wear and tear. All tangible assets, except land and buildings, depreciate in value.

The business has to calculate depreciation each year and make an adjustment for it so that the value of the vehicles and equipment comply with the requirements of the definition of an **asset**, i.e. the business must own it and must be able to get cash back for it. If a vehicle was bought for R250 000 in 2007, it cannot be an asset worth R250 000 in 2014 because it could be not sold for this amount.

The Depreciation account is not a payment like most other expenses, but it is a cost that is attributed or ascribed to the fact that the tangible assets diminish in value. It is as much a cost of running a vehicle as the fuel and maintenance. It is tax deductible so the owner is quite happy to write off depreciation and pay less personal tax.

A journal entry is needed to bring the Depreciation account into existence at the end of the accounting period. It is closed to the Profit and loss account with all the other expenses.

However, in the General Ledger the Vehicles account and the Equipment account must **always show the cost price** of the assets bought in accordance with the **GAAP** principle of Historical cost.

In order to show that these assets have diminished or decreased in value **two new accounts** must be opened:

- **Accumulated depreciation on vehicles**
- **Accumulated depreciation on equipment**

ACCUMULATED: total

These accounts are negative assets (A–) as their only function is to decrease (diminish) the value of the tangible assets to their actual value. All we do is swop the signs round so that the debit side is negative and the credit side is positive, just like we did with Debtors allowances and Drawings.

The Accumulated depreciation accounts will be balanced, but that for us means sub-totalled. The only figures in these accounts in Grade 10 will be on the credit side.

The same method and the same rate of calculating depreciation must be used each year in order to comply with the principle of consistency.

EXAMPLE

The business has one vehicle. Depreciation is written off at 25% p.a. on cost price.

GENERAL LEDGER OF TINY TOTS

+ VEHICLES (A) –

? Mar	1	Bank	CRJ	200 000					

– ACCUMULATED DEPRECIATION ON VEHICLES (A-) +

					2013 Mar	1	Balance	b/d	100 000

From these two accounts we can tell that:

- Tiny Tots has one vehicle which **cost** R200 000
- it is **worth** R100 000 on 1 March 2013 (200 000 – 100 000)
- the business has had it for 2 years i.e. it was bought on 1 March **?** = 2011 because depreciation of 25% p.a. on R200 000 = R50 000 per year and the Accumulated (total) depreciation is R100 000.

Two methods of calculating depreciation

1. on cost price / fixed instalment / straight line method → → → → →

2. on diminishing balance / book value / carrying value ↘ ↘ ↘

METHOD 1: depreciation on cost price / fixed instalment / straight line method

The following account appears in the

GENERAL LEDGER OF TINY TOTS

+ VEHICLES (A) –

2013 Mar	1	Balance	b/d	200 000					
Dec	1	Bank	CPJ	320 000					
				520 000					

Calculate the depreciation on vehicles for the year ending 28 February 2014. Depreciation is calculated at 25% p.a. **on cost.**

'Old' assets

When the asset account starts with a balance it means it has an 'old' asset, i.e. the business has it for **more than 1 year**. If there is another figure too, it means a 'new' asset was bought during the year.

The vehicle which cost R200 000 is '**OLD**' therefore the depreciation calculation is

R200 000 × 25% = **R50 000** (200 000 × 0,25)

'New' assets

The vehicle which cost R320 000 is **NEW**, it was bought **less than 1 year** ago. It was bought on 1 December so on 28 February they have had it for only 3 months.

The calculation is: R320 000 × 25% × 3/12 = **R20 000** (320 000 × 0,25 × ¼)

To calculate depreciation on a NEW asset, look carefully at the date it was bought to see how many months we have had it.

The journal entry for depreciation is:

GENERAL JOURNAL OF TINY TOTS

Feb	28	Depreciation (E+) (50 000 + 20 000)	N	70 000	
		Accumulated depreciation on vehicles (A–)	B		70 000
		depreciation written off at 25% p.a. on cost			

The ledger accounts will look like this:

GENERAL LEDGER OF TINY TOTS

– ACCUMULATED DEPRECIATION ON VEHICLES (A–) +

					2012 Feb	29	Depreciation	GJ	50 000
					2013 Feb	28	Depreciation	GJ	50 000
					2014 Feb	28	Depreciation	GJ	70 000
									170 000

+ DEPRECIATION (E) –

2014 Feb	28	Accumulated			2014 Feb	28	Profit and loss	GJ	70 000
		depreciation							
		on vehicles	GJ	70 000					

From these accounts we can tell that:

- the business bought a vehicle costing R200 000 on 1 March 2011
- it is worth R50 000 on 1 March 2014 (200 000 – 150 000)
- the business bought a second vehicle on 1 December 2013 for R320 000.
- it is worth R300 000 on 1 March 2014 (320 000 – 20 000)

'Very old' assets – only applies to depreciation on cost price

The vehicle which was bought for R200 000 on 1 March 2011 has been depreciated for 3 years @ R50 000 per year. It is now worth only R50 000.

How much depreciation can be written off in the 4th year? If another R50 000 is written off the vehicle will be worth R0! An asset cannot be worth '0' because that would mean that the business does not have it any more.

A 'very old asset' must be left in the books with **a value of R1**.
Depreciation written off in the 4th year will be R49 999 (50 000 – 1.)

Calculate the depreciation on vehicles for the year ended 28 February 2015

The 'very old' vehicle can only be depreciated by R49 999.

The old vehicle (no longer 'new' as they have had it for more than a year) will be depreciated by R320 000 × 25% = R80 000.

The journal entry will be

GENERAL JOURNAL OF TINY TOTS

Feb	28	Depreciation (E+) (49 999 + 80 000)	N	129 999	
		Accumulated depreciation on vehicles (A–)	B		129 999
		depreciation written off at 25% p.a. on cost			

The ledger account will look like this:

– ACCUMULATED DEPRECIATION ON VEHICLES (A-) +

					2012 Feb	29	Depreciation	GJ	50 000
					2013 Feb	28	Depreciation	GJ	50 000
					2014 Feb	28	(50 000 + 20 000) Depreciation	GJ	70 000
					2015 Feb	28	(49 999 + 80 000) Depreciation	GJ	129 999
									299 999

On 1 March 2015 the value of the vehicles in total is R520 000 – 299 999 = R220 001

The 'very old' vehicle is worth R 1
and the 'old' vehicle is worth (320 000 – [20 000 + 80 000]) R220 000

METHOD 2: depreciation on diminishing balance / book value / carrying value

The following accounts are in the General Ledger:

+ EQUIPMENT (A) –

2011 Mar	1	Balance	b/d	40 000					
2013 Sept	1	Creditors control	CPJ	32 000					
				72 000					

– ACCUMULATED DEPRECIATION ON EQUIPMENT (A-) +

					2012 Feb	29	Depreciation	GJ	4 000
					2013 Feb	28	Depreciation	GJ	3 600
									7 600

Calculate the depreciation on equipment for the year ending 28 February 2014. Depreciation is calculated at 10% p.a. **on diminishing balance.**

'Old' assets

Remember, when the asset account starts with a balance it means the business has it for **more than 1 year**, i.e. it is 'old'. If there is another figure too, it means the firm bought a 'new' asset.

The equipment which cost R40 000 is '**OLD**'.
The **depreciation calculation in the 1st year** was R40 000 × 0,1 = R4 000

It is **VERY IMPORTANT** to read the question carefully to be sure you use the correct method of calculating depreciation.
'Diminishing balance' is not the same as 'cost or straight line'. The wording tells you that depreciation must be smaller each year. That means we must subtract the depreciation already written off.
The **depreciation calculation in the 2nd year** was R40 000 – R4 000 × 0,1 = R3 600

To depreciate the 'old' asset in the 3rd year the accumulated depreciation (total) written off so far must be subtracted from the cost R40 000 to get the diminished balance (carrying value / book value) of this asset.
R40 000 – R7 600 (R4 000 – R3 600) = R32 400
The **depreciation calculation in the 3rd year** i.e. 28 February 2014 will be
R40 000 – R7 600 × 0,1 = R3 240

'New' assets

The equipment that cost R32 000 is **NEW**, i.e. the business has had it for **less than 1 year**. It was bought on 1 September 2013 i.e. they have had it for 6 months.
The calculation is: R32 000 × 10% × ½ = **R1 600** (32 000 × 0,1 × ½)

GENERAL JOURNAL OF TINY TOTS

Feb	28	Depreciation (E+) (3 240 + 1 600)	N	4 840	
		Accumulated depreciation on vehicles (A-)	B		4 840
		depreciation written off at 10% p.a. on			
		diminishing balance			

The ledger accounts will look like this:

GENERAL LEDGER OF TINY TOTS

+ DEPRECIATION (E) –

2014 Feb	28	Accumulated			2014 Feb	28	Profit and loss	GJ	4 840
		depreciation							
		on equipment	GJ	4 840					

– ACCUMULATED DEPRECIATION ON EQUIPMENT (A-) +

					2014 Feb	29	Depreciation	GJ	4 000
					2013 Feb	28	Depreciation	GJ	3 600
					2014 Feb	28	Depreciation	GJ	4 840
									12 440

The value of the equipment in the 3rd year in total is R72 000 – 12 440 — R59 560
The 'old' equipment is worth R40 000 – (4 000 + 3 600 + 3 240) — R29 160
and the 'new' equipment is worth R32 000 – 1 600 — R30 400

We do not have to worry about '**very old' assets** when using the diminishing balance method of calculating depreciation. The asset **will never be '0'** in the books.

Try it! Take a cost price of R50 000 and write off 25% p.a. on diminishing balance for 4 years.

Do it on your calculator: 50 000 × 0.75 × 0.75 × 0.75 × 0.75 = R15 820,31
Now do it on cost: 50 000 – (12 500 × 4) = 0

Now do QUESTIONS 41 to 44 on page 116 to 121.