



UNIT-7 End of Period Procedures

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Understand the meaning of depreciation? And what factors effect depreciation.
- ✓ Understand the purpose of reconciliation
- ✓ Discuss what Trail balance is and how the entries are recorded using this method.

Unit 7

End of Period Procedures

In this unit, we will be providing you with some basic knowledge with regard to depreciating your assets, reconciling cash, reconciling investments, working with the trial balance, bad debt, as well as posting adjustments and corrections.



Depreciation

The term depreciation is derived from the Latin word depretium. Split into “de” and “pretium” de means decline and pretium means price. So, the literal meaning of depreciation is decrease in the value of an asset. True profit can be calculated only after charging depreciation on assets.

As you have probably heard, when you drive your brand new vehicle off that car lot, it automatically depreciates in value. This same concept can be applied in accounting. If you buy something that has a life expectancy of over one year, and it is not expected for resale, it is considered a depreciable asset.

Depreciation is taken at a fixed rate. The portion allowed for that current year can be deducted as an expense.



Causes of Depreciation:

1. Wear and Tear:

Some assets physically deteriorate due to wear and tear in use. When an asset is constantly used for production, the asset wears out. More and more use of an asset, the greater would be the wear and tear. Physical deterioration of an asset is caused from movement, strain, friction, erosion etc. For instance, building, machineries, furniture, vehicles, plant etc. The wear and tear is general but primary cause of depreciation.

2. Inefficiency/Obsolescence:

Appearance of new and improved machines results in discarding of old machines. Thus new inventions, change in fashions and taste, market condition, Government policies etc. are the causes to discard the value of an asset. But this is not the cause of depreciation and not depreciation in real sense.

3. Lapse of Time:

There are certain assets like leasehold property, patents, copy-right etc. that are acquired for a particular period. After the expiry of the period, they are rendered useless i.e. their value ceases to exist. Thus, their cost is written off over their legal life.

4. Permanent fall in the market value

Assets like investments lose their value due to a downfall in their market value. It is only the permanent fall in the value of asset. Temporary shrinkage in the value of assets should be ignored for depreciation calculation.

5. Weather and accidental elements

Assets lose their value due to weather, rain, sunshine or any accident like fire, earthquake, flood, tidal forces or similar other disasters. The effect of these factors enter into calculating depreciation.

Factors Affecting Depreciation Calculation

Certain factors enter into consideration for determining depreciation. They are Value of assets, Estimated working life, Repairs and renewal, Addition and extension, Scrap value, Loss of interest on capital invested and Legal provisions. They are briefly discussed as below.

1. Value of Assets

Value of depreciable asset is the cost of the same asset that represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to improvements thereof. An increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors may cause changes in the historical cost a depreciable asset.

2. Estimated Working Life

Working life is determined by

- Legal or contractual limits such as the expiry dates of related leases.
- Extraction or consumption.
- Extent of use and physical deterioration on account of wear and tear which again depends upon operational factors like number of shifts for which the asset is to be used, repair and maintenance policy of the enterprise.

3. Repairs and Renewals

Repairs and renewals keep the assets in good working condition. A well maintained asset yields good results over its stipulated life. If it is poorly maintained, it will become useless after a short period. So, repairs and renewals are an important consideration while determining the amount of depreciation.

4. Additions and Extensions

Additions and extensions are normally made to existing assets like plants and buildings. The purpose is to increase their capacity. Expenditures on additions and extensions are of capital nature. The dates of incurrence of such expenditures are considered to ascertain depreciation.

5. Residual Value

Scrap value of an asset represents the amount which the assets will fetch when discarded. Residual or scrap value of the assets should be deducted from their original cost.

6. Obsolescence

An asset is likely to become outdated due to change in technology. The possibility of an asset going out of fashion should be carefully weighed while calculating the amount of depreciation.

7. Loss of Interests

The purchase of an asset involves a heavy sum. It may be alternatively invested elsewhere. So, capital involved in the purchase of an asset implies a loss of interest on alternative investment.

8. Legal Requirements

Provision for depreciation on assets is subject to the Income Tax Act and Companies Act. Their legal provisions do enter into calculation of depreciation.

Reconciliation

Accounting reconciliation is the process of ensuring all account balances are correct between two accounts at the end of an accounting period. Reconciliations are helpful to automate the financial close process.

Reconciliation in accounting is done in three steps. First accountants compare balances between various independent systems. Then, they verify statements and reports for accuracy and if and when discrepancies

are found, they investigate those. Finally, they take action to correct any identified discrepancies.

Companies are required to reconcile all balance sheets that could contain material or significant misstatement. Doing so allows companies to identify and post all necessary adjustments to their general ledger in a timely manner to ensure the accuracy and completeness of their financial statements.

Steps in Account Reconciliation

Account reconciliation generally happens after the close of a financial period.

1. Accountants go through every account in the general ledger to verify that the listed balance is both correct and accurate.
2. To do this, they must compare the general ledger account balance with other independent sources of data such as bank and credit card statements.
3. When and if discrepancies are found, the accountants investigate the issues and take the necessary corrective action such as making journal entries to correct errors.
4. All of the information that is found, the analysis performed, and actions that are taken, is stored for audit purposes.

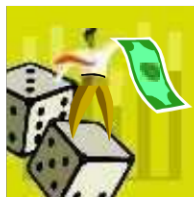
Reconciling Cash

Cash reconciliation, is whenever you need to compare two lists of data and find either differences or the similarities, reconciling two accounts that represent the same information, or when migrating data from an old system to a new one. For example, when you compare your bank statement with amounts of money you deposited or have withdrawn to make sure they match. You will need to compare daily deposits on a cash activity report. You will also need to compare summary totals.



Reconciling Investments

When reconciling investments, you will be basically doing the same thing as reconciling cash, only using investments. You will be comparing all documents making sure everything matches appropriately. Some items that can be reconciled are: interest from stocks, bonds, and mutual funds.



Trial Balance

Working with the Trial Balance

A trial balance simply entails making a list of all accounts that have a balance other than zero. It is basically a list of all the accounts that still owe money. The balances of each account will be shown, along with their debits and credits and totaled.



Method of Extraction of Trial Balance

The trial balance can be extracted using either total method or balance method. In the total method, the total of both sides are extracted while only the balance are used in the balances method.

Procedure:

1. Balance off the ledger accounts and bring down the balances.
2. Enter the debit balances in the ledger to the debit column of the trial balance.
3. Enter the credit balances in the ledger to the credit column of the trial balance.
4. For the cash book, transfer all the entries in the debit column of the cash book to the credit column of the trial balance and all the items in the credit column of the cash book to the credit column of the trial balance if the entries were not posted to ledger accounts, otherwise trial balance and vice versa.
5. Add the two sides (Dr. and Cr), the total of the two sides must agree.(i.e. must be equal).

Note that the principal aim of the trial balance is to test the arithmetical accuracy of the ledger entries. Once the double entry principle is properly observed and due care taken in recording the values, the two sides of the trial balance will always agree.

The format or listing of the trial balance is expected to appear as follows:

Particulars	Dr	Cr
All fixed (Non-current) Assets	X	
All current Assets	X	
Capital		X
All long term liabilities		X
All current liabilities		X
All income and gains		X
Return outwards		X
All reserves		X
All paid expenses	X	
All accrued expenses		
All investments	X	

Carriage outwards	X	
Return Inwards	X	
Carriage Inwards	X	
Drawings	X	
Discounts received		X
Discount allowed	X	
Depreciation	X	
Provisions for depreciation		X
Share capital	X	
Share premium		X
Debenture		X
Sale		X
Purchases	X	
Subscriptions in arrears	X	
Subscription in advance		X
Interest receivable		X
Total	XX	XX

Errors That Affect the Trial Balance

Some other errors that might affect the trial balance or cause it not to balance include:

- 1. Incorrect addition or casting of figures.** This type of error occurs when balancing accounts in the ledger especially when manual approach is adopted. The figures may be wrongly added thereby leading to wrong balances which is translated to the trial balance.
- 2. Entering or posting an item only on one side of the account.** Sometimes, if the double entry principle is not observed, this may result in posting only one side of the account and failing to complete the corresponding entry. This type of error will affect the trial balance.
- 3. Incorrect entering of transaction value on one side of the account.** Cases may equally arise where one side of the account is correctly posted while the corresponding entry is made with a wrong value.
- 4. Listing a debit balance in the ledger on the credit if the trial balance and vice versa.** During extraction of balances from the ledger to the trial balance, if a debit balance is extracted to credit side the trial balance or vice versa, the error will affect the trial balance.
- 5.** It is therefore, necessary to state that the agreement of totals in the trial balance does not in any way prove error free entries. This then implies that there are some errors that do not affect the trial balance.

Error That Do Not Affect the Trial Balance

As stated earlier, the agreement or equality of the totals of the two sides of the trial balance does not indicate an error free ledger. The essence of the trial balance is mostly to prove the arithmetical accuracy of the entries in the ledger. It only shows that every debit entry has a corresponding credit entry and vice versa. Some errors might be committed in the trial balance but still it will balance. Such errors include:

- 1. Error of Omission:** this is a situation where a transaction is completely omitted from the books. i.e. there is no debit or credit entries at all and the transaction is not captured in the subsidiary books.
- 2. Error of Commission:** this is an error committed when a transaction is posted to a wrong account. The correct class of account and correct amount is posted but to the wrong person. This error will not make the trial balance not to balance or agree.
- 3. Error of Principle:** this error is made if entries are posted in the correct side of the ledger but in wrong class of account. Example, a fixed asset such as motor van transaction is debit to an expense account such as motor van expenses account instead of fixed asset account.
- 4. Compensating Error:** this occurs when two errors in opposite sides of the accounts cancel out each other. By being equal in amount, two errors in one or two different but opposite accounts cancel each other. Example, sales account may be understated by £100 and salaries account

equally understated by the same amount. When this happens, the two errors will compensate each other and it will not affect the agreement of the trial balance.

5. **Error of Original Entries:** this arises in situation where the original figure posted the subsidiary book was wrong, yet the double entry principle was properly observed using the incorrect figure. For instance, credit sales £100 was credited to the sales account. This error will not affect the trial balance.
6. **Complete Reversal of Entries:** In this type of error, the correct accounts are used but each item is shown on the wrong side of the account.

Bad Debt

Every now and then a company will accumulate some bad debt, for example, debt from customers who have not paid their bills (You know who you are). Information is retrieved so that an attempt to collect can be pursued. Most times it is very difficult to collect the bad debt, so it should be removed from the books.



Collection accounts should be pursued after a certain period of time (usually 90 days). Un-collectible accounts should be written off, only if they are legitimate.

Posting Adjustments and Corrections

It is important to post any corrections or adjustments to the general ledger. Such a posting may consist of a simple entry which summarizes the corrections that were needed and those which were made. Adjustments and corrections should be made when necessary in order to create uniformity in all journals and other transaction documents for a business.



Further Reading:

- ✓ *Morgan Housel, (2020), The Psychology of Money: Timeless Lessons on Wealth, Greed, and Happiness*
- ✓ *Tiffani the Tiffani the Budgetnista Aliche, (2021), Get Good with Money: Ten Simple Steps to Becoming Financially Whole*

