

O Level Principles of Accounts (7110)

Unit 3: Accounting Adjustments

Recommended Prior Knowledge

Students need some understanding of commercial transactions and an understanding of double entry principles.

Context

This unit covers aspects of accounting which are required because business is continuous but accounting covers discrete periods of time. The adjustments largely derive from the application of accounting concepts and look at the accounting bases and methods used to apply those concepts. This could be studied in conjunction with the latter part of Unit 10.

Outline

This unit concentrates on adjustments which feature in virtually every examination, either as part of financial statements and/or in separate questions.

AO	Learning outcomes	Suggested Teaching activities	Learning resources															
2.1	Candidates should be able to: <ul style="list-style-type: none"> • explain the meaning of capital expenditure and revenue expenditure • distinguish between and account for capital and revenue expenditure • distinguish between and account for capital and revenue receipts • calculate and comment on the effect on profit and asset valuation of incorrect treatment 	Explain the matching concept. Income and revenue expenditure should be matched to the year they were incurred. Capital and revenue expenditure is an important distinction because an error in categorisation affects the profit and balance sheet. Students should be able to provide definitions, identify and state examples and calculate the effects of incorrect categorisation. Students may find making notes in a matrix form will help revision, for example: <table style="margin-left: auto; margin-right: auto; border: none;"> <tr> <td></td> <td style="text-align: center;">Definition</td> <td style="text-align: center;">Example</td> </tr> <tr> <td style="padding-right: 20px;">Capital expenditure</td> <td></td> <td></td> </tr> <tr> <td style="padding-right: 20px;">Capital receipts</td> <td></td> <td></td> </tr> <tr> <td style="padding-right: 20px;">Revenue expenditure</td> <td></td> <td></td> </tr> <tr> <td style="padding-right: 20px;">Revenue receipts</td> <td></td> <td></td> </tr> </table>		Definition	Example	Capital expenditure			Capital receipts			Revenue expenditure			Revenue receipts			http://www.bized.ac.uk/stafsup/options/accounting/work03.htm Past question papers available from CIE, e.g. Nov 2003 Paper 1 Q11 Jun 2005 Paper 1 Q14
	Definition	Example																
Capital expenditure																		
Capital receipts																		
Revenue expenditure																		
Revenue receipts																		
	Candidates should be able to:	A non-current asset arises from capital expenditure. Depreciation of the non-current asset is revenue expenditure	http://www.staffs.ac.uk/schools/business/badmin/staff/s5/acccsys/wfour.htm#1															

AO	Learning outcomes	Suggested Teaching activities	Learning resources
	<ul style="list-style-type: none"> • define depreciation • explain the reasons for accounting for depreciation • name and describe the straight line, diminishing (reducing) balance and revaluation methods of depreciation 	<p>Students should be able to define depreciation clearly and show brief calculations as an example. Comparing different methods of depreciation for one asset over a period of two to three years should clearly show the differences to students. Students should, at this stage, be aware that depreciation is an example of an 'accounting base' and is applied by various 'methods' such as straight-line.</p>	<p>Past question papers available from CIE, e.g. Jun 2005 Paper 1 Q15</p>
	<ul style="list-style-type: none"> • prepare ledger accounts and journal entries for the provision of depreciation 	<p>A useful exercise to help students is to prepare ledger accounts for specific assets and their respective provisions for depreciation accounts at this stage and then bring these accounts into a later income statement and balance sheet when studying financial statements. This will help them see the connections.</p>	<p>Nov 2003 Paper 1 Q14</p>
	<ul style="list-style-type: none"> • prepare ledger accounts and journal entries for the disposal of fixed assets 	<p>Students often experience difficulties with preparing disposal accounts. Clear diagrams of the various accounts and how they interrelate and practice in preparing disposal accounts is recommended.</p>	<p>Nov 2003 Paper 1 Q13 Jun 2005 Paper 1 Q5 Specimen Paper 1 Q13</p>
1.9	<p>Candidates should be able to:</p> <ul style="list-style-type: none"> • make entries in the journal and ledger accounts to record accrued and prepaid expenses • make entries in the journal and ledger accounts to record outstanding and prepaid incomes 	<p>Explain that accounting adjustments are required because accounts are produced for a period of time (often a year) but business is continuous. So amounts are outstanding at the end of the period (e.g. wages are owed to employees – an accrual).</p> <p>A progressive approach is the best way to illustrate accruals and prepayments, for example:</p> <ol style="list-style-type: none"> 1) illustrate an accrual followed by practice 2) illustrate a prepayment, then practice 3) take the illustrations on another period where an account starts a year with an accrual and ends with a prepayment and vice versa. 	<p>http://www.staffs.ac.uk/schools/business/badmin/staff/s5/accsys/wthree.htm#t</p> <p>http://www.bized.ac.uk/stafsup/options/accounting/work05.htm</p> <p>Past question papers available from CIE,</p>

AO	Learning outcomes	Suggested Teaching activities	Learning resources
		Candidates often find this subject confusing so time and practice are essential to reinforce understanding.	e.g. Nov 2003 Paper 1 Q22
	<ul style="list-style-type: none"> • make entries in the journal and ledger accounts to write off bad debts • make entries in the journal and ledger accounts to make and adjust provisions for doubtful debts <p>Questions will not be set on bad debts recovered.</p>	Ensure students are clear on the difference between actual bad debts and a provision. By considering them separately rather than together, they are less likely to confuse the two. Practice journal and ledger account entries together as further reinforcement of double entry principles.	Past question papers available from CIE, e.g. Jun 2005 Paper 2 Q19 Jun 2002 Paper 2 Q3 Specimen Paper 1 Q11