How to identify errors made in sales ledger

- The sum of the total individual debtor accounts in the sales ledger should be the same as the closing balance on the sales ledger control account
- If there is a difference there may be some errors either in the sales ledger or nominal ledger

<u>Accounting concepts</u>

**Consistency**

The business decides to make a provision for depreciation on plant and machinery at 10% per annum, using the straight line method, should continue to use that percentage and method for future final accounts for this class of asset

- Direct comparison between the final accounts of different years can be made

**Accruals**

The benefit which a fixed asset provides over its economic life is matched with the depreciation for the same period

(expenses incurred and revenue earned during the accounting period should be recorded in the same period of accounts regardless of the actual receipt of payment of cash)

Eg. Accruals and prepayments

- The cost of the fixed asset is spread over the useful life of the asset
- The balance sheet will show a true figure for both assets and prevents overstatement of assets

**Prudence**

Requires that final accounts should always report a conservative figure for profit or the valuation of assets

Profits are not to be anticipated and all known liabilities should be provided for at the year end

Eg. Provision for doubtful debts, bad debt expense, provision for depreciation

- Business is able to report a profit which accurately reflects the true cost that has been incurred for the year instead of simply the amount that has been paid ➔ Prevent overstatement of profit
- The balance sheet will also show a true figure for both assets and liabilities ➔ Prevent overstatement of assets

**Materiality**

Identifies that some items in accounts may have low monetary value that is not worthwhile recording them separately.

Eg. Year end stocks of paper clips

- Not valued for end of year stocks of the final accounts because the amount is not the purpose of the final accounts
- The amount is not material and does not justify the time and effort involved. These items are charged as expense in the P&L instead of being classed as capital expenditure
- Depends on size of business➔ Large company may consider items of less than $1000 not material

**Business entity**

States that only transactions involving the business should be included in the business books

The goods for own use are drawings, they need to be ignored in the calculation of cost of sales

Only the purchases used in the business are recorded

- Send regular reminder

10. How to reduce the risk of bad debts
    - Obtain reference from new customers
    - Fix a limit for each credit customer
    - Follow up over dues promptly
    - Refuse further supplies until old dues are paid
11. Problems of inter firm comparison
    - All businesses are not same in all sense
    - Different businesses follow different accounting policies
    - Different firm sizes
    - Started at different dates
12. Limitations of ratio analysis
    - Difference in type of stock which affects rate of stock turnover and GPM
    - Difference in firm's policy because some firms are selling on cash and on credit terms
    - Difference in firm's policy
    - Difference in management