FINANCIAL STATEMENT ADJUSTMENTS AND NOTES

Grade 12 Accounting

Companies and Financial Statements

CHAPTER OUTCOMES

After studying this chapter, you should be able to:

✓ Explain the purpose of year-end adjustments

✓ Process inventory adjustments

✓ Process accrued income

✓ Process income received in advance

✓ Process accrued expenses

✓ Process loan adjustments

✓ Process bad debts and provision for bad debts

✓ Process dividends correctly

✓ Prepare company notes

✓ Avoid common NSC examination mistakes

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1. INTRODUCTION

This chapter separates average learners from distinction learners.

Many learners can prepare financial statements.

However, when adjustments are introduced, they struggle.

In the NSC examination, the examiner rarely gives perfect figures.

Instead, learners are expected to adjust information before preparing statements.

WHAT IS AN ADJUSTMENT?

An adjustment is a correction or update made at the end of the financial year to ensure that financial statements are accurate.

WHY ARE ADJUSTMENTS IMPORTANT?

Financial statements must reflect:

✓ The correct income

✓ The correct expenses

✓ The correct assets

✓ The correct liabilities

Without adjustments, profits and financial position will be incorrect.

STUDYPACK EXAM TIP

Whenever you see:

"Additional Information"

Stop.

Read every line carefully.

Most marks are hidden in the adjustments.

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2. INVENTORY ADJUSTMENTS

Inventory is one of the most tested company adjustments.

WHY DO INVENTORY ADJUSTMENTS OCCUR?

Because:

- Inventory may be overvalued
- Inventory may be undervalued
- Incorrect valuation methods may be used
- Stock counts may reveal shortages

NSC EXAMPLE

Suppose inventory was recorded as:

R500 000

After a stock count:

Actual inventory:

R470 000

Adjustment required:

Decrease inventory by:

R30 000

EFFECT

Assets decrease

Profit decreases

EXAM TIP

Always check:

FIFO

Weighted Average

Specific Identification

These valuation methods often appear in Question 1.

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3. TRADE RECEIVABLES (DEBTORS)

Debtors owe money to the company.

Not all debtors will pay.

Therefore adjustments are required.

BAD DEBTS

Definition

Amounts owed by customers that will never be recovered.

EXAMPLE

Debtor owes:

R5 000

Customer is liquidated.

Adjustment:

Bad Debts

R5 000

EFFECT

Profit decreases

Receivables decrease

4. PROVISION FOR BAD DEBTS

Companies estimate future bad debts.

WHY?

To follow the prudence principle.

EXAMPLE

Debtors:

R400 000

Provision:

5%

Required Provision:

R20 000

FORMULA

Provision

=

Debtors

×

Percentage

EXAM TRAP

The examiner may state:

Provision must be adjusted to 4%.

Do not use the old provision.

Calculate a new one.

WORKED EXAMPLE

Debtors

R600 000

Required Provision

4%

Provision

=

R24 000

Net Receivables

=

R576 000

STUDYPACK MEMORY TIP

Bad Debt

=

Known loss

Provision

=

Expected loss

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5. ACCRUED INCOME

One of the easiest adjustment marks.

DEFINITION

Income earned but not yet received.

EXAMPLE

Commission earned:

R10 000

Received:

R8 000

Outstanding:

R2 000

ADJUSTMENT

Add:

R2 000

to income.

EFFECT

Income increases

Assets increase

COMMON EXAM EXAMPLES

Outstanding:

✓ Commission income

✓ Rent income

✓ Interest income

MEMORY TIP

Earned but not received

=

Accrued Income

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6. INCOME RECEIVED IN ADVANCE

Money received before it has been earned.

EXAMPLE

Rent received:

March and April next year

but already recorded this year.

ADJUSTMENT

Remove future income from current year.

EFFECT

Income decreases

Liabilities increase

EXAM TRAP

Many learners think:

Money received = income

WRONG

Income is only recognised when earned.

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7. ACCRUED EXPENSES

Expenses incurred but not yet paid.

EXAMPLE

Audit fee:

R15 000

Outstanding at year-end.

ADJUSTMENT

Add:

R15 000

to expenses.

EFFECT

Profit decreases

Liabilities increase

COMMON EXAM ITEMS

Outstanding:

✓ Audit fees

✓ Electricity

✓ Telephone

✓ Interest

✓ Salaries

MEMORY TIP

Incurred but not paid

=

Accrued Expense

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8. PREPAID EXPENSES

Expenses paid in advance.

EXAMPLE

Insurance paid for:

March and April next year.

ADJUSTMENT

Remove future portion.

EFFECT

Expenses decrease

Assets increase

EXAM QUESTION

Why remove prepaid expenses?

Because they belong to the next financial period.

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9. LOAN ADJUSTMENTS

This is one of the highest-mark company adjustments.

IMPORTANT CONCEPT

A loan has two portions:

Non-current portion

Current portion

EXAMPLE

Mortgage Loan

R2 000 000

Amount payable next year

R250 000

PRESENTATION

Non-current loan

R1 750 000

Current portion

R250 000

EXAM TIP

Never show the entire loan under non-current liabilities.

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10. INTEREST ON LOAN

Many learners ignore interest adjustments.

EXAMPLE

Interest expected next year:

R120 000

Loan repayment:

R400 000

Current Portion Calculation

Current Portion

=

Loan repayment

-

Interest

EXAM STRATEGY

Separate:

Capital repayment

and

Interest

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11. DIVIDENDS

One of the most tested adjustments.

INTERIM DIVIDEND

Paid during the year.

Already recorded.

FINAL DIVIDEND

Declared at year-end.

Usually unpaid.

EXAMPLE

Final Dividend:

R2 500 000

Declared

Not paid

PRESENTATION

Current Liability

Shareholders for Dividends

R2 500 000

EXAM TRAP

Declared

≠

Paid

STUDYPACK MEMORY TIP

Declared but unpaid

=

Liability

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12. TAXATION ADJUSTMENTS

Tax is frequently tested.

TAX REFUND

SARS owes company.

Current Asset

EXAMPLE

Tax refund:

R70 000

Presentation:

Trade and Other Receivables

TAX PAYABLE

Company owes SARS.

Current Liability

EXAMPLE

Tax payable:

R25 000

Presentation:

Trade and Other Payables

EXAM TIP

Ask:

Who owes whom?

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13. TRANSFER BETWEEN DEBTORS AND CREDITORS

Advanced learners often lose these marks.

EXAMPLE

Customer overpaid:

R5 000

Should be transferred:

Debtors → Creditors

EFFECT

Debtors decrease

Creditors increase

TOTAL EFFECT

No effect on profit.

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14. NOTES TO FINANCIAL STATEMENTS

Notes explain figures appearing in statements.

COMMON NOTES

Ordinary Share Capital Note

Retained Income Note

Fixed Assets Note

Cash Flow Notes

WHY ARE NOTES IMPORTANT?

They provide:

✓ Detailed calculations

✓ Movement explanations

✓ Supporting information

EXAM TIP

Always complete notes before the financial statement.

The notes usually provide figures required later.

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15. ADJUSTMENT CHECKLIST

Before preparing the Statement of Financial Position ask:

✓ Is inventory correct?

✓ Are debtors adjusted?

✓ Is provision updated?

✓ Is accrued income included?

✓ Is deferred income removed?

✓ Are accrued expenses added?

✓ Is the loan split correctly?

✓ Are dividends processed?

✓ Is taxation adjusted?

DISTINCTION STRATEGY

Professional accountants use:

WORKING PAPERS

You should too.

Create a working area for:

Inventory

Receivables

Payables

Loan

Dividends

Tax

before completing statements.

COMMON EXAM MISTAKES

❌ Forgetting to update provision

✓ Recalculate provision

❌ Treating declared dividends as expenses

✓ Dividends are appropriations

❌ Showing overdraft as asset

✓ Overdraft is liability

❌ Ignoring accrued income

✓ Add outstanding income

❌ Showing entire loan as non-current

✓ Separate current portion

PRACTICE QUESTIONS

QUESTION 1

Define accrued income.

(2)

QUESTION 2

Debtors:

R500 000

Provision:

4%

Calculate the provision.

(2)

QUESTION 3

A debtor owing R7 000 is declared insolvent.

What adjustment is required?

(3)

QUESTION 4

Commission income earned but not received:

R4 500

Explain the adjustment.

(3)

QUESTION 5

A final dividend of R800 000 has been declared but not paid.

How will it be shown?

(3)

QUESTION 6

A mortgage loan is:

R1 500 000

Current portion:

R200 000

Show how it will appear in the Statement of Financial Position.

(4)

MEMORANDUM

QUESTION 1

Income earned but not yet received.

(2)

QUESTION 2

R500 000 × 4%

=

R20 000

(2)

QUESTION 3

Write off R7 000 as Bad Debts.

Receivables decrease.

(3)

QUESTION 4

Add R4 500 to income.

Record as accrued income.

(3)

QUESTION 5

Current Liability

Shareholders for Dividends

R800 000

(3)

QUESTION 6

Non-current liability

Mortgage Loan

R1 300 000

Current liability

Current Portion Loan

R200 000

(4)

CHAPTER SUMMARY

You should now understand:

✓ Inventory Adjustments

✓ Bad Debts

✓ Provision for Bad Debts

✓ Accrued Income

✓ Deferred Income

✓ Accrued Expenses

✓ Prepaid Expenses

✓ Loan Adjustments

✓ Dividend Adjustments

✓ Tax Adjustments

✓ Notes to Financial Statements

These adjustments are the foundation of Question 1 in the NSC Accounting examination and are often the difference between a pass and a distinction.