

MANAC Assignment #4, Group 30

Question #1A

If the Debit and Credit Trial balance does not match, then it is obviously not correct.

However, there can be cases where the two match but are still incorrect. Hence, Trial Balance is not a conclusive proof of the accuracy of the account books.

We would be explaining this by referring to the case of Rohan Software given in illustration 2.1 of chapter 2. All figures here are in lakhs.

Ledger Items	Original Trial Balance Debit	Original Trial Balance Credit	Errors of Principle Debit	Errors of Principle Credit	Compensation Error Debit	Compensation Error Credit	Omitting a Transaction Debit	Omitting a Transaction Credit
Cash	₹ 14.00		₹ 14.00		₹ 12.00		₹ 15.00	
Receivable	₹ 8.00		₹ 11.00		₹ 8.00		₹ 8.00	
Supplies	₹ 6.00		₹ 6.00		₹ 6.00		₹ 6.00	
Computer	₹ 58.00		₹ 58.00		₹ 58.00		₹ 58.00	
Sundry Creditors		₹ 4.00		₹ 4.00		₹ 2.00		₹ 4.00
Loans		₹ 20.00		₹ 20.00		₹ 20.00		₹ 20.00
Capital		₹ 50.00		₹ 50.00		₹ 50.00		₹ 50.00
Sale of Software		₹ 20.00		₹ 20.00		₹ 20.00		₹ 20.00
Salaries	₹ 4.00		₹ 4.00		₹ 4.00		₹ 4.00	
Office Rent	₹ 1.00		₹ 1.00		₹ 1.00		₹ 0.00	
Dividend	₹ 3.00		₹ 0.00		₹ 3.00		₹ 3.00	
Total	₹ 94.00	₹ 94.00	₹ 94.00	₹ 94.00	₹ 92.00	₹ 92.00	₹ 94.00	₹ 94.00

Errors of Principle:

- A principle error would occur when an accountant would classify a Debit Side item as another Debit side item (same for Credit side). In this case the balance would remain the same and the equation would hold.
- In the above case if the accountant added the dividend to Cash, then Dividends would be down by 3lakhs, Cash would be up by 3 and it would still show the same result in total.

Compensating Errors:

- If an accountant makes a numeric error by an equal amount of both Credit and Debit side, then it would result in balancing of the equation but the amount would be reduced/increased depending on the case.
- In the above case, if the accountant considers Cash to be less by 2 lakhs and also Sundry Creditors to be less by 2 lakhs, the final balances would match but would be incorrect

Omitting a Transaction:

- If an accountant completely ignores a transaction, the credit and debit changes associated with it would not be reflected and the equation would balance.
- In the above case, if the accountant completely ignores the office rent part, office rent would be 0 and additional cash of 1 lakh would exist and the equation would balance.

Posting into a Wrong Account:

- These errors are very similar to Errors in Principle except that they exist within the same ledger item.
- Example if we had receivables worth 4 lakhs from Bata and 4 lakhs from Tata, and the accountant wrote 8 lakhs from Bata, this worksheet would not catch it but it would still be an error.

Clerical Error:

- These are again similar to **Compensating Errors**, minor typing mistakes while entering data or arithmetic mistakes while calculating ledgers can cause these

Question #1B

- Although, Tesco PLC is a going concern, reporting of revenues should be done following the accounting principles of realization and matching. This is to avoid overstating/understating of revenues.

- In case the revenues are not correctly reflected, it could have implications on investor sentiments.
- Consider the case where revenues are **overstated**.
- In this cases investors would believe that Tesco is doing really good operations and they would start investing in Tesco expecting great YoY profits.
- Banks/Lenders would think of Tesco as a concern having good capability of paying back any loans and would end up sanctioning higher amounts of loan which Tesco may default.
- Cases of **understating** revenues could also create issues related to tax.
- Imagine a case where we have tax slabs as 10% for profits up to \$100 and 20% tax for above. If my profits are \$120 and \$60 in 2 accounting periods, my taxes would be \$9+\$6+\$6 = \$21. I can show the profits as \$90 and \$90 and pay \$18 taxes.
- As we can see the profit reported is \$180 in both cases, but saved \$3 on taxes.

Question #2

Jupiter Infomedia Ltd.: Income Statement constituents

Schedule of income statement	Two biggest constituents	Value (in ₹ '000, FY15)	As % of net sales	YoY change
Revenues	Revenue from operations	4050	100.0%	(14.2%)
	Other income	3159	78.0%	130.6%
Other income	Net Gain on sale of Long Term Investments	2713	67.0%	568.2%
	Income from Long term Investments	267	6.6%	(63.8%)
Cost of Services	Server Space and Domain Name Charges	309	7.6%	8.8%
	Electricity expenses	184	4.5%	(0.12%)
Employee benefit expense	Salaries	847	20.9%	(56.7%)
	Staff Welfare	61	1.5%	110.3%
Finance cost (only Interest expense mentioned under it)	Interest expenses	229	5.7%	(3.8%)
Depreciation and Amortization expense	Tangible assets			
	Motor car	390	9.6%	-
	Office equipment	76	1.9%	-
	Intangible assets			
	Website content	1194	29.5%	-
	Comp. software	51	1.3%	-
Other expenses	Share issue expenses written off	869	21.5%	26.9%
	Market Making Expenses	480	11.9%	0.0%
Tax Expense	Current tax	264	6.5%	100.0%
	Deferred tax	26	0.6%	137.7%

No Extraordinary and Exceptional items for the period.

Comments:

1. 'Other Income' forms a large part of Revenues. Also, YoY change in 'Revenue from operations' is negative, while the company has made profits for FY15. This means that while the company might have turned up a profit in FY15, it is not due to its primary business activity, but rather from the occasional 'Net Gain on Sale of Long-term Investments'.
2. Electricity expenses are included in the 'Cost of Services' and not as fixed overhead costs. This is expected for an internet services company, as the only direct expenses, apart from server space and domain name charges, are electricity costs incurred in running the servers, etc.

3. A sharp drop in 'Salaries' is observed in FY15 (56.7% YoY). The company might have reduced its headcount in FY15. Also, welfare spend on employees have increased ('Staff welfare' costs up 110.3% YoY). The company might be aiming to run leaner, more efficient operations by retaining only top performers and spending on them.
4. SIC-32 interpretation of IAS 38 stipulates that website developed by an entity using internal expenditure is an internally generated intangible asset. The same can be observed under 'Depreciation and Amortization Expense' where 'Website content' amortization cost is recognized.

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