:: Final Term Exam ::

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Subject: Principles of Accounting

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Q1: On 2nd July 2010, Delta Company acquired a new machine with an estimated useful life of 5 years. Cost of equipment was $75,000 with $5,000 residual value. Calculate the amount of depreciation under each of the three depreciation methods listed below.

1) **Straight-Line**
2) **Double decline balance**
3) **MACRS**

STRAIGHT LINE METHOD OF DEPRICIATION

SOLUTION:

FOR CALCULATING THE DEPRICIATION AMOUNT / PERCENTAGE, WE MUST FIRST PUT IT INTO THE STANDERED FORMULA:

STRIGHT LINE METHOD= $\frac{\text{(PURCHASE COST-RESIDUAL VALUE)}}{\text{EXPECTED LIFE TIME}}$

PUTTING THE VALUE IN FORMULLA= $\frac{(75{,}000-5000)}{5}$ =**14000 DEPRICIATION AMMOUNT**

Year	Beginning book value	Depreciation amount	Accumulated depreciation amount	Ending Book Value
1	$75,000	$14,000	$14,000	$61,000
2	$61,000	$14,000	$28,000	$47,000
3	$47,000	$14,000	$42,000	$33,000
4	$33,000	$14,000	$56,000	$19,000
5	$19,000	$14,000	$70,000	$5,000

THE REMAINING AMOUNT OF **5,000** IS THE REMINING, SOLVAGE OR RESIDUAL VALUE OF THE ITEM PURCHASED.

DOUBLE DECLINING METHOD OF DEPRICIATION

SOLUTION:

Depreciation factor of two is equivalent to annual depreciation rate of 40.00% for 5 years.

Year	Beginning book value	Depreciation percent	Depreciation amount	Accumulated depreciation amount	Ending book value
1	$75,000	40.00%	$30,000	$30,000	$45,000
2	$45,000	40.00%	$18,000	$48,000	$27,000
3	$27,000	40.00%	$10,800	$58,800	$16,200
4	$16,200	40.00%	$6,480	$65,280	$9,720
5	$9,720	48.56%	$4,720	$70,000	$5,000

THE REMAINING AMOUNT OF 5,000 IS THE REMINING, SOLVAGE OR RESIDUAL VALUE OF THE ITEM PURCHASED.

MACRS METHOD OF DEPRICIATION

SOLUTION:

Schedule	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
MACRS	20.00%	32.00%	19.20%	11.52%	11.52	5.76%

Year	Adjusted Basis	Rate %	Depreciation	Cumulative	Book Value	Method
1	75,000	20	15,000	15,000	60,000	DB
2	60,000	32	24,000	39,000	36,000	DB
3	36,000	19.2	14,400	53,400	21,600	DB
4	21,600	11.52	8,640	62,040	12,960	SL
5	12,960	11.52	8,640	70,680	4,320	SL
6	4,320	5.76	4,320	75,000	0	SL

Q2: Why we need adjusting entries? Define types of adjusting Entries.

Some transactions affect the revenue or expenses of more than one period. Therefore, adjusting entries are needed at the end of each period. The purpose of these entries is to assign to each period the appropriate amount of revenue and expenses. Adjustments are mostly recorded by management at month end or period end closing for financial reporting purpose which complies with the applicable financial reporting framework. These adjustments include:

- **Accrued revenue:**

  This is booked when a company provide services to a customer and does not bill it in the same accounting period. Although services are performed therefore the company needs to pass an adjustment entry to book accrued revenue. This accrued revenue is booked on the balance sheet and a corresponding cash or receivable entry is booked. Subsequent to the year end the revenue is booked into profit and loss statement and the accrued revenue from balance sheet is credited.
- **Accrued expenses:**

  This adjustment is passed by management of the company when the expense has been incurred but invoices are not received from the suppliers/vendors. The accrual concept considers that the expense should be booked in the same period when the benefits were consumed and hence management should book an expense in the same accounting period in which the benefit was consumed.
- **Deferred revenue:**

  This part of adjustment is passed when the company books revenue in advance. There might be instances where the company receives cash in advance but does not deliver the services at the end of reporting period. In this case there is a liability which the management should record and is called deferred revenue. This revenue would be actualized in the profit and loss statement when the services are actually delivered. Therefore management needs to pass and adjustment entry for deferred revenue where cash is received in advance but services are not provided. Example of airline industries where the air ticket is sold in advance prior to the flights and therefore the airline industry should be booking deferred revenue for the services not delivered to the customers.

- **Prepaid expenses:**

  This adjustment is passed by management when the company pays for services in advance and has not yet consumed the benefits. At the end of reporting period management should be passing an adjustment entry and analyze the benefits consumed and remaining portion. For example if a company has paid rent in advance for the next 12 months. At the end of financial reporting period management should analyze the and calculate the prepaid expense for the remaining period as prepaid expense is calculated on straight line basis and is spread across the period of contract. Therefore the prepaid expense would be the remaining amount management has paid in advance and would be recorded as an asset in the balance sheet.

- **Depreciation expense:**
  Depreciation expense is booked by the management towards the useful life of PPE. Management needs to pass this adjustment entry manually unless the system is configured to pass this adjustment automatically. The purpose is to record depreciation expenses in the period where the benefits were consumed and this is recorded by passing an adjustment entry in the books.

Q3: Distinguish among a general partnership, limited partnership and a limited liability partnership?

General Partnership:

General partnership is a partnership which is with at least two individuals or people who want to do business together and make profit out of it. They share the ownership, profit, lose, liabilities together as partners. Defecto Business type for two or more owner it doesn't have any requirement and no step registration requirement.

Limited Partnership:

Limited partnership is a partnership in business at some set obligations or limits. In limited partnership, the partners agree to do business at limited partnership base. The limits are set between the partners at the time of partnership. The limits are set for losses, profits.

Limited liability partnership:

It is a type of partnership in which the partners agree that up to "set limit" we are responsible for the liabilities. The business is conducted on set liability partnership. They do not take more liabilities than the set liability partnership.

Q4: Distinguish between partnership and corporation?

Partnership:

Partnership is formed with at least two individuals or people who want to do business together and make profit out of it. They share the ownership, profit, lose, liabilities together as partners.

Corporation:

Corporation is owned by shareholders and it may be formed for profit or for non-profit purpose. Corporation is a big form of business means that it has a business at high levels and it has many shareholders who has rights to claim the ownership.

Corporation	**Partnership**
A corporation is where a separate legal entity is formed by an individual or group of individuals known as shareholders. The owners are different from the legal entity and all transactions take placed under company's legal name.	A partnership is a business set up by an individual or group of individuals. A partnership agreement is prepared which specifies the contribution made by each partner and profit distribution ratio
The owners of the corporation are called stockholders or sometimes referred to as shareholders. The contribution made by the shareholders in known as share capital.	The owners of the business are called partners. The contribution made by the partners is known as partner capital.
The corporation is formed under the company laws and operational state laws of the company referred as articles of association and the company is bound to follow the compliance	A partnership agreement is formed and terms of the partnership agreement is mutually agreed.
Management of the corporation may be different from the owners. E.g. in some instance a board is appointed who runs the company on shareholders behalf. The corporation has a formal hierarchy of management and formal organization structure.	In partnership, the owners run the business and are actively engagement in day to day operations of the business. There is no formal hierarchy of management and lack of organization structure because the partners are involved in almost all the activities of the business.

The finance is raised by issuing shares to public and stock bonds.	Finance is raised by partners in terms of personnel loans to the partnership.
The corporation is registered as limited liability based on which the shareholders has limited liability and the risk is borne by the company as separate legal entity.	The entire risk of the partnership lies with the partners. In case of liabilities the partners are fully responsible.
The dissolution process is formal and undergoes through a detailed process of liquidation which has to be approved by shareholders and government. A liquidator is appointed.	No formal process of liquidation is required here. Partners can terminate the partnership based on their mutual consent.