

## C02 Financial Accounting Fundamentals – Control Accounts

Let's consider a more detailed example:

Tyrell proves the accuracy of its sales and purchase ledgers by preparing monthly control accounts. At 1 May 2012 the following balances existed in the company's accounting records, and the control accounts agreed:

	Debit \$	Credit \$
Sales ledger control account	188,360	2,140
Purchase ledger control account	120	89,410

The following are the totals of transactions which took place during May 2012, as extracted from the company's records.

	\$
Credit sales	101,260
Credit purchases	68,420
Returns inwards	9,160
Returns outwards	4,280
Cash received from customers	91,270
Cash paid to suppliers	71,840
Cash discounts allowed	1,430
Cash discounts received	880
Irrecoverable debts written off	460
Contra settlements	480

At 31 May 2012 the balances on the customers and supplier personal accounts were extracted and totalled as follows:

	Debit balances \$	Credit balances \$
Sales ledger	To be ascertained	2,680
Purchase ledger	90	To be ascertained

An initial attempt to balance the two ledgers showed that neither of them agreed with their control accounts. The differences were found to be due to the following:

- (i) A credit balance of \$680 had been omitted when listing the sales ledger personal accounts,
- (ii) A contra settlement of \$500 had not been included in the totals of transactions prepared for the control accounts,
- (iii) A new employee had mistakenly entered five sales invoices into the purchases day book as if they had been purchase invoices and entered the amounts to new supplier personal accounts. The total of these invoices was \$1,360.
- (iv) A \$20 cash refund to a customer was made, and has not been included in the summary of transactions given above. The \$20 was entered to the customer's personal account as if it had been a cash receipt from the customer, and this resulted in a \$40 credit balance on the account, which was still outstanding at 31 May 2012.

When these errors had been corrected both control accounts agreed with the personal accounts.



**Sales Ledger Control Account**

	Dr		Cr
Balance b/d	188,360	Balance b/d	2,140
Credit sales	101,260	Returns inwards	9,160
		Cash received from customers	91,270
		Cash discounts allowed	1,430
		Irrecoverable debts written off	460
		Contra with purchase ledger	480

**Purchase Ledger Control Account**

	Dr		Cr
Balance b/d	120	Balance b/d	89,410
Returns outwards	4,280	Credit purchases	68,420
Cash paid to suppliers	71,840		
Cash discounts received	880		
Contra with sales ledger	480		

Now lets consider each one of the adjustments in turn

- (i) A credit balance of \$680 had been omitted when listing the sales ledger personal accounts,

This error will result in the total of credit balances on the personal accounts being lower than they should be. At present this balance was given to us at \$2,680. We must now increase this amount by the missing \$680 and revise the balance c/d for the control account. The closing balance is revised to \$3,360

- (ii) A contra settlement of \$500 had not been included in the totals of transactions prepared for the control accounts,

A contra is treated as a settlement in both control accounts so it must be adjusted in both the sales ledger control account and the purchase ledger control account. Notice that the list of balances is not mentioned and so we assume that they have already been recorded there.

- (iii) A new employee had mistakenly entered five sales invoices into the purchases day book as if they had been purchase invoices and entered the amounts to new purchase ledger personal accounts. The total of these invoices was \$1,360.

As the employee has entered the sales invoices incorrectly in the purchase day book it means that both the control accounts and the list of balances will be affected. Individual invoices are recorded in the day books and the personal accounts at the same time so if an error is made in the day book it will be repeated in the personal accounts. The total of the day book is then taken to the control account so if the individual entries are incorrect, the total is incorrect and the control accounts need to be adjusted.

In this case credit sales and the personal accounts of the customers balance must be increased and credit purchases and the personal accounts of the suppliers must be reduced.

- (iv) A \$20 cash refund to a customer was made, and has not been included in the summary of transactions given above. The \$20 was entered to the customer's personal account as if it had been a cash receipt from the customer this has resulted in a \$40 credit balance on the account, which was still outstanding at 31 May 2012.

This is a complex adjustment as it affects many things.

To record a cash refund the journal would be:

Dr (Increase) Personal account \$20

Cr (Reduce) Cash \$20

Instead they have recorded a cash receipt

Dr (Increase) Cash \$20

Cr (Reduce) Personal account \$20

This has created a credit balance of \$40 in a personal account that doesn't exist so it needs to be removed from the closing credit balances in the sales ledger control account. The revised balance is now \$3,320 (3,360-40).

The cash refund also needs to be included in our sales ledger control account as we have not yet recorded it due to its omission from the transactions list given in the question above. The figure to be adjusted is the original \$20.

The reconciliations will now be as follows:

### Sales Ledger Control Account

	Dr		Cr
Balance b/d	188,360	Balance b/d	2,140
Credit sales	101,260	Returns inwards	9,160
Credit sales (omitted invoices) (iii)	1,360	Cash received from customers	91,270
Cash(cash refund)(iv)	20	Cash discounts allowed	1,430
		Irrecoverable debts written off	460
		Contra with purchase ledger	480
		Contra adjustment (ii)	500
Balance c/d (Insert from adj iv above)	3,320	Balance c/d (Balancing figure)	188,880
	<u>294,320</u>		<u>294,320</u>
Balance b/d	<u>188,880</u>	Balance b/d	<u>3,320</u>
	\$		
List of balances			
At 1 May 2012	?		
Omitted credit balance	(680)		
Sales invoices omitted	1,360		
Cash refund error	40		
At 31 May 2012 (188,880 - 3,320)	<u>185,560</u>		

### Purchase Ledger Control Account

	Dr		Cr
Balance b/d	120	Balance b/d	89,410
Returns outwards	4,280	Credit purchases	68,420
Cash paid to suppliers	71,840		
Cash discounts received	880		
Contra with sales ledger	480		
Contra adjustment (ii)	500		
Sales invoices error (iii)	1,360		
Balance c/d (Balancing figure)	78,460	Balance c/d (Insert from question)	90
	<u>157,920</u>		<u>157,920</u>
Balance b/d	<u>90</u>	Balance b/d	<u>78,460</u>
	\$		
List of balances			
At 1 May 2012	?		

Sales invoices error	(1,360)
At 31 May 2012 (78,460 – 90)	<u>78,370</u>

The final stage is to work backwards from the balance at 31 May 2012 to 1 May 2012 for each of the list of balances. From the last statement made in the question – “When these errors had been corrected both control accounts agreed with the personal accounts.” This means that we can take the net balance from the control accounts and work backwards to the opening balances for the list of balances.

Sales ledger list of balances	\$	Purchase ledger list of balances	\$
At 1 May 2012	184,840	At 1 May 2012	79,730
Omitted credit balance	(680)	Sales invoices error	(1,360)
Sales invoices omitted	1,360		
Cash refund error	40		
At 31 May 2012 (188,880 - 3,320)	<u>185,560</u>	At 31 May 2012 (78,460 – 90)	<u>78,370</u>

Now let’s try some shorter questions closer to what you’ll see in your exam.

1. A sales ledger control account had a closing balance of \$8,500. It contained a contra to the purchase ledger of \$400, but this had been entered on the wrong side of the sales ledger control account.

**The correct balance on the control account should be?**

The contra transaction should have been recorded as:

Dr	Purchase ledger control account	\$400
Cr	Sales ledger control account	\$400

But has actually been recorded as

Dr	Sales ledger control account	\$400
Cr	Purchase ledger control account	\$400

This means that total receivables has been over stated by  $2 \times \$400$  (\$800), and should therefore be \$7,700 rather than \$8,500.

2. In a sales ledger control account, which of the following lists consists **ONLY** of items that would be recorded on the **credit side** of the account?

- A Credit sales, cash refunds to customers, irrecoverable debts written off, discounts allowed.
- B Cash received from customers, discounts allowed, interest charged on overdue accounts, irrecoverable written off.
- C Credit sales, cash refunds to customers, interest charged on overdue accounts, contra against amounts due to suppliers in the purchases ledger.
- D Cash received from customers, returns inwards, irrecoverable debts written off, contra against amounts due to suppliers in the purchases ledger.

Using the pro-forma above work through each combination eliminating incorrect answers until you have the right answer. Look at all four solutions before you make your decision

- A Credit sales are a debit – wrong
- B Interest charged is a debit Dr SLCA Cr Interest received – wrong
- C Credit sales, cash refunds, interest charged all debits - wrong
- D Cash received, returns inwards, irrecoverable debts and contra are all credits - CORRECT!

3. The sales day book has been overcast by \$400 and the purchase day book has been under cast by \$550. Purchase and sales ledger control accounts are maintained as part of the double entry bookkeeping system.

**Which of the following will be the effect of correcting these errors?**

- A adjust control accounts, with no effect on profit
- B adjust control accounts, with a decrease in profit of \$950
- C adjust personal accounts of the individual customer and suppliers, with no effect on profit
- D adjust personal accounts of the individual customer and suppliers, with a decrease in profit of \$950.

Firstly let's think about the impact on profit. If the sales day book is over cast that means there are too many sales recorded and profit will need to be reduced. If the purchases day book is under cast that means there are too few purchases and so profit will be reduced again. This will reduce profit by a total of \$950 so answers that say no impact on profit - A & C must be **WRONG**.

The fact that it is the totals of the day books that are incorrect not the individual entries means that the personal accounts will be fine but the control accounts must be adjusted so the **ANSWER** is B.