STADIO

Accounting 1
ACC152

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A Glossary of terms is provided at the end of this study guide to clarify some important terms.

Any reference to the masculine gender may also imply the feminine. Similarly, singular may also refer to plural and vice versa.

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Module purpose and outcomes

In this module you will be introduced to the basic principles of accounting. The double-entry principle and accounting equation are addressed. In addition, you will learn about different types of journal entries, ledger accounts and bank reconciliation statements. Different types of financial statements are also covered.

On completion of the module, you should be able to:

1. Apply the principles of basic bookkeeping and accounting.
2. Analyse the effect of transactions on the financial position of a business entity.
3. Prepare journal entries and draw up the general ledger and control accounts.
4. Prepare bank reconciliations and year-end adjustments.
5. Interpret the different types of financial statements of a business entity on a basic level.

Topic 1
Introduction to key accounting concepts and the double-entry accounting system

1.1 INTRODUCTION

This topic relates to the following module outcomes:

1. Apply the principles of basic bookkeeping and accounting.
2. Analyse the effect of transactions on the financial position of a business entity.

This topic will introduce you to the basic principles of an accounting system and will help you understand why it is necessary to have such a system in place. This uniform system applies to all business entities.

It is necessary to identify the process that must be followed before preparing a set of financial statements. Once this process has been followed, you need to understand the reasons for preparing these statements. This topic will explore the purpose of the accounting system and the financial information that people use, as well as the different users of financial statements. It is also important to identify and understand the different forms of business entities and their financial periods.

We will also define the different terminology used in the accounting equation. Remember, together with the double-entry system, the accounting equation is the starting point for the process of recording accounting data.

Furthermore, the flow of a transaction, from entering the information into the accounting records to summarising the year's records in the financial statements, will be covered. This is known as the accounting cycle.

In this topic, you will gain knowledge in the following areas:

1. Accounting concepts and their definitions
2. Users of financial statements
3. Flow of transactions
4. Concept of debits and credits
5. Effect of transactions on the financial position of a business entity.

1.2 ACCOUNTING CONCEPTS AND THEIR DEFINITIONS

1.2.1 Accounting as a system

Accounting around the world is based on a double-entry system. The processing rules may differ from one country to another, but the system is the same. The name is a giveaway. In the simplest form, it means that you must pass two entries to 'process' any transaction. This concept is fundamental to everything from here onwards in this module. Although an entire topic is dedicated to this later, it is important that you first understand the principle.

Later in the topic, we also study the accounting equation in more depth. Some of these points will then become clearer.

It is important to emphasise that there is an offset that takes place in our everyday use of money. Have a look at this example:

Example:

You work for a full month. At the end of the month, you have a real asset — a salary receivable. When the transaction happens (on the 20th, 25th or the last day of the month) you 'gain' cash, but instantaneously 'lose' the receivable. Therefore, two transactions have taken place. If you then use part of your salary to pay debt, the following happens: you instantaneously 'lose' cash, but also 'gain' because you have settled a debt.

This example shows that there are (at least) two entries for every transaction.

For accounting information to be produced, financial data must be recorded, classified and summarised. This process can best be described as a system in which the data (that is the input into the system) is processed to produce the accounting information (that is the output). The accounting system is illustrated in the following figure.

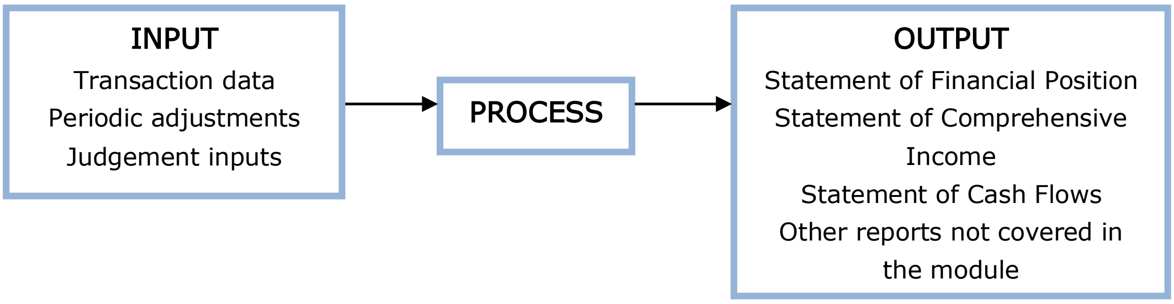


Figure 1.1 The accounting system

The three components of the accounting system — input, process and output — will now be explained in detail.

Input

There are two sources of input into the accounting system: the transaction data and the periodic adjustments. Transactions are the various activities that a business carries out when conducting its operations.

Each transaction is recorded on a source document, which indicates the origin of the transaction. Examples of source documents that would often be used to record transactions include (among others):

- **Cash register roll**, which records cash received through the cash register (till) for sales of goods or services rendered
- **Invoice**, which records sales or purchases of goods or services rendered on credit, for which the money will be received or paid at some specified future date
- **Cash receipt**, which is used as confirmation that a cash transaction has taken place and that cash has been received by the business entity — usually used for cash sales and payments of accounts by customers who had previously bought goods or received services on credit (such customers are called trade receivables or debtors)
- **Bank deposit slip**, which records the money deposited into the bank account. It is common practice for businesses to deposit cash from sales daily
- **Credit note**, which is issued by the seller (supplier) to record the cancellation of an entire invoice or part of an invoice for reasons such

as changes to the invoice after it was issued, damage to the goods or pricing mistakes on the original invoice

- **Debit note**, which is issued by the buyer to record the return of goods, previously bought on credit, to the seller (supplier)

- **Electronic funds transfer** (EFT) proof of payment, which serves as proof that an electronic transfer of funds has been made into the business entity's bank account

- **Petty cash voucher**, which records small amounts of money used from the petty cash

- **Journal voucher**, which records adjustments and corrections performed by accountants such as credit losses (bad debts) and depreciation expense for the year.

The transactions recorded on each source document become inputs into the accounting system. The details on each source document need to be recorded by the business.

Some inputs into the system may be generated internally without involving an external party such as a customer. Such events, which also have financial implications for a business, are known as periodic adjustments*.* The calculation of depreciation by accountants would be seen as a source document. Every entry into the financial pool of data must be recorded. Periodic adjustments are recorded in journals that must still be approved and retained.

To illustrate the principle of a periodic adjustment, let us assume that a business owns a motor vehicle. The motor vehicle is used for business purposes and, in this capacity, is gradually 'used up'. This usage represents a cost to the business, as the vehicle will become less reliable over time. Even though the usage of the vehicle might not involve cash payments, the fact that it is being used must be recorded.

The periodic adjustment to reflect this event is known as depreciation. It is important to note that depreciation does not include the running costs of the vehicle such as fuel and repairs and maintenance costs. These are transactions that will be recorded on source documents. Depreciation transfers the cost of the asset to expenses over the useful life of the asset.

Some of the entries require some degree of judgement. Some judgement calls become policy and only require updating when the policy is changed. For example, the useful life of a photocopying machine can suddenly reduce because of new technology, causing the remaining useful life of the machine to be less than previously estimated.

Another example affects the recoverability of a debt, which could become questionable. An allowance for such doubtful debts must be created as the amount at which the debtor was initially recorded may not be fully recoverable.

Process

This component of the accounting system comprises the transformation of the input data into an organised and systematic database from which the financial reports — the output of the system — can be prepared. The process of the accounting system will be discussed in greater detail later in this topic.

The output of the accounting system

The output of the accounting system comprises the various financial reports produced by accountants. In accounting, the reports present the financial results of the operations (i.e. the Statement of Profit or Loss and Other Comprehensive Income) of a business for a particular period of time, and its financial position at a particular point in time (the Statement of Financial Position). The financial reports are collectively referred to as **financial statements**.

In this topic, we will closely examine the process and output phases of the accounting system. In particular, the accounting equation will be used as a basis for recording the transactions and periodic adjustments of a business, as well as for preparing financial statements.

Activity

Write down the answers to the following:

- **Explain** what is meant by the double-entry system.
- **Name** the key elements that resulted in the establishment of the double-entry system of recording.

You should now be able to identify the need for an accounting system and the information required by an accounting system.

1.2.2 Formalising financial reports

The company's operations are reported to interested parties through a set of financial statements. These interested parties may include management, investors, bankers, shareholders, suppliers, customers, or labour unions. A company generates various financial reports, each communicating information that is of interest to different parties. For purposes of this module, we will concentrate on the **Statement of Profit or Loss and Other Comprehensive Income** and the **Statement of Financial Position**.

The Statement of Cash Flows forms part of financial statements; however, in this module, we will focus on the cash forecast, which is a forward-looking planning tool and not a mandatory annual report. The Statement of Changes in Equity is also beyond the scope of this module.

1.2.3 Statement of Profit or Loss and Other Comprehensive Income

The Statement of Profit or Loss and Other Comprehensive Income presents the financial results of the entity over a specified period of time (usually a financial year), showing the business owner or manager exactly how the business has performed.

As the overall objective of the business is to make a profit (and therefore improve the owner's equity), this report is used to reflect whether a profit or loss has been achieved over the specified period.

The financial result (i.e. profit or loss) is made up of the income earned less the expenses incurred by the entity in the relevant period, as follows:

PROFIT = INCOME (REVENUE OR TURNOVER) – EXPENSES

The following is an example of a Statement of Profit or Loss and Other Comprehensive Income. Remember that the heading of the Statement of Profit or Loss and Other Comprehensive Income must reflect the time period to which it relates, the name of the statement, and organisation's name.

Example:

4M SERVICES
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20XX

INCOME			
Revenue (services rendered)		R	1 750 000
EXPENSES		(R	1 250 000)
Salaries	R450 000		
Rent paid	R150 000		
Depreciation	R475 000		
Repairs	R175 000		
NET PROFIT FOR THE YEAR		R	500 000

1.2.4 Statement of Financial Position

The Statement of Financial Position reports the financial position of the entity at a specific point in time. The financial position is made up of the following:

1. **The assets** that belong to the entity at that specific time
2. **The liabilities** (i.e. the debts) owed by the entity at that specific time
3. **The owner's equity** (or net worth). This is the difference between the assets and liabilities of the business entity, and includes the capital invested by the owner and profits ploughed back into the business by the owner (i.e. retained earnings), less drawings (i.e. the cash and goods taken by the owner from the business for private use).

The Statement of Financial Position shows where funds (i.e. the money) have come from and how they have been used.

<u>MONEY IN</u>	=	<u>MONEY OUT</u>		
Capital invested + Retained earnings		Owner's equity	=	Assets
+				
Borrowings/debt		Liabilities		

Money in should always be equal to money out. Therefore, the diagram above can be restated using the accounting equation as follows:

THE ACCOUNTING EQUATION

OWNER'S EQUITY	+	LIABILITIES	=	ASSETS
	(MONEY IN)			(MONEY OUT)
OR				
OWNER'S EQUITY	=	ASSETS	–	LIABILITIES
(Capital + retained earnings)		(what we own)		(borrowings)

Remember that the Statement of Financial Position reflects the financial health of a business at a specific point in time.

Example:

The following is an example of a Statement of Financial Position:

4M SERVICES
STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20XX

ASSETS	
Non-current assets	**800 000**
Property, plant and equipment	800 000
Current assets	**3 400 000**
Inventory	1 350 000
Accounts receivable	1 850 000
Cash and cash equivalents	200 000
Total assets	**4 200 000**
EQUITY AND LIABILITIES	
Capital and reserves	**1 950 000**
Capital	1 200 000
Retained earnings	750 000
Non-current liabilities	**950 000**
Long-term loan	950 000
Current liabilities	**2 250 000**

Bank overdraft	300 000
Accounts payable	1 950 000
Total equity and liabilities	**4 200 000**

1.2.5 The Statement of Cash Flows

A third financial statement can be prepared from the accounting information generated by the accounting system. This statement, which is called a Statement of Cash Flows, is prepared after the Statement of Financial Position and the Statement of Profit or Loss and Other Comprehensive Income, and reports on the results of the cash transactions of the business.

The Statement of Cash Flows differs from a cash-flow forecast, which is prepared before any transactions have taken place. The cash-flow forecast is a budget of the future (i.e. the expected) cash movements.

In practice, the Statement of Cash Flows (SOCF) usually has three headings:

1. Cash flows from **operating activities** (e.g. cash received from customers and cash paid to suppliers and employees)
2. Cash flows from **investing activities** (e.g. buying non-current assets) and
3. Cash flows from **financing activities** (e.g. obtaining a loan).

The Statement of Cash Flows (SOCF) produces a different result from a Statement of Profit or Loss and Other Comprehensive Income. The reason for this is that the SOCF is prepared using the cash basis of accounting (that is, reporting only cash receipts and payments), while the Statement of Profit or Loss and Other Comprehensive Income is prepared using the accrual basis of accounting (reporting all revenue and expenses for the period, whether paid, received or not).

In practice, the financial statements of a business comprise:

1. The Statement of Financial Position
2. The Statement of Profit or Loss and Other Comprehensive Income
3. The Statement of Cash flows
4. The Statement of Changes in Equity and
5. Explanatory notes.

Note

The SOCF is regarded as an important source of information about the cash transactions of an enterprise, but it is beyond the scope of this module.

1.2.6 The financial period of an enterprise

If we consider the lifespan of a business, we can identify the various stages through which it will progress. The business is created, it will trade/operate, and continue to trade/operate into the foreseeable future, or eventually it will cease to trade/operate and be wound up. Throughout these periods, the owners, lenders and all other parties involved will need information about the business in order to make economic decisions.

Activity

List the sets of information that you, as a business owner, need to have at your fingertips in order to manage your business efficiently.

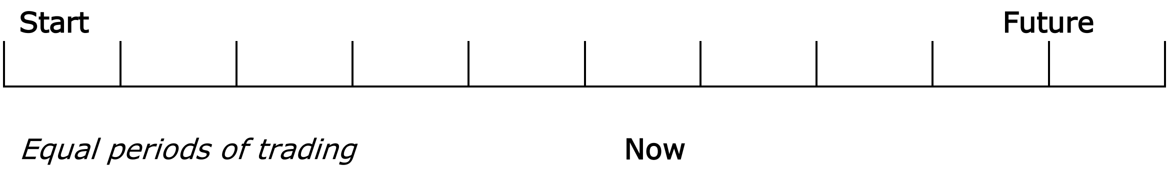
Refer to your answer above. Now, let us consider the timeline of a business:

Business starts	Business ceases

Generally, a business owner is in business to make a profit. The owner intends to generate a profit from the time the business starts trading to the time the owner decides to exit the business or cease trading. The problem is that the business owner does not know when the business is going to cease trading; and if he does, he cannot wait until the business ceases trading to determine whether or not a profit has been made.

In practice, what happens is that the business owner breaks up the total period of existence into smaller, equal-sized periods. These could be months, quarters, or years.

Business cycles differ from one company to another. Understandably, a supermarket that sells goods at least once a day has a different cycle to a construction company that works on different projects, some of which could take years to complete. However, annual reports are the minimum standards required by law, and almost every business prepares monthly reports. When reading these reports, it is important to read the notes to the annual financial statements in order to understand the rules applied to group activities over the period of the year.



The business owner looks at the results of each trading period and determines what profit (or loss) has been achieved.

Note

Profit is essentially the difference between revenue and expenses.

The documents that the business owner examines are:

1. Statement of Profit or Loss and Other Comprehensive Income for the period just ended (i.e. an historical performance)
2. Statement of Financial Position at the current date (i.e. at a point in time)
3. Cash-flow forecast for the forthcoming periods (i.e. a future outlook).

These documents can be matched to the lifeline of the business as follows:

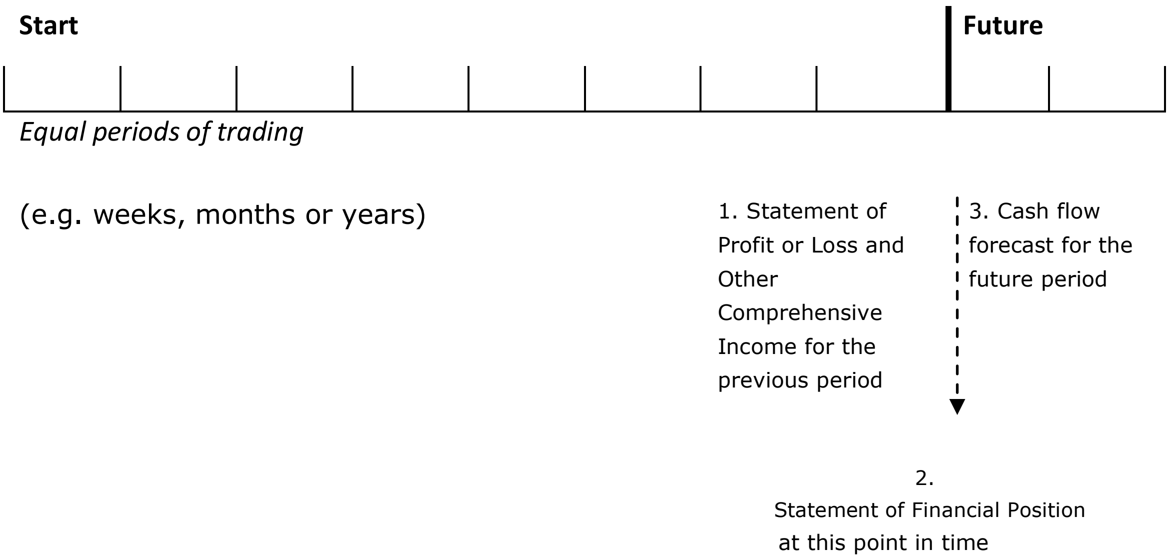


Figure 1.2 The lifeline of a business

For accounting purposes, one must differentiate between individuals and other forms of enterprise.

Individuals are persons who operate their business in their own capacity. Examples of this are natural persons who trade as sole proprietors or who trade in partnerships. These individuals will have a financial period that commences on 1 March of each year and runs for a period of 12 months, ending on 28/29 February the following year. This coincides with the year of assessment, as prescribed by the South African Revenue Services (SARS).

All other entities may have a financial period of a year that commences at any date and ends 12 months later. Companies, both public and private, and close corporations fall within this category.

All activities (i.e. transactions) that take place in this 12-month period must be recorded in various financial records.

This means that all purchases, manufacturing expenses, sales, and other income that occurred in a financial period must be accounted for within that period of 12 months. This is normally referred to as the financial records for the year of an enterprise.

1.2.7 Understanding financial analysis

The process of financial statement analysis consists of the application of analytical tools and techniques to financial statements and data, in order to derive from them measurements and relationships that are both significant and useful in decision-making. First and foremost, financial statement analysis serves the essential function of converting data (of which, thanks to computers, there is a bewildering quantity and variety) into useful information.

The processes of financial statement analysis can be described in various ways, depending on the objectives to be achieved. Financial statement analysis can be used as a preliminary screening tool when evaluating loan applications, equity investments, or merger candidates.

It can be used as a tool to forecast the future financial results and identify current and potential problem areas. It can also serve as a tool in the evaluation of management. Above all, financial statement analysis reduces the reliance on pure hunches, guesses, and intuition. This reduces and narrows down the inevitable areas of uncertainty that accompany all decision-making processes.

In summary, financial statement analysis is a very important tool in aiding decision-making. We have dedicated an entire topic to this issue in a later module in the qualification.

Note

Financial statement analysis does not lessen the need for judgement, but rather establishes a sound and systematic basis for its rational application.

Different categories of people and organisations will use the financial information that is disclosed in the financial records of an enterprise. They need this information to make decisions when investing in an enterprise or lending funds to the enterprise. This process is called the financial analysis of the enterprise.

Activity

The financial statements of ABC Stores have just been finalised for the year ended 31 December 2022. Identify and explain the use of these financial statements, and the reasons for the performance of financial analysis. Write these answers in a notebook.

1.2.8 The process component of the accounting system

One normally starts a business by asking the following questions:

- From which source(s) will the enterprise obtain funds to commence trading?
- In which specific industry am I going to trade? What is going to be sold or manufactured, and at what cost (i.e. expense)?

Even though you may have great ideas, you cannot just open a business and start trading without knowing whether you will receive more money (i.e. income) than you will pay in expenses. Therefore you need to know how to process all of the information of an accounting system.

The process component of the accounting system transforms the input data into an organised and systematic database from which the financial statements can subsequently be prepared. This requires the recording of transaction data from the source documents and the periodic adjustments into a set of accounting records that will classify and summarise these events. The accounting record we will use for the recording of transactions and adjustments is the accounting equation.

Before proceeding, we will redraft the diagram of the accounting system shown in Figure 1.1, in terms of the functions performed at each stage of the system. This is illustrated in Figure 1.3.

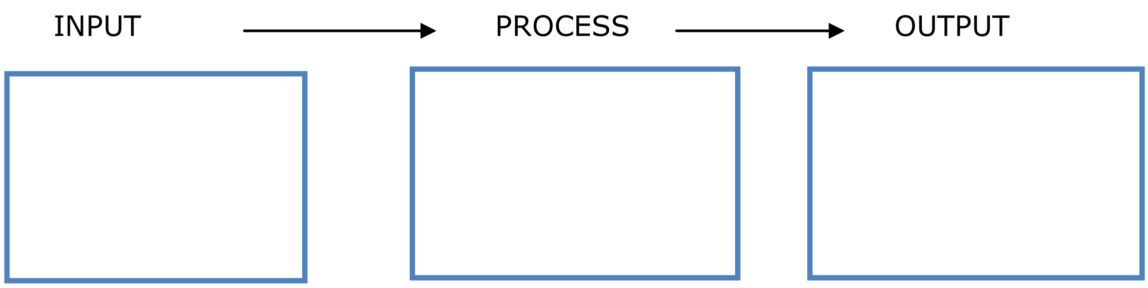


Figure 1.3 The functional perspective of the accounting equation

Figure 1.3 sets out the accounting functions that occur in each phase of the accounting system. Our focus in this topic will be on the process phase, — recording, classifying, and summarising the transaction data and periodic adjustments of a business.

You should now be able to:

- identify the need to keep records of transactions entered into by an enterprise during a financial period.
- understand and describe the process component of an accounting system from the input data (i.e. the source documents) to an organised and systematic database (i.e. the accounting records) from which financial statements can be prepared.

You will recall from earlier in the topic that the accounting equation is:

1. ASSETS = OWNER'S EQUITY + LIABILITIES

Applying basic mathematics, we can also write the equation as follows:

2. OWNER'S EQUITY = ASSETS − LIABILITIES

or as:

3. LIABILITIES = ASSETS – OWNER'S EQUITY

We encourage you to not simply learn these off by heart, but to make sure you understand these equations. Either way, it is a fundamental accounting concept and, together with the double-entry system, the foundation on which to build any accounting knowledge.

Later in the topic, this concept is worked through in detail with a case study; however, below is an example to aid your understanding at this point.

Example:

A business owner contributes R2 000 to the firm, so the firm has R2 000 in its bank account. The owner's net worth is R2 000 (assets = owner's equity). Should the firm now borrow R5 000 from a financial institution, it will have R7 000 in the bank.

Is the owner now worth R7 000? Clearly not. He needs to deduct liabilities from assets to get his net worth (see Formula 2 above). He is still worth R2 000 (R7 000 – R5 000).

Looking at this, by using Formula 3, we know the loan from the bank is R5 000; therefore, liabilities are clearly R5 000. The R5 000 debt equals the bank balance (i.e. the assets) of R7 000, less the owner's equity of R2 000.

If you were to write the above in the accounting equation, it would be as follows:

ASSETS	**=**	**OWNER'S EQUITY + LIABILITIES (A = OE + L)**
Bank (R2 000)	=	Capital (R2 000) + 0
Bank (R7 000)	=	Capital (R2 000) + Loan (R5 000)

The accounting equation reflects a situation in which all assets owned or controlled by a business are subject to claims by owners and creditors. We will use the accounting equation to record business transactions and periodic adjustments.

To illustrate the principles of recording business transactions and adjustments, assume that, in February 20XX, J. Jones decided to start a business in the health industry. The business, which J. Jones decided to call Jones's Gym, would provide a gymnasium and training facilities to the public. It would not, however, trade any products, as it is a service undertaking. J. Jones expected the business, which was due to commence operations in March 20XX, to do well (i.e. to make a profit).

To commence business, J. Jones deposited R200 000 into the bank account of Jones's Gym on 1 March 20XX. The transaction was recorded in the accounting equation as:

Date	Assets	=	Equity	+	Liabilities
1 March	R 200 000		R 200 000		R 0

This indicates that the business has assets (i.e. cash) of R200 000. This is also the amount that the business owes to J. Jones, the owner. The amount should therefore be recorded as equity. No creditors or potential investors have placed resources in the business at this stage, so there are no liabilities owing by the business.

Note

Note that the equation balances. The assets equal equity plus liabilities. This state of equilibrium must always exist because assets will always be equal to equity and liabilities at any point in time.

The accounting equation is the foundation of, and starting point for, the recording process. All accounting transactions and adjustments that affect both financial position and financial performance can be recorded and organised in terms of this equation. To understand how to do this, the terms 'assets', 'liabilities', and 'equity' need to be examined in more depth.

Assets

Assets are resources controlled by the business as a result of past events, from which future economic benefits are expected to flow to the business. Assets are further classified as non-current assets and current assets.

<u>Non-current assets</u>

Non-current assets are assets with a useful life of more than 12 months. These assets are purchased for purposes other than trade or resale.

Example:

The following are examples of non-current assets:

- Land and buildings
- Machinery
- Equipment
- Vehicles
- Furniture.

Current assets

Current assets are assets with a useful life of less than 12 months. These are used, consumed, or sold by the business in order to create additional value by earning net income, and are also items owing to the business (i.e. trade receivables/debtors control).

Example:

The following are examples of current assets:

- Inventory
- Accounts receivable/debtors control
- Bank (i.e. a favourable bank balance)
- Petty cash
- Cash float
- Consumable stores on hand.

Liabilities

Liabilities are the present obligations of a particular business entity to transfer assets (usually by paying money), or to provide services to other entities in the future because of past transactions or events. Liabilities therefore represent claims against the assets of a business. Liabilities are further classified as non-current liabilities and current liabilities.

Non-current liabilities

These obligations will mainly be in respect of entities from which the business borrowed money, such as banks and other financial institutions.

Current liabilities

An entity often needs to purchase products or services, and it may be necessary to purchase these on credit (from, say, suppliers of goods or services).

Equity

Equity is the owner's residual (i.e. the remaining) interest in the assets of an enterprise after deducting all the entity's liabilities. This residual interest represents the amount of the owner's claims against the business if all of the assets are realised (i.e. sold) for cash at the amounts at which they are recorded, and all of the liabilities are discharged (i.e. paid) at the amounts at which they are recorded.

We will now continue with the example of Jones's Gym, using the accounting equation to record the transaction data and periodic adjustments of the business for March 2022.

Remember, equity comprises capital and retained earnings. Initial capital is the contribution that the owner made to the business; and after a few years, that amount is not as visible anymore (however, it is not less valid, as it is a product of a number of things after a few years, not initial capital only. Rather, it is less **clearly defined**).

Equity will always be assets minus liabilities. One of the contributors to owner's equity is retained earnings. This is the sum of the profits that were not distributed to the owner over the years.

It is already established that profit = income **less** expenses. It has also been established that owner's equity includes profit.

It can therefore be concluded that:

OWNER'S EQUITY = CAPITAL + INCOME − EXPENSES − DRAWINGS

Again, using mathematics, the equation can be rewritten into five different variants. The purpose of this module, however, is for you to understand that any profit not distributed to the owner forms part of equity. We will cover this again at a later stage.

1.2.9 The double-entry principle (a rule)

Earlier, we looked briefly at the double-entry system. For every amount that accountants 'process', at least two entries into different accounts are required. We process entries in ledger accounts. Ledger accounts are groupings of similar transactions. For example, if we regularly purchase bond paper, we will open an account called 'stationery', and all the entries in the month relating to stationery are recorded in the stationery ledger account.

At the end of the period, it is then easy to see what the total stationery cost is. You can imagine the hundreds of thousands of entries for a large firm, and if we do not group like with like, understanding the accounts will be impossible. These ledger accounts are then grouped together again and classified for the financial statements. Accounts are classified into asset accounts, equity accounts, and liability accounts.

In its simplest form, a ledger account can be visualised as the letter 'T'. In the past, when manual bookkeeping was common, firms purchased ledger books with a vertical line down the middle of each page. When the page was given a name on top, it resembled the letter 'T'. In these days of automation, ledger prints still resemble the letter 'T'.

The left side of the centre line is the debit side and the right side is the credit side. This is important. Read it again. Study it.

For the purposes of Topic 1, we are focusing on understanding the effect of a transaction on equity, assets, or liabilities. But for now, you need to understand the effect only in terms of increases and decreases.

A useful summary

The framework shown in Table 1.1 presents a useful overview of the accounting equation and the related subcategories. Examples of relevant accounts are given under the related categories. You will need to know this information before you attempt further work.

Using the double-entry principle, we can record the effect of the following transactions by Jones's Gym on the accounting equation, by asking the following questions:

1. Which elements (i.e. assets, equity, and/or liabilities) in the equation are affected by these transactions?

2. Which of the following elements will increase or decrease?

Recording of transactions

As explained, the amount of R200 000 contributed by the owner, J. Jones, was deposited into a newly opened bank account in the name of Jones's Gym on 1 March 20XX. The business then prepared itself to start business by concluding the following transactions during March 20XX:

Table 1.1 Jones' Gym's transactions during March 20XX

Date	Transaction
3 March	Acquired premises for R105 000. This amount was paid through an electronic funds transfer (EFT).
4 March	Purchased gym equipment on credit for R65 000.
6 March	Obtained a long-term loan of R45 000 from the bank. The loan bears interest at 18% per annum, payable quarterly in arrears. The loan is repayable on 9 March 20XX.
10 March	Bought consumables, such as handwashing soap, oils, and creams amounting to R1 800, to be used by gym members. The amount was paid by bank card.
12 March	Jones's Gym placed advertisements in the local newspaper at a cost of R3 900.
17 March	Deposited R9 700 in the bank. This was received from members for fitness training and gym usage for the period 4 March to 16 March 20XX.
20 March	Concluded non-refundable contracts with new members for R15 200. The money has not yet been received.
31 March	Paid the following amounts: R13 000 to fitness trainers, masseurs, and nutritionists. R9 000 to the suppliers of the equipment purchased on 4 March.

We will now record the transactions of Jones's Gym within the framework of the accounting equation. Each transaction will be considered in the light of its impact on the accounting equation i.e. how the assets under the control of the business have changed, and how these changes affect the claims against the business.

The information in the accounting equation will be used to draft a Statement of Financial Position, and a Statement of Profit or Loss and Other Comprehensive Income.

The effects of the transaction on 1 March 20XX have already been explained at the beginning of the topic. 'Cash' in the bank increases assets, and R200 000 is also entered under equity, because it is the amount owing to the owner, J. Jones.

The transaction will be recorded in the accounting equation (A = OE + L) as follows:

Mar	Accounts affected	Assets	Equity	Liabilities
01	Cash increases, capital increases	+ 200 000	+ 200 000	

Note

Note that we already have a Statement of Financial Position (with two Statement of Financial Position items: assets = equity).

Table 1.2 Statement of Financial Position of Jones's Gym as at 1 March 20XX

ASSETS	
Current assets	**R200 000**
Bank	R200 000
Total assets	**R200 000**
EQUITY AND LIABILITIES	
Capital	R200 000
Total equity	**200 000**
Total equity and liabilities	**R200 000**

Any further transactions recorded will affect the accounting equation and therefore the Statement of Financial Position. We will now analyse the remaining transactions in terms of this framework:

3 March: purchased premises, costing R105 000, for cash

Premises are an asset. Cash is also an asset. Premises were acquired, so assets will increase. However, cash was spent, which results in a decrease in assets.

The transaction will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar 01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 − 105 000		
	Balances	**200 000**	**200 000**	

Note

The accounting equation remains in equilibrium after each transaction.

Table 1.3 Statement of Financial Position of Jones's Gym as at 3 March 20XX

ASSETS	
Non-current assets	**105 000**
Property, plant and equipment	105 000
Current assets	**95 000**
Bank	95 000
Total assets	**<u>200 000</u>**
EQUITY AND LIABILITIES	
Capital	200 000
Total equity	**200 000**
Total equity and liabilities	**<u>200 000</u>**

4 March: purchased equipment costing R65 000 on credit

1. Equipment is an asset. Money owed to the supplier represents a liability, known as trade payables or creditors control.
2. When equipment is purchased, assets increase. The creation of trade payables or creditors control causes liabilities to increase.

The transaction will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar 01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 − 105 000		
04	Equipment increases, trade payables increase	+ 65 000		+ 65 000
	Balances	**265 000**	**200 000**	**65 000**

Table 1.4 Statement of Financial Position of Jones's Gym as at 4 March 20XX

ASSETS	
Non-current assets	**170 000**
Property, plant and equipment	170 000
Current assets	**95 000**
Cash and other cash equivalents	95 000
Total assets	**265 000**
EQUITY AND LIABILITIES	
Capital	200 000
Total equity	**200 000**
Current liabilities	**65 000**
Trade and other payables	65 000
Total equity and liabilities	**265 000**

6 March: received a long-term loan of R45 000 from the bank

1. Money in the bank is an asset and a loan from the bank is a liability because it must be repaid to the bank by 9 March 20XX.
2. When money is received, assets increase. The loan received causes liabilities to increase.

The transaction will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar 01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 − 105 000		
04	Equipment increases, trade payables increase	+ 65 000		+ 65 000
06	Cash increases, loan increases	+ 45 000		+ 45 000
	Balances	**310 000**	**200 000**	**110 000**

Table 1.5 Statement of Financial Position of Jones's Gym as at 6 March 20XX

ASSETS	
Non-current assets	**170 000**
Property, plant and equipment	170 000
Current assets	**140 000**
Cash and other cash equivalents	140 000
Total assets	**310 000**
EQUITY AND LIABILITIES	
Capital	200 000
Total equity	**200 000**
Non-current liabilities	**45 000**
Long-term loan	45 000
Current liabilities	**65 000**
Trade and other payables	65 000
Total equity and liabilities	**310 000**

The transactions of Jones's Gym recorded to date relate to setting up the operating structure of the business. However, it has not yet begun operating, which it will have to do to generate revenue. Wealth creation, as measured through the financial performance of a business, is achieved if the business makes a profit.

Recall that profit is determined as:

NET PROFIT = INCOME – EXPENSES

Income

Revenue is the net inflow of cash or receivables that arises in the module of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of the enterprise's resources.

Revenue is measured by the charges to customers or clients for goods supplied and services rendered to them, and by the charges and rewards from the use of resources by them. It excludes amounts collected on behalf of third parties, such as Value-Added Tax (VAT).

Note

Different types of revenue that may be earned (depending on the nature of a business) include sales, the rendering of services, membership fees, consultation fees, royalties, rent, and commission earned.

Revenue earned also includes transactions for which cash has not yet been received, but the goods have been delivered or the service has been rendered; therefore, the word 'earned' is used, rather than 'received'. For example, a business may provide services during December 20XX, but receive the money only in January of the following year. This is revenue earned during December 20XX, and it must be recorded in the accounting equation during December 20XX. The revenue was earned in December, because a service, measured in monetary terms, for which the client must ultimately make payment, was provided during that period. This is also known as 'accrued income'.

Expenses incurred

Expenses are the costs of assets consumed and services used in order to earn revenue.

Example:

Expenses include electricity and water, salaries, depreciation, telephone, and rent paid.

It is possible for an expense to be incurred but not yet paid. For example, a business may use the telephone during December 2018, but only settle the account in January 2019. The telephone was used in December, so it is an expense for that period and must be recorded as such.

From the preceding discussion, it is apparent that revenue earned and expenses incurred both affect equity. If revenue earned is greater than expenses incurred, the business makes a profit. A profit represents a return to the owner on his investment and will increase the claim of the owner against the assets of the business. If expenses incurred are greater than the income earned, the business incurs a net loss and equity will be decreased.

It follows that:

Revenue earned will increase equity.
Expenses incurred will decrease equity.

By including revenue earned and expenses incurred in the determination of net profit or loss, we are using the **accrual basis of accounting**. As explained in this topic, this specifies that revenue and expenses should be recognised in the period in which they are earned and incurred, respectively, and not necessarily when the amounts are received or paid.

We can now continue to record the transactions of Jones's Gym.

10 March: purchased consumables costing R1 800 for cash.

1. Consumables represent an expense, and cash is an asset.
2. The expense will decrease equity, and cash, as it is being paid, will reduce assets.

The transaction will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar 01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 − 105 000		
04	Equipment increases, trade payables increase	+ 65 000		+ 65 000

06	Cash increases, loan increases	+ 45 000		+ 45 000
10	Consumables (expense) increase, cash decreases	−1 800	− 1 800	
	Balances	**308 200**	**198 200**	**110 000**

Table 1.6 Statement of Financial Position of Jones's Gym as at 10 March 20XX

ASSETS	
Non-current assets	**170 000**
Property, plant and equipment	170 000
Current assets	**138 200**
Cash and other cash equivalents	138 200
Total assets	**<u>308 200</u>**
EQUITY AND LIABILITIES	
Capital	200 000
Retained profit	−1 800
Total equity	**198 200**
Non-current liabilities	**45 000**
Long-term loan	45 000
Current liabilities	**65 000**
Trade and other payables	65 000
Total equity and liabilities	**<u>308 200</u>**

Note

Important: Retained profit = Income − Expenses − Drawings.

12 March: paid for advertisements costing R3 900

An advertisement is an expense and cash is an asset. An expense will reduce equity, and cash, as it is being paid, will reduce assets.

17 March: deposited fees received of R9 700

1. Fees represent revenue and cash is an asset.
2. The revenue earned will increase equity, and cash received will increase assets.

The transactions will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar	Cash increases, capital	+ 200 000	+ 200 000	
01	increases			
	Premises increases, bank	+ 105 000		
03	decreases	− 105 000		
	Equipment increases, trade	+ 65 000		+ 65 000
04	payables increase			
	Cash increases, loan	+ 45 000		+ 45 000
06	increases	− 1 800	− 1 800	
10	Consumables (expense)			
	increase, cash decreases	− 3 900	− 3 900	
12	Advertising increases, cash			
	decreases	+ 9 700	+9 700	
17	Cash increases, revenue			
	increases			
	Balances	**314 000**	**204 000**	**110 000**

20 March: entered into non-refundable contracts of R15 200 for introductory course on credit

This transaction represents revenue earned, because the five-day introductory courses would have been provided by Jones's Gym before the end of March.

1. Revenue is income and trade receivables are assets.
2. Revenue increases equity. Although cash has not yet been received, assets will also increase. There are now members that owe the business money.

31 March: paid R13 000 for salaries and R9 000 to suppliers of equipment

1. Salaries are an expense which decreases equity. Cash is paid and, because cash is an asset, assets will decrease.
2. The business started to repay trade payables incurred when the equipment was acquired on 4 March. Trade payables are a liability, and

liabilities will decrease by R9 000. Assets will also decrease since cash is paid out to the supplier of the equipment.

The three transactions above will be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar 01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 – 105 000		
04	Equipment increases, trade payables increase	+ 65 000		+ 65 000
06	Cash increases, loan increases	+ 45 000 – 1 800	– 1 800	+ 45 000
10	Consumables (expense) increase, cash decreases	– 3 900	– 3 900	
12	Advertising increases, cash decreases	+ 9 700	+9 700	
17	Cash increases, revenue increases	+ 15 200	+ 15 200	
20	Trade receivables increase, revenue increases	– 13 000	– 13 000	
31	Salaries increase, cash decreases	– 9 000	– 9 000	
	Trade payables decrease, cash decreases			
	Balances	**307 200**	**206 200**	**101 000**

Table 1.7 Statement of Financial Position of Jones's Gym as at 31 March 20XX

ASSETS	
Non-current assets	**170 000**
Property, plant and equipment	170 000
Current assets	**137 200**
Trade receivables	15 200
Cash and other cash equivalents	122 000
Total assets	**<u>307 200</u>**

EQUITY AND LIABILITIES	
Capital	200 000
Retained profit	6 200
Total equity	**206 200**
Non-current liabilities	**45 000**
Long-term loan	45 000
Current liabilities	**56 000**
Trade and other payables	56 000
Total equity and liabilities	**307 200**

1.2.10 Measuring performance

What about the financial performance of Jones's Gym? The business commenced operations, so it should be possible to measure the extent of its success. Revenue and expenses affect equity, so it is this column (i.e. equity) to which we need to direct our attention in order to assess the performance of the business. There are two ways of doing this:

1. By comparing the opening and closing balances of equity in the equation. This would yield an increase of R206 200 (R206 200 − nil), suggesting that net income of this amount was earned.

2. By analysing the details in the equity column. There are six amounts in the column, namely: +R200 000, −R1 800, −R3 900, +R9 700, +R15 200, and −R13 000. Of these, only five affect the financial performance. These are revenues of R9 700 and R15 200, totalling R24 900, and expenses of R1 800, R3 900 and R13 000, totalling R18 700. By combining these five figures, net income of R6 200 (R24 900 − R18 700) is obtained.

The difference between the total of the equity column and the net income for the month represents the owner's capital contribution to the business, which is not part of net income.

The details of the financial performance of the business can be set out in a Statement of Profit or Loss and Other Comprehensive Income as follows:

Table 1.8 Statement of Profit or Loss and Other Comprehensive Income of Jones's Gym for the month ended 31 March 20XX

Revenue	R	24 900
Expenses	–R	18 700
Net Profit	R	6 200

Note

Transactions other than revenue and expenses can affect equity. We have seen that contributions by owners increase equity. Conversely, cash or goods taken out of the business by the owner for personal use (i.e. drawings) will decrease equity.

This situation can be summarised as follows:

- Contributions by the owner increase equity
- Drawings by the owner decrease equity
- Neither capital contributions nor drawings affect net income.

1.2.11 Recording periodic adjustments

If J. Jones were to review the financial statements of Jones's Gym at this stage, he might well ask questions such as:

- Has the decrease in the value of the gym equipment due to usage been accounted for?
- Has the interest due on the loan been accounted for?

These questions relate to adjustments that may be required in order to accurately reflect the financial position and performance of a business. In order to examine such adjustments, we need to extend the example of Jones's Gym.

Additional information

1. The Jones's Gym accountant decided that premises would not be depreciated, but that all equipment acquired should be depreciated at 20% per annum.
2. It is established that R940 of the R1 800 of consumables purchased on 10 March were still unused as at 31 March.
3. Interest on the loan has not yet been taken into account.

Each of these adjustments derived from the additional information will now be discussed.

- **Depreciation**

  The equipment acquired on 4 March should be depreciated to reflect its approximate usage. As the equipment was acquired on 4 March, we can assume that it was in use for approximately one month. Depreciation should accordingly be provided for as follows:

  20% × R65 000 × 1/12 = R1 083

  Depreciation is an expense, so it will reduce equity. The other effect of the transaction is to show the equipment at a lower amount, so assets should be decreased.

Note

This concept will be discussed in greater detail in later topics.

- **Consumables used**

  The purchase of consumables costing R1 800 on 6 March was recorded as an expense. From the information provided, it is evident that consumables (costing R940) have not yet been used up. To continue reflecting R1 800 as an expense would be incorrect.

  To correct this, the unused amount (R940) should be deducted from expenses and shown as an asset. Expenses are now reduced, which has a positive effect on equity. Equity increases by R940, and assets increase by R940 (i.e. consumable stores on hand).

- **Interest on the loan**

  The business has had the use of the loan for about 24 days since 6 March 20XX, so a charge must be recorded to reflect this. This charge, 'interest on loan', is payable at 18% per annum. It might be argued that the interest should be recorded only when it is paid, but this is incorrect, because the use of the service (namely, the loan) took place in March.

Interest on loan should be recorded, because it meets the definition of an expense incurred, even though it has not yet been paid. The amount to be recorded is:

18% × R45 000 × 24/365 = R533 (rounded off to the nearest Rand)

Interest on loan is an expense, so it will reduce equity. The amount has yet to be paid, so it will increase liabilities (i.e. expense payable/accrued expense). The adjustments will now be recorded in the existing accounting equation as follows:

Date	Accounts affected	Assets	Equity	Liabilities
Mar				
01	Cash increases, capital increases	+ 200 000	+ 200 000	
03	Premises increases, bank decreases	+ 105 000 −105 000		
04	Equipment increases, trade payables increase	+ 65 000		+ 65 000
06	Cash increases, loan increases	+ 45 000		+ 45 000
10	Consumables (expense) increase, cash decreases	− 1 800	− 1 800	
12	Advertising increases, cash decreases	− 3 900	− 3 900	
17	Cash increases, revenue increases	+ 9 700	+9 700	
20	Trade receivables increase, revenue increases	+ 15 200	+ 15 200	
31	Salaries increase, cash decreases	− 13 000	− 13 000	
	Trade payables decrease, cash decreases	− 9 000	− 9 000	
	Depreciation expense increases, equipment decreases	− 1 083	− 1 083	
	Consumable stores on hand increases, consumables decrease	+ 940	+ 940	
	Interest on loan increases, expenses payable (accrued expenses) increase		− 534	+ 534
	Balances	**307 057**	**205 523**	**101 534**

Table 1.9 Statement of Financial Position of Jones's Gym as at 31 March 20XX

ASSETS	
Non-current assets	**168 917**
Property, plant and equipment	168 917
Current assets	**138 140**
Consumable stores on hand	940
Trade receivables	15 200
Cash and other cash equivalents	122 000
Total assets	**307 057**
EQUITY AND LIABILITIES	
Capital	200 000
Retained profit	5 523
Total equity	**205 523**
Non-current liabilities	**45 000**
Long-term loan	45 000
Current liabilities	**56 534**
Trade and other payables	56 000
Expenses payable/accrued expenses	534
Total equity and liabilities	**307 057**

Table 1.10 Statement of Profit or Loss and Other Comprehensive Income of Jones's Gym for the month ended 31 March 20XX

Revenue (9 700 + 15 200)	R24 900
Expenses (3 900 + 13 000 + 1800 − 940 + 1 083 + 534)	R19 377
Net profit for the month	**R 5 523**

Activity

For each of the following transactions, identify and write down the effect of the transaction on:

1. Owner's equity

2. Assets
3. Liabilities.

Transactions:

a) An asset is disposed of at a profit.
b) A debtor who owes R200 is declared insolvent. The debtor pays 50 cents in the Rand and the balance needs to be written off as irrecoverable. What is the effect on equity/assets/liabilities of the writing off of the debt?
c) The Board of Directors declares an ordinary dividend of 20 cents per share. The dividend is yet to be paid by the end of the financial year.
d) A vehicle was stolen and the insurance company did not pay out the claim.
e) Interest is earned on a fixed deposit.
f) A vehicle was stolen and the insurance company replaces the vehicle immediately.
g) A fixed deposit matures and pays out to the company bank account.
h) The company had an overdraft facility of R1m. The bank increased the facility to R1.5m.
i) The company pays wages from the overdraft.
j) The company lost a CCMA case and must pay the employee three months' salary.

You will need to understand and describe the accounting equation. This is the foundation and starting point for the recording process of accounting data.

Assets = Owner's Equity + Liabilities

1.2.12 Assessing the usefulness of financial statements

Do the latest financial statements provide information that is useful to investors? The two statements still provide limited details about the financial position and performance of the business. An indication of the value of the investment of J. Jones can, however, be obtained from the Statement of Profit or Loss and Other Comprehensive Income.

As J. Jones's investment of R200 000 is the equity at the beginning of the period (month), an indication of the performance of his investment can be obtained by calculating the return on his equity. This is done as follows:

(Net income for the period/investment at beginning of period) × 100

For Jones's Gym, this will be:

(R5 523/R200 000) × 100 = 2.76%

This represents the return on equity for one month, so J. Jones can multiply this figure by 12 to obtain an approximate annual return. This will yield an annual return on equity of 33%, which Jones can compare to the return he expected to earn from the business, given the particular risk level of Jones's Gym.

Note, however, that this return of 33% per annum is an approximation, as the business did not actually conduct business for a full month. This percentage assumes that the return on equity earned in March will be earned for the remainder of the financial year.

Furthermore, return on equity, while indicative of the performance of a business, does not really give the owner an idea of the value of his investment. This can be determined only by assessing the future cash inflows and cash outflows of the business.

1.2.13 The bookkeeping process

The starting point in bookkeeping is the transaction. Once the transaction has occurred, the recording of the transaction begins. This is then followed by the reporting of the financial results by means of financial statements. From an accounting point of view, all businesses consist of transactions. A transaction is a mutual transfer of value between two parties.

As an example, let us assume you buy jeans from a clothing store. You give the clothing store a sum of money (e.g. R595) and the clothing store sells you the pair of jeans. There has been a 'mutual transfer of value between two parties', because you paid the store money and in return you received a pair of jeans.

The following are examples of transactions incurred by a clothing retailer:

- A cash sale of goods
- A sale of goods on credit
- A payment received from a trade debtor
- The purchase of inventory on credit
- The purchase of inventory for cash
- A payment to a trade creditor
- The interest charged on its bank account
- The payment of expenses (e.g. salaries)
- The purchase of non-current assets.

All the economic activities of the enterprise occur through transactions. These transactions are the starting point of the bookkeeping process. The bookkeeping process classifies, records, summarises and, finally, reports on the results of these transactions.

In some businesses, the volume of transactions may be low (e.g. a business that rents out only one property), while another business may conduct a large number of transactions (e.g. Pick n Pay).

A small business may use manual bookkeeping records, while a large business will rely on a computer-based bookkeeping system. In the end, the primary tasks of accounting (namely, classification, recording, summarising, and reporting) remain the same.

Now that you understand that the supermarket, the hardware store, and the video store all apply the same accounting process, you will appreciate how a sound understanding of the fundamental aspects of the accounting process will enable you to understand all businesses better.

Transactions	=	economic activities
Transaction	=	mutual transfer of value between two parties
Transaction	=	starting point of the bookkeeping process

The stages of the bookkeeping process:

1. Classification
2. Recording
3. Summarisation
4. Reporting.

Before continuing with this topic, please complete the following activity:

Activity

For each of the following transactions, write down whether it will be classified as an asset, a liability, capital, income, or an expense:

1. Bought a manufacturing plant for R80 000 on credit from a supplier
2. Sold goods for R45 000, cash
3. Paid R4 200 for water and electricity.

The bookkeeping process always starts with a transaction. From the time that a transaction occurs, you need to understand how it is recorded in the books of a business, and the flow of this recording to the financial statements.

1.3 USERS OF FINANCIAL STATEMENTS

1.3.1 Introduction

The following stakeholders have an interest in the financial statements and may want to analyse them by means of ratio analysis:

The owner(s)

The owner needs to determine the return made on the capital investment. The owner can compare the return with the returns available on alternative investments in the market. The owner would also want to understand the risk that the business is carrying in terms of debt. The Statement of Comprehensive Income ratios will assist the owner in better managing the business.

Investors

Investors are interested in the stability, liquidity and profitability of the firm. Investors will look for the best investment opportunities, so the ratio analysis will enable them to compare various businesses in order to make informed economic decisions.

Creditors and financiers

Creditors and financiers are interested in the ability of the company to pay them back. Ratio analysis can provide the necessary information. By granting a loan to a business, the bank is actually making an investment on which a return in the form of interest is expected. The more financially stable the business is, the lower the risk that the bank will not receive its money.

Employees

Employees have an interest in the ability of the business to compensate them for their labour for as long as possible. Closely linked to employees are labour and trade unions that represent the employees. Before wage negotiations, labour and trade unions review the business' financial results to gauge the entity's ability to afford their demands and whether the pressures that management speak of are true.

Customers

Customers are interested in the company's ability to continue trading. A firm may supply a customer with a key ingredient/component. Stability of supply is important to the customer's own survival.

Government

Government is interested in regulating the activities of the entity, determining tax resource allowances and tax policies, and compiling statistics.

Public

The public is interested in assessing the contribution that the entity has made and is likely to continue to make to the local economy.

Note

You will need to be able to name, explain, and understand the roles of various stakeholders in a business.

1.4 FLOW OF TRANSACTIONS

1.4.1 The accounting cycle

The formal recording procedures occur within a specific framework, known as the 'accounting cycle'. See the following diagram:

The transaction

⇩

The source document
(e.g. invoice)

⇩

Recording the transaction
(journals, also known as books of first entry)

⇩

Summarising the transaction
(general ledger, also known as T-accounts)

⇩

Reporting of financial information
(financial statements)

⇩

Analysis and interpretation of financial information
(ratio analysis)

⇩

Decision-making
(using financial information for future transactions)

Figure 1.4 The accounting cycle

1.4.2 The transaction

An example of a transaction could be the purchase of 200 pairs of jeans for R20 000 by a clothing store from Van Wyk Wholesalers. This would start the accounting cycle.

1.4.3 The source document

The details of the transaction are usually recorded on source documents. These source documents are often used as evidence of the transaction and, in many cases, the books of the business are drawn up from these source documents.

Example:

Examples of source documents are:
- receipts
- invoices
- cash slips
- credit card receipt, etc.

The information relating to the transaction is recorded on the source document, which should contain the following information:
- The nature of the transaction (i.e. the type of transaction)
- The goods or services involved in the transaction
- The value of the transaction
- The date of the transaction
- The parties to the transaction.

This information needs to be available, because it is required when recording the transactions in the accounting records at a later stage.

In the example of the clothing store buying jeans, the source document would be the original purchase invoice supplied by the wholesaler.

1.4.4 Recording the transaction

Refer to Topic 2 for the different types of journals.

The journal is the first book used to record the transaction. In all transactions, at least two events happen:

1. Something is received (e.g. jeans received).
2. Something is given up (e.g. R20 000 paid for the jeans).

In more complicated transactions, more than two events can occur that need to be recorded.

In the preceding example, the transaction would be recorded in the creditors journal, where it would indicate what was bought (i.e. trading stock) and from whom (i.e. trade creditors: Van Wyk Wholesalers).

1.4.5 Summarising the transaction (the ledger)

Once the transaction has been journalised, it is then recorded in the general ledger. The general ledger is a recording/summarising system that keeps all of the debits and credits on different sides, so that balances of each account may be calculated.

Remember, the journal merely records the transaction. The entries in the journal must now be grouped/classified into similar transactions/accounts for which balances must be obtainable.

In the example below, we need to keep a record of all 'PURCHASES' and 'TRADE CREDITORS'. This record is known as the 'LEDGER ACCOUNT'.

As you can imagine, a large firm may make numerous purchases of merchandise in a month. All the entries are recorded in date order in the journal, and totals are added up at the end of the month. These totals are then posted to the ledger. In the example below, one entry of R20 000 is made to the purchases and creditors control accounts, but it could have been a number of actual purchases.

INVENTORY ACCOUNT

Debit	Credit
31/11/XX Creditors control R20 000	

CREDITORS CONTROL

Debit	Credit
	31/11/XX Inventory R20 000

The ledger account shows us a number of things:

1. The name of the account (e.g. 'INVENTORY' and 'CREDITORS CONTROL').
2. The corresponding/contra entries in the accounts (debit the inventory account and credit the creditors control account with R20 000 each).
3. The total/balance because of the entry. Inventory (i.e. an asset) has a debit balance of R20 000, and creditors control (i.e. a liability) has a credit balance of R20 000.

The trial balance

As every transaction takes place, it is recorded in the journal and posted to the general ledger. Note that subsidiary ledgers (e.g. a trade debtors/creditors ledger, which keeps a record of transactions with each trade debtor/creditor in the business' books) may also be opened up. This helps the business keep track of amounts due from each debtor or due to each creditor.

Assuming the R20 000 is made up of several suppliers, the details of each supplier need to be available to allow the entity to pay each supplier their correct share of the R20 000. With computer applications, an individual entry is immediately posted to the creditors ledger as and when the total is posted to the creditors control account.

Note

It is a key reconciliation task to ensure that the total of the creditors list always corresponds to the total of the creditors control account.

To ensure that the double-entry principle has been correctly applied, the bookkeeper will regularly draw up a 'TRIAL BALANCE'. The trial balance contains a summary of all the general ledger balances. If the double-entry principle has been correctly applied, one would expect the total of the debit balances to be equal to the total of the credit balances. Depending on the business, trial balances may be drawn up daily, weekly, monthly or even annually.

As the business grows, there will be numerous entries captured into the journals and posted to the general ledger. This is where problems can creep in, and the total debit and credit balances may not add up.

Questions to ask yourself:

1. Has each transaction been correctly recorded as a debit and a credit in the correct accounts?
2. Have you lost track of the balances of each account in the general ledger and why is it that the balances or totals have been incorrectly calculated?
3. Have you checked why the two columns add up incorrectly?

Mistakes that cannot be identified by the trial balance:

1. A transaction that has not been recorded at all (error of omission)
2. A transaction recorded to the correct side, but of the wrong account (error of principle); e.g. posted to the vehicle account instead of vehicle repairs account
3. A wrong amount recorded in both accounts (error of commission)
4. Two mistakes that cancelled each other out (compensating errors).

In order to extract a trial balance, two very simple procedures need to be followed:

1. Determine the balance or total of each general ledger account (see the following page):

Debit	INVENTORY ACCOUNT		Credit
Bank	R12 500		
Trade creditors	7 500		
Cash	11 750	Balance c/d*	31 750
	31 750		31 750
Balance b/d*	R31 750		

Debit		CREDITORS CONTROL ACCOUNT	Credit
Creditors allowances	R500	Inventory	R 7 500
Balance c/d*	37 000	Equipment	30 000
	37 500		37 500
		Balance b/d*	37 000

*c/d means balance carried down, whereas b/d means balance brought down.

2. List all of the debits on one side and all of the credits on the other side. The two sides should balance (i.e. agree). This is because, for every debit entry, we have a corresponding credit entry and vice versa (i.e. the double-entry system).

The following structure is advisable for a trial balance:

TRIAL BALANCE OF............. AS AT 28 FEBRUARY 20XX			
	Fol	Debits	Credits
Statement of Financial Position section			
Capital			XXX
Land and buildings		XXX	
Equipment		XXX	
Vehicles		XXX	
Bank		XXX	
Creditor control – AA Suppliers			XXX
Debtor control – BB Estate agents		XXX	
Nominal Section			
Current income			XXX
Rates and taxes		XXX	
Water and electricity		XXX	
Telephone		XXX	
Wages		XXX	
Salaries		XXX	
Motor expenses		XXX	
Stationery		XXX	
Rent received			XXX
		XXXX	XXXX

1.4.6 Reporting of financial information (financial statements)

At the end of an accounting period (week, month, or year), the financial results of the business, along with the financial position of the business, are reported. These reports are a summary of the accounting transactions for the period concerned. This reporting is usually done in the form of financial statements.

The financial statements reveal the total profit or loss made during the period, as well as the asset and liability position of the entity. As alluded to earlier in this topic, for purposes of this module we will focus on the Statement of Profit or Loss and Other Comprehensive Income and the Statement of Financial Position.

The Statement of Profit or Loss and Other Comprehensive Income

At this stage, we are only looking at the Statement of Profit or Loss and Other Comprehensive Income as the next stage of the bookkeeping process. Once we have completed our trial balance and are certain that total debits and total credits are equal, we are able to prepare the Statement of Profit or Loss and Other Comprehensive Income. This statement reflects the results of the trading activities of the business.

The profit of the business is equal to the total income earned less all the expenses incurred when generating the income. If total income exceeds total expenses, then the business will report a profit for the period. If the expenses exceed the income, then a loss will be reported. Therefore, all general ledger accounts that relate to the income and expenses of the business are posted to the Statement of Profit or Loss and Other Comprehensive Income.

PROFIT = INCOME – EXPENSES

The Statement of Profit or Loss and Other Comprehensive Income is often referred to as the 'FINANCIAL HISTORY BOOK' of a business. This is because anything that appears in the Statement of Profit or Loss and Other Comprehensive Income has already happened. All the income reflected has already been earned, although not necessarily received, over the past period and all the expenses (salaries, rent, interest paid, etc.) have already been incurred, although not necessarily paid.

The Statement of Financial Position

The Statement of Financial Position shows, at a particular date, what assets are owned by the business and what is owed by the business, in the form of equity and liabilities (remember the accounting equation above.)

You will recall that any general ledger accounts dealing with income or expenses are transferred to the Statement of Profit or Loss and Other Comprehensive Income. What then remains are the assets, liabilities, and capital accounts. The profit/loss figure generated by the Statement of Profit or Loss and Other Comprehensive Income must be added to/subtracted from the owner's equity.

Assets are recorded on the one side of the Statement of Financial Position while equity and liabilities are recorded on the other side. The total of the assets must equal the total of the equity and liabilities. This means that the Statement of Financial Position must balance.

ASSETS = EQUITY + LIABILITIES

or

EQUITY = ASSETS – LIABILITIES

The Statement of Financial Position is often referred to as the 'FINANCIAL SNAPSHOT'. This is a picture of the business frozen in a moment in time, because what appears in the Statement of Financial Position is a reflection of the business at that instant. It does not (and cannot) show what happened to the business the moment before, or what will happen the moment after the Statement of Financial Position was drawn up.

1.4.7 Analysis and interpretation (ratios)

Users of financial statements study and analyse the information contained therein in order to formulate an opinion on the financial performance and condition of the business. The profit and loss is considered in relation to the activity of the business (sales) and the money invested (assets or equity). This is generally called **ratio analysis**.

Based on the analysis of financial information, decisions can be made that seek to bring about improvements to the financial results and the financial position of the business in future periods.

A decision may be made to change suppliers, change products sold or even to close shop. As such, decisions affect future periods, and therefore future transactions are also affected.

Before continuing with this topic, please complete the following activity.

Activity

1. Draw a diagram of the accounting cycle.

2. Select a word in column B that matches the description in column A.

A		B	
a)	Drawn up after the trial balance	(i)	Trial balance
b)	Summary of assets and liabilities on a specific date	(ii)	Journals
c)	Summary of account balances and totals to check if the double-entry principle has been correctly applied	(iii)	General ledger
d)	First books used to record transactions	(iv)	Statement of Profit or Loss and Other Comprehensive Income
e)	Recorded transactions from source documents	(v)	Statement of Financial Position
f)	Identify a profit/loss for the period		
g)	Posted total of journals to the different accounts		

3. Circle the correct answer:

3.1 A person or business that owes you money is called a:
a) Trade debtor
b) Trade creditor

3.2 A person or business to whom you owe money is called a:
a) Trade debtor
b) Trade creditor

3.3 The first place where transactions are recorded from source

documents is called the:
a) General ledger
b) Journal

3.4 Bookkeeping is based on the principle of:
a) double-entry.
b) income and expenses.

3.5 Source documents are used to:
a) record transactions in the general ledger.
b) journalise transactions.

4. The totals of the two columns in the trial balance may be equal but that may not necessarily mean that all is in order. What types of mistakes, if any, cannot be revealed by the trial balance?

With an overall grasp of the module, you will be able to understand:

- the overriding principles that govern the gathering, recording and processing of financial information.
- how to record this information in the bookkeeping process.
- the flow of a transaction from when you begin to enter information in the accounting records.
- how to summarise the year's records in the financial statements.

As mentioned, the flow of a transaction and the formal recording process occur in a specific framework and are known as the 'accounting cycle'.

1.5 THE CONCEPT OF DEBITS AND CREDITS

You may ask the question: 'So what is a DEBIT and what is a CREDIT?'

You will, of course, have come across these terms before, but do you know what they mean in accounting terms?

All transactions can be translated into debits and credits. The conventional general ledger account is normally presented in the T-format, with the debit on the left and the credit on the right. This left and right practice is merely a convention, but a very important one that must be memorised.

GENERAL LEDGER ACCOUNT

Debit side (Dr)	Credit side (Cr)

Remember from the example above: every transaction has at least two elements:

1. Something is received (e.g. jeans)
2. Something is given out (e.g. money).

The something that is received translates into the DEBIT entry, while the something that is given out translates into the CREDIT entry.

GENERAL LEDGER ACCOUNT

Debit entry 'received' (Dr)	Credit entry 'given out' (Cr)

Let us now go back to the example of buying jeans:

Figure 1.5 The debit and credit concept

JEANS were received by YOU in exchange for cash. This is a DEBIT entry to INVENTORY (the jeans were bought for sale).

CASH was given out by YOU in exchange for the jeans. This is a CREDIT entry to CASH (bank).

Please take note that the double-entry concept has been applied:

GENERAL LEDGER ACCOUNT

Debit entry 'received'	**Credit entry 'given out'**
Inventory	Cash
R195	R195
(Dr)	**(Cr)**

An entry on the debit side (i.e. the left) is called a debit entry, and an entry on the credit side (i.e. right) is called a credit entry. The process of making an entry on the debit side (i.e. left) is referred to as **debiting** the account, while the process on the credit side (i.e. right) is called **crediting** the account.

Unfortunately, in accounting, we cannot simply say that a debit or a credit increases or decreases the balance of an account. It is more complex than that. The term 'debit' or 'credit' merely refers to an entry on the left- or right-hand side of the general ledger account. The balances of certain accounts **increase** when debited, while the balances of other accounts **decrease** when debited. The effect on the account depends on whether the account is an asset account, a liability account, a capital account, an income account, or an expense account.

We need to refer back to the basic accounting equation and the Statement of Financial Position, which was discussed extensively earlier in this topic.

A Statement of Financial Position is **<u>always</u>** in balance. The left-hand side **<u>always</u>** equals the right-hand side.

ASSETS	=	OWNER'S EQUITY	+	LIABILITIES
(Left)		(Right)		(Right)
DEBIT		CREDIT		CREDIT

- The balance (b/d) of an account generally appears on the same side as that on which the item appears in the accounting equation above.
- The balance of an account increases when an entry is made on the same side as that on which the item appears in the accounting equation above.
- The balance of an account decreases when an entry is made on the opposite side to that on which the item appears in the accounting equation above.

Note

Remember: if you debit a basic debit account, it will increase. If you credit a basic debit account, it will decrease.

Vice versa: if you credit a basic credit account, it will increase. If you debit a basic credit account, it will decrease.

From the diagram above, we can conclude that:

- **Asset accounts** should have debit balances (i.e. left). Increases would result from debit entries.

- **Owner's equity accounts** should have credit balances (i.e. right). Increases would result from credit entries.

- **Liability accounts** should have credit balances (i.e. right). Increases would result from credit entries.

By now, we know that owner's equity increases when a profit occurs.

Owner's equity (Credit balance)	=	Capital invested	+	Retained Earnings (Profit)
Profit (Credit balance)	=	Income (Credit)	−	Expenses (Debit)

From this, we can deduce that income items (which increase owner's equity) should have credit balances and increases would result from credit entries. Expense items (which reduce owner's equity) should have debit balances and increases would result from debit entries.

The above can be summarised graphically as follows:

Assets (balance = debit)		=	Owner's equity (balance = credit)		+	Liabilities (balance = credit)	
DR	CR		DR	CR		DR	CR
+ Increase	− Decrease		− Decrease	+ Increase		− Decrease	+ Increase

Expense accounts (Balance = debit)			Income accounts (Balance = credit)	
DR	CR		DR	CR
+ Increase	− Decrease		− Decrease	+ Increase

Please remember that each transaction affects at least two accounts: one debit and one credit of equal value. In order to process the transaction into the accounting records, the following two steps need to be performed:

The IT rule: I = identify; T = translate

Note

First, identify which two accounts are affected by the transaction.

Then, determine from the rules above which account is to be debited and which account is to be credited (i.e. translate into debits and credits).

Example:

Goods sold for R500 cash.

a) Identify the two accounts: SALES and BANK.

b) Translate into debits and credits: Which account is debited and which account is credited?

Money has been received by the business from the customer. This is a DEBIT entry to the bank account.

Sales (i.e. goods) have been given out to the customer. This is a CREDIT entry to the sales account.

From the rules above, we can determine that INCOME (i.e. sales) is increasing, which is a CREDIT entry, while the ASSET account (i.e. bank) is also increasing, which is a DEBIT entry.

The journal entry

This transaction will be recorded in the cash receipts journal and posted to the general ledger accounts as follows:

	Debit	Credit
Bank account (asset)	R500 (received)	
Sales (income)		R500 (given out)

BANK ACCOUNT
R500

<u>Received (DEBIT)</u> ⇑

YOU

<u>Given out (CREDIT)</u> ⇓

SALES
R500

Figure 1.6 The concept of a journal entry

Example:

Goods bought on credit from Cheap Suppliers cc for R100.

1. **Identify the two accounts**:
   Because the word 'credit' appears in the sentence, this means that the goods have been bought, but not yet paid for. As the business had bought the goods, Cheap Suppliers cc will be its TRADE CREDITOR (i.e. the business owes them money).

   The two accounts are:
   INVENTORY and **TRADE CREDITORS (Cheap Suppliers cc)**

2. Which is **debited** and which is **credited**?

   Inventory (goods) has been received from the supplier. This is a **DEBIT entry** to the **'inventory' account**. Inventory is a basic debit account. Review Table 1.1.

The goods have been bought on credit. This means you have not yet paid for the goods. The question is: what has been given out by you? The trade creditor, Cheap Suppliers cc, has allowed you to pay later, so it is essentially funding your business.

It has provided you with the money to buy the goods. What you have given out is an acknowledgement of a liability to repay it. The provision of finance (liability to repay) was given out by you to your trade creditor. This is a CREDIT entry to the trade creditors account. Liabilities are basic credit accounts.

From the above rules, we can determine that inventory is increasing, which is a DEBIT entry. The LIABILITY account (creditor) is also increasing, which is a CREDIT entry.

The journal entry

This transaction will be recorded in the creditors journal and posted to the ledger as follows:

	Debit	Credit
Inventory	R100 (received)	
Trade creditors (Cheap Suppliers cc)		R100 (given out)

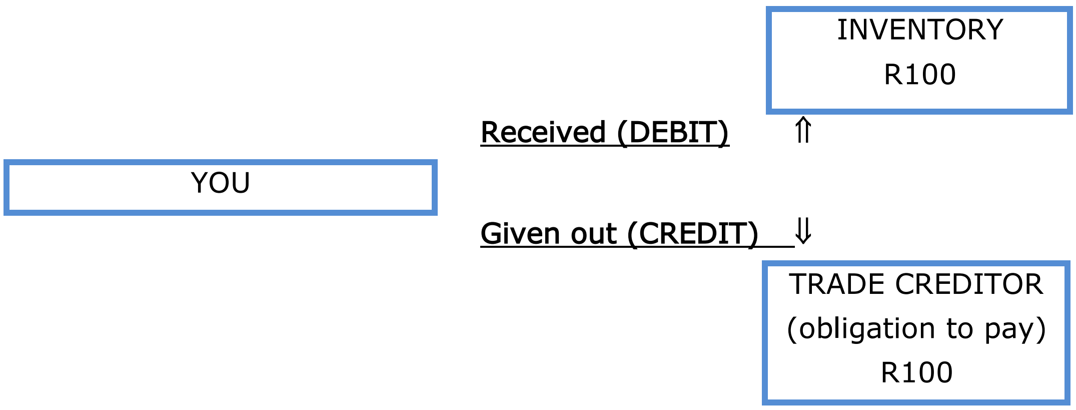


Figure 1.7 The recording of a journal entry

Before continuing with this topic, complete the following activity.

Activity

Identify the two accounts that are affected by each of the following transactions:

1. ABC Stores paid salaries to its employees of R45 000.
2. The company bought office equipment from an overseas supplier at a cost price of R150 000.
3. Sold inventory on credit for R6 500.

For each of the transactions above, prepare the journal entry to illustrate the double-entry principle.

Make sure that you understand what is meant by the double-entry principle. For every transaction that needs to be recorded, at least two entries are required in different accounts in the general ledger. This means one entry on the debit side and another on the credit side.

1.6 EFFECTS OF TRANSACTIONS ON THE FINANCIAL POSITION (ACCOUNTING EQUATION)

1.6.1 Accounting equation

Accounting is built on the foundation of the double-entry principle. For every transaction that is entered in the general ledger of a business, there will be a debit entry and a credit entry. The amount that appears on the source document will therefore be reflected as the same amount on both the debit and credit side of the two different general ledger accounts.

It is then necessary to see the influence of such a transaction on the accounting equation. Remember the following:

- **Asset accounts** normally have debit balances. Any entries on the debit side would result in an increase in the asset.
- **Liability accounts** normally have credit balances. Any entries on the credit side would result in an increase in the liabilities.
- **Capital accounts** have credit balances. Any entries on the credit side would result in an increase in the owner's equity.

- **Income accounts** have credit balances. Any entries on the credit side would result in an increase in the income account.
- **Expense accounts** normally have debit balances. Any entries on the debit side would result in an increase in the expense.

In all of the above, we have used terms such as 'assets', 'liabilities', 'capital', 'income', and 'expenses', but we have not yet come to grips with these terms. We have even briefly mentioned the treatment of assets, liabilities, capital, income, and expenses. Let us now look at these items in more detail.

1.6.2 Assets

Assets are resources controlled by the business as a result of past events, from which future economic benefits are expected to flow to the business. They include items of value owned by the business (such as cash, money in the bank, and equipment). Assets also include items owing to the business (such as trade receivables). They are used, consumed or sold by the business in order to create additional value by earning net income. Other examples of assets include land, inventory for resale, and consumable stores on hand (stationery, cleaning materials, and packing materials). There are two types of assets:

- **Non-current assets**: land, equipment, and motor vehicles, etc. not intended for resale.
- **Current assets**: inventory (i.e. stock), trade receivables (i.e. debtors), cash and cash equivalents (i.e. petty cash, cash float, etc.).

The question to ask yourself when deciding whether something is an asset or not is, can I sell this item for money? If the answer is 'yes', then that 'something' is an asset. An asset is acquired if the 'something received' has an enduring benefit. An <u>enduring benefit</u> means that the value paid has not been completely consumed during the period concerned.

So far, we have deduced the accounting treatment of asset accounts from the basic accounting equation:

ASSET ACCOUNTS
(Balance = Debit)

Dr	Cr
+ Increase	– Decrease

Note

It is important to remember that:

1. All asset accounts have DEBIT balances.
2. To increase an asset account, DEBIT the asset account.
3. To decrease an asset account, CREDIT the asset account.

Let us now look at the effect of asset transactions on the accounting equation:

Example:

Lion Fred's cc buys a computer for R5 000 cash. The impact on the accounting equation is as follows:

ASSETS	= OWNER'S EQUITY	+ LIABILITIES
Increase in computers (assets)	= No effect	No effect
Decrease in bank (assets)		
(+R5 000) − (−R5 000)	= 0	+ 0
0	= 0	+ 0

No effect on owner's equity and liabilities. Total assets remain unchanged; one asset was merely exchanged for another.

Example:

Lion Fred's cc exchanges a computer (which was valued at R3 000 in their accounting records) for cash. The impact on the accounting equation is as follows:

ASSETS	= OWNER'S EQUITY	+ LIABILITIES
Increase in bank	= No effect	No effect
Decrease in computers		
+ R3 000 − R3 000	= 0	+ 0
0	= 0	+ 0

No effect on owner's equity and liabilities. Total assets remain unchanged; one asset was merely exchanged for another.

The situation would be different if the computer was bought on credit, but it still would not affect equity.

Example:

Lion Fred's cc buys a computer on credit for R5 000. The impact on the accounting equation is as follows:

ASSETS	= OWNER'S EQUITY + LIABILITIES	
Increase in computers	= No effect	Increase in creditors
+ R5 000	= 0	+ R5 000

No effect on owner's equity. An increase in assets was offset by an increase in liabilities.

Example:

Lion Fred's cc disposes of a computer valued at R3 000 to a debtor. The impact on the accounting equation is as follows:

ASSETS	= OWNER'S EQUITY + LIABILITIES	
Increase in debtors	= No effect	No effect
Decrease in computers		
+ R3 000 − R3 000	= 0	+ 0
0	= 0	+ 0

No effect on owner's equity and liabilities. Total assets remain unchanged; one asset was exchanged for another.

1.6.3 Liabilities

A liability is a present obligation of an entity to transfer assets (usually by paying money) or to provide services to another entity in the future because of past transactions or events. Liabilities therefore represent claims against the assets of a business. These obligations will mainly be in respect of entities from which the business borrowed money, such as banks and other financial institutions, or entities from which it obtained credit, such as suppliers of goods or services. Earlier, we saw the accounting treatment of liability accounts from the basic accounting equation:

LIABILITY ACCOUNTS
(Balance = Credit)

Dr	Cr
− Decrease	+ Increase

Note

It is important to remember that:

1. All liability accounts have CREDIT balances.
2. To increase a liability account, CREDIT the liability account.
3. To decrease a liability account, DEBIT the liability account.

Let us now look at the effect of liability transactions on the accounting equation:

Example:

Lion Fred's cc buys a computer on credit of R15 000. The impact on the accounting equation is as follows:

ASSETS	**= OWNER'S EQUITY + LIABILITIES**	
Increase of assets	= No effect	Increase in loan
+ R15 000	= 0	+ R15 000

No effect on owner's equity. An increase in assets was offset by an increase of liabilities.

Example:

Lion Fred's cc repays the loan of R15 000. The impact on the accounting equation is as follows:

ASSETS	**= OWNER'S EQUITY**	**+**	**LIABILITIES**
Decrease of bank	= No effect		Decrease in loan
− R15 000	= 0	+	− R15 000

No effect on owner's equity. A decrease in assets was offset by a decrease in liabilities.

Be careful not to confuse the cost of the loan with the loan itself. The **interest** on the loan **does** affect equity (refer below), but the loan itself does not.

1.6.4 Income

Income would be the value that has been **earned** in the current year, in **exchange** for goods sold, services rendered, or for placing assets at the disposal of third parties.

Earlier, we deduced the accounting treatment of income accounts from the basic accounting equation:

INCOME ACCOUNTS
(Balance = Credit)

Dr	Cr
− Decrease	+ Increase

Note

It is important to remember that:

1. All income accounts have CREDIT totals.
2. To increase an income account, CREDIT the income account.
3. To decrease an income account, DEBIT the income account.

Let us now look at the effect of income transactions on the accounting equation. Owner's equity can be calculated as follows:

OWNER'S EQUITY = CAPITAL + RETAINED PROFIT
= CAPITAL + INCOME − EXPENSES − DRAWINGS

Therefore, if an income account is increased, then <u>owner's equity</u> will increase, and if an income account is decreased, then <u>owner's equity</u> will decrease.

Example:

Lion Fred's cc sells goods for R17 000 on a cash basis. The impact on the accounting equation is as follows:

ASSETS	=	OWNER'S EQUITY	+	LIABILITIES
Bank increases	=	Sales increase		No effect
+ R17 000	=	+ R17 000	+	0

No effect on liabilities. A cash sale increases cash in the bank and owner's equity. Later on we will take into account the effect of a sale on inventory (asset) and cost of sales (expense).

1.6.5 Expenses

Expenses are the costs of assets consumed (i.e. used up) and the services used in order to earn revenue. Expenses may also be described as resources sacrificed in order to earn revenue. The resource sacrificed will be the cost of the asset consumed or the service used. Examples of expenses include electricity, salaries, depreciation, telephone, and cost of goods sold. Expenses are basic debits.

Earlier, we explored the accounting treatment of expense accounts from the basic accounting equation:

EXPENSE ACCOUNTS
(Balance = Debit)

Dr	Cr
+	–
Increase	Decrease

Note

It is important to remember that:

1. All expense accounts have DEBIT totals.
2. To increase an expense account, DEBIT the expense account.
3. To decrease an expense account, CREDIT the expense account.

Let us now look at the effect of expense transactions on the accounting equation. From the owner's equity equation above, it is clear that an increase in expenses causes owner's equity to decrease and a decrease in expenses causes owner's equity to increase.

Example:

Lion Fred's cc pays wages of R2 000. The impact on owner's equity is as follows:

ASSETS	**=**	**OWNER'S EQUITY**	**+**	**LIABILITIES**
Bank decreases	=	Expenses increase		No effect
− R2 000	=	− R2 000	+	0

No effect on liabilities. The payment of salaries reduces cash in the bank, which is an asset, and increases expenses, which have the effect of reducing equity.

1.6.6 Assets versus expenses

From the preceding notes, answer the following questions:

1. What balance does an asset account have? ______________
2. What balance does an expense account have? ______________
3. What would be the effect on owner's equity of each of the following situations?
   - Decrease and increase in an asset account ________________
   - Increase in an expense account __________________________

Even though both asset and expense accounts have debit balances, their effect on owner's equity is entirely different. An increase or decrease in an asset account has no effect on owner's equity, while an increase or decrease in an expense account results in a decrease or increase in owner's equity.

The difference between an asset and an expense is, basically, that an asset has an enduring benefit. This means that the value paid has not been consumed. An example of this could be the purchase of a computer for R15 000. The computer is not consumed by the entity in the operation of its business and provides an enduring benefit.

An expense, on the other hand, is an expenditure on an item that does not provide an enduring benefit, because it is consumed by the entity. An example of this is the payment of rental. The rental for which the business is paying is for the occupation of the premises, which has been consumed by the business. There is no enduring benefit provided by the payment of the rental.

Note

Expense	=	value that has **been consumed**.
Asset	=	value that has **not been consumed** (it could be used over several accounting periods). Something **owned** by the business.
Consumption	=	**value diminished** due to reduced market value.

1.6.7 Liabilities versus income

From the preceding notes, answer the following questions:

1. What balance does a liability account have? ___________
2. What balance does an income account have? ___________
3. What effect would the following have on owner's equity?
   - Increase in a liability account: _________________
   - Increase in an income account: ________________

Although both types of accounts have credit balances, the effect on owner's equity is entirely different, depending on whether the account is a liability or an income. An increase in an income account results in an increase in owner's equity.

It is very important to differentiate between the two types of accounts. They both originate from the 'giving out' of something by the business, for which money (or value) is received in return. This money (or value) represents either income or a liability, depending on the details of the transaction.

Income would be value that has been earned in the current year in exchange for goods sold, services rendered, or for placing assets at the disposal of third parties.

A liability, on the other hand, is debt owed by the business to someone else. Nothing has been earned. The full amount received is owed (i.e. it must be given back) to the person from whom the money (or value) came. The liability has financed the business. It has been used to increase the assets. It <u>must</u> therefore have a credit balance.

This can be summarised as follows:

Income	=	value that has **<u>been earned</u>**.
Liability	=	value that has **<u>not been earned</u>**. Something **<u>owed</u>** by the business to others.

The following table summarises the previous points:

Table 1.11 Summary of assets, liabilities, income, and expenses

Effect on equity	Debit balances	Credit balances
Assets have no effect on equity. Increases in income result in owner's equity increasing.	**<u>ASSETS</u>** • Land and buildings • Office equipment • Office furniture • Computer equipment • Motor vehicles • Bank balance • Petty cash • Trade debtors • Inventory	**<u>INCOME</u>** • Sales • Fees earned • Rent received • Commission received • Interest received
	Debit balances	**Credit balances**
Increases in expenses result in owner's equity decreasing. Liabilities have no effect on equity.	**<u>EXPENSES</u>** • Salaries and wages • Rent paid • Advertising • Electricity and water	**<u>LIABILITIES</u>** • Bank loans • Mortgage bond • Bank overdraft • Trade creditors

You should be able to identify and define the following terminology:

- Income
- Expenses
- Profit
- Loss
- Assets
- Liabilities.

You should now be able to:

- explain the influence of this terminology on the gathering of information for the bookkeeping process.
- determine and understand the influence of each entry on these accounts. (Will it increase/decrease or have no influence?)

A thorough understanding of the accounting equation must be displayed at this stage.

1.6.8 Capital

Capital is the contribution made by the owners of the business to the business. If the business is a company, we call the capital the 'share capital'. When the business is a close corporation (where still operating), it is called 'members' contribution'.

The owners put capital into the business to get the business up and running. Capital does not have to be cash only. An owner may contribute a building or furniture to the business. This will still be recorded as a contribution of capital.

When the owner contributes capital, remember the business entity concept: the owner must be kept separate from the business. This means that any contribution of capital by the owner is owed back to the owner of the business.

In many respects, CAPITAL can therefore be seen as a LIABILITY of the business. As such, capital is OWED by the business to the owners. We will, however, refer to capital as capital, and not as a liability, although both have credit balances.

Note

- Capital accounts have credit balances.
- To increase a capital account, use a credit entry.
- We do not reduce capital accounts because:
    a) it is generally not allowed for companies.
    b) for sole proprietors and partnerships, we DEBIT an account called DRAWINGS for anything that the owner takes out of the business.

You should now be able to identify and define what is meant by the terms 'capital' or 'owner's equity'.

1.6.9 The effect of transactions on the financial position

Remember, for each transaction there must be two entries:

1. Something **received**
2. Something **given out**.

We will now look at the impact of various double-entry transactions on the financial position of a business.

Transactions usually fall into two categories:

1. Those that have no impact on profit/loss and therefore no effect on owner's equity (i.e. only affect assets and liabilities)
2. Those that do affect profit/loss and therefore have an effect on owner's equity.

1.6.10 Transactions that do not affect profit/loss

These are:

EITHER: an increase in an asset and an equal increase in a liability, such as purchasing a computer and borrowing money (i.e. a loan) from the bank to pay for it.

OR: a decrease in an asset and an equal decrease in a liability. For example, selling an old computer and using the money received to pay off a loan. NOTE: We are assuming that the computer is not sold at a profit or a loss.

OR: one asset decreases, while another asset increases by an equal amount. For example, withdrawing money from your bank account and buying a computer.

OR: one liability item decreases, while another liability increases by an equal amount. For example, paying off trade creditors through a bank overdraft.

In all the examples above, owner's equity is unaffected.

1.6.11 Transactions that affect profit/loss (owner's equity)

These are:

EITHER: an increase in an asset and an equal increase in equity. For example, the bank account increases through the interest earned on a positive balance.

OR: a decrease in an asset and an equal decrease in equity. For example, spending money (bank) on paying a telephone account (expense).

OR: a decrease in equity and an equal increase in liability. For example, paying for rent (expense) through a bank overdraft (liability).

In all of the examples above, the owner's equity either increases or decreases.

You should be able to describe and understand the influence of the following items on the financial position of an enterprise:

- **Assets**
  - Non-current assets
  - Current assets.
- **Liabilities**
  - Non-current liabilities
  - Current liabilities.
- **Equity**
  - Capital
  - Income
  - Expenses
  - Drawings.

Summary

Accounting is a system whereby inputs, transactions and adjustments are processed in order to produce outputs (i.e. financial statements). This topic covered the Statement of Profit or Loss and Other Comprehensive Income, which reports the financial results of a business for a certain period, as well as the Statement of Financial Position, which reports the financial health of a business at a specified point in time. These statements are presented for a predetermined period of time, which is referred to as the financial year of the business.

You should also have gained insight into the various types of business entities and their financial periods. In this module, we will be concentrating on sole proprietors and companies.

The five elements of accounting, namely, income, expenses, equity, liabilities, and assets were covered in this topic. All business transactions can be classified into these five elements of accounting. The effect of business transactions on the five elements was explored by means of the accounting equation. According to the accounting equation, assets should always be equal to equity and liabilities.

The accounting cycle was also covered in this topic. The accounting cycle represents a sequence of steps followed from the moment transactions occur to the moment when financial statements are prepared. Details of transactions are first captured on source documents before being recorded in various journals. From the journals, the transactions are then posted to the general ledger, from which the trial balance is extracted. The trial balance is then used to draw up financial statements.

As you would have learnt in this topic, it is vital that you understand the influence of the double-entry system on the accounting equation. The double-entry principle requires that, for every debit entry, there should be a corresponding credit entry. The correct application of the double-entry principle ensures that the accounting equation always holds and that the trial balance balances.

Self-Assessment Questions

Multiple-choice questions

1. What does the Statement of Profit or Loss and Other Comprehensive Income of a business reflect?
   a) It reflects the financial position and the trading results of a business over a period of time (e.g. a month or a year).
   b) It reflects the financial result and the trading results of business over a period of time (e.g. a month or a year).
   c) It reflects the financial position and the net increase or decrease in owner's equity as at a given date (e.g. one day in a year).
   d) It reflects financial results and the net increase or decrease in owner's equity as at a point in time (e.g. one day in a year).

2. What does the Statement of Financial Position of a business reflect?
   a) It reflects the financial position and the trading results of a business over a period of time (e.g. a month or a year).
   b) It reflects the financial result and the trading results of a business over a period of time (e.g. a month or a year).
   c) It reflects the financial position and the net increase or decrease in owner's equity as at a given date (e.g. one day in the year).
   d) It reflects the financial result and the net increase or decrease in owner's equity as at a given date (e.g. one day in a year).

3. Which items will <u>**not**</u> be reflected on a Statement of Financial Position?
   a) Non-current assets
   b) Inventory
   c) Expenses
   d) Bank overdraft.

4. Which items will <u>**not**</u> be reflected on a Statement of Profit or Loss and Other Comprehensive Income when using the perpetual inventory system?
   a) Inventory
   b) Revenue
   c) Expenses
   d) Cash on hand.

5. Which items will **not** be reflected on a cash flow statement?
   a) Depreciation
   b) Salaries
   c) Bank charges
   d) Interest paid.

6. If assets equal R32 000 and liabilities equal R22 000, how much is owner's equity?

7. If assets equal R45 000 and owner's equity R33 000, how much are liabilities?

8. A business has assets of R60 000, liabilities of R15 000, and the owner's equity (excluding capital contribution by the owner during the year) of R25 000. What amount did the owner contribute?

9. A business records the following movements of cash during March 20XX:

Receipts:		
For cash sales during March	R	18 000
For credit sales during February	R	4 500
As deposits on future sales	R	1 200
Payments:		
For assets bought during March	R	8 000
For expenses incurred during March	R	11 000
For expenses incurred, but not paid for during February	R	5 500

Required:

Determine the income, expenses, and net profit that would be shown in the Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 March 20XX.

10. The records of a business reflect an amount of R23 000 for owner's equity at 28 February 2023. The business commenced trading on 1 March 2006. During the year, the owner contributed cash of R20 000. He subsequently withdrew R8 000.

Determine the profit made by the business during the year.

11. The bookkeeping records of a new business are destroyed by a fire shortly before the financial year-end, 31 December 20XX. The bookkeeper is able to reconstruct the following figures as at that date:

    Trade receivables, R22 000; trade payables, R14 000; motor vehicles, R26 000; cash, R3 500; loan from bank, R10 000; net profit, R8 500.

    Determine the amount of cash contributed by the owner during the year.

12. The following are some examples of typical business transactions:

    a) Purchases of office equipment on credit, R65 000
    b) The owner contributes money to the business, R200 000
    c) Purchases of office furniture for cash, R4 000
    d) Collection of amounts from trade receivables, R2 500
    e) Payments to accounts payable, R1 200
    f) The return of certain office equipment previously purchased on credit, R5 000.

    Show the effect of the transactions above in the accounting equation of the entity.

Topic 2

Journal entries: Books of first entry

2.1 INTRODUCTION

This topic relates to the following module outcome:

3. Prepare journal entries.

As you can imagine, it will be impossible for a large business organisation to record every single transaction in a general ledger account. There would just be too many entries. That is why the books of first entry are used to group specific types of transactions together.

You would recall from the previous topic, when we looked at the accounting cycle, that all transactions that need to be recorded from source documents will be recorded in the books of first entry. Think of all the cash sales that are made by a large supermarket on a daily basis. They will be captured in a cash receipts journal. If these sales were made on credit, however, they will be recorded in the debtors' journal.

Each of these books of first entry is referred to as a journal, and all of these journals will be discussed in this topic.

In this topic, you will gain knowledge in the following areas:

1. Introduction to journals
2. The layout of the cash receipts and cash payments journals
3. The layout of the debtors journal
4. The layout of the debtors allowances journal
5. The layout of creditors journal
6. The layout of the creditors allowances journal
7. The layout of the petty cash journal
8. The layout of the general journal.

2.2 INTRODUCTION TO JOURNALS

2.2.1 Different types of journals

Before you can start capturing transactions in the different journals, it is important to realise that all entries must be made from relevant source documents.

Journals are also known as books of first entry. The purpose of journals is to keep track of transactions during a specific month. The entries in the journals will then be posted to the general ledger at month-end.

There are eight commonly used journals:

Journal	Transactions recorded	Abbreviation
Cash receipts journal	Cash received	CRJ
Cash payments journal	Cash payments	CPJ
Creditors journal	Goods purchased on credit	CJ
Creditors allowances journal	Returns outwards of goods previously purchased on credit	CAJ
Debtors journal	Sales made on credit	DJ
Debtors allowances journal	Returns inwards of goods previously sold on credit	DAJ
Petty cash journal	Small amounts of expenses paid in cash	PCJ
General journal	All other types of transactions that are not captured in any of the above journals	GJ

These journals are a chronological record of all the transactions undertaken by the business. They are the link between the source documents and the general ledger accounts.

If a query is raised on an entry in the general ledger, the user must inspect the relevant journal in order to resolve the query or to identify the relevant transaction that led to the entry in the general ledger.

Note

Please note that, although there are different types of journals, the following minimum information should be contained in each journal entry:

- Source document number
- Date of the transaction
- Details of the other party to the transaction
- The general ledger accounts affected by the transaction
- A short description (narration) of the transaction, in the case of a general journal.

With modern-day data-storage capabilities and the advent of fully integrated computer systems, the information that is stored per transaction is increasing rather than decreasing. This is more reason for a structured journal system, rather than an **ad hoc system**.

Take the example of Pick n Pay: let us use the cash sales for one day, and this includes debit cards, credit cards, and cash. The system could be set up to drill down to a single transaction in the event of a rejected credit card transaction, or even counterfeit cash in the banking system. With modern systems, sales can be drilled down to the specific pay point and even the time of the transaction.

The reason for this discussion is to point out that, with a well-structured database, an excellent 'roll up' of data can be achieved. To accumulate the individual daily sales of milk and bread to the afternoon shift, to the pay point daily total, to the daily store total, to the weekly store total, to the monthly store total, to the region total, to the national total, is possible in a series of journals.

Journals are used to prepare and analyse the general ledger. One last example: it would be easier to review the creditors journal to find the last purchase from ABC Wholesalers than to review the entire creditors control account in the general ledger.

Another benefit of having various journals is that the accounting process can be subdivided into sections. Different people can be assigned responsibility for separate sections of the accounting process. For example, one person can be in charge of sales (i.e. the debtors journal and debtors allowance journal), while another person is in charge of purchases (i.e. the creditors journal and creditors allowances journal), with yet another person in charge of the cash book.

Finally, it should be stressed that the journals discussed here are the common journals. Every firm should decide what to use. For example, if only one credit sale is done for a single client every month, the usefulness of a debtors journal is questionable.

On the other hand, one may decide to open a separate creditors journal for a category of purchases. Examples of this would be a fresh food creditors journal or a processed food creditors journal.

Very few businesses prepare these journals manually. Even the smallest firm can easily afford a simple electronic system. They cost about R1 500 and are extremely user-friendly. However, manual systems form the base of the programming, and a debtors journal is found in all businesses, from the most basic to the most complicated. The manual journals that follow are critical to understanding accounts and accounting.

By now, you should be able to name the different types of journals contained in the table at the beginning of this section.

2.3 THE LAYOUT OF THE CASH RECEIPTS AND CASH PAYMENTS JOURNAL

2.3.1 The layout and workings of the cash receipts and cash payments journal

These two journals are probably the most important journals to any business. Why do you think this is so?

All businesses need cash to operate smoothly. They need sufficient cash inflows in order to meet their cash outflows (i.e. salaries/wages, rent, electricity and water, etc.). It does not matter how profitable a business is, if it does not have the money to pay its debts, the creditors will force the business into liquidation.

The cash journals allow the management to keep a close eye on the business' cash flows and cash requirements. The journals are merely a record of the cash flowing in (i.e. receipts) and out (i.e. payments) of the business.

It can also be said that the two journals are the business' record of its bank account. They should be a mirror image of the business' bank account.

Combined, these two journals are sometimes referred to as the cash book. In practice, the records of the bank are often different from the records of the business. In fact, there are almost always items that differ between the bank records and our cash book. We will review this in detail in a later topic.

2.3.2 The layout of the cash receipts journal and cash payments journal

a) The cash receipts journal records all incoming cash (i.e. receipts), which increases the bank balance.

b) The cash payments journal records all outgoing cash (i.e. payments), which reduces the bank balance. Because the bank account is an asset, when we receive money, the bank account is debited. When we pay money out, the bank account is credited.

This agrees with the rules that we learned earlier.

Debit entry 'Received' (Dr)	Credit entry 'Given out' (Cr)

Let us now look at a working example of transactions that affect these two journals.

Example:

Thirst Quenchers was started in November 20XX by Mr I.M. Dry. The following transactions (including VAT) occurred during the month of November 20XX:

1 The owner opens a current account, deposits R10 000 into the account and makes out receipt 0001 to himself.

2 He makes a payment of R1 140 to City Prop for rent via an electronic funds transfer (EFT) and R6 840 to Makro for cold drinks for resale using the business' debit card.

6 He sells part of the stock above for R4 560, issues receipt 0002.

7 He makes an EFT payment of R500 for the week's wages.

10 He purchases stationery for R570 from CAN using the business' debit card.

12 He makes a sale of R2 280 on credit to AB Store, issues invoice 0001.

14 He pays wages of R500 via an EFT.

18	He borrows from his father-in-law (H.B. Jacobs). He receives R5 000 and issues receipt 0003.
19	He purchases additional cold drinks from Makro for R4 560 using the business' debit card.
21	He makes an EFT payment of R500 for the week's wages.
23	He receives payment from AB Store for R2 280, issues receipt 0004.
25	He withdraws R1 500 for himself from the ATM.
28	He makes an EFT payment of R500 for the week's wages.
29	He makes another sale of cold drinks for R3 420, issues receipt 0005.
30	He makes the following EFT payments: - R1 140 to City Prop for rent - R342 to Telkom for telephone - R456 Tshwane Municipality for rates.

Thirst Quenchers is registered for VAT on the invoice basis.

The first step is to identify which transactions are to be captured in the cash receipts journal, which transactions are to be captured in the cash payments journal and which transactions are not for the cash journals. This is done with relative ease:

1. All receipt numbers related to monies received are recorded in the cash receipts journal.
2. All receipt numbers related to monies paid, all EFT payments, and all cash withdrawals are recorded in the cash payments journal.
3. No other transactions are to be posted in the cash journals.

Go through the transactions above and identify which transactions should be recorded in the cash receipts journal, and which transactions are recorded in the cash payments journal.

Note

Please note that other documents and transactions may also find themselves recorded in these two journals. They include debit orders, bank charges, interest on overdrafts, interest on a positive bank balance, bank facility fees, unpaid debit order fees, and many more. These are outside the scope of this topic but are entries that will appear on our bank statement. We will touch on these later on in Topic 4.

The second step is to identify the accounts affected by each receipt and each payment. All these transactions are cash transactions, so we know that the bank account is one of the accounts affected.

The other accounts affected depend on the specific transaction, and this step can be resolved by reading the text relating to each transaction above.

Please remember that VAT is recorded on an invoice basis. Output VAT arises from cash and credit sales. Therefore, receipts from a debtor will not affect the output VAT account since the VAT would have already been recorded when the credit sale took place.

Similarly, input VAT arises from cash and credit purchases. However, payments to a trade creditor will not affect the input VAT account since the VAT will have already been recorded when the credit purchase took place. Read through the transactions above and identify the accounts affected by each transaction.

As with all the journals, the cash journals are in columnar form. The columns used depend on the needs of the business. The total column is called 'Bank'. From the list of transactions, you will determine which columns are needed. The VAT is currently levied at 15% and is already included in the transactions above. This means that, in order to determine the VAT portion included in the transaction, you multiply the VAT inclusive amount by 15/115 i.e. **VAT = 15/115 × VAT-inclusive amount.**

Table 2.1 Thirst Quenchers cash receipts journal – November 20XX

THIRST QUENCHERS
CASH RECEIPTS JOURNAL – NOVEMBER 20XX
CRJ 01

Doc. no.	Date	Details	Bank (Dr)	VAT (Cr)	Sales (Cr)	Trade debtors (Cr)	Sundries		
							Fol.	Amount	Details
R0001	1	I.M. Dry	10 000					10 000	Capital
R0002	6	Cash sales	4 560	595	3 965				
R0003	18	H.B. Jacobs	5 000					5 000	Loan
R0004	23	AB Store	2 280			2 280			
R0005	29	Cash sales	3 420	446	2 974				
			25 260 c/c	1 041	6 939	2 280		15 000	

Table 2.2 Thirst Quenchers cash payments journal – November 20XX

THIRST QUENCHERS CASH PAYMENTS JOURNAL – NOVEMBER 20XX CPJ 01									
Doc. no.	Date	Details	Bank (Cr)	VAT (Dr)	Inventory (Dr)	Wages (Dr)	Sundries		
							Fol.	Amount	Details
EFT	2	City Prop	1 140	149				991	Rent expense
B/S	2	Makro	6 840	892	5 948				
EFT	7	Cash	500			500			
B/S	10	CNA	570	74				496	Stationery
EFT	14	Cash	500			500			
B/S	19	Makro	4 560	595	3 965				
EFT	21	Cash	500			500			
B/S	25	I.M. Dry	1 500					1 500	Drawings
EFT	28	Cash	500			500			
EFT	30	City Prop	1 140	148				992	Rent expense
EFT	30	Telkom	342	45				297	Telephone
EFT	30	Tshwane	456	59				397	Rates and taxes
			18 548 c/c	1 962	9 913	2 000		4 673	

Note

Please note that the transaction on the 12th, the sale of R2 280 on credit to AB Store (invoice 1), does not affect either of the cash journals. It is a credit transaction, with no cash inflow or outflow.

Also, all transactions above are VAT inclusive.

2.3.3 Month-end procedures

At the end of each month, all of the columns in the cash receipts journal and the cash payments journal are added up (vertically). All items appear in both the bank column and analysis columns. To double-check the arithmetic, add the totals across (horizontally). This is called a 'cross-cast' (shown as c/c above).

Explanation of the columns

The columns in the cash journals are self-explanatory. The Details column normally records the party being receipted (CRJ), paid (CPJ/PCJ), the customer (DJ/DAJ), or the supplier (CJ/CAJ), depending on the journal being used. Rent paid would normally be the name of the landlord, and purchases would be the name of the supplier. Sales and purchases are normally VAT inclusive; as such, the VAT-exclusive amount is recorded in the Sales or Inventory (or Sundries column depending on what was purchased) column and the VAT component is recorded in the VAT column.

Accounts that are debited or credited regularly will need their own dedicated column (e.g. bank, sales, inventory, VAT, trade debtors, and trade creditors). Accounts that are not debited or credited regularly are often relegated to the Sundries column. The Sundries column is split into the Amount and Details columns. The Amount column records the VAT-exclusive amount (assuming the transaction includes VAT) while the Details column records the name of the account to be debited or credited.

Before continuing with this topic, complete the activity.

Activity

Complete the cash journals (i.e. the cash receipts journal and the cash payments journal) for the following business:

Sole Trader cc, a computer store, records VAT on the invoice basis. The following transactions were recorded during the month of December 20XX:

Date	**Transactions**
2	Sold computer goods worth R3 363 (receipt 00562).
7	Paid wages of R1 000 (EFT).
10	Bought computer equipment for R5 700 on credit from IMB (invoice 2569).
11	Sold computer goods worth R5 928 (receipt 00563).
13	Received payment of R5 430 from I. Nerd, a trade debtor (receipt 00564).
14	Paid wages of R1 000 (EFT).
17	Paid Macrohard Software R6 441 for goods purchased (debit card).
21	Paid wages of R1 000 (EFT).
25	Made EFT payments for the following:

-	R570 to Telkom for telephone
-	R1 368 to Zwasi Properties for rental
-	R228 to ABZ for Office refreshments
-	R6 270 IMB (creditor).

29 Sold computer goods worth R6 612 (receipt 00565).
30 Received R150 interest earned on the bank account (receipt 00566).
30 Received R7 410 from R. Games, a trade debtor (receipt 00567).

All the transactions above are inclusive of VAT where VAT is applicable.

SOLE TRADER CC
CASH RECEIPTS JOURNAL – DECEMBER 20XX
CRJ 01

Doc. no.	Date	Details	Bank (Dr)	VAT (Cr)	Sales (Cr)	Trade debtors (Cr)	Sundries		
							Fol.	Amount	Details

SOLE TRADER CC
CASH PAYMENTS JOURNAL – DECEMBER 20XX
CPJ 01

Doc. no.	Date	Details	Bank (Cr)	VAT (Dr)	Inventory (Dr)	Wages (Dr)	Sundries		
							Fol.	Amount	Details

2.3.4 Practical application

The combined cash receipts and payments journals, i.e. the cash book, are updated frequently. In fact, a good control system would demand daily postings and daily bank statement reconciliations. Two of the main reasons for this regular process are cash planning and fraud control.

Cash planning: when cash is monitored closely and large payments are made or received regularly, an additional day in the bank account could mean lost income from interest. For example, the treasury manager needs to monitor cash balances every day. Companies often have restrictions on the amount of cash they may (upper limits) or must (minimum levels) hold. These levels are advised to the treasury manager who then places trades to generate or consume cash.

Cash received from debtors is often paid into the business' bank account. The debtors controller becomes aware that a payment has been received when the cash receipts clerk captures the cash receipt into the cash receipts journal and posts the entries to the debtors ledger. At any moment, the debtors controller can be fully advised of the status of accounts receivable.

Promptly performing the receipt-writing duty can save some embarrassment. Imagine a scenario in which a call for payment is placed to the debtor on the 31^{st}, but the account had already been paid on the 2^{nd} of the month. This would happen if the cash receipts clerk failed to perform her duties by capturing the receipt in the cash receipts journal and posting the entry to the debtors ledger.

Fraud: financial institutions place time limits on resolving queries; for example, the reversal of EFT payments can only be done within 30 days of the payment. If the questionable payment is detected more than 30 days after the payment, it may be too late to query it with the bank.

These days, many systems are fully integrated. This means that, after every transaction has been captured, the entry is posted immediately to the various ledgers. The accounts are always up to date.

At any point, however, a month-to-date payments journal can be printed for review or analysis. Often, we use the combined cash receipts and payments journals as a single book of prime entry, called the cash book.

You will have noted that payments made to suppliers and receipts from customers are also recorded in the cash journals. To ensure that each trade debtor and trade creditor's account is always up to date, postings from the cash journals to the debtors and creditors subsidiary ledger must not be neglected. None of these books of entry can operate in isolation.

You should now be able to:

- describe the purpose of the cash receipts journal (CRJ).
- describe the purpose of the cash payments journal (CPJ).
- demonstrate an understanding of what information is recorded and how to record this information in the CPJ.
- demonstrate an understanding of what information is recorded and how to record such information in the CRJ.

2.4 THE LAYOUT OF THE DEBTORS JOURNAL

2.4.1 The layout and workings of the debtors journal

The debtors journal is used to record credit sales. Credit sales are different from cash sales (which are recorded directly in the CRJ) in that, with credit sales, the sale transaction is concluded immediately but payment will be received from the customer at a later date, while with cash sales, payment is received at the time of the sale transaction.

Cash sale	**=**	**Payment received immediately**
Credit sale	**=**	**Payment will be received at a later date**
	=	Right to receive payment
	=	Results in trade debtors (trade receivables).

The trade debtors accounts are updated from this debtors journal, as well as the sales accounts. The accounts affected are:

Debit: Trade debtors account (asset increases)
Credit: Sales account (income increases)
Credit: VAT output account (liability).

The source document used for sales is the duplicate credit sales invoice.

Note that, although the invoice is used as the source document for both purchases and sales, we are talking about two different types of invoice:

1. In the case of purchases, the original invoice is received by the business concerned (i.e. the invoice is generated externally). The invoice numbers will be haphazard because they are received from many different suppliers.

2. In the case of sales, the invoice is issued by the business concerned (i.e. the invoice is generated internally). The business will use a copy of the invoice issued. The invoice numbers will run sequentially because the business generated the invoices that were issued.

From this source document, you must first identify the accounts affected by that particular transaction. We know that, since all the goods are sold on credit, the trade debtors account will be affected. The other accounts affected are the sales account and, possibly, the VAT account.

Example of the debtors journal

THIRST QUENCHERS
DEBTORS JOURNAL – NOVEMBER 20XX
DJ01

Doc. no.	Date	Details	Fol.	Trade Debtors	VAT	Sales (Beverage)	Sales (Food)
623	5	Rob Johnny		1 128.60	147.21	660.00	321.39
624	14	Anne Other		604.20	78.81	525.39	
625	20	John Doe		1 425.00	185.87		1 239.13
626	28	Jane Roe		7 182.00	936.78	3 122.61	3 122.61
				10 339.80	1 348.67	4 308.00	4683.13
				c/c			

2.4.2 Month-end procedures

At the end of each month, all the columns in the debtors journal are added up (vertically). To double-check the arithmetic, add the totals across (horizontally). This is called a 'cross-cast' (shown as c/c above).

Explanation of the columns

Document number (Doc. no.)
This column reflects the invoice number of the business. The numbers do run sequentially, as the invoices are generated and issued by this business. In the event of a query, these invoice numbers help you trace the invoice.

Date
This column reflects the date of the invoice (usually the same as the transaction date).

Details
This column reflects the name of the customer (trade debtor).

Folio
This is a reference column. Written in here is the general ledger account number of the relevant account to which the amount is posted. The number is used as a cross reference.

Trade debtors
This column reflects the total amount of the invoice (inclusive of VAT). The total of this column reflects the total credit sales for the current month which is posted to the debtors control account in the general ledger.

VAT
This column reflects the output VAT portion of the invoice (i.e. the VAT that is payable to the South African Revenue Services) on goods that have been issued by the business.

Sales
These columns record the credit sales of the business after deducting the payable VAT portion. A separate column will be used for each major type of goods sold by the business. The total amount in these columns is the amount earned by the business from sales in the month.

2.4.3 Practical application

Not only is it important for you to know the total amount that your debtors owe you, but you must also know the individual names and the age of the debts. This will help you to understand when you will actually be getting cash, and from whom.

It also allows you to follow up on slow payers. You know you will be getting R10 339.80 in total, but who do you call to follow up on the R10 339.80 for payment? It is important to know Rob Johnny will be paying R1 128.60, and Anne Other will be paying R604.20, and so forth.

On a practical level, if these are regular clients who owe you money, you will have the name of the person holding the purse strings and will be able to confirm payment dates.

When the total of the trade debtors column in the debtors journal is posted to the debtors control account in the general ledger, the individual entries are also posted to the individual debtors' accounts in the debtors ledger.

You will need to be able to reconcile what you believe you are owed to what the customer thinks that they owe, and what they actually pay. Where there are gaps, you must close them by reviewing the detail of the debtors ledger.

The accountant will also make sure that the debtors control balance and the total of the debtors list (extracted from the debtors ledger balances) are the same.

A host of other variables also come into play. These are managed from the debtors ledger and ageing process:

- **Credit terms**: the time (30, 60, 90 days) you have given the customer to pay.
- **Credit limit**: the maximum exposure that you will accept. It is important to update the debtors journal regularly to understand if a customer has reached the credit limit.
- **Settlement discount**: incentive offered to customer to encourage early settlement of accounts; this is often 2.5% for 30 days.
- **Age analysis**: amounts due from trade debtors sorted by the number of days each amount has been outstanding.
- **Query resolution**: the debtors ledger lists the entries for the specific debtor. When the amount that the debtor wants to pay differs from the amount that you expect, you use the debtors ledger to find the differences, and not the various debtors journals.

To obtain the debtors journal in the business world, you would probably ask for the list of sales on credit, or the invoice listing, split between cash and credit sales. Also ask for the detailed age analysis. A debtors ledger print-out per debtor would also list invoices and credit notes. But beware, it could be a large print-out.

By now, you should be able to:

- define and describe the purpose of the debtors' journal.
- demonstrate the layout and workings of the debtors journal.

Note

Reference is sometimes made to a sales journal. This is exactly the same as a debtors journal.

Before continuing with this topic, complete the activity.

Activity

Complete the debtors journal of the following business:

The following invoices were generated (i.e. sales made) by computer shop Sole Trader cc during the month of December 20XX:

Invoice No.	Date	Trade Debtor (incl. VAT)	Amount	Details
2876	2	C. Gates	R570.00	Operating software
2877	5	A. Drive	R684.00	Computer
2878	10	I. Lotus	R285.00	Accounting software
2879	15	C. Drom	R199.50	PC screens
2880	19	G. Excel	R226.86	Operating software

DEBTORS JOURNAL
MONTH:___________

Doc. no.	Date	Details	Fol.	Trade debtors	VAT (Output)	Sales (Software)	Sales (Hardware)

2.5 THE LAYOUT OF THE DEBTORS ALLOWANCES JOURNAL

2.5.1 The layout and workings of the debtors allowances journal

The debtors allowances journal is used to record the return of goods or services previously sold on credit. This may happen owing to:

- the goods being unacceptable to the customer.
- incorrect goods being delivered.
- the goods being damaged in transit.
- an incorrect price having been charged.

In these cases, the customer will either return the goods or request a reduction in the selling price of the goods. If the seller agrees, the seller will then issue a credit note to the customer, informing them that their account has been reduced by the amount indicated on the credit note.

The accounts affected by the credit note are:

Debit:	Sales returns control (i.e. reduce income)
Debit:	VAT input account (i.e. increase the asset)
Credit:	Trade debtors account (i.e. reduce the asset)

The source document used in the debtors allowances journal is the duplicate credit note.

Note

Although the credit note is used as the source document in both the creditors allowances and debtors allowances journals, we are talking about two different types of credit note:

1. In the case of creditors allowances, the original credit note is received by the business concerned (i.e. the credit note is generated externally), so the credit note numbers will not run sequentially.
2. In the case of debtors allowances, the credit note is issued by the business concerned (i.e. the credit note is generated internally), so the credit note numbers will run sequentially and the duplicate credit note will be used.

Example of the debtors allowances journal:

DAJ1

THIRST QUENCHERS DEBTORS ALLOWANCES JOURNAL NOVEMBER 2019 DAJ1							
Doc. no.	Date	Details	Fol.	Trade Debtors	VAT (Input)	Sales returns (Beverages)	Sales returns (Food)
586	10	Rob Johnny		228.00	29.00	199.00	
587	25	Anne Other		171.00	22.00	____	149.00
				399.00 c/c	51.00	199.00	149.00

2.5.2 Month-end procedures

At the end of each month, all of the columns in the debtors allowances journal are added up (vertically). To double-check the arithmetic, add the totals across (horizontally). This is called a 'cross-cast' (shown as c/c above).

Explanation of the columns

Document number (Doc. no.)

This column reflects the credit note number of the business. The numbers do run sequentially, as the credit notes are generated and issued by this business. These credit note numbers help you trace the credit note in the event of a query.

Date

This column reflects the date of the credit note.

Details

This column reflects the name of the debtor.

Folio

This is a reference column. Written in here is the general ledger account number of the relevant account to where the amount is posted. The number is used as a cross reference.

Trade debtors

This column reflects the total amount of the credit note (inclusive of VAT). The total of this column reflects the total sales returned by trade debtors for the current month.

VAT
This column reflects the input VAT portion of the credit note (i.e. the VAT that is refundable by the South African Revenue Services) for goods that have been received back by the business.

Sales returns
These columns record the credit sales returned to the business, after deducting the claimable VAT portion. A separate column will be used for each major type of goods sold by the business.

Before continuing with this topic, please complete the activity.

Activity

Complete the debtors allowances journal of the following business:

The following credit notes were issued by computer shop Sole Trader cc during the month of December 20XX:

Doc. No.	Date	Debtor	Amount (incl. VAT)	Details	Reason
569	10	B Gates	R228.00	1 × software	Disc corrupted
570	15	A Drive	R285.00	1 × computer	Incorrect price

DEBTORS ALLOWANCES JOURNAL MONTH:___________							
Doc. no.	Date	Details	Fol.	Trade debtors	VAT (input)	Sales returns (Software)	Sales (Hardware)

2.5.3 Practical application

The debtors allowances journal can be seen as a correction to the debtors journal. While the debtors journal is often lengthy, the debtors allowances journal is often much shorter. Again, it is critical to record the position of every debtor separately, as is the case for the debtors journal.

Therefore, adjustments must also be posted to the individual debtor's account in the debtors ledger. Note that the debtors control account and the debtors ledger must always balance, and returns or overcharges must reduce the amounts due from the debtors.

Businesses should be loath to issue any debtor adjustments. Doing so reduces profits and owner's equity and, ultimately, the cash to be received from customers.

Although many of these credit notes could be perfectly valid, others may not be, and it could just be an attempt on the part of a debtor (i.e. accounts receivable) to reduce their payments.

Businesses must have a system in place to control the issue of credit notes. Normally, a senior person approves all credit notes.

To prepare the debtors allowances journal, you would probably ask for the list of credit notes issued. Also ask for the detailed age analysis. A debtors ledger print-out would also list invoices and credit notes, but beware, it could be a large print-out.

2.6 THE LAYOUT OF THE CREDITORS JOURNAL

2.6.1 The layout and workings of the creditors journal

The creditors journal is used to record credit purchases. Credit purchases are different from cash purchases (which are recorded directly into the CPJ) in that with credit purchases the transaction has taken place but payment to the supplier will be made at a later date, while with cash purchases the payment is made at the time of the transaction.

Cash purchase	**=**	**Payment made immediately**
Credit purchase	**=**	**Payment to be made at a later date**
	=	Obligation to pay (liability)
	=	Results in trade creditors

The source documents used for purchases on credit are the original supplier's invoice (also known as the credit invoice) and the goods received note. The information from these documents is capture in the creditors journal.

From the invoice, you must first identify the accounts affected by the transaction. Because all the goods are purchased on credit, the trade creditors account will be one of the accounts affected. Other accounts affected depend on what was purchased.

If goods for resale have been purchased, the inventory account will be affected, and possibly the VAT account. If the goods or services purchased are not for resale, other accounts are affected, such as office equipment and vehicles. It is up to you to identify the affected accounts.

The trade creditors' accounts are updated from the creditors journal, the cash payments journal, the creditors allowances journal and the general journal. The affected accounts are:

Debit:	Inventory (asset increased)
Debit:	VAT input (VAT refundable)
Credit:	Trade creditors (liability increased)

Example of the creditors journal:

THIRST QUENCHERS
CREDITORS JOURNAL
NOVEMBER 20XX CJ

Doc no.	Date	Details	Fol.	Trade Creditors	VAT (input)	Inventory		Fol.	Sundries	
						Beverage	Food		Amt	Details
6578	8	Snack Suppliers		456.00	59.48	300.00	96.52			
239	14	SA Bottlers		171.00	22.30	148.70				
428	18	Samba Chip		255.36	33.31		222.05			
5111	21	Ongon Garage		85.00	--				85.00	Petrol
3519	28	Packets Inc		262.20	34.20				228.00	Packaging
				1 229.56 c/c	149.29	448.70	318.57		313.00	

2.6.2 Month-end procedures

At the end of each month, all the columns in the creditors journal are added up (vertically). To double-check the arithmetic, add the totals across (horizontally). This is called a 'cross-cast' (shown as c/c in the creditors journal above).

Explanation of the columns

Document number (Doc. no.)
This column reflects the original credit invoice number. The numbers do not run sequentially, as the invoices are generated different suppliers. These invoice numbers help you to trace the invoice, in the case of a query.

Date
This column reflects the date of the invoice.

Details
This column reflects the name of the supplier.

Folio
This is a reference column. The general ledger account number of the relevant account to where the amount is posted is written in here. The number is used as a cross reference.

Trade creditors
This column reflects the total amount of the invoice (inclusive of VAT). The total of this column reflects the total credit purchases for the current month.

VAT
This column reflects the input VAT portion of the invoice (i.e. the VAT that is claimable from the South African Revenue Services). If the supplier's invoice is issued inclusive of VAT, then the VAT portion must be calculated by the recipient.

Please note that only VAT that is claimable is reflected in this column. This means that VAT charged on goods and services that are specifically excluded is not recorded in this column.

Inventory
These columns record the goods for resale purchased on credit by the business after deducting the claimable VAT portion. A separate column will be used for

each major type of inventory bought by the business. The total amount in these columns represents the value of goods bought by the business for resale purposes in the month.

Sundries

These columns reflect all other goods or services purchased on credit during the month. The VAT-exclusive amount is reflected in Amount column, and the account to be debited in the Details column. The Sundries columns are used to accommodate any type of transaction that cannot be allocated to the inventory columns.

Before continuing with this topic, complete the following activity.

Activity

Please complete the creditors journal of the following business:

The following invoices were received by Sole Trader cc, a computer shop, during the month of December 20XX:

Invoice No.	Date	Supplier	Amount (Incl. VAT)	Details
5613	2	Macrohard	R 1 311.00	10 × operating software
2936	5	IMB	R 3 135.00	5 × computers
583	10	Ongon garage	R 76.50	Petrol for delivery truck
2163	15	Pastel software	R 1 026.00	3 × Accounting software
896	19	General wholesaler	R 399.00	Tea, sugar and milk
589	21	Ongon garage	R 638.40	Service of truck
3193	25	Steve's Repairs	R 513.00	Repair of copier
7569	29	Apple Computers	R 1 128.60	2 × computers

Note

1. No VAT is charged on petrol.
2. No input VAT is permitted to be claimed on staff refreshments.
3. Input VAT charged on the repair of a vehicle is claimable.

CREDITORS JOURNAL MONTH:____________										
Doc. no.	Date	Details	Fol.	Trade creditors	VAT (Input)	Inventory		Sundries		
						Software	Hardware	Fol.	Amount	Details

Note

Please attempt to answer in full before referring to the model answer. Students are encouraged to draft their own 'blank' journals.

2.6.3 Practical application

Not only is the creditors journal used to summarise the postings to the general ledger for acquired goods (which may include purchases, expenses, or capital goods), but it is critical to record what is owed to every individual. In addition to posting the total column to the general ledger, the entry details are also posted to the creditors ledger. This is a separate, secondary ledger that records the status of every creditor.

From the creditors journal, we know we owe R8 227.50 to creditors, but it is also important to know that we owe R1 311 to Macrohard and R3 135 to IMB, and so forth.

When it comes to payment time, we cannot just write a cheque of R8 227.50 to trade creditors. We need to know who the individual creditors are to whom we must make separate payments. The accountant will also need to ensure that the balance of the creditors control account in the general ledger and total of the creditors list are the same at all times.

A host of other variables also come into play. These are managed from the creditors ledger and age analysis:

- **Credit terms**: the time (30, 60, 90 days etc.) stipulated by the supplier for the settlement of the account.
- **Credit limit**: the maximum exposure that the creditor will take. This is the amount of credit that they will give us.
- **Settlement discount**: incentive offered by suppliers to encourage the business to settle its account earlier than the agreed credit term. This is often 2.5% for 30 days.
- **Age analysis**: amounts due to suppliers sorted by the number of days from the date of purchase the amount has been outstanding.
- **Query resolution**: the creditors ledger lists the entries for the specific creditor. When the amount we want to pay differs from the amount that he is asking, we use the ledger to find the differences, not the various creditors journals.

In the business world, to prepare the creditors journal, you would probably ask for the list of suppliers or creditor invoices for a certain period. Some firms call it a list of purchases. Also ask for a detailed age analysis.

By now, you should be able to:

- define and describe the purpose of the creditors journal.
- demonstrate the layout and workings of the creditors journal.

2.7 THE LAYOUT OF THE CREDITORS ALLOWANCES JOURNAL

2.7.1 The layout and workings of the creditors allowances journal

The creditors allowances journal is used to record returns of goods or services previously purchased on credit. Returns happen when, on delivery of the goods by a supplier, it is found that either:

- the incorrect goods were delivered, or
- certain goods have been damaged in transit, or
- goods have been priced incorrectly by the supplier, or
- goods were short-supplied.

In any of the cases above, the business claims a reduction in the price of the originally invoiced goods delivered. The business will request that the supplier issue them with a credit note for the amount agreed upon. The source documents used in the creditors allowances journal are the original credit notes.

The credit note will give rise to a transaction as follows:

Debit:	Creditors control (i.e. liability decreasing)
Credit:	Purchase returns (i.e. expense decreasing)
Credit:	VAT output (VAT input previously claimed being paid back)

Example of the credit note:

Number: 7631

CREDIT NOTE

To:	Thirst Quenchers 45 Jorrissen Street Johannesburg 2152	From: SA Bottlers 32 Rivonia Road Sandton 2162

Date: 25 November 20XX **VAT Registration No.: 8561 1524 20**

Quantity	Details	Amount
2	Cases of cola	R 100.00
5	Cases of lemonade	R 250.00
	Sub-total	R 350.00
	VAT @ 15%	R 52.50
	Total	R 402.50
	Reason: Cases damaged in delivery. Returned by customer.	

Example of the creditors allowances journal:

THIRST QUENCHERS
CREDITORS ALLOWANCES JOURNAL – NOVEMBER 20XX
CAJ01

Doc. no.	Date	Details	Fol.	Trade Creditors	VAT (Output)	Inventory		Sundries		
						Beverage	Food	Fol.	Amt	Details
2389	10	Samba Chips		171	22		149			
7631	21	SA Bottlers		399	52	347				
				570	74	347	149			
				c/c						

Note

Please note that sometimes reference is made to a purchases journal. This is exactly the same thing as a creditors journal.

2.7.2 Month-end procedures

At the end of each month, all the columns in the creditors allowances journal are added up (vertically). To double-check the arithmetic, add the totals across (horizontally). This is called a 'cross-cast' (shown as c/c above).

Explanation of the columns

Date
This column reflects the date of the credit note.

Details
This column reflects the name of the trade payable (i.e. the creditor).

Document number (Doc. no.)
This column reflects the original credit note number. The numbers do not run sequentially, as the credit notes are received from different suppliers. These credit note numbers help you to trace the credit note in the case of a query.

Folio
This is a reference column. The general ledger account number of the relevant account to which the amount is posted is written in here. The number is used as a cross reference.

Trade creditors
This column reflects the total amount of the credit note (inclusive of VAT). The total of this column reflects the total purchases returned to creditors for the current month.

VAT
This column reflects the output VAT portion of the credit note (i.e. the VAT that is payable to the South African Revenue Services). Please note the difference between the VAT column in the creditors journal and the VAT column in the creditors allowances journal.

In the creditors journal, the column is Input VAT (VAT claimable), because goods have been received, while the creditors allowances journal column is for Output VAT (VAT payable), as the goods have been returned to the suppliers.

Inventory

These columns record the purchases of the business that have been returned to suppliers, after deducting the VAT portion. This column will reduce the amount of inventory previously bought and captured in the creditors journal.

Sundries

These columns reflect all other goods or services returned during the month. The amount is reflected in one column and the details in the other. It will be impossible to have separate columns under purchases for each type of transaction, so the sundries columns are very important. These columns are used to accommodate any type of transaction that cannot be allocated to the purchases columns.

Before continuing with this topic, complete the activity.

Activity

Complete the debtors allowances journal of the following business:

The following credit notes were issued by computer shop Sole Trader cc during the month of December 2019:

Doc. no.	Date	Creditor (incl. VAT)	Amount	Details	Reason
297	15	Macrohard	R262.20	1 × software	Damaged
198	18	IMB	R522.50	1 × computer	Overcharge
1187	19	General Wholesaler	R 99.00	1 × Sugar	Not ordered

CREDITORS ALLOWANCES JOURNAL
MONTH:__________

Doc. no.	Date	Details	Fol.	Trade creditors	VAT (Output)	Inventory		Sundries		
						Software	Hardware	Fol.	Amount	Details

2.7.3 Practical application

In some ways, the creditors allowances journal can be seen as a correction to the creditors journal. Where the creditors journal is often a lengthy journal, the creditors allowances journal is much shorter.

Again, it is critical to record the transactions with each creditor separately, as is the case for the creditors journal. Adjustments must therefore also be posted to the individual creditor accounts. Note that the balance of the creditors control account in the general ledger and total of the creditors list must always be the same and returns or overcharges must reduce the amounts payable.

As the source document is the credit note issued by the supplier, a business must have some system in place to tell the supplier if there are mistakes. Many methods exist, ranging from a formal request for credit, to an informal telephone call or email.

It is vital that you have systems in place to ensure that payments are not released for items short-received. The less money that flows out of the firm, the more profit is made. The creditors allowances journal is therefore critical when it comes to recording overcharges by suppliers.

In the business world, to obtain the creditors allowances journal you would probably ask for the list of supplier or creditor transactions for a certain period. Some firms call it a 'list of purchases', which include credits received. Also ask for the detailed age analysis. A creditors ledger print-out per creditor would also list invoices and allowances. But beware; it could be a large print-out!

2.8 THE LAYOUT OF THE PETTY CASH JOURNAL

2.8.1 The purpose of the petty cash journal

An organisation usually deposits all money received daily and makes all payments by EFT or bank card. However, certain payments are small enough not to justify payments by EFT or bank card, such as the payment of stamps, delivery charges on parcels, wages to casual labourers, and milk and tea. It is impractical and often expensive to make an EFT or swipe a bank card for such small amounts.

For this reason, a certain amount of cash is kept on hand for such small payments. This type of transaction is called a petty cash transaction and is captured in the petty cash journal.

2.8.2 The layout and workings of the petty cash journal

When you start a petty cash system, the chief cashier will make a cash withdrawal for the amount agreed upon. The cash withdrawn will be handed to the petty cashier.

Example:

On 9 May 20XX, Mary Alexander decided to operate a petty cash system. She withdrew R300 from the bank as the imprest (i.e. petty cash).

A petty cash account must be opened in the general ledger. The transfer of money from the bank to petty cash is recorded in the books by crediting the bank account (the bank account is giving) and debiting the petty cash account (the petty cash account is receiving).

The petty cash account is a current asset account. Debit entries are made for monies received, and credit entries are made for the total monthly petty cash payments.

The influence of the transaction on the accounting equation:

ASSETS =	OWNER'S EQUITY +	LIABILITIES
+ R300 − R300	0	0

Petty cash (an asset) is debited because it is increasing. Petty cash is a basic debit account. Bank (an asset) is credited because it is decreasing. Bank is a basic debit account.

2.8.3 Source and supporting documents

Source document: before any money is paid out from petty cash, written authorisation should be obtained. This is done by completing and signing a petty cash voucher and giving it to the person concerned to authorise the payment. This person, along with the petty cashier, signs the document and the payment can be made. These petty cash vouchers are numbered and filed in sequence. The petty cash journal is drawn up from the petty cash vouchers.

Petty cash voucher	
Susan Alex	No. 15
Required for	5 May 20XX
Postage	R5.20
Signature: G. van Wyk	Authorised by: S. Alex

In a small enterprise, the owner will usually authorise payment of money from petty cash themselves. In larger enterprises, this authorisation is sometimes transferred to one or two of the managers or senior personnel.

Supporting documents: where possible, it is very important for the petty cashier to make sure that they receive a supporting document for all payments made. When cash purchases are made, the cash slip or cash register slip meets this purpose.

2.8.4 The petty cash journal

All payments from petty cash should be captured in the petty cash journal. The entry of petty cash transactions in the petty cash journal is similar to entries of cash payments in the cash payments journal.

In addition to the petty cash column (for total petty cash payments), an analysis column should be opened for each type of expense account for which we expect to make a number of payments each month.

Activity

Use the following information to draw up a petty cash journal for Susan Alex. Make provision for the following additional analysis columns: Stationery and Postage. Use voucher numbers from No. 46 onwards. Ignore VAT.

On 1 May 20XX, the petty cash started with an opening balance of R300.

The following payments were made from petty cash:

May 20XX

3	Stamps	R2.56
5	Chocolate for the owner	R4.78
6	Envelopes	R8.95
7	Repairs to computer	R69.34
8	Computer covers	R34.90
9	Trading stock	R23.45
10	Typing paper	R56.98
11	Stamps	R16.99

Notes regarding the columns:

Explanation of the columns

Document number
The petty cash voucher number.

Day
Day on which the transaction takes place.

Details
Details of what was purchased or to whom payment was made from petty cash.

Petty cash
All payments are first entered in the Petty Cash column and then into the analysis column concerned. The sum of the total of the Petty Cash column should always correspond with the sum of the total amounts of the different analysis columns, i.e. the analysis columns and the Petty Cash column are checked by means of cross-balancing.

Postage, stationery
These columns are opened because several payments were made during the month for postage and stationery and other repeated expenses.

Sundry accounts — amounts
Accounts for which no analysis columns are opened. All of the other entries for which no columns are opened are entered in the sundry accounts (i.e. the different accounts) column.

Sundry accounts — folio

Only the general ledger numbers of the accounts in the sundry column are indicated here. Expenses that are entered in their own columns do not receive individual folio numbers. Their folio numbers are entered below the totals of the columns when posted to the ledger.

Sundry accounts — details

This column is used to indicate the names of the general ledger accounts for which no analysis columns were opened and that will be debited.

Notes regarding the totals

Apply cross-balancing to determine whether the columns have been added correctly.

2.8.5 Transfer of the petty cash totals and posting to the ledger

The petty cash journal is posted to the ledger in the same way that the cash payments journal is posted.

These are the influences of payments from petty cash on the accounting equation:

Payment of expenses

An expense account is debited and therefore decreases the owner's equity. Petty cash is credited, which decreases current assets.

Purchases of current assets

When assets are purchased, the asset account is debited (assets increase) and the petty cash account is credited (assets decrease).

Drawings by the owner

The drawings account is debited (owner's equity decreases) and the petty cash account is credited (current assets decrease).

GENERAL LEDGER OF SUSAN ALEX
STATEMENT OF FINANCIAL POSITION SECTION

Dr			EQUIPMENT (B1)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 31	Petty cash	PCJ1	34.90				

Dr			DRAWINGS (B3)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 5	Petty cash	PCJ1	4.78				

Dr			PETTY CASH (B2)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 1	Balance	b/d	300.00	20XX May 31	Total payments Balance	PCJ1 c/d	217.95 82.05
			300.00				300.00
June 1	Balance	b/d	82.05				

NOMINAL SECTION

Dr			STATIONERY (N5)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 31	Petty cash	PCJ1	65.93				

Dr			POSTAGE (N6)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 31	Petty cash	PCJ1	19.55				

Dr			REPAIRS (N7)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX May 7	Petty cash	PCJ1	69.34				

2.8.6 Balancing of the petty cash account

Two systems can primarily be used when balancing the petty cash account. These are the imprest system and the varying balances system.

The system of varying balances

According to this system, the petty cashier receives cash from the chief cashier when money is required. The balance of petty cash varies from one month to the next, as the money used during the month is credited against the petty cash balance. The cash available at the end of the month is simply determined by balancing the account.

Dr			PETTY CASH (B2)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX				20XX			
May 1	Bank		300.00	May 31	Total payments	PCJ1	217.95
					Balance	c/d	82.05
			300.00				300.00
June 1	Balance	b/d	82.05				

Take the petty cash as an example. On 1 May, the cashier received R300 cash. The entry was recorded in the cash payments journal and posted to the debit side of the petty cash account.

During the month, total payments of R217.95 were made from petty cash, entered in the petty cash journal and posted to the credit side of the petty cash account on 31 May 20XX. The petty cashier must first balance the account to see how much money is left. On 1 June, the petty cashier had R82.05 available to make further payments.

The imprest system

According to this system, the money that the petty cashier would need during the month is determined beforehand, and the amount is given to the cashier as an advance. At the end of the month, the amount paid out by the cashier is paid back, so that the balance of petty cash is the same at the end of the month as at the beginning of the month. The petty cash starts with the same amount every month.

If additional cash is received during the month, the amount required at the end of the month to restore the imprest must be accurately determined.

Dr			PETTY CASH (B2)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX				20XX			
May 1	Balance	b/d	300.00	May	Total	PCJ1	217.95
31	Bank	CPJ1	217.95	31	payments		
					Balance	c/d	300.00
			517.95				517.95
June 1	Balance	b/d	300.00				

At the end of the month, the petty cashier will receive an amount of R217.95 from the cashier, which was posted from the cash payments journal to the debit side of the petty cash account on 31 May. The account is now balanced, i.e. the imprest of R300 is restored.

2.8.7 Practical application

Even in some large organisations, the petty cash is run in Excel, or manually. The totals are then included in a general petty cash journal, to post to the general ledger at month-end. Very little automation takes place because the amounts are immaterial and 'petty', as the name suggests.

Both the imprest and varying balances system have their advantages and pitfalls. The risk with the varying balances system is that petty cash can be replenished without reconciling or attaching receipts. With the imprest system, refunds (i.e. the R217.95) are only made if supported by receipts. The journal is an additional control.

The system of varying balances is perfectly acceptable, but checks to determine whether cash on hand equals petty cash ledger balances must be performed regularly (i.e. spot counts).

2.9 THE LAYOUT OF THE GENERAL JOURNAL

So far, we have learned about the specific books of first entry that are used to record specific transaction types. The books of first entry we have used are:

Book of first entry	Transactions recorded
Cash receipts journal	Cash received by the business
Cash payments journal	Cash paid by the business
Creditors journal	Goods purchased on credit
Creditors allowances journal	Returns of goods previously bought on credit
Debtors journal	Sales made on credit
Debtors allowances journal	Returns of goods previously sold on credit
Petty cash journal	Payments out of petty cash

These journals only record the transactions identified above. What happens if transactions that are different to the ones above occur? Where is this information captured before it is posted to the general ledger?

The answer to this is the general journal. As the name implies, it is a general-purpose journal used for recording all other types of transactions. The 'other' types of transactions may be:

Discounts received	Discount given to the business by a supplier
Discounts allowed	Discount granted by the business to a customer
Credit losses (bad debts)	A trade debtor is unable to repay their debt and their account is written off as a 'bad debt'
Non-cash capital contributions or drawings	The owner may contribute other assets, other than cash, as capital. The owner may also take assets, other than cash, for personal use.

The first step to recording a transaction into the general journal is to identify which accounts are affected by the transaction. This is done by re-reading the text describing the transaction.

The second step is to identify the debit entries and the credit entries. Remember, each transaction results in both debit entries and credit entries of equal value.

2.9.1 An example of a general journal

Example:

I.M. Dry starts his new business, Thirst Quenchers, on 1 January 20XX and transfers office furniture that he owns, valued at R10 000, to the new business.

a) **Which accounts are affected?**

The two accounts affected are:
Office equipment (received)
Capital: Thirst Quenchers (owed by the business to him)

b) **Which accounts are debited and credited?**

The asset (office equipment) is increasing, so it is DEBITED.
(The asset has been received)

The equity (capital account) is also increasing, so it is CREDITED.
(The equity is owed — given out)

This transaction will be journalised as follows:

THIRST QUENCHERS GENERAL JOURNAL J1				
Date	**Details**	**Fol.**	**Debit**	**Credit**
20XX 1 Jan	Office equipment Capital		10 000	 10 000
	Furniture brought in by owner			

Example:

A trade debtor of Thirst Quenchers, H. Broke, owes R2 850. He is declared bankrupt and is unable to repay the debt. Process the general journal entry, in order to write this amount off as bad debt on 31 January 20XX.

a) **Which accounts are affected?**

The accounts affected are:
Credit losses (expense)
Trade debtors (written off)
VAT (levied on the original sale – reversed)

b) **Which accounts are debited and credited?**

The expense (credit losses) is increasing, so it is DEBITED. The asset (trade receivable) is decreasing, so it is CREDITED (although money is not physically coming in, the account is treated as if the trade debtor is paying his account).

If output VAT has already been paid over by I.M. Dry:

- The asset (input VAT) is increasing, so it is DEBITED (SARS must refund I.M. Dry for the VAT, and SARS is therefore treated as a trade debtor in Thirst Quenchers).

If output VAT has not been paid over by I.M. Dry:

- The liability (output VAT) is decreasing, so it is DEBITED.

This transaction will be journalised as follows:

THIRST QUENCHERS GENERAL JOURNAL				J1
Date	**Details**	**Fol.**	**Debit**	**Credit**
20XX				
31 Jan	Credit losses		2 478.26	
	Input VAT		371.74	
	Trade debtors — H. Broke			2 850
	Debt written off as irrecoverable			

Note

Please note the following:

1. The debit entries are entered first.
2. A narration (i.e. a brief explanation) of the transaction is entered below the entries in the details column (it is usually an authorisation by a senior staff member).
3. The year, month, and date on which the transaction occurred are entered at the top of the page, in the date column.
4. The folio column is used to indicate the general ledger account to which a specific item is posted.
5. The journal entry balances, i.e. the debit entries equal the credit entries.

6.	The journal is numbered J1. The chief financial officer will insist on keeping these journals filed numerically, for control purposes.

2.10 THE LAYOUT OF OTHER JOURNALS

2.10.1 Other transactions that you may encounter

We cannot cover every single type of transaction, but the following is a guide to the treatment of certain transactions:

1. Discount is received from a creditor because we settled the account before the due date.

Journal entry	Debit	Credit
Trade creditors (liability decreasing)	XXX	
Discount received (recognised against the particular asset bought or expense incurred)		XXX
Output VAT (liability increasing)		XXX

2. Discount is granted to a trade debtor on receipt of payment of an existing debt.

Journal entry	Debit	Credit
Discount allowed (recognised against the particular revenue)	XXX	
Input VAT (asset increasing)	XXX	
Trade debtors (asset decreasing)		XXX

Many different transactions are recorded into the general journal. When you encounter a transaction, first establish whether or not it can be accommodated in any of the other journals (i.e. the creditors journal, creditors allowances journal, debtors journal, debtors allowances journal, or cash journals). If not, the general journal should be used.

Remember to apply the following two steps (IT):

1. Identify the accounts affected.
2. Identify (i.e. translate) which accounts are debited and which accounts are credited.

Summary

In this topic, you learned about many journals. However, it is vital that you understand that there are massive volumes of transactions that need to be recorded by a business. For this reason, it is necessary to classify transactions so they can be entered into the correct journals first before being posted to the general ledger. All similar transactions are recorded in the same journal, and the total of the journal is then posted to the general ledger.

The cash receipts journal is used to record all transactions in which a business receives cash. The source document used is a duplicate receipt, or the cash register roll. The cash payments journal is used to record all transactions in which a business pays out cash. The main source documents are the bank statement and EFT proof of payment. The primary column in the cash journals is 'Bank'.

The creditors journal is used to record all transactions in which a business makes credit purchases. The source document used is an original invoice or purchases invoice. The creditors allowances journal is used to record all transactions in which a business returns items that it had purchased on credit. The source document used is either an original credit note received, or a duplicate debit note issued. The primary column in these journals is Creditors control/Accounts payable/Trade payables.

The debtors journal is used to record all transactions in which a business sells goods on credit. The source document used is a duplicate invoice or sales invoice. The debtors allowances journal is used to record all transactions in which a customer returns goods which had been previously sold on credit. The source document used is an original debit note or a duplicate credit note. The primary column in these journals is Debtors control/Accounts receivable/Trade receivables.

The petty cash journal is used to record all cash payment transactions that are considered small in terms of the size of the operations of the business. The source document used is the petty cash voucher. The primary column of this journal is 'Petty cash'.

Some transactions cannot be classified into the abovementioned journals. These transactions are recorded in the general journal. The source document used is the journal voucher, but these transactions must first be approved by management.

It is necessary to know the headings to the specific columns in the journals. An explanation and description regarding the entries into these columns are also necessary. After completing all of the transactions in a specific journal, you will have to understand what happens at month-end. Ensure that you know how to total the journals.

In the next topic, we will cover how to post these totals to the general ledger.

Self-Assessment Questions

1. Mrs U. Blossom started a florist business, Blossoms, on 1 September 20XX. The following transactions were recorded for the month of September 20XX:

Date	Transaction
1	Mrs Blossom opened a bank account and deposited R10 000 into the account (receipt 1).
2	Mrs Blossom contributed furniture and fittings, valued at R15 000, to the business.
3	She purchased flowers worth R11 343 on credit from Budding Roses cc (invoice 565).
4	She sold flowers to Mrs Greenfingers for R5 643 on credit (invoice 1).
7	She paid wages of R990 (EFT).
9	She bought office refreshments from Smit Stores for R456 (bank debit card).
11	Miscellaneous cash sales of flowers were banked. The deposit was R3 420 (receipt 2).
13	She purchased 20 planters on credit from Roots (Pty) Ltd for R1 083 (invoice 286).
15	Mrs Greenfingers complained that the flowers sold to her were damaged. Mrs Blossom passed a credit note in favour of Mrs Greenfingers for R741 (credit note 1).
17	She returned two planters to Roots (Pty) Ltd, as they were defective. Received a credit note from Roots for R108.30 (credit note 896).
19	Mrs Blossom sold 50 bunches of roses on credit to Mr Thorn for R1 710 (invoice 2).
20	She bought 20 bunches of carnations for R171, using petty cash, from a street vendor (petty cash voucher 1).
21	She purchased petrol on credit for the delivery vehicle, R150 (invoice 856), from PB Garage.
25	She paid wages of R990 (EFT).
27	She paid Budding Roses cc for goods previously bought on credit for R11 343 (EFT).
29	She received payment from Mrs Greenfingers of R4 902 for goods previously sold on credit (receipt 3).

Complete the books of first entry for Blossoms. The business is registered as a vendor for VAT on the invoice basis. Record your answer in these journals (in pencil):

BLOSSOMS CREDITORS JOURNAL MONTH:____________ CJ1									
Doc. no.	Date	Details	Fol.	Trade creditors	VAT (Input)	Inventory	Sundries		
							Fol.	Amount	Details

BLOSSOMS CREDITORS ALLOWANCES JOURNAL MONTH:___________ CAJ1									
Doc. no.	Date	Details	Fol.	Trade creditors	VAT (O/put)	Inventory	Sundries		
							Fol.	Amount	Details

BLOSSOMS

DEBTORS JOURNAL

MONTH:__________ DJ1

Doc. no.	Date	Details	Fol.	Trade debtors	VAT (Output)	Sales

BLOSSOMS

DEBTORS ALLOWANCES JOURNAL

MONTH:__________ DAJ1

Doc. no.	Date	Details	Fol.	Trade debtors	VAT (Input)	Sales returns

BLOSSOMS CASH RECEIPTS JOURNAL MONTH:___________ CRJ1									
Doc. no.	Date	Details	Bank (Dr)	VAT (Cr)	Sales (Cr)	Trade debtors (Cr)	Sundries		
							Fol.	Amount	Details

BLOSSOMS CASH PAYMENTS JOURNAL MONTH:__________ CPJ1									
Doc. no.	Date	Details	Bank (Cr)	VAT (Dr)	Inventory (Dr)	Wages (Dr)	Sundries		
							Fol.	Amount	Details

BLOSSOMS GENERAL JOURNAL Month: __________ GJ1				
Date	Details	Folio	Debit	Credit

Make sure that you have answered in full before referring to the model answer.

2. On 30 June 20XX, the manager of Dumbo appointed a petty cashier to deal with its petty cash payments. The business decided to work according to the imprest system. Start with voucher No. 36.

Required:

a) Enter the transactions in the cash payments journal and petty cash journal, making provision for additional analysis columns for wages, postage, and stationery. Close them off at the end of the month.

b) Post to the ledger accounts. Ignore VAT.

Transactions for June 20XX:

1 Received R210 cash from the chief cashier as imprest.
2 Bought pens and pencils from Smithies, R12.56.
7 Bought stamps for R8.40.
9 Paid for the cleaning of the windows, R30.
16 Received R60 from the chief cashier.
17 Paid railage on merchandise bought from P. Love, R34.45.
19 Gave a donation to a netball league, R50.
21 Paid for postage for an insured parcel, R12.
25 Paid for repairs to a computer, R27.89.
29 Paid for the cleaning of the storeroom, R40.
30 Received cash from the chief cashier to restore the imprest.

3. The petty cash clerk of ABC Limited has never done a petty cash journal before. She attempted her first journal and brought it to you for review. She cannot get the totals to cross-cast and down-cast. She also asked you to review it for general mistakes. Help her to balance the journal and point out errors.

							Sundries		
Doc No.	Date	Details	Petty cash	Wages	Stationery	Postage	Amount	Fol.	Details
42	1	Courier cost	89.00			98.00			
43	3	Elastic bands	44.55		55.44				
44	5	Certified letters	39.98						
46	9	Stickers: Casual day	120.00		120.00		120.00	A23	Staff welfare
47	11	Coffee and tea	175.23				175.23	A23	Staff welfare
48	12	Cleaning: casual worker	100.00	100.00					
49	18	Postage stamps	105.00			105.00			
50	22	Pencils: casual worker	75.32		75.32				
51	23	Cleaning	95.00	95.00		95.00			
12	25	Wages	8 000	8 000					
			8 844.08	**8 195.00**	**250.76**	**298.00**	**295.23**		

4. In the table that follows, indicate the journal that would be used to capture the following transactions for the month of January 20XX.

1.	ABC Wholesalers, your major client, has paid 50% of the credit sales delivered to them in November of last year. You are considering sending a harsh letter, as the terms at the time demanded that 100% be paid in January. You gave the equivalent of the COD price at the time.	
2.	DEF Traders returned two items sold on credit in December, with a request for credit. You agree to issue a credit note.	
3.	GHI Sales, one of your loyal clients, accidentally overpaid you because you have a name similar to another firm. You agree to refund GHI the overpayment and must record the refund.	

4.	You realise that you have accidentally posted the depreciation in the wrong accounting period. It has to be corrected.	
5.	You want to purchase goods on credit worth R100 from one of your trade creditors, JKL Suppliers. You place an order, but the supplier informs you that your credit has been revoked. You buy the same goods on credit from MNO, although they are more expensive.	
6.	This is the second time this month that you have had returns from a certain product line. You decide to look at quality control. Reluctantly, you issue a credit note to the debtor, but only for 80% of the value, because part of the product line can still be used.	
7.	You have managed to restore your credit at JKL Suppliers (see 5), and they have a massive sale. You purchase sale items, paying cash.	
8.	You return goods purchased on credit and issue a request for credit, which the supplier honours.	
9.	You complain to MNO about their high prices (see 5) and you get a 5% discount and receive a credit note.	
10.	The owner decides that he is taking the old laptop home to use for his children's projects. He says that you must 'fix' the books.	
11.	The bank pays you interest on a positive balance.	
12.	You make a sale on credit to a large customer on credit terms. He agrees to pay you within 45 days.	
13.	You realise that you have received another order for the customer in 12, and you raise another invoice.	
14.	You decide to buy pies for the office from petty cash.	
15.	You purchase non-sale merchandise on credit from JKL (see 5 and 7).	

5. Below, find a table relating to books of prime entry. You are required to complete the missing fields.

Journal	Source Document	Primary total posted to ledger account	DR/ CR
	Receipts issued or CR entries on the bank statement	Bank	
Cash payments journal	Cheque counterfoils or DR entries on the bank statement		CR
Creditors journal		Trade creditors/ Accounts payable	
	Original supplier's credit note		DR

Journal	Source Document	Primary total posted to ledger account	DR/ CR
	Duplicate credit sales invoice	Trade debtors/Accounts receivable	DR
Debtors allowances journal			CR
	Petty cash voucher	Petty cash	CR

Topic 3
General ledger and control accounts

3.1 INTRODUCTION

This topic relates to the following module outcome:

3. Draw up general ledgers and control accounts.

In the previous topic, you learned that the transactions are captured for the first time in the books of accounting in the journals. The capturing of transactions occurs on a daily basis or as the transactions occur.

The next step is to post the totals of the various columns in the journals to the respective accounts in the general ledger. You need to know the specific general ledger accounts that will be used to do the postings from the journals, and whether postings will be made to the debit or credit side of the general ledger accounts.

From Topic 2, you will remember the effect of debit or credit entries on asset, liability, income, and expense accounts. At month-end, all the accounts in the general ledger are balanced. These balances are then used to draw up the trial balance. Upon completion of this topic, you will need to be able to prepare general ledger accounts and extract the trial balance.

In this topic, you will gain knowledge in the following areas:

1. Posting procedure from journals to the general ledger
2. Different types of control accounts
3. Balancing of general ledger accounts
4. Preparation of a pre-adjustment trial balance.

3.2 POSTING PROCEDURE FROM JOURNALS TO THE GENERAL LEDGER

3.2.1 The posting procedure from the journals to the general ledger

This process can be summarised graphically as follows:

Transactions
↓
Source documents
↓
Capturing transactions in journals
↓
Posting to general ledger accounts
↓
General ledger accounts balanced and closed off
↓
Extracting the trial balance

Figure 3.1 The accounting procedure

The general ledger is merely a term for the collection of separate accounts. It is the principal book in which all the separate accounts are recorded. It contains, in a summarised and classified form, all the transactions of the business. It is the most important accounting record.

Let us now look at how each book of first entry posts its transactions to the general ledger.

3.2.2 The creditors journal

The balanced and cross-casted creditors journal is the starting point of this procedure.

See the following page.

Table 3.1 An example of the creditors journal

THIRST QUENCHERS CREDITORS JOURNAL NOVEMBER 20XX											CJ1
Doc. no.	Date	Details	Fol.	Trade creditors (Cr)	VAT (input) (Dr)	Inventory (Dr)		Sundries (Cr)			
						Bev.	Food	Amt	Fol.	Details (Dr)	
6578	8	Snack Suppliers		456.00	59.48	300.00	96.52				
239	14	SA Bottlers		171.00	22.30	148.70					
428	18	Samba Chip		255.36	33.30		222.06				
5111	21	Ongon Garage		85.00				85.00		Petrol	
3519	28	Packets Inc		262.20	34.20			228.00		Packaging	
				1 229.56 c/c	149.28	448.70	318.58	313.00			

The balanced and cross-cast creditors journal above needs to be converted into DEBITS and CREDITS. The total of each of the four main columns (namely, Trade creditors, VAT, Inventory: Beverage and Inventory: Food) is posted to the relevant general ledger account. The items in the Sundries columns are individually posted to the relevant general ledger accounts.

The first column, Trade creditors, is increasing, as goods or services have been bought on credit (i.e. there is a liability to pay). From the rules discussed previously, this represents something 'given out' by the business, as the creditors are providing the business with 'funds' in order to make the purchase. An increase in a liability is a CREDIT entry. Trade creditors in the general ledger must be credited with R1 229.56.

The second column, VAT Input, reflects the amount that the business can claim back from SARS (i.e. the account receivable). This is 'Receivable', because SARS has not paid the refund yet, and it is therefore an asset that is increasing. The VAT control account must be DEBITED with R149.28.

The third and fourth columns, Inventory, reflect the amount of goods purchased for resale during the month. As assets (i.e. inventory) are clearly 'received', the assets are increasing. The inventory accounts must therefore be DEBITED with R448.70 and R318.58, respectively.

The final columns are the Sundries columns. As the items entered in these columns are made up of different types of transactions, the individual entries are posted separately to the relevant general ledger accounts:

- Petrol is an expense of the business, which is increasing: DEBIT the petrol account with R85 (received).
- Packaging is an expense of the business, which is increasing: DEBIT the packaging account with R228 (received).

The DEBITS and CREDITS above should equal each other (i.e. the double-entry concept). This can (**and should**) be checked before posting to the general ledger accounts.

In practice, when using a computerised system, the check is performed automatically before every entry. In fact, it would not allow the user to complete the entry unless the journal was in balance. Posting this 'in balance' journal to the general ledger would ensure that the general ledger always balances. Now at least we have a set of general ledger accounts in balance as a starting point for the trial balance.

General ledger account	Debit	Credit
Trade creditors		R1 229.56
Input VAT	R149.28	
Inventory: beverage	R448.70	
Inventory: food	R318.58	
Petrol expense	R85.00	
Packaging expense	R228.00	
Total (balances)	**R1 229.56**	**R1 229.56**

The debits are equal to the credits; we can therefore post the information from the creditors journal to the general ledger, as follows:

GENERAL LEDGER

Dr			INVENTORY: BEVERAGE					Cr
Date	**Details**	**Folio**	**Amount**		**Date**	**Details**	**Folio**	**Amount**
30 Nov	Trade creditors	CJ1	448.70					

Dr			INVENTORY: FOOD					Cr
Date	**Details**	**Folio**	**Amount**		**Date**	**Details**	**Folio**	**Amount**
30 Nov	Trade creditors	CJ1	318.58					

Dr			PACKAGING					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
28 Nov	Trade Creditors	CJ1	228.00					

Dr			PETROL					Cr
Date	Details	Folio	Amount		Date	Details	Fol.	Amount
21 Nov	Trade Creditors	CJ1	85.00					

Dr			TRADE CREDITORS					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					30 Nov	Total purchases	CJ1	1 229.56

Dr			VAT INPUT					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Trade creditors	CJ1	149.28					

We can summarise the key points regarding the posting procedure from the creditors journal to the general ledger as follows:

1. The totals of the following columns in the creditors journal are posted from the creditors journal to the appropriate accounts in the general ledger at the end of the month:

Inventory: Beverage account	Debited
Inventory: Food account	Debited
VAT input account	Debited
Trade creditors account	Credited

2. The items in the Sundries column of the creditors journal are posted individually to the DEBIT side of the accounts concerned in the general ledger.

Note

Please take note of the date reflected in the general ledger accounts of Packaging and Petrol. The date of the original transaction is entered into the general ledger date column, and not the last day of the month, as with the posting of the column totals.

3. The columns reflected in the general ledger accounts (both the debit and the credit side) reflect the following:

   Date
   This is the date on which the transaction took place. Please note that the date used in accounts posted from the total columns is the last day of that month. Those amounts are only posted at the end of the month. The date used in accounts posted from the Sundries columns is the date of the original transaction, as these transactions are posted individually.

   Details
   This column gives you additional information about the transaction. It is usual to write the contra (i.e. the matching) account name in this column. This means that the account being debited reflects the account name that is being credited, and the account that is being credited reflects the account name that is being debited.

   Folio
   This is a reference column. The journal number is reflected, which tells you from which journal the entry has come ('CJ1' for Creditors Journal 1 in our example). This number is used as a cross-reference. In the journal, the general ledger account number to which the amount has been posted is reflected.

   Amount
   This is the amount debited or credited to the account.

3.2.3 The creditors allowances journal

The balanced and cross-cast creditors allowances journal is the starting point of this procedure.

Table 3.2 An example of the creditors allowances journal

THIRST QUENCHERS CREDITORS ALLOWANCES JOURNAL NOVEMBER 20XX								CAJ11		
Doc. no.	Date	Details	Folio	Trade creditors (Dr)	VAT (output) (Cr)	Inventory (Cr)			Sundries (Cr)	
						Bev	Food	Fol.	Amt	Details
2389	10	Samba chips		171.00	22.30		148.70			
7631	21	SA Bottlers		399.00	52.04	346.96				
				570.00	**74.34**	**346.96**	**148.70**			
				c/c						

Again, we start with the balanced and cross-cast creditors allowances journal, which needs to be converted into DEBITS and CREDITS. The four main columns (i.e. Trade creditors, VAT, Inventory: Beverage, and Inventory: Food) are posted to the relevant general ledger accounts in total. The items in the Sundries columns are individually posted to the relevant general ledger accounts.

The first column, Trade creditors, is decreasing, as goods or services have been returned to the suppliers. From the rules discussed in a previous topic, a decrease in a liability is a DEBIT entry. Trade creditors in the general ledger must be debited with R570.

The second column, VAT, reflects the amount that the business has to pay to SARS. This is a liability which is increasing. The VAT control account must therefore be CREDITED with R74.34. This represents money that has not yet been paid to SARS.

The third and fourth columns, Inventory, reflect the value of goods that were returned. As the asset (i.e. inventory) is decreasing, the inventory accounts must be CREDITED with R346.96 and R148.70, respectively.

The final columns are the Sundries columns. As the items (if any) entered in these columns are made up of different types of transactions, the individual entries are posted separately to their relevant general ledger accounts.

The above DEBITS and CREDITS should equal each other (i.e. the double-entry concept). This can (**and should**) be checked, before posting to the general ledger accounts.

General ledger account	Debit	Credit
Trade creditors	R570.00	
Output VAT		R 74.34
Purchases: Beverage		346.96
Purchases: Food		148.70
Total (balances)	**R570.00**	**R570.00**

As the debits equal the credits, we can post the information from the creditors allowances journal to the general ledger, as follows:

GENERAL LEDGER

Dr			INVENTORY: BEVERAGE					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amt
					30 Nov	Trade creditors	CAJ1	346.96

Dr			INVENTORY: FOOD					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					30 Nov	Trade creditors	CAJ1	148.70

Dr			TRADE CREDITORS					Cr
Date	Details	Fol.	Amt		Date	Details	Fol.	Amount
30 Nov	Total purchases (returns)	CAJ1	570					

Dr			VAT OUTPUT					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					30 Nov	Trade creditors	CAJ1	74.34

The posting procedure from the creditors allowances journal to the general ledger can be summarised as follows:

1. The totals of the following columns in the creditors allowances journal are posted at the end of the month from the creditors allowances journal to the appropriate accounts in the general ledger:

   - Inventory: Beverage account Credited
   - Inventory: Food account Credited
   - VAT output account Credited
   - Trade creditors account Debited.

2. The items in the SUNDRIES column (if any) of the creditors allowances journal are posted individually to the CREDIT side of the accounts concerned in the general ledger.

3.2.4 The debtors journal

The balanced and cross-cast debtors journal is the starting point of this procedure.

Table 3.3 An example of the debtors journal

THIRST QUENCHERS DEBTORS JOURNAL NOVEMBER 20XX							DJ1
Doc. no.	Date	Details	Fol.	Trade debtors (Dr)	VAT (output) (Cr)	SALES Beverage (Cr)	SALES Food (Cr)
623	5	Rob Johnny		1 128.60	147.21	660.00	321.39
624	14	Anne Other		604.20	78.81	525.39	
625	20	John Doe		1 425.00	185.87		1 239.13
626	28	Jane Roe		7 182.00	936.78	3 122.61	3 122.61
				10 339.80	**1 348.67**	**4 308.00**	**4 683.13**
				c/c			

We need to convert the journal in Table 3.3 into debits and credits:

Trade debtors column	Asset increasing, DEBIT with R10 339.80
Output VAT column	Liability (VAT payable) increasing, CREDIT with R1 348.67
Sales: Beverage column	Income increasing, CREDIT with R4 308.10
Sales: Food column	Income increasing, CREDIT with R4 683.23

We can now check whether the above DEBITS and CREDITS equal each other (i.e. the double-entry concept):

General ledger account	Debit	Credit
Trade debtors	R10 339.80	
Output VAT		R 1 348.67
Sales: Beverage		4 308.00
Sales: Food		4 683.13
Total (balances)	**R10 339.80**	**R10 339.80**

As the debits equal the credits, the information is posted from the debtors journal to the general ledger as follows:

GENERAL LEDGER

Dr			SALES: BEVERAGE					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					30 Nov	Trade debtors	DJ1	4 308.00

Dr			SALES: FOOD					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					30 Nov	Trade debtors	DJ1	4 683.13

Dr			TRADE DEBTORS					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Total sales	DJ1	10 339.80					

Dr			VAT OUTPUT					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					30 Nov	Trade debtors	DJ1	1 348.67

3.2.5 The debtors allowances journal

The balanced and cross-cast debtors allowances journal is the starting point of this procedure.

Table 3.4 An example of the debtors allowances journal

THIRST QUENCHERS DEBTORS ALLOWANCES JOURNAL NOVEMBER 20XX							DAJ1
Credit Note No.	Date	Details	Folio	Trade debtors (Cr)	VAT (input) (Dr)	SALES Beverage (Dr)	SALES Food (Dr)
586	10	Rob Johnny		228	29.74	198.26	
587	25	Anne Other		171	22.39	_	148.61
				399	52.13	198.26	148.61
				c/c			

We need to convert the previous journal into debits and credits:

Trade debtors column	Asset decreasing, CREDIT with R399.00
Input VAT column	Asset (VAT receivable) increasing, DEBIT with R52.13
Sales: Beverage column	Income decreasing (sales returned), DEBIT with R198.26
Sales: Food column	Income decreasing (sales returned), DEBIT with R148.61

We can now check whether the above DEBITS and CREDITS equal each other (i.e. the double-entry concept):

General ledger account	Debit	Credit
Trade debtors		R399.00
Input VAT	R52.13	
Sales: Beverage	R198.26	
Sales: Food	R148.61	
Total (balances)	**R399.00**	**R399.00**

As the debits equal the credits, the information is posted from the debtors journal to the general ledger, as follows:

GENERAL LEDGER

Dr			SALES: BEVERAGE					Cr
Date	**Details**	**Folio**	**Amt**		**Date**	**Details**	**Folio**	**Amount**
30 Nov	Trade debtors	DAJ1	198.26					

Dr			SALES: FOOD					Cr
Date	**Details**	**Folio**	**Amt**		**Date**	**Details**	**Folio**	**Amount**
30 Nov	Trade debtors	DAJ1	148.61					

Dr			TRADE DEBTORS					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					30 Nov	Total sales (returns)	DAJ1	399

Dr			VAT INPUT					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Trade Debtors	DAJ1	49					

3.2.6 Cash journals

The balanced and cross-cast cash receipts journal and cash payments journal is the starting point of this procedure.

See the example below.

Table 3.5 An example of the cash receipts journal

THIRST QUENCHERS CASH RECEIPTS JOURNAL – NOVEMBER 20XX CRJ 1								
Rec. No.	Date	Details	Bank (Dr)	VAT output (Cr)	Sales (Cr)	Trade debtors (Cr)	Sundries	
							Fol.	Amount
1	1	I.M. Dry: Capital	10 000.00					10 000.00
2	6	Cash sales	4 560.00	594.78	3 965.22			
3	18	H.B. Jacobs: loan	5 000.00					5 000.00
4	23	AB Store: debtor	2 280.00			2 280.00		
5	29	Cash sales	3 420.00	446.08	2 973.92			
			25 260.00 c/c	1 040.86	6 939.14	2 280.00		15 000.00

Table 3.6 An example of the cash payments journal

THIRST QUENCHERS CASH PAYMENTS JOURNAL – NOVEMBER 20XX CPJ1								
Doc. no.	Date	Details	Bank (Cr)	VAT input (Dr)	Inventory (Dr)	Wages (Dr)	Sundries (Dr)	
							Folio	Amount
1	2	City Prop.	1 140	148.70				991.30

2	2	Makro	6 840	892.17	5 947.83			
3	7	Cash	500			500		
4	10	Stationery	570	74.34				495.66
5	14	Cash	500			500		
6	19	Makro	4 560	594.78	3 965.22			
7	21	Cash	500			500		
8	25	I.M. Dry	1 500					1 500
9	28	Cash	500			500		
10	30	City Prop	1 140	148.70				991.30
11	30	Telkom	342	44.61				297.39
12	30	Rates	456	0.00				456.00
			18 548 c/c	**1 903.30**	**9 913.05**	**2 000**		**4 731.65**

We need to convert the journals above into debits and credits:

Cash receipts:

Bank column: Asset increasing, DEBIT bank account with R25 260.

Output VAT column: Liability (VAT payable) increasing, CREDIT VAT control account with R1 040.86.

Sales column: Income increasing, CREDIT sales account with R6 939.14.

Trade debtors column: Asset decreasing, CREDIT trade debtors account with R2 280.

Sundry column: Each transaction in this column is individually posted to the general ledger:

- Capital (liability) is increasing, money in from owners, CREDIT capital account with R10 000.
- Loan account (liability) is increasing, CREDIT loan account with R5 000.

Cash payments:

Bank column: Asset decreasing, CREDIT bank account with R18 548.

Input VAT column: Asset (VAT receivable) increasing, DEBIT VAT control account with R1 962.78.

Inventory column: Assets increasing, DEBIT inventory account with R9 913.05.

Wages column: Expense increasing, DEBIT salaries and wages account with R2 000.

Sundry column: Each transaction in this column is individually posted to the general ledger:

- Rental (expense) is increasing, DEBIT rent expense account with R991.39 (2/11/20XX) and R991.39 (30/11/20XX).
- Stationery (expense) is increasing, DEBIT stationery account with R495.66.
- Drawings (equity) is decreasing, DEBIT drawings account with R1 500.
- Telephone (expense) is increasing, DEBIT telephone account with R297.39.
- Rates (expense) is increasing, DEBIT rates and taxes account with R396.52.

We can now check whether the DEBITS and CREDITS above equal each other (i.e. the double-entry concept):

CASH RECEIPTS JOURNAL

General ledger account	Debit	Credit
Bank	R25 260.00	
Output VAT		1 040.86
Sales		6 939.14
Trade debtors		2 280.00
I.M. Dry: Capital		10 000.00
H.B. Jacobs: Loan		5 000.00
Total balances	**25 260.00**	**25 260.00**

CASH PAYMENTS JOURNAL

General ledger account	Debit	Credit
Bank		R18 548.00
Input VAT	R1 962.78	
Inventory	9 913.05	
Wages	2 000.00	
Rental	991.30	
Stationery	495.66	
Drawings	1 500.00	
Rental	991.30	
Telephone	297.39	
Rates	396.52	
Total balances	**R18 548.00**	**R18 548.00**

As the debits equal the credits, the information is posted from the cash books to the general ledger as follows:

GENERAL LEDGER

Dr			SALES					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					30 Nov	Bank	CRJ1	6 939.14

Dr			INVENTORY					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Bank	CPJ1	9 913.05					

Dr			STATIONERY					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
10 Nov	Bank	CPJ1	495.66					

Dr			SALARIES AND WAGES					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Bank	CPJ1	2 000					

Dr			RENT EXPENSE					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
2 Nov	Bank	CPJ1	991.30					
30 Nov	Bank	CPJ1	991.30					

Dr			TELEPHONE					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Bank	CPJ1	495.66					

Dr			RATES AND TAXES					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Bank	CPJ1	396.52					

Dr			BANK					Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Total receipts	CRJ1	25 260		30 Nov	Total payments	CPJ	18 548

Dr				DRAWINGS				Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
25 Nov	Bank	CPJ	1 500					

Dr				VAT INPUT				Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
30 Nov	Bank	CPJ1	1 962.78					

Dr				VAT OUTPUT				Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					30 Nov	Bank	CRJ1	1 040.86

Dr				TRADE DEBTORS				Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					30 Nov	Bank	CRJ1	2 280

Dr				LOAN ACCOUNT: H.B. JACOBS				Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					18 Nov	Bank	CRJ1	5 000

Dr				CAPITAL: I.M. DRY				Cr
Date	Details	Folio	Amount		Date	Details	Folio	Amount
					1 Nov	Bank	CRJ1	10 000

3.2.7 General journal

The general journal entry is posted to the general ledger.

THIRST QUENCHERS GENERAL JOURNAL GJ1				
Date	Details	Folio	Debit	Credit
20XX				
1 Jan	Office equipment		10 000	
	Capital: I.M. Dry			10 000
	Furniture brought in by owner			

The entries above are posted individually to the general ledger accounts, as follows:

Dr			OFFICE EQUIPMENT					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
1 Jan	Capital: I.M. Dry	GJ1	10 000					

Dr			CAPITAL: I.M. DRY					Cr
Date	Details	Fol.	Amount		Date	Details	Fol.	Amount
					1 Jan	Office equipment	GJ1	10 000

In summary, always perform the following tasks:

- Cast and cross-cast each journal
- Translate the journal into DEBITS and CREDITS
- Check that DEBITS = CREDITS
- Insert the FOLIO numbers once the amount has been posted to the general ledger.

3.3 DIFFERENT TYPES OF CONTROL ACCOUNTS

3.3.1 The trade debtors control account and the trade debtors ledger

In the previous examples, we posted only the total of the trade debtors column to the trade debtors account in the general ledger. This is inadequate, because we would then have no record of the amounts owed by each individual debtor. The trade debtors account will only reflect the total amount owed by all the debtors combined. The business is in no position to identify which debtors have long-outstanding debts or who owes vast amounts of money.

In a previous topic, the use of a sub-ledger (i.e. a subsidiary ledger) was introduced. In this topic, a practical application to demonstrate the reconciling of the two sub-ledgers is included.

The trade debtors ledger is a 'subsidiary' ledger of the general ledger. This means that if all the individual debtors accounts in the trade debtors ledger are added up, the total will agree with the balance reflected in the trade debtors account in the general ledger. It is very important for the business to reconcile the trade debtors ledger to the trade debtors account on a regular basis. This is usually performed monthly.

The reconciliations must be done a minimum of once a month; however, these checks are usually conducted more regularly, thanks to computerised systems.

Any journal that uses a trade debtors column should use this column to post to both the trade debtors account (in the general ledger) and the individual debtors accounts in the trade debtors ledger.

As an example, we will post from the debtors journal to the trade debtors ledger.

THIRST QUENCHERS DEBTORS JOURNAL NOVEMBER 20XX DJ1							
Doc. no.	Date	Details	Fol.	Trade debtors	VAT (Output)	SALES Beverage	SALES Food
623	5	Rob Johnny	D1	1 128.60	147.21	660.00	321.39
624	14	Anne Other	D2	604.20	78.81	525.39	
625	20	John Doe	D3	1 425.00	185.87		1 242.13
626	28	Jane Roe	D4	7 182.00	936.78	3 122.61	3 122.61
				10 339.80 c/c	1 348.67	4 308.00	4 686.13

The entries above will be posted to the trade debtors ledger as follows:

TRADE DEBTORS LEDGER

ROB JOHNNY D1					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			2 392.00
Nov 5	Invoice 623	DJ1	1 128.60		3 520.60

ANNE OTHER D2					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			1 497.00
Nov 14	Invoice 624	DJ1	604.20		2 101.20

JOHN DOE D3					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			3 856.00
Nov 20	Invoice 625	DJ1	1 425.00		5 281.00

JANE DOE D4					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			16 203.00
Nov 28	Invoice 626	DJ1	7 182.00		23 385.00

LIST OF DEBTORS

Rob Johnny	D1	3 520.60
Anne Other	D2	2 101.20
John Doe	D3	5 281.00
Jane Doe	D4	23 385.00
		34 287.80

The total of the trade debtors sub-ledger will now be reconciled to the general ledger.

As a quick check to aid understanding, we will prove the correctness of the opening balance first:

D1	2 392.00
D2	1 497.00
D3	3 856.00
D4	16 203.00
Total	**23 948.00**

At the start of the month, the ledger and sub-ledger agreed.

GENERAL LEDGER
TRADE DEBTORS ACCOUNT (200)

Date	Description	Folio	Amount	Date	Description	Folio	Amount
1 Nov	Balance	b/d	23 948.00				
30 Nov	Sales	DJ1	10 339.80				
			34 287.80				

You will notice that the total of the sub-ledger corresponds with that of the general ledger. With this simple example, it almost seems obvious. In practice, however, with pages and pages of debtor accounts, a debtors journal of several pages, general journals and a debtors allowances journal, mistakes **do** happen and the totals **do** go out of balance from time to time.

The journal for entries to the debtors control account is the balanced and cross-cast debtors journal.

At the end of the month, the debtors journal will show balances (Trade debtors, VAT, Sales and other columns that the business thinks will be necessary). These **totals** are then posted to their relevant general ledger accounts, respectively. However, the total for the Sundries column cannot be booked over to one account. Each item in the Sundries column must be posted to the respective general ledger account.

You must ensure that you understand whether you should book these balances to the debit or credit side of the accounts.

A basic tip is that **income** increases with increased entries in the debtors journal. Income that increases must have a credit entry.

But the price for which one sells an item includes VAT, which is excluded from the selling price (i.e. sales) in the debtors journal. It has a separate column. The business must pay VAT to SARS on income items. Therefore, the business owes the VAT levied on sales to SARS. This is the reason why the VAT output account will be credited if VAT is included in a sales item.

When postings need to be made from the debtors allowances journal, one has to understand that goods that were previously sold to debtors and have already been recorded in the debtors journal are being returned to the business. The opposite of the debit and credit postings is now true.

Income now decreases and must be debited. Because VAT was included in the sales price of the goods that are being returned, less VAT is owed to SARS by the business and the VAT account must therefore be debited.

As trade debtors are parties to whom the business has sold goods, these parties owe the business money. They are therefore assets to the business and must be debited in the general ledger.

If goods are returned by debtors, they now owe the business less money. Assets are therefore decreased, and the trade debtors must be credited.

One can describe the trade debtors ledger as a subsidiary ledger of the general ledger. The total of the individual balances of the individual debtors will reconcile with the balance in the trade debtors account.

3.3.2 The trade creditors control account and the trade creditors ledger

As discussed above, we also need detailed information about the individual creditors. When the trade creditors ledger is used, each individual creditor will have a separate account where all the transactions are recorded. From these individual accounts, the business is able to identify which creditors have not been paid, as well as the amount owed.

The trade creditors ledger is a 'subsidiary' ledger of the general ledger. This means that, if all the individual creditors' accounts in the trade creditors ledger are added up, the total will agree with the balance reflected in the trade creditors account in the general ledger. It is very important for the business to reconcile the trade creditors ledger to the trade creditors account on a regular basis.

Any journal that contains a trade creditors column is used to post to both the trade creditors account (in the general ledger) and the individual creditor accounts in the trade creditors ledger. The journal for entries to the creditors control account is the balanced and cross-cast creditors journal.

At the end of the month, the creditors journal will show the totals of each column (Trade creditors, VAT, Inventory and other columns that the business thinks will be necessary). These **totals** are then posted to their relevant general ledger accounts, respectively.

However, the total for the Sundries column cannot be booked over to one account. Each item in the Sundries column must be posted to the respective general ledger account.

Detailed information is required for all the individual creditors. This information is required to determine what was purchased from each creditor, what they are owed and what amount they were paid during the month. As an example, we will post from the creditors journal to the trade creditors ledger.

THIRST QUENCHERS
Creditors Journal
NOVEMBER 20XX CJ1

Doc. no.	Date	Details	Fol.	Trade creditors	VAT (input)	Inventory		Sundries		
						Bev	Food	Fol.	Amt	Details
6578	8	Snack Suppliers	C1	456.00	59.48	296.52	100.00			
239	14	SA Bottlers	C2	171.00	22.30	148.70				
428	18	Samba Chips	C3	255.36	33.31		222.05			
5111	21	Ongon Garage	C4	85.00					85.00	Petrol
3519	28	Packets Inc	C5	262.20	34.17	—			228.03	Packaging
				1 229.56	149.26	445.22	322.05		313.03	
				c/c						

The previous entries will be posted to the trade creditors ledger, as follows:

TRADE CREDITORS LEDGER

SNACK SUPPLIERS C1					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			2 323.00
8	Invoice 6578	CJ1		456.00	2 779.00

SA BOTTLERS C2					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			890.00
14	Invoice 239	CJ1		171.00	1 061.00

SAMBA CHIPS C3					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			1 234.00
18	Invoice 428	CJ1		255.36	1 489.36

ONGON GARAGE C4					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			7 500.00
28	Invoice 5111	CJ1		85.00	7 585.00

PACKETS INC C5					
Date	Details	Folio	DEBIT	CREDIT	BALANCE
Nov 1	Balance	b/d			6 816.00
28	Invoice 3519	CJ1		262.20	7 078.20

LIST OF CREDITORS

Snack Suppliers	C1	2 779.00
SA Bottlers	C2	1 061.00
Samba Chips	C3	1 489.36
Ongon Garage	C4	7 585.00
Packets Inc	C5	7 078.20
		19 992.56

As a quick check to aid understanding, we will prove the correctness of the opening balance first:

C1	2 323.00
C2	890.00
C3	1 234.00
C4	7 500.00
C5	6 816.00
Total	**18 763.00**

At the start of the month, the ledger and sub-ledger agreed. The total of the trade creditors column will be posted to the creditors control account, as follows:

Table 3.7 Example of the general ledger

Dr			TRADE CREDITORS CONTROL					Cr
Date	**Details**	**Fol.**	**Amount**		**Date**	**Details**	**Fol.**	**Amount**
					1 Nov	Balance	b/d	18 763.00
					30 Nov	Inventory	CJ1	1 229.56
								19 992.56

You must ensure that you understand whether you should book these balances to the debit or credit side of the accounts. A basic tip is that purchases of goods on credit increase the amount owed to suppliers, and therefore should be recorded on the credit side of the trade creditors account.

When postings need to be made from the creditors allowances journal, one has to understand that goods that were previously purchased from creditors and have already been recorded in the creditors journal, are now returned to creditors. The opposite of the debit and credit postings is now true.

Assets (i.e. inventory) now decreases and must be credited. Because VAT was included in the purchase price of the goods that are being returned, SARS owes the business less VAT, and the VAT account must therefore be credited.

Trade creditors are parties from which the business has purchased goods, so the business owes these parties money. They are therefore liabilities to the business and must be credited in the general ledger. If goods are returned to creditors, the business owes them less money and liabilities are therefore decreased. Trade creditors must therefore be debited.

3.3.3 Other books of prime entry and the sub-ledgers

Because the debtors allowances journal and the creditors allowances journal affect the individual debtors and creditors respectively, we must also post the individual transactions from these journals to the sub-ledgers. The same methodology would apply to the following:

- Cast and cross-cast the journal
- Translate the journal in debits and credits
- Check that the debits = credits
- Insert the folio numbers, once the amounts have been posted, to assist with cross-referencing.

By now, your knowledge of debits and credits should be sound. When we post the debtors allowances journal to the individual debtors, the inverse thinking is applied to the debtors journal. Where the individual debtors were debited for sales made in the case of the debtors journal, for the debtors allowances journal, we credit the trade debtors sub-ledger for credit notes passed. The same reasoning would apply for the creditors allowances journal.

Where the cash receipts journal and cash payments journal contain entries relating to trade debtors and trade creditors, these must also find their way to the sub-ledgers. An example would be a trade debtor paying their debt. We must record the cash coming in on the credit side of the debtors sub-ledger. This transaction reduces the balance of the asset in the sub-ledger. When we reduce an asset, we CREDIT the account.

Only in extreme cases would entries in the petty cash journals be posted to the debtors and creditors sub-ledgers.

The transactions from the following journals must also be posted to the sub-ledgers:

- Debtors allowances journal
- Creditors allowances journal.

The individual transactions from the debtors allowances journal and the creditors allowances journal must be posted to the respective debtors and creditors.

3.4 BALANCING OF GENERAL LEDGER ACCOUNTS

This balancing process means that, at the end of the accounting period (usually monthly), the general ledger accounts need to be balanced. The difference between the totals of the two sides of an account is the balance of that account.

What this means is that the debit entries in each individual account are added up, the credit entries are added up, and the difference between the two totals is calculated.

The balance of the account is written on the lesser side, in order to make both sides equal. At the beginning of the following accounting period, the balance is brought down to the opposite side of the account, as this balance belongs to the side that is greater.

Note

If the debit total exceeds the credit total, the balance in the individual account is a debit balance. Conversely, if the credit total exceeds the debit total, the balance is a credit balance.

The balance of an account is calculated as follows:

1. Add up the entries on the debit side of the account and write down the total in pencil.

2. Add up the entries on the credit side of the account and write down the total in pencil.

3. Deduct the smaller total from the larger total. The difference determined in this way constitutes the balance of the account.

4. This 'balance' is entered on the side of the account with the smaller total. The letters c/d are written in the folio column. These letters mean **carried down**, which means that this balance is carried forward to the following month.

5. The totals are now entered. After entering the balance, as discussed in (4) above, the totals of both sides of the account will now be equal. The totals are underlined with a double line.

6. On the first day of the following month, the balance calculated in (3) above is carried over to the opposite side of the account and entered below that side's total. This constitutes the opening balance for the new month's transactions. The letters b/d are written in the folio column. These letters stand for **brought down**, which means that this balance was carried forward from the previous month.

Example:

Dr			ACCOUNTS RECEIVABLE				Cr
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
20XX May 31	Sales (note 1)	DJ1	1 229.56	20XX May 31	Bank (note 1)	CRJ1	650.00
				(note 2)	**Balance**	c/d	**579.56**
(note 3)			1 229.56	(note 3)			1 229.56
June 1 (note 4)	**Balance**	b/d	**579.56**				

Note

1. The debit side totals R1 229.56, and the credit side totals R650. The balance is therefore R1 229.56 – 650 = R579.56.
2. The balance of R579.56 is entered on the same side as the smaller amount, i.e. credit side. The letters c/d are written in the folio column, to represent carried down, and are brought forward in the following month.
3. The two sides are totalled (and should agree), and a double line is drawn under the two totals.
4. The balance is brought down (b/d) on the opposite side on the 1st day of the following month. This balance becomes the opening balance for that particular account for that month.

An account is said to balance, or to be in balance, when both sides are equal. Double lines are drawn under each entry to show that the ledger account balances.

Example:

Dr			CREDIT LOSSES				Cr
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
20XX 5 May	Accounts receivable	GJ1	R500	20XX 31 May	Bank	CRJ1	R500

If an account has only one entry, there is no need to balance the account. The one entry would constitute the balance.

Example:

Dr			BANK CHARGES				Cr
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
20XX 31 May	Bank	CPJ1	R225.00				

If an account has more than one entry, but all the entries are on the same side of the account, then just add up the entries. Double lines are not drawn under the total, as this total would constitute the opening balance of the account for the next month.

Dr			ADVERTISING				Cr
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
20XX 31 May	Creditors	CJ1	1 250				
	Bank	CPJ1	5 800				
			7 050				

DEBIT BALANCE: DEBIT SIDE > CREDIT SIDE = ASSETS or EXPENSES

CREDIT BALANCE: CREDIT SIDE > DEBIT SIDE = LIABILITIES or INCOME

IN BALANCE: DEBIT SIDE = CREDIT SIDE

Before continuing with this topic, complete the following activity.

Activity

Fill in the missing words in the gaps below:

1. The difference between the two sides of an account is called the _________ of the account.

2. If an account has greater debit entries than credit entries, the balance on that account will be a ___________ balance.

3. If both sides of an account are equal to each other, we say that the account ________________.

4. A credit balance is the amount by which the ________ side of an account exceeds the __________ side.

5. The letters c/d stand for ______________.

6. If the debit side of an account is R2 500 and the credit side is R1 500, then the balance will be _________ on the ________ side.

7. The letters b/d stand for _______________.

8. If an account has only one entry, then ______________________.

9. If an account has more than one entry, but they are all on the same side of the account, then ________________________.

3.5 PREPARATION OF A PRE-ADJUSTMENT TRIAL BALANCE

3.5.1 The extraction of the trial balance

The final stage in the bookkeeping process is the extraction of the trial balance.

At the end of the accounting period (usually monthly), after all the general ledger accounts have been balanced, the balances of all the ledger accounts are written onto a separate sheet of paper, showing the debit balances in one column and the credit balances in a separate column. Because the double-entry concept has been followed, the total of the debit balances should equal the total of the credit balances.

The trial balance is not part of the bookkeeping system and is prepared on a separate sheet of paper. In addition, the trial balance is used as a summary that reflects the balances of all of the general ledger accounts from which the financial statements (i.e. the Statement of Profit or Loss and Other Comprehensive Income, and the Statement of Financial Position) are prepared.

The trial balance can also be used to check that the double-entry concept has been accurately applied (i.e. the total of the debit balances equals the total of the credit balances).

The following information is usually recorded on the trial balance:

a) Heading consisting of the statement name, company name and date
b) The name of the ledger account
c) The reference number of the ledger account
d) The balance of the account, with debits in one column and credits in another column.

I.M. THRIFTY TRIAL BALANCE AS AT 31 MARCH 20XX			
General ledger account	**Ref. No.**	**Debit**	**Credit**
Statement of Financial Position section:			
Bank	10	910	
Office equipment	15	1 500	
Accumulated depreciation: equipment	20		25

I.M. THRIFTY TRIAL BALANCE AS AT 31 MARCH 20XX			
General ledger account	Ref. No.	Debit	Credit
Capital: I.M. Thrifty	25		3 000
Drawings: I.M. Thrifty	30	400	
Accounts payable	35		100
Accounts receivable	40	600	
Statement of Profit or Loss and Other			
Comprehensive Income section:	100		1 300
Fees earned	110	400	
Rental	120	200	
Printing and stationery	130	40	
Telephone	140	350	
Salaries	150	25	
Depreciation		R4 425	R4 425

Note

Please remember that, even though your trial balance might balance (i.e. the total of debit balances equals the total of credit balances), this does not necessarily mean that your trial balance is correct. There could be other errors that are not picked up by the trial balance. These include the following:

- **Incorrect amounts recorded**: a purchase of R18 could be mistakenly recorded as R81 on both the debit and the credit sides of the relevant general ledger accounts.
- **Incorrect account used**: an expense item (e.g. Stationery) could be incorrectly posted to assets (e.g. Furniture and fittings) by mistake.
- **Transaction omitted**: a transaction could have been left out and not recorded.

3.5.2 Error identification: when your trial balance does not balance

If your trial balance does not balance, then proceed with the following steps until the error is identified:

1. Check the arithmetic of the debit and credit columns in the trial balance.
2. Compare the account balances, as reflected in the trial balance, with the account balances in the general ledger.
3. Re-perform the balancing procedure for each general ledger account.
4. Check the posting to the general ledger of each transaction.

Remember, prevention is better than cure. Ensure that each transaction is correctly posted to the correct accounts, so that these accounts are correctly balanced and reflected in the trial balance. This will ensure that you do not need to go through the laborious procedure of correcting errors after they have occurred.

Note

The Rule of 9: if the trial balance does not balance, the cause is often a transposition error. For instance, R18 is recorded as R81. To check if this happened to you, determine the difference between the two totals. If that difference is clearly divisible by nine (9), there is probably a transposition error. Let us attempt to apply the rule. R81 − R18 = 63. 63 ÷ 9 = 7. Remember, for this to apply there cannot be fractions. For example, 7.12 indicates other problems too.

Activity

The following journals appeared in the accounting records of Alma (Pty) Ltd, a VAT vendor. The accountant of Alma (Pty) Ltd left the company unexpectedly, and you have been appointed to assist with posting these journals to the correct ledger accounts. Amounts include VAT, where applicable.

Cash Receipts Journal of Alma (Pty) Ltd for the month of October 20XX

CRJ

Doc. no.	Date	Details	Bank (R)	VAT (R)	Sales (R)	Debtors (R)	Sundries	
							Amount (R)	Details
001	2	Cash sales	25 000	?	?			
002	5	R Brown	5 000			5 000		
003	15	ABC Bank	4 500				4 500	Interest
			34 500	**?**	**?**	**5 000**	**4 500**	

Cash Payments Journal of Alma (Pty) Ltd for the month of October 20XX

CPJ

Doc. no.	Date	Details	Bank (R)	VAT (R)	Creditors (R)	Wages (R)	Sundries	
							Amount (R)	Details
1010	3	Cash – wages	4 000			4 000		
1011	10	Marlboro	15 000		15 000			
1012	20	AB Suppliers	8 600	?			?	Purchases
1013	25	Lion Ltd	55 000	7 174			?	Equipment
1014	30	Cash – wages	4 000			4 000		
			86 600	**?**	**15 000**	**8 000**	**?**	

Debtors Journal of Alma (Pty) Ltd for the month of October 20XX

DJ

Doc. no	Details	Debtors (R)	VAT (R)	Sales (R)
IN800	R MartinsThy	8 500	1 109	7 391
IN801	P Bolobedu	2 500	326	2 174
IN802	T Scott	1 350	176	1 174
		12 350	**1 611**	**10 739**

Debtors Allowances Journal of Alma (Pty) Ltd for the month of October 20XX

DAJ

Doc. no	Details	Debtors (R)	VAT (R)	Sales (R)
IN800	R. Martins	350	46	304
		350	**46**	**304**

The following accounts have these opening balances, respectively:

Bank R5 400 (DR)
Debtors control R42 500 (DR).

Required:

Prepare the following general ledger accounts of Alma (Pty) Ltd for the month of October 20XX. These accounts need to be properly balanced off with the following:

1.1 The bank account
1.2 The debtors control account
1.3 The VAT control account.

Summary

Upon completion of this topic, you would have learned that the totals from the specific journals are posted to the general ledger. However, in certain circumstances, there are sundry entries that are made in a journal (think cash payments journal). These sundry entries cannot be grouped together and are therefore entered into the general ledger account on the day that they occur.

The same principle will apply to the general journal. Each journal entry must be individually posted.

You would have realised that, in all the journals, there are primary columns. The totals of these accounts must be posted to either the debit or credit side of the primary account. All the totals in the other accounts of the journal would then be posted to the opposite side to the posting in the primary account.

Totals of different columns (with the exception of the Sundries column where entries are posted individually) are posted from the CJ, CAJ, DJ and DAJ to the respective control accounts. All the entries in these journals must also be posted to the individual creditors or debtors in the creditors and debtors ledgers, respectively. The balance of the debtors control account and a list of all of the debtors from the debtors ledger should balance (the same principle applies to creditors).

In the last two subtopics, you learned how to balance the ledger accounts at month-end and how these balances must be reflected in a trial balance.

You learned how to end off books of first entry and how to post these totals to the general ledger. At the end of the period, normally a month, all general ledger accounts must be balanced. This is done by totalling the debit and credit sides. The balance carried down on the last day of the month is the difference between the two totals. The balance carried down is inserted on the side that is short. This balance is brought down on the first day of the next month on the opposite side. For example, if debits exceed credits, the balance carried down will be on the credit side, and the balance brought down on the debit side.

Once all the accounts have been balanced, a trial balance sheet can be drawn up. A trial balance is a list of all the accounts and their balances. If the double-entry principle has been correctly applied, the trial balance should balance, i.e. the total debits should equal the total credits.

Self-Assessment Questions

1. The following are the books of first entry of Blossoms. Post to the general ledger accounts, trade accounts receivable ledger accounts, and the accounts payable ledger accounts. Reconcile the accounts receivable and the accounts payable ledgers to their general ledger accounts. Ignore VAT.

   The following balances occurred in the books on 1 September 20XX:

<u>Debtors</u>		Capital	R30 000
Mrs Greenfingers	R2 755	Bank (Dr)	R14 792
Mrs Thorn	R4 110	Accounts receivable	R 6 865
<u>Creditors</u>		Accounts payable	R 3 657
Budding Roses (Pty) Ltd	–	Furniture & fittings	R12 000
Roots (Pty) Ltd	R3 457		
PB Garage	R 200		

BLOSSOMS
CREDITORS JOURNAL
MONTH: SEPTEMBER 20XX CJ1

Doc. no.	Date	Details	Fol.	Accounts payable	Inventory	Sundries		
						Fol.	Amt.	Details
565	3	Budding Roses (Pty) Ltd		9 950	9 950			
286	13	Roots (Pty) Ltd		950	950			
856	21	PB Garage		150			150	Petrol
				11 050	10 900		150	
				c/c				

BLOSSOMS CREDITORS ALLOWANCES JOURNAL MONTH: SEPTEMBER 20XX CAJ1								
Doc. no.	Date	Details	Fol.	Accounts payable	Inventory	Sundries		
						Fol.	Amt.	Details
896	17	Roots (Pty) Ltd		95.00	95.00			
				95.00	**95.00**			
				c/c				

BLOSSOMS DEBTORS JOURNAL MONTH: SEPTEMBER 20XX DJ1					
Doc. no.	Date	Details	Fol.	Accounts receivable	Sales
1	4	Mrs Greenfingers		4 950.00	4 950.00
2	19	Mrs Thorn		1 500.00	1 500.00
				6 450.00	**6 450.00**
				c/c	

BLOSSOMS DEBTORS ALLOWANCES JOURNAL MONTH: SEPTEMBER 20XX DAJ1					
Doc. no.	Date	Details	Folio	Accounts receivable	Sales
14	15	Mrs Greenfingers		650.00	650.00
				650.00	**650.00**
				c/c	

BLOSSOMS CASH RECEIPTS JOURNAL MONTH: SEPTEMBER 20XX CRJ1								
Doc. no.	Date	Details	Bank (Dr)	Sales (Cr)	Accounts receivable (Cr)	Sundries (Cr)		
						Fol.	Amount	Details
1	1	Mrs Blossom	10 000				10 000	Capital
2	11	Cash sales	3 000	3 000				
3	29	Mrs Greenfingers	4 902		4 902			
			17 902	**3 000**	**4 902**		**10 000**	
			c/c					

BLOSSOMS GENERAL JOURNAL J1				
Date	Details	Fol.	Debit	Credit
20XX Sept 2	Furniture and fittings Capital: Mrs Blossom *Furniture and fittings brought in by owner*	300 310	15 000.00	 15 000.00

See the following page.

BLOSSOMS CASH PAYMENTS JOURNAL MONTH: SEPTEMBER 20XX CPJ1									
Doc. no.	Date	Details	Bank (Cr)	Inventory (Dr)	Accounts payable (Dr)	Wages (Dr)	Folio	Sundry (Dr)	Details
1	7	Cash	990			990			
2	9	Office Refreshments	456					456	Refreshments
3	20	Cash	150	150					
4	25	Cash	990			990			
5	27	Budding Roses (Pty) Ltd	9 950		9 950				
			12 536	150	9 950	1 980		456	
			c/c						

Make sure you have attempted to answer the question fully, before looking at the solution.

2. Balance the Blossoms general ledger accounts and draft a trial balance as at 30 September 20XX.

3. Prove the accounting equation:

   Assets = Owner's equity + Liabilities using the trial balance created in Question 2.

4. **Multiple-choice questions**

   4.1 Which entry from the cash payments journal will be posted to the accounts receivable account in the general ledger?

   a) You pay a legal firm to start legal proceedings against a debtor who has not paid the firm for 120 days.

b) Your biggest debtor accidentally overpaid you when settling current purchases last week. You refund the overpayment.

c) You pay a supplier for goods delivered on credit last month.

d) You purchase a Christmas gift for the general manager of your biggest credit sales client.

4.2 Identify which primary journal would normally contain an entry to be posted to the debit side of the accounts receivable control account in the general ledger.

a) Petty cash journal

b) Debtors journal

c) Cash receipts journal

d) Creditors adjustment journal

4.3 **Select** which account is **not** normally found in a petty cash journal.

a) Stationery

b) Postage

c) Staff refreshments

d) Accounts receivable

4.4 In which journal column is the general ledger account number of the relevant account written?

a) Folio

b) Details

c) Sundry

d) Purchases

4.5 What is the purpose of the cash receipts journal?

a) Records cash being spent by the business

b) Records, among other things, deposits from accounts receivable

c) Records, among other things, payments made by cheque

d) Records the imprest cheque issued by the cashier, which is, in turn, received by the petty cash clerk

4.6 What happens when posting to the general ledger from the cash receipts journal?

a) The total of the accounts receivable column is a debit to the accounts receivable account.
b) The folio column is not important, because no one ever queries deposits
c) The bank account would be credited with the total receipts
d) The bank account would be debited with the total receipts

4.7 What is the petty cash imprest system?
a) A performance measurement system that measures petty cash staff performance
b) The advance paid to the petty cash — the petty cash should always balance at month-end
c) The rolling balance of the cash advanced, less cash spent
d) The minimum amount of cash that the petty cash clerk would be allowed to keep in the petty cash tin

4.8 Which document would be used as a source document to record entries found in the creditors journal?
a) Cheque issued
b) Invoice issued by your marketing manager
c) Invoice received from supplier
d) Request for credit note raised

5. **Indicate whether the following statements are true/false**:

5.1 Entries in the debtors journal must also be posted to the accounts receivable ledger.

5.2 When posting to the ledger, it is not necessary to state the contra account (i.e. the other account affected).

5.3 A balance is brought down on the last day of the month.

5.4 It does not matter if the accounts receivable general ledger control account does not agree with the accounts payable ledger.

5.5 A balance carry-down will always appear on the side that has the highest total.

5.6 Cash payments for accounts payable do not have to be posted to the accounts payable subsidiary ledger.

5.7 Sundry entries in the journals are posted to the ledger on the date on which they occur.

5.8 The accounts receivable account in the general ledger will only reflect the total amount owing by all of the debtors.

5.9 When we reduce an asset, we debit the account.

5.10 The trial balance cannot pick up all errors made in the accounting process.

Topic 4
Bank reconciliation

4.1 INTRODUCTION

This topic relates to the following module outcome:

4. Prepare bank reconciliations.

A business will have a bank account with one or more commercial banks. The business will make use of cash receipts and cash payments journals to record its cash transactions. The total of the bank column of the cash receipts and cash payments journals are posted to the bank account in the general ledger at the end of each month. The balance in the bank account in the general ledger reflects the amount of cash the business believes to have in the bank. However, the balance shown in the bank account in the general ledger might not be the same as balance according to the bank, as reflected on the bank statement sent by the bank. It is, therefore, necessary to compare the balance shown on the bank statement to the balance shown in the bank account, and then reconcile these balances. In this topic, you will learn why there are discrepancies between these balances and how to reconcile these discrepancies.

The business will most probably only bank the cash received each day on the following business day. The business will also make electronic funds transfers and card payments. These payments might not immediately be reflected on the bank statement. It is for this reason that the balance in the business bank account and the balance that the commercial bank has in its books will not be the same at month-end.

In this topic, you will gain knowledge in the following areas:

1. The need for bank reconciliations
2. Understanding reconciling items
3. Preparation of bank reconciliation statement.

4.2 THE NEED FOR BANK RECONCILIATIONS

4.2.1 Purpose

Performing bank reconciliations in a business is a formal requirement. However, we perform reconciliations every day.

Examples:

Example 1:
You withdraw R1 000 from an ATM. When you look in your wallet again, you note that only R600 is left. You wonder if you have lost some money, but after adding up your cash spend in your head, you realise that R600 is about right.

Example 2:
You receive your statement from the bank and review it for errors. You may or may not write down a reconciliation note, but at least if the balance is not what you had expected, you will be able to see why and to satisfy any questions that you may have.

The examples above are all forms of reconciliation. In a business, the process is more formal and the business' own records (i.e. cash book) must be formally reconciled to the bank statement.

Cash is one of the most important assets that a business can have. It is therefore essential to check or reconcile the bank statement that you receive with the balance on the bank account shown in the books of the business.

In the business world, the bank statement and the cash book seldom agree, but they need to be reconciled (i.e. made to agree). The reasons why they may not agree fall into three categories: unrecorded or adjusting items, timing differences, and errors.

4.2.2 The reasons why the bank statement and cash book may not agree

1. Items appear on the bank statement that have not yet been accounted for in the cash book ('unrecorded items'). These include:
   - Bank charges
   - Interest charged on a negative bank balance or interest received on a positive bank balance

- Debit orders and stop orders
- Direct payments made by debtors.

2. Items that appear in the cash book but are not yet reflected on the bank statement (i.e. timing differences). These include:
   - Outstanding electronic funds transfers (EFTs)
   - Deposits not yet credited by the bank
   - Errors made by the business.

3. Errors or fraud. These include:
   - Incorrect capturing of figures (for example, R12 captured as R21)
   - Unauthorised transactions that have been honoured by the bank (for example, unauthorised debit orders)
   - Debits being recorded as credits either in the cash book or on the bank statement.

We will now discuss these categories in more detail.

4.3 UNDERSTANDING RECONCILING ITEMS

4.3.1 Items in the bank statement that have not yet been accounted for in the cash book

Certain transactions are generated by the bank without the business being aware of the transactions. The business only becomes aware of these transactions upon receiving its bank statement for the month. The business will then use the bank statement as a source document to record the transactions in the cash book. These transactions are known as unrecorded or adjusting items, because they have not yet been recorded in the accounting records of the business.

Bank charges

Banks charge account holders for services provided. Services provided by the bank include deposit taking, account maintenance, processing domestic and international payments, processing instant payments, processing debit orders and stop orders, and reversing debit orders and cancelling stop orders. These are classified in the business books as bank charges and are reflected on the bank statement.

From the bank statement, the business will ascertain the amount of bank charges for the current month and record these charges as payments in the cash payments journal.

Interest received or interest paid

Depending on the bank balance amount, the account holder will either pay interest to the bank or receive interest from the bank. If the account balance is positive (i.e. the business has money in the bank so the bank owes the business money), then the bank will pay interest to the business.

If the account balance is negative (i.e. the business has borrowed money from the bank, and as such, owes money to the bank), then the bank will charge the business interest.

The business will see, from the bank statement, the amount of interest for the current month and record:

- interest paid as a payment in the cash payments journal.
- interest received as a receipt in the cash receipts journal.

Debit orders and stop orders

Debit orders are instructions to a third party, such as internet service provider or insurer, to withdraw money from your account. The permission is granted for a specified amount to a specified person or business on a specific date. This often occurs when paying a recurring monthly amount, such as insurance or rent.

A stop order is an arrangement with the bank where you give the bank permission to pay someone on your behalf. A stop order can be cancelled by approaching the bank and instructing the bank to cancel the stop order. A debit order, on the other hand, can be cancelled by approaching the third party you authorised to withdraw money from your account and ask them to cancel the debit order with the bank.

On receipt of the bank statement, the business will identify which debit orders and stop orders have been processed by the bank and record them as payments in the cash payments journal.

Direct deposits

Third parties, such as debtors and suppliers, can make payments directly into the business' bank account. Deposits into the bank account can be made by making a deposit in a bank branch, making a deposit at an automated teller machine (ATM), making an EFT via internet banking or a banking app, or through debit orders and stop orders. Direct deposits appear on the bank statement, but not in the cash receipts journal. Upon receipt of the bank statement, the business will need to record the direct deposits in the cash receipts journal.

Before continuing with this topic, complete the activity.

Activity

1. The bank statement is prepared and issued by __________.

2. A debit entry in your cash book would equate to a _________ entry on the bank statement.

3. A transaction that is generated by the bank and appears on the bank statement but is not yet accounted for in the business's cash book is called a ______________________.

4. A transaction that appears in the cash book but has not yet been reflected on the bank statement is known as a ___________________.

5. Name four examples of 'unrecorded items'.

4.3.2 Items in the cash book that are not yet reflected in the bank statement

These are known as 'timing differences', because the only reason they are reflected in the cash book and not in the bank statement is because there has not been sufficient time for the bank to receive these transactions.

Outstanding EFTs

When an EFT is made, the bank and the business should become aware of the transaction at the same time. However, there are instances where EFT payments are recorded in the cash payments journal, but not be fully processed immediately by the bank. These payments might not appear on the bank statement immediately.

When performing the bank reconciliation, it is important to first compare the list of EFTs made by the business (as per the cash payments journal) to the list of EFTs recorded by the bank (as per the bank statement). Any EFTs that are not shown on the bank statement must be reflected on the bank reconciliation as outstanding EFTs.

Outstanding deposits

Depending on the time of day that the business deposited the money at the bank, the bank may only reflect the receipt the following day. This will be an outstanding deposit if the day concerned is the last day of the month.

The business will reflect the deposit in the cash receipts journal on the last day of the month, but the bank will only reflect the deposit in the bank statement on the first day of the following month.

When performing the bank reconciliation, the list of deposits made by the business (as per the cash receipts journal) must be compared to the list of deposits received by the bank (as per the bank statement). Any deposits that are not shown on the bank statement must be reflected on the bank reconciliation as outstanding deposits.

Errors and fraud

Errors are sometimes found when reconciling a bank statement. Payments or deposits could be recorded incorrectly. These errors could have been made in the accounting records of the business, or even made by the bank. The different methods of handling these errors depend on where the mistake was made.

Errors made in the cash book journals must be corrected in the cash book journals. This can be done by deleting the incorrect amount and writing in the correct amount, or by writing in an adjusting amount.

Errors made by the bank or fraudulent/unauthorised entries must be shown on the bank reconciliation and the bank must be notified of these.

4.4 PREPARATION OF BANK RECONCILIATION STATEMENT

4.4.1 The format and procedure of the bank reconciliation statement

The following are the steps to be followed when performing the bank reconciliation:

1. Update and balance the cash book journals for the current month.

2. Receive the bank statement from the bank.

3. Compare the cash book journals account for the current month with the bank statement for the current month and the bank reconciliation statement from the previous month.

   Items that appear on both the cash book journals and the bank statement (i.e. reconciled items) must be agreed (usually ticked). Similarly, items that appeared on the previous month's bank reconciliation statement and on the current month's bank statement must be agreed (last month's timing differences).

   Remember that the items will appear on opposite sides of the cash book journals and the bank statement (i.e. compare entries in the cash receipts journal with entries in the credit column of the bank statement and entries in the cash payments journal with entries in the debit column of the bank statement).

   The unreconciled items must be inspected and classified into the categories discussed in the sections above.

4. Unrecorded items that appear on the bank statement, but not in the cash book, must be recorded in the cash book journals.

5. The final step, now that the cash book journals have been updated and corrected with all valid transactions, is the preparation of the bank reconciliation statement. This statement will contain the items that already appear in the records of the business, but do not appear in the bank statement, along with errors made by the bank on the bank statement.

The format of the bank reconciliation statement is as follows:

Bank reconciliation statement of Cash Traders (Pty) Ltd for the month of March 2023	
	R
Balance per bank statement	XXXX
Less: outstanding EFTs	(XXXX)
Add: outstanding deposits	XXXX
Less/add: bank errors	XXXX
Balance as per cash book	**XXXXX**

In the format above, we have assumed that the bank account has a positive balance (the business has money in the bank). For this reason, when the outstanding EFTs are finally fully processed by the bank, the bank balance will decrease. When outstanding deposits are received by the bank, the bank balance will increase.

Therefore, in this format, outstanding EFTs are shown as a deduction from the bank statement balance and outstanding deposits are shown as additions to the bank statement balance.

Before continuing with this topic, complete the activity.

Activity

1. A 'timing difference' is when ______________________________________.

2. EFTs that have been made by a business but have not yet appeared on the bank statement are known as _________________________________.

3. Cash deposits made by a business, but which have not yet appeared on the bank statement are known as _________________________________.

4. If a business incorrectly records an EFT as R199, instead of the correct R119, then the correction must be ________________________________.

5. If the bank incorrectly records an EFT as R199, instead of the correct R119, then the correction must be ________________________________.

6. Transactions that appear correctly on both the bank statement and the cash book are known as ____.

7. When performing the bank reconciliation, the 'unrecorded items' must be ____.

8.	When performing the bank reconciliation, the 'timing differences' must be ____.

4.5 PRACTICAL EXAMPLES OF BANK RECONCILIATION

In the following example, you are required to:

a) Update the cash book where necessary.
b) Complete the bank reconciliation statement for the month of March 2023.

BANK RECONCILIATION STATEMENT OF CASH TRADERS FOR THE MONTH OF FEBRUARY 2023	
	R
Balance per bank statement	6 103.18
Less outstanding EFTs:	
EFT no. 594	(2 000.00)
EFT no. 595	(40.00)
EFT no. 596	(320.00)
EFT no. 599	(200.00)
EFT no. 601	(300.00)
Add outstanding deposits:	
Deposit slip no. 0371	500.00
Balance as per bank account	**3 743.18**

CASH BOOK OF CASH TRADERS FOR THE MONTH OF MARCH 2023		
	Debit	Credit
Opening balance	3 743.18	
Cash receipts:		
March 3	500.00	
March 10	300.00	
March 17	700.00	
March 24	2 000.00	
March 31	200.00	

Cash payments:		150.00
EFT no. 602		200.00
EFT no. 603		100.00
EFT no. 604		800.00
EFT no. 605		3 000.00
EFT no. 606		400.00
EFT no. 607		350.00
EFT no. 608		2 443.18
Bank balance at 31 March 2023	7 443.18	7 443.18

NATIONAL BANK BANK STATEMENT OF CASH TRADERS FOR THE MONTH OF MARCH 2023				
Date	**Description**	**Debit (R)**	**Credit (R)**	**Balance**
1	Balance			6 103.18
2	Deposit		500.00	6 603.18
3	EFT no. 594	2 000.00		4 603.18
	Transaction fees	3.18		4 600.00
5	Deposit		500.00	5 100.00
7	EFT no. 595	40.00		5 060.00
	EFT no. 601	300.00		4 760.00
	Monthly account fees	5.00		4 755.00
12	Deposit		300.00	5 055.00
14	EFT no. 602	150.00		4 905.00
	EFT no. 605	800.00		4 105.00
16	EFT no. 606	3 000.00		1 105.00
18	Deposit		700.00	1 805.00
	EFT no. 596	320.00		1 485.00
21	EFT no. 603	200.00		1 285.00
	Transaction fees	2.00		1 283.00
	EFT no. 604	100.00		1 183.00
25	Deposit		2 000.00	3 183.00
31	EFT no. 607	400.00		2 783.00

Please try to answer this question on your own before referring to the model answer.

SUGGESTED SOLUTION PRACTICAL EXAMPLE

1. First agree (i.e. reconcile) items that appear on the bank statement and either the cash book journals or the previous month's bank reconciliation.

The reconciled items have been ticked off as shown below.

BANK RECONCILIATION STATEMENT OF CASH TRADERS FOR THE MONTH OF FEBRUARY 2023	
	R
Balance per bank statement	6 103.18
Less outstanding EFTs:	
EFT no. 594	(2 000.00) √
EFT no. 595	(40.00) √
EFT no. 596	(320.00) √
EFT no. 599	(200.00)
EFT no. 601	(300.00) √
Add outstanding deposits:	
Deposit slip no. 0371	500.00 √
Balance as per bank account	**3 743.18**

CASH BOOK OF CASH TRADERS FOR THE MONTH OF MARCH 2023		
	Debit	**Credit**
Opening balance	3 743.18	
Cash receipts:		
March 3	500.00 √	
March 10	300.00 √	
March 17	700.00 √	
March 24	2 000.00 √	
March 31	200.00	
Cash payments:		
EFT no. 602		150.00 √
EFT no. 603		200.00 √
EFT no. 604		100.00 √
EFT no. 605		800.00 √
EFT no. 606		3 000.00 √
EFT no. 607		400.00 √

EFT no. 608		350.00
Bank balance at 31 March 2023		2 443.18
	7 443.18	**7 443.18**

NATIONAL BANK BANK STATEMENT OF CASH TRADERS FOR THE MONTH OF MARCH 2023				
Date	**Description**	**Debit (R)**	**Credit (R)**	**Balance**
1	Balance			6 103.18
2	Deposit		500.00 √	6 603.18
3	EFT no. 594	2 000.00 √		4 603.18
	Transaction fees	3.18		4 600.00
5	Deposit		500.00 √	5 100.00
7	EFT no. 595	40.00 √		5 060.00
	EFT no. 601	300.00 √		4 760.00
	Monthly account fees	5.00		4 755.00
12	Deposit		300.00 √	5 055.00
14	EFT no. 602	150.00 √		4 905.00
	EFT no. 605	800.00 √		4 105.00
16	EFT no. 606	3 000.00 √		1 105.00
18	Deposit		700.00 √	1 805.00
	EFT no. 596	320.00 √		1 485.00
21	EFT no. 603	200.00 √		1 285.00
	Transaction fees	2.00		1 283.00
	EFT no. 604	100.00 √		1 183.00
25	Deposit		2 000.00 √	3 183.00
31	EFT no. 607	400.00 √		2 783.00

The cash book is updated for the unrecorded items:

CASH BOOK OF CASH TRADERS FOR THE MONTH OF MARCH 2023		
	Debit	**Credit**
Opening balance	3 743.18	
Cash receipts:		
March 3	500.00 √	
March 10	300.00 √	
March 17	700.00 √	

March 24	2 000.00 √	
March 31	200.00	
Cash payments:		
EFT no. 602		150.00 √
EFT no. 603		200.00 √
EFT no. 604		100.00 √
EFT no. 605		800.00 √
EFT no. 606		3 000.00 √
EFT no. 607		400.00 √
EFT no. 608		350.00
Bank charges (3.18 + 5.00 + 2.00)		10.18
Bank balance at 31 March 2023		2 433.00
	7 443.18	**7 443.18**

3. The bank reconciliation statement for the month of March 2023 can then be prepared:

BANK RECONCILIATION STATEMENT OF CASH TRADERS FOR THE MONTH OF MARCH 2023	
Balance per bank statement	2 783.00
Less outstanding EFTs:	
EFT no. 599	(200.00)
EFT no. 608	(350.00)
Add outstanding deposits:	
Deposit no. 0377	200.00
Balance as per cash book	**2 433.00**

Summary

In the introduction to this topic, it was explained that the balance in the business account may not agree with that of the commercial bank. This is because EFTs and deposits may not yet be processed by the bank. However, the bank will also debit the account holder (i.e. the business) with items such as bank charges and debit order. The business would only find out about these items once it receives its bank statement.

The fact remains, however, that these balances still need to be rectified, so that the business knows how much cash it has available to pay its debts.

The first step in the bank reconciliation process is comparing the previous month's reconciliation statement, the bank statement for this month and the cash journals. You would have learned how to adjust for these differences. Any amounts that appear on the bank statement and not in the cash journals are called unrecorded items, because they have not been recorded in the books of the business. These transactions would still have to be recorded in the cash journals of the business.

Where amounts appear in the cash journals but not on the bank statement, it is due to timing differences. There is a time delay before these amounts are reflected by the bank. These differences must be recorded on the bank reconciliation statement.

The process of a bank reconciliation statement begins with the balance, as per the bank statement; then we add or subtract any timing differences and errors, and reconcile this to the bank account as per the accounting records (i.e. the cash journals). After this process, the balance as per the bank statement will reconcile with that of the bank account.

The next topic will culminate in the drawing up of financial statements.

Self-Assessment Questions

1. The following information is provided for Spenders (Pty) Limited. You are required to:

   1.1 Complete the cash book.

   1.2 Complete the bank reconciliation statement for March 2023.

BANK RECONCILIATION STATEMENT OF SPENDERS (PTY) LTD FOR THE MONTH OF FEBRUARY 2023	
Balance per bank statement	1 065.00
Less outstanding EFTs:	
EFT no. 235	(250.00)
EFT no. 238	(365.00)
Add outstanding deposits:	
Deposit slip no. 0379	500.00
Balance as per cash book	**950.00**

Summary of the CRJ and CPJ:

CASH BOOK OF SPENDERS (PTY) LTD MARCH 2023						
	Receipts				Payments	
Date	Detail	Amount	Date	Detail	EFT No.	Amount
02	Deposit	750.00	01	Wages	239	600.00
09	Deposit	655.00	05	Purchases	240	1 500.00
16	Deposit	1 560.00	12	Rent	241	750.00
23	Deposit	900.00	16	Electricity	242	150.00
28	Deposit	1 450.00	21	Wages	243	600.00
			25	A. Creditor	244	950.00
			28	Drawings	245	500.00

NATIONAL BANK BANK STATEMENT OF SPENDERS (PTY) LTD MARCH 2023				
Date	Transaction details	Debit (R)	Credit (R)	Balance (R)
01	Balance			1 065.00
	Deposit		500.00	1 565.00
02	EFT no. 235	250.00		1 315.00
03	Deposit		750.00	2 065.00
05	EFT no. 239	600.00		1 465.00
	EFT no. 238	365.00		1 100.00
09	EFT no. 240	1 500.00		(400.00)
10	Deposit		655.00	255.00
17	Deposit		1 560.00	1 815.00
19	EFT no. 241	750.00		1 065.00
	EFT no. 242	150.00		915.00
21	EFT no. 243	600.00		315.00
24	Deposit		900.00	1 215.00
27	Debit order (insurance)	150.00		1 065.00
28	Bank charges	50.00		1 015.00

2. The following information is provided for Checkit Traders. You are required to:

   2.1 Complete the cash book.

   2.2 Complete the bank reconciliation statement for December 2022.

BANK RECONCILIATION STATEMENT OF CHECKIT TRADERS FOR THE MONTH OF NOVEMBER 2022	
Balance per bank statement	950.00
Less outstanding EFTs:	
EFT no. 1265	(500.00)
EFT no. 1270	(700.00)
EFT no. 1273	(400.00)
Add outstanding deposits:	
Deposit slip no. 0382	2 500.00
Balance as per cash book	**1 850.00**

Summary of the CRJ and CPJ:

CASH BOOK OF CHECKIT TRADERS DECEMBER 2022						
Receipts			Payments			
Date	Detail	Amount	Date	Detail	EFT No.	Amount
08	Deposit	1 500.00	02	Wages	1274	2 100.00
15	Deposit	1 800.00	10	Electricity	1275	500.00
22	Deposit	1 200.00	15	A. Creditor	1276	3 500.00
30	Deposit	1 600.00	18	C. Debt	1277	2 300.00
			23	Wages	1278	1 700.00
			29	AC Supplies	1279	1 750.00

NATIONAL BANK BANK STATEMENT OF CHECKIT TRADERS DECEMBER 2022					
Date	Transaction details	Debit (R)	Credit (R)	Balance (R)	
01	Balance			950.00	
02	EFT no. 1270	700.00		250.00	
	Deposit		2 500.00	2 750.00	
05	EFT no. 1274	2 100.00		650.00	
09	Deposit		1 500.00	2 150.00	
	EFT no. 1273	400.00		1 750.00	
13	EFT no. 1275	500.00		1 250.00	
16	Deposit		1 800.00	3 050.00	
18	EFT no. 1276	3 500.00		(450.00)	OD
20	Deposit		500.00	50.00	
	EFT no. 1277	3 200.00		(3 150.00)	OD
23	Deposit		1 200.00	(1 950.00)	OD
25	EFT no. 1278	1 700.00		(3 650.00)	OD
30	Bank charges	150.00		(3 800.00)	OD
OD = overdrawn					

Additional information:

- The deposit on 20 December of R500.00 was made directly into Checkit Traders' bank account by a debtor.
- EFT number 1277 was incorrectly recorded by the bank. The cash book entry is correct.

3. **Multiple-choice questions**:

3.1 Identify the journals to which the bank statement is reconciled:
   a) The cash receipts and cash payments journal
   b) The debtors and debtors adjustment journal
   c) The creditors and the creditors adjustment journal
   d) The petty cash journal

3.2 A set of annual financial statements has recorded bank and cash under the liabilities section. Select the correct statement:
   a) The bank account in the ledger will have a debit balance and the bank statement a debit balance.
   b) The bank account in the ledger will have a debit balance and the bank statement a credit balance.
   c) The bank account in the ledger will have a credit balance and the bank statement a debit balance.
   d) The bank account in the ledger will have a credit balance and the bank statement a credit balance.

3.3 What item is **not** classified as an unrecorded item in the context of bank reconciliations?
   a) Bank charges
   b) Deposits not yet credited by the bank
   c) Interest received
   d) Facility fee

3.4 Select the true statement:
   a) Errors or fraud on the bank statement must also be recorded in the cash payments journal, until the bank corrects it.
   b) Errors or fraud on the bank statement are not to be recorded anywhere.
   c) Errors or fraud on the bank statement must be recorded in the profit and loss account to be prudent.
   d) Errors or fraud on the bank statement must be recorded on the bank reconciliation until the bank corrects it.

3.5 What are examples of timing differences in the bank reconciliation process?
   a) Outstanding EFTs not yet presented for payment

b) Outstanding interest that the bank has not yet paid and that has not been recorded in the cash receipts journal
c) Outstanding bank charges that the bank will levy on the first day of the next month
d) All of the above

3.6 A business incorrectly records an EFT in the cash book for R100, instead of R110. On what is the correction done?
a) Bank reconciliation
b) Creditors journal
c) Petty cash journal
d) Cash book

3.7 Select the incorrect statement:
a) EFTs will be recorded in numerical sequence in the cash payments journal.
b) EFTs not appearing on the bank statement will be listed on the reconciliation.
c) EFTs will appear in numerical sequence on the bank statement.
d) EFTs will appear on the bank statement in the order that the bank processed them.

3.8 Assume a positive bank balance. There are several EFTs not yet appearing on the bank statement. Select the correct statement:
a) The cash journal will have a lesser balance than the bank.
b) The cash journal will have a greater balance than the bank.
c) The cash journal will have the same balance as the bank.
d) The cash journal will not record the EFTs unless they have been cleared by the bank.

3.9 Assume a positive bank balance. There are bank charges not recorded in the cash payments journal. Select the correct statement:
a) The cash journal will have a lesser balance than the bank.
b) The cash journal will have a greater balance than the bank.

c) The cash journal will have the same balance as the bank.

d) The cash journal will not record the bank charges.

3.10 Is the following statement true or false: a debit entry in the general ledger will result in a credit entry on the bank statement.

a) False

b) True

4. You are presented with a bank reconciliation of Chancers Limited. Review the document and answer the related questions.

Bank reconciliation of Chancers Limited for February 2023

Line	Description	Total
01	Balance per bank statement	10 000
02	Outstanding EFTs:	
03	EFT no. 129	850
04	EFT no. 185	750
05	EFT no. 186	300
06	EFT no. 188	100
07	EFT no. 189	200
09	Outstanding cash deposits 28 February	3 000
10	Deposit incorrectly recorded by the bank as R5 200 instead of R2 500	2 700
11	EFT incorrectly debited twice on bank statement	500
12	Unauthorised debit order — NKL Trading	600
13	Balance per cash book	9 200

4.1 The accountant did not indicate whether the amounts are to be added to or deducted from the bank balance. The bank statement had a favourable balance of R10 000. Correct the signage to allow the reconciliation to balance on R9 200.

4.2 Line 10: apart from noting the deposit as incorrect on the bank reconciliation, what else should be done?

4.3 Line 11: provide an explanation for what could have caused the duplication on the bank statement.

4.4 Line 12: what is the process to follow to correct the unauthorised debit order?

4.5 What is the balance that will be recorded in the trial balance and the annual financial statements: R10 000 or R9 200? Why?

5. Indicate whether the statements below are true or false. The questions relate to the bank reconciliation of Risk Takers (Pty) Ltd found below.

Bank reconciliation of Risk Takers (Pty) Ltd for March 2023

Line	Description	Total
01	Balance per bank statement	(5 000)
02	Outstanding EFTs:	
03	EFT no. 29	(25)
04	EFT no. 85	(75)
05	EFT no. 86	(30)
06	EFT no. 88	(100)
07	EFT no. 89	(200)
08	Outstanding cash deposits 28 February	350
09	Interest due and payable that the bank only credited on 1 June 2019 in error	175
10	**Balance per cash book**	

5.1 The bank statement has an overdrawn balance.

5.2 In the event of a positive bank balance, outstanding EFTs are added and, when overdrawn, the EFTs are deducted.

5.3 The correct balance per the cash book is R4 905 (overdrawn).

5.4 Bank reconciliations record differences between the bank statements and cash payments journal only.

Topic 5
Year-end adjustments

5.1 INTRODUCTION

This topic relates to the following module outcome:

4. Prepare year-end adjustments.

Topic 3 dealt with the posting of journal entries to the general ledger and the closing of such accounts. A trial balance was then drawn up. You need to remember that all of this is done at month-end.

In accounting, it is necessary to bring these amounts into consideration only for the period for which they are made or due. This is part of what is referred to as 'accounting concepts'.

At year-end, however, there could be certain amounts received or payments made by the business during the current accounting period that relate to the following accounting period or amounts that are due to the business or due by the business that have not been paid by the end of the current accounting period.

The key accounting concepts are the **matching concept**, the **prudence concept** and the **accrual concept**. You will learn the meaning of these concepts and how to apply them for a specific accounting period. You will also learn of the general ledger accounts involved, the determination of amount of the adjustment required and the preparation of the relevant adjusting journal entries.

Once these adjustments have been made, it is necessary to draw up another trial balance. This trial balance is known as the 'post-adjustment trial balance'. This trial balance is then used to draw up the financial statements of a business.

In this topic, you will gain knowledge in the following areas:

1. Matching and prudence concepts
2. Depreciation adjustment

3. Inventory adjustments
4. Year-end adjustments
5. Extraction of the adjusted balances and preparation of the post-adjustment trial balance.

5.2 MATCHING AND PRUDENCE CONCEPTS

5.2.1 The matching concept

The matching concept states that revenue and expenses must be matched within the relevant accounting period. If an expense has been incurred that will only produce a benefit in the next accounting period, then such an expense must be carried over to the next accounting period, so that it will be matched with the revenue that it earns.

Because the expense has already been incurred, the business is still owed the benefit. It is for this reason that the expense will be carried over as an asset to the next accounting period on the Statement of Financial Position.

Similarly, if revenue is received for a benefit that will only be reaped in the next accounting period, then such revenue (e.g. rent received in advance) must be carried over to the next accounting period, to match the benefit. This will be reflected in the Statement of Financial Position as a liability because the benefit is still owed by the business.

The same applies to depreciation. If a motor vehicle is purchased, it will produce economic benefits to the business over several years, but the cost of acquiring the vehicle is incurred in the first year (assuming a cash purchase). The cost of acquiring the vehicle must therefore be spread over the useful life of the vehicle to match the benefit derived from the use of the vehicle each year. The portion of the cost that is matched to the revenue is called depreciation and is deducted from income as an expense in the Statement of Profit or Loss and Other Comprehensive Income.

Inventory (i.e. stock) is also affected by the matching concept. Any inventory that has been purchased but not yet sold at period-end (i.e. closing inventory) must be carried over to the next period as opening inventory. This allows the business to match the inventory sold as an expense against the revenue earned from the sale of such inventory.

5.2.2 The prudence concept

This concept states that receipts are only recognised as income if the receipt is certain. Appropriate provision must be made for all liabilities in connection with expenses and losses. A profit is only recognised when it is made, but a loss is accounted for as soon as it becomes known.

5.3 DEPRECIATION ADJUSTMENT

Businesses need non-current assets in order to function. These non-current assets could include motor vehicles, office equipment, computers, etc. Non-current assets are purchased items that have an expected useful life of longer than 12 months. In terms of the matching concept, the cost of the non-current assets needs to be allocated as an expense against the income that those assets help produce over their useful lives.

Example:

Machinery and equipment costing R2 000 000 are purchased on 1 January 2022. The useful life of the equipment is expected to be ten years, at which time the equipment is expected to be worth R100 000. Over the ten-year period, the machine will cost the business R1 900 000 (i.e. the original cost less the realisable value: R2 000 000 less R100 000).

This R1 900 000 needs to be accounted for as an expense in the accounting records of the business over the useful life of the machine. It is incorrect for the business to show the full R1 900 000 as an expense in the first year in which the machine is purchased (2022). It is also incorrect for the business to show the full expense in the year that the machine is disposed of (2032). The correct method is to write off the expense over the ten-year period.

Depreciation is the allocation of the depreciable amount of an asset over its estimated useful life. Depreciation is a measure of wear and tear, consumption, or other loss of value in a non-current asset. This arises due to use, the lapsing of time, or obsolescence due to technological advancement or changes in the market.

5.3.1 Accounting for depreciation

The portion of the asset that is allocated as the amount of depreciation in an accounting period is debited to the depreciation account (i.e. an expense). The corresponding double entry will be a credit to the accumulated depreciation account (i.e. a reduction in the value of the asset). The accumulated depreciation (i.e. the negative asset) account is 'attached' to the asset account, which remains unchanged.

The difference between the asset account (i.e. the debit balance) and the accumulated depreciation account (i.e. the credit balance) is the net carrying (i.e. the book) value of the asset, which represents the portion of the fixed asset that has not yet been apportioned as an expense.

A machine costing R25 000 is acquired on 1 January 2022. The anticipated useful life is four years, at which point the asset will be worth R9 000. Each year, the depreciation will be recorded as follows:

General journal

	Debit	**Credit**
Depreciation (expense)	4 000	
Accumulated depreciation		4 000

Calculation:

$$\text{Depreciation} = \frac{(\text{R}25\ 000 - \text{R}9\ 000)}{4}$$

At the end of Year 1, the following balances will be reflected in the general ledger:

	Debit	**Credit**
Depreciation (expense account)	4 000	
Computers (fixed asset account)	25 000	
Accumulated depreciation — computers		4 000

The carrying (book) value of the computer will be:

R25 000 – 4 000 = R21 000

Several methods exist to calculate the depreciation charge. However, for purposes of this module, we will focus on two of these methods.

5.3.2 Methods of calculating depreciation

There are various methods used to calculate depreciation. Remember, the matching concept requires us to match the costs of the non-current asset to the income that the asset has produced.

The consistency concept also requires us to keep the same method once we have decided on one. This is to ensure comparability in different accounting periods. The best way to gain an understanding of the different methods is by way of example.

5.3.3 The straight-line method (fixed instalment (amount) method)

With this method, equal amounts are written off as depreciation over the life of the asset. An asset costs R45 000 on 1 January 2020, and it has an anticipated useful life of five years. At the end of the five years, the asset is expected to be worth R5 000.

The annual depreciation is calculated as follows:

(R45 000 – R5 000)/5 years = R8 000 per annum

The asset, the accumulated depreciation, the net book value, and the depreciation accounts will be as follows over the useful life of the asset:

Date	Cost price	Depreciation	Accumulated depreciation	Net carrying amount
01/01/2020	R45 000	-	-	R45 000
31/12/2021	R45 000	R8 000	R 8 000	R37 000
31/12/2022	R45 000	R8 000	R16 000	R29 000
31/12/2023	R45 000	R8 000	R24 000	R21 000
31/12/2024	R45 000	R8 000	R32 000	R13 000
13/12/2025	R45 000	R8 000	R40 000	R5 000

5.3.4 The reducing (diminishing) balance method

With this method, the amount of depreciation reduces each year. When the asset is new, it loses value more quickly than it does as it gets older. Depreciation is calculated by applying a fixed percentage against the net carrying value (as opposed to the original cost, less scrap value, which is used in the straight-line method). The percentage used is often higher than the percentage used in the straight-line method. Let us re-use the example from the method above:

An asset costs R45 000 on 1 January 2020. The depreciation rate is, say, 40%.

The annual depreciation is calculated as follows:

Year 1	=	R45 000 × 40% = R18 000
Year 2	=	(R45 000 – R18 000) × 40% = R10 800
Year 3	=	(R45 000 – R28 800) × 40% = R6 480
Year 4	=	(R45 000 – R35 280) × 40% = R3 888
Year 5	=	(R45 000 – R39 168) × 40% = R2 332.80

The asset, the accumulated depreciation, the carrying (book) value and the depreciation accounts will be as follows over the useful life of the asset:

Date	Cost price	Depreciation	Accumulated depreciation	Carrying value
01/01/2020	R45 000			
31/12/2021	R45 000	R18 000	R18 000	R27 000
31/12/2022	R45 000	R10 800	R28 800	R16 200
31/12/2023	R45 000	R6 480	R35 280	R9 720
31/12/2024	R45 000	R3 888	R39 168	R5 832
13/12/2025	R45 000	R2 333	R41 500	R3 499

Activity

Activities should require you to think about something or apply something — the following is content-based:

1. Why is depreciation charged as an expense? Think about the accounting concepts that are applied.

2. What is meant by the term 'net carrying value'?

3. Name and explain the methods used to calculate depreciation.

4. How does the matching concept help us to understand the need for depreciation?

At this point, it is not necessary to understand all the various methods of calculating depreciation. However, it is necessary to **understand the basic workings of the straight-line and reducing balance method** of calculating depreciation.

5.4 INVENTORY ADJUSTMENTS

5.4.1 The inventory (cost of sales) adjustment

For most businesses, the inventory of unsold goods is the single largest, most valuable asset. Think of a company such as Pick n Pay. At the end of the financial period, the unsold goods on hand need to be counted and valued.

There are two main inventory systems used by businesses: the perpetual inventory system and the periodic inventory system. With the perpetual inventory system, all movements of inventory are recorded in the inventory account and the cost of inventory sold can be established at any given point in time. With the periodic inventory system, all purchases of inventory are recorded in the purchases account and the cost of inventory sold will only be established following an inventory count.

For this section, we will assume that the periodic inventory system is in use. Under the periodic inventory system, purchases of inventory are debited to the purchases account (i.e. expense account). Without any adjustment to the purchases account, the 'cost of sales' that would appear in the Statement of Comprehensive Income would incorrectly match the cost of all goods bought against the sales made in that accounting period. Included in this incorrect 'purchases' expense is the cost of goods bought that remain unsold. These goods may well be sold over the next accounting period, so they need to be matched against the sales during the next accounting period.

It is very difficult for businesses to keep an accurate record of their cost of sales, especially when the goods purchased during the month have not been completely consumed at the end of the accounting period. Businesses keep a record of their sales and their purchases through their general ledger accounts and invoices, but their cost of sales often poses a problem.

'Purchases' only become 'cost of sales' when the goods are physically consumed. Until then, they constitute 'inventory on hand'. Remember that the matching concept dictates that the expenses incurred must match the revenues earned. This means that cost of sales must match the sales earned.

Think of a supermarket that buys a carton of canned fruit (i.e. purchases). These cans are then sold over the next few months. When they sell the canned fruit, the sale is recorded via the cash register (i.e. the till). If, at the end of the month, they still have canned fruit in stock, the full purchase price of the carton of canned fruit cannot be considered as cost of sales.

Only a portion of the purchase price of the carton relates to the canned fruit sold during the month. The supermarket must count the cans of fruit in inventory at the end of the month and apportion the purchase price accordingly.

Example:

Thrifty Supermarket has R25 000 stock on 1 January 2023. During January, they purchase stock worth R50 000. At the end of January, they perform a stock count and establish that they have stock worth R30 000 on hand.

Inventory (asset) account:		R 30 000
Cost of sales (expense):	Opening balance	R 25 000
	Add Purchases	R 50 000
	Inventory available	R 75 000
	Less Closing balance	(R30 000)
	Inventory consumed	**R 45 000**

Remember, when the inventory was bought, we debited the purchases account. No entries have been passed to the inventory account yet.

At year-end, once the inventory count has been performed and a value assigned to closing inventory, the original opening inventory amount (brought forward from the previous accounting period) must be transferred back from the inventory account to the trading account and replaced with the closing inventory amount. Thrifty Supermarket’s total sales for the same period were R70 000.

The recording of the adjusting journal entry is as follows:

GENERAL JOURNAL

Date	Details	Folio	Debit	Credit
2023	(GJ1)			
Jan 31	Trading account		25 000	
	Opening inventory			25 000
	Transfer of opening inventory to trading account			
2023	(GJ2)			
Jan 14	Closing inventory		30 000	
	Trading account			30 000
	Recording of closing inventory on hand at 31 January 2023			
2023	(GJ3)			
Jan 31	Trading account		50 000	
	Purchases			50 000
	Transfer purchases to trading account			
2023	(GJ4)			
Jan 31	Sales		70 000	
	Trading account			70 000
	Transfer sales to trading account			

These journal entries will be recorded in the general ledger as follows:

Debit		PURCHASES		Credit
2023 Jan 31	Total GJ 3	50 000	2023 Jan 31	Trading account 50 000

Dr				TRADING ACCOUNT			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
2023 Jan 31	Purchases Opening inventory Income and expense (Gross profit)	GJ3 GJ1	50 000 25 000 25 000 100 000	2023 Jan 31	Sales closing inventory	GJ4 GJ2	70 000 30 000 100 000

Debit				INVENTORY ON HAND			Credit
Date	Details	Fol.	Amt	Date	Details	Fol.	Amt
2023				2023			
Jan 1	Balance	b/d	25 000	Jan 31	Trading account	GJ1	25 000
31	Trading account	GJ 2	30 000		Balance	c/d	30 000
			55 000				55 000
		b/d					
Feb 1	Balance		30 000				

The 'inventory on hand' balance of R30 000 will appear under 'current assets' in the Statement of Financial Position.

In our Thrifty Supermarket example, we calculated that the inventory consumed was R45 000. This is the amount that affects owner's equity, i.e. the cost of sales expense. We calculated the figure to be the balancing figure of three other amounts:

1. **Opening stock**: the inventory available to sell includes the prior period adjustment made to close the books (recording stock in hand). We must reverse the prior period entry to increase the available-to-sell assets, because this stock has now been sold.

2. **Purchases**: usually from the cash payments journal or the creditors journal.

3. **Closing stock**: this is the periodic adjustment that we are making at the closing of the period. By doing this, we are recognising an asset and that every entry needs to:
   a) meet the double-entry rule.
   b) satisfy the accounting equation. In the absence of liabilities, we can write assets − nil = owner's equity. This transaction recognises an asset, and stock meets the definition. (Future economic benefits will flow to the firm when this is sold.) The component of equity affected is the trading account (cost of sales). This entry recorded an increase (credit) to equity. We can conclude that assets = owner's equity.

In practice, however, supermarkets have pilferage, even recorded theft, wastage and damage. By diligently calculating closing stock, these losses are automatically recorded in the inventory consumed.

Activity

Assume the opening inventory at the beginning of the year is R20 000 and purchases made during the year were R10 000.

If we had a higher inventory value after the count of, say, R12 000, calculate the cost inventory consumed (i.e. sold) during the year. Also calculate the effect on net profit.

Note

The final value of the stock (i.e. the inventory) depends on the number of units on hand and the valuation (i.e. the price applied) of these units. We have seen that having increased inventory results in higher profits. Normally, larger businesses do not engage in dubious exercises; but some operators **do** artificially increase inventory to increase profits.

Activity

1. What are the advantages of performing a physical inventory count?
2. What is the formula used to calculate 'cost of sales'?

It is important for you to understand that not all items purchased in a specific accounting period would have been sold at the end of that accounting period.

This means that it is not only the goods that were purchased and sold during an accounting period that should be recognised as an expense and an income. This is an application of the matching concept of accounting.

It is also important that you can define and understand what is meant by the terms **trading account** and **gross profit**.

A trading account appears in the Statement of Comprehensive Income and consists of the following accounts:

- Sales
- Opening inventory
- Purchases
- Carriage on purchases.

Closing inventory

- Income and expense account (gross profit).

The aim of a business is to sell purchased goods at as great a profit as possible. We call this the **gross profit** (sales less the cost of sales). When a business purchases goods, this is recognised as an expense. Businesses then add their gross profit to these **purchases** to sell their goods.

However, not all purchased goods are sold at year-end. To arrive at the cost of sales, one must do the following calculation:

1. Establish the inventory on hand at the beginning of the accounting period. (This is done by physically counting the inventory on hand.)
2. Add all purchases during the current financial period to this opening inventory.
3. This will give you the total inventory available for the year.
4. From this total, the closing inventory at the end of the accounting period can be worked out.
5. The result will be the actual inventory consumed for the year (again, a physical counting at year-end).

5.4.2 Trading account

An example of a trading account in tabular format (in addition to the general ledger format, as discussed):

SALES	xxxx
LESS COST OF SALES	xxxx
Opening inventory	Xxxxx
Purchases (remember to deduct purchases returns)	xxxxx
Carriage in	xxxxx
Import tariffs	xxxxx
Customs duties	xxxxx

Less: Closing inventory	(xxxxx)
GROSS PROFIT	xxxxx

You should now be able to:

- describe and draw up a trading account.
- explain and understand the purpose of the **profit and loss account**.

One starts with the GROSS PROFIT and then adds other income and deducts operating expenses to arrive at NET PROFIT/LOSS.

5.4.3 Other income

Other income is prepared in the profit and loss section.

Interest received	xxxx
Dividends received	xxxx
Rental income	xxxx
Discount received	xxxx
And any other types of income not relating to the trading (i.e. the operating) activities of the business	

5.4.4 Operating expenses

Operating expenses are prepared in the profit and loss section.

Wages	xxxx
Salaries	xxxx
Insurance	xxxx
Interest paid	xxxx
Discount allowed	xxxx
Water and electricity	xxxx
Advertising	xxxx
Telephone	xxxx
Depreciation	xxxx
And any other types of expenses relating to the trading (i.e. the operating) activities of the business	

5.5 YEAR-END ADJUSTMENTS

5.5.1 Accrual concept

In the day-to-day running of a business, there will be many instances where income is received and expenses are incurred that do not apply to that particular accounting period. Revenue and expenses are recorded into the journals and general ledger when received or paid, and not when earned or incurred. These transactions distort the true profit or loss of the business for the period, and adjustments need to be made. Only the amount of income or expense actually earned or incurred in that accounting period must be reflected. The unearned or un-incurred portion must be adjusted out into another accounting period.

The adjustments required fall into one of four types:

1. Accrued expenses (expenses not yet recorded: expenses payable)
2. Accrued income (income not yet recorded: income receivable)
3. Prepaid expenses (expenses paid for in advance)
4. Income received in advance.

5.5.2 Accrued expenses (expenses payable)

An accrued expense is an expense that has been incurred (i.e. the benefit has already been received) but payment has not yet been made and the debt is still owing (such as a creditor). Because no payment has been made, there is no record of the expense in the accounting records. The prudence concept and the accrual concept dictate that we accrue for this expense, as the expense has been incurred.

Recall the accounting periods. Because the owners cannot wait until the business cycle is complete to understand the profit that was made, adjustments are done. We need to report the state of affairs as best we can. We argue: if this was the end of the business cycle today and not just the last day of the year, what expenses would still have to be paid? There are always a few 'standard culprits' (e.g. electricity billed in arrears, cellphone calls billed in arrears, the municipal bill that is always late, Telkom calls are billed in arrears, etc.).

Let us use electricity as an example. Please note this would not apply where the prepaid system is used. It applies to metered billings only.

The benefit of the expense (i.e. the use of the electricity) is received now, but payment for use is only made later, when the electricity statement is received. The expense for the electricity consumed must be recorded in the same accounting period that the benefit of the use is received (now). The business must record all expenses that have been incurred in the relevant accounting period (i.e. the benefit received), in order to accurately and correctly calculate the profit or loss incurred during that accounting period.

There are three steps involved in adjusting the journal relating to an accrued expense:

1. Identify the general ledger accounts that are involved.
2. Determine the amount of the accrued expense.
3. Record the adjusting journal entry.

Example:

Thrifty Stores pays wages every two weeks. On 10 March 2023, wages of R1 200 were paid for the two weeks then ended. On 24 March 2023, wages of R1 200 were paid for the two weeks then ended. The business's financial year-end is 31 March 2023. Prepare the required adjusting journal entry:

1. **Identify the general ledger accounts that are involved.**

   Wages for the final week of March (24–31) have not been paid or provided for.

   The accounts involved are:
   Wages
   Accrued expenses (liability) account.

2. **Determine the amount of the accrued expense.**

   Two weeks' wages amount to R1 200. Therefore, the accrual for one week will be R600.

3. **Record the adjusting journal entry.**

THRIFTY STORES GENERAL JOURNAL				
2023			**Debit**	**Credit**
Mar 31	Wages		600	
	Accrued expenses			600
	Recording the wages due for the week 24 to 31 March.			

This journal entry will be recorded in the general ledger as follows:

THRIFTY STORES Wages							
Debit				**Credit**			
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
2023							
Mar 10	Bank		1 200				
Mar 24	Bank		1 200				
Mar 31	Accrued expenses		600				
			3 000				

THRIFTY STORES Accrued expenses							
Debit				**Credit**			
Date	**Details**	**Folio**	**Amount**	**Date**	**Details**	**Folio**	**Amount**
				2023			
				Mar 31	Wages		600.00

The wages account (R3 000) will appear in the Statement of Comprehensive Income as an expense.

The accrued expenses account (R600) is equivalent to a trade payable entry (i.e. debt not yet paid), and will be shown in the Statement of Financial Position under current liabilities.

Before we move on to the next category, let us consider the following month-end. In the example, March wages have been charged with an additional R600. It has been posted, incurred, and the decrease in equity recorded.

At the end of the next month, looking at the two months together, the situation would have corrected itself. If we now have a similar situation in April, where the wage fortnight runs over and we must accrue using the same principles, there will be two sets of R600 expenses over two months.

Recall the principle of the adjustment. It is an adjustment for a specific month and point in time. The first step before doing the next month's accruals is to reverse the previous month's accruals.

5.5.3 Accrued income

Accrued income is the income equivalent of accrued expenses. Accrued income is that which has been earned, but payment has not yet been received. The debt is still owed to the business (i.e. a trade receivable). As no payment has been received, there is no record of the income in the accounting records.

An example of accrued income would be interest earned on a fixed deposit. The interest is earned monthly, but only paid the following month. The income relating to the interest earned must be recorded in the same accounting period that the benefit of use is given out (i.e. money deposited in the bank).

Let us quickly ask the question: if this were the last day of the business, would we be entitled to the interest? The answer is 'yes'. In fact, the owners can already plan to spend the cash, because if the bank does not pay up, they can validly sue for the cash. It is a true asset. In a few days, it will become cash.

Note

It is important to note that these entries do not affect cash on hand. They are accounts payable and accounts receivable-type entries.

Should a large period-end adjustment in the context of the net profit be made, the bank employee must take this into consideration when the ability to repay loans is investigated. A high level of income in advance, for example, means that some profitability for the next period is already included in the bank on the Statement of Financial Position. When the advance payment is reversed, there will be a profit recognised without corresponding cash flows. A solid profit forecast does not equal a solid cash forecast. The risk is higher with construction contract-type companies.

The business must record all income that has been earned in the relevant accounting period (benefit given out), to accurately and correctly calculate the profit or loss incurred during that accounting period.

There are three steps involved in the adjusting journal relating to an accrued income:

1. Identify the general ledger accounts that are involved.
2. Determine the amount of the accrued income.
3. Record the adjusting journal entry.

Example:

On 1 June 2023, Thrifty Stores invested R100 000 in a 12-month fixed deposit, earning 18% interest per annum. Interest earned is paid out on the second day of the following month. Prepare the adjusting journal entry that is needed to accrue this income, assuming a 30 June financial year-end.

1. Interest has been earned, but not yet received. The accounts involved are:
   a) Interest income
   b) Accrued income (asset).

2. The amount of the accrued income is:

   Interest = Capital × interest rate × time period
   = R100 000 × 18 % × 1/12
   = R1 500

3. The adjusting journal entry will be as follows:

THRIFTY STORES GENERAL JOURNAL				
2023			**Debit**	**Credit**
June 30	Accrued income		1 500	
	Interest income			1 500
	Recording the interest earned on fixed deposit in June.			

These journal entries will be recorded in the general ledger as follows:

THRIFTY STORES Interest Income							
Debit				Credit			
Date	Details	Folio	Amount	Date	Details	Folio	Amount
				2023 June 30	Accrued income		1 500

THRIFTY STORES Accrued Income							
Debit				Credit			
Date	Details	Folio	Amount	Date	Details	Folio	Amount
2023 June 30	Interest income		1 500				

The interest income account (R1 500) will appear in the Statement of Comprehensive Income as an income item.

The accrued income account (R1 500) is equivalent to a 'trade receivable' (debt not yet received) and will be shown in the Statement of Financial Position under current assets.

5.5.4 Prepaid expenses

This is the opposite from what was discussed in Section 5.3.1 (accrued expenses). A prepaid expense is an expense that has been paid, but the related benefit is only received in a future period. The accrual concept dictates that we apportion this expense into the portion that relates to expenses that have been incurred, and to that portion that relates to expenses that have not yet been incurred.

An example of a prepaid expense is insurance paid annually in advance. The annual insurance payment relates to 12 months of insurance cover. Only part of the payment is an expense that relates to the current month. The unconsumed portion is an asset that relates to consumption in a future period (i.e. a future benefit).

Example:

An annual insurance premium of R3 000 is paid in January 2023.

This payment of R3 000 is for 12 months of insurance cover. This equates to R250 for each month of cover. The expense that needs to be reflected each month is R250. Assume that the business has a 31 August year-end. There are therefore eight months in the financial period, and four months are outside of the financial period:

January 2023	R250	
February 2023	R250	
March 2023	R250	
April 2023	R250	
May 2023	R250	
June 2023	R250	
July 2023	R250	
August 2023	R250	Year-end, expense = R250 × 8 = R2 000
September 2023	R250	Prepaid expense (asset) = R250 × 4 = R1 000
October 2023	R250	
November 2023	R250	
December 2023	R250	
Total payment:	**R3 000**	

At year-end, the unconsumed portion (i.e. the asset) of the annual insurance premium that will appear in the Statement of Financial Position will be for the four months September to December 2023. This is 4 × R250 = R1 000.

Let us ask the question: if this was the last day of business and not just the last day of the month, what asset would the business have? Can a real asset be identified?

Recall the accounting equation: Assets = Owner's equity + Liabilities. Also recall that Owner's equity = Capital + Profit (Income − Expenses) − Drawings. Since we do not have a liability in this example, we can write: Assets = Owner's equity (profit). To record this transaction, the entry would be:

DR: Prepaid expenses (assets increased)
CR: Insurance (expense decreased, therefore equity increased)

The insurance expense that will appear in the Statement of Comprehensive Income is the portion of the insurance premium that relates to the expired period: January to August 2023 (i.e. eight months). This is 8 × R250 = R2 000.

There are three steps involved in the adjusting journal relating to a prepaid expense:

1. Identify the general ledger accounts involved and determine their balances.
2. Determine the amount of the expense paid for the following financial period.
3. Record the adjusting journal entry.

Example:

On 30 December 2022, Thrifty Stores paid R14 400 as rent for the period 1 January 2023 to 30 June 2023. This amount was debited to the rent expense account. The financial year-end of the business is 28 February. Prepare the required adjusting journal:

1. The accounts involved, and their balances are:
   a) Rental expense
   b) Prepaid expense.

2. The apportionment of the payment into its asset and expense elements:

   The monthly cost relating to this rental payment is:

   R14 400/6 months = R2 400 per month

January	2023	R2 400 expense
February	2023	R2 400 (R4 800)
March	2023	R2 400
April	2023	R2 400
May	2023	R2 400
June	2023	R2 400 asset prepaid = R9 600
Amount paid		**R14 400**

3.	Recording the adjusting journal entry: The full payment (R14 400) is currently sitting in the rent expense account. The prepaid portion (R9 600) needs to be transferred to the asset account (i.e. prepaid expense).

THRIFTY STORES GENERAL JOURNAL				
2023			Debit	Credit
Feb 28	Prepaid expense		9 600	
	Rent expense			9 600
	Recording of rent paid in advance			

These journal entries will be recorded in the general ledger as follows:

THRIFTY STORES
Rent expense

Debit				Credit			
Date	Details	Folio	Amount	Date	Details	Folio	Amount
2022				2023			
Dec 30	Bank		14 400	Feb 28	Prepaid expenses		9 600
					Profit and loss		4 800
			14 400				14 400

THRIFTY STORES
Prepaid expense

Debit				Credit			
Date	Details	Folio	Amount	Date	Details	Folio	Amount
2023							
Feb 28	Rent expense		9 600				

The rent expense account (R4 800) will appear in the Statement of Profit or Loss and Other Comprehensive Income as an expense at year-end. The prepaid expense account (R9 600) is equivalent to a 'trade receivable', and will be shown in the Statement of Financial Position under current assets.

5.5.5 Income received in advance

This is the income equivalent of what has been discussed in paragraph 5.3.3 (prepaid expense). Income received in advance is payment received before the income is earned. A liability exists for the business to earn the income in some future period.

An example of income received in advance is an upfront payment to a builder. The builder receives the money before performing any duties. He is still required to honour his side of the contract and construct the building. The unfinished portion is a liability, as it relates to an obligation that still exists on the side of the builder.

Even though the builder has received the money, there is work to be performed before he can earn the money (i.e. a future obligation). If he does not build, he can be sued for the refund.

When it comes to income received in advance, there are three steps involved in the adjusting journal:

1. Identify the general ledger accounts involved and determine their balances.
2. Determine the income received in advance for the following financial period.
3. Record the adjusting journal entry.

Example:

On 4 January 2023, a client paid Thrifty Contractors R45 000 to build a swimming pool. At 28 February, Thrifty Contractors' financial year-end, the pool was two-thirds completed.

Prepare the required adjusting journal:

1. The accounts involved are:
   a) Construction income
   b) Income received in advance.

2. The apportionment of the payment into its liability and income elements:
   The total value of the completed work was R45 000.

On 28 February, 2/3 of the work was completed. Therefore, income earned is equal to:

Income earned = R45 000 × 2/3
= R30 000

The income received in advance (not yet earned) is equal to:

Income received in advance = R45 000 – R30 000
= **R15 000**

3. Recording the adjusting journal entry:

The full amount received from the client (R45 000) is currently in the 'construction' income account. The portion received in advance (not yet earned, R15 000) needs to be transferred to the liability account (i.e. income received in advance).

THRIFTY CONSTRUCTION GENERAL JOURNAL				
2023			**Debit**	**Credit**
Feb 28	Construction income		15 000	
	Income received in advance			15 000
	Construction income received in advance.			

The journal entries will be recorded in the general ledger as follows:

THRIFTY CONSTRUCTION Construction income							
Debit				**Credit**			
Date	**Details**	**Fol.**	**Amount**	**Date**	**Details**	**Fol.**	**Amount**
2023				2023			
Feb 28	Income received in advance		15 000	Feb 5	Bank		45 000
	Income and expense		30 000				
			45 000				45 000

THRIFTY CONSTRUCTION Income received in advance Debit							Credit
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
				2023 Feb 28	Construction income		15 000

The construction income account balance of R30 000 will appear in the Statement of Comprehensive Income as income. The income received in advance account (R15 000) is equivalent to a 'trade payable' and will be shown in the Statement of Financial Position under Current liabilities.

5.5.6 Summary

DECISION TABLE

TIMING OF PAYMENT	EXPENSE	INCOME
ARREAR (AFTER)	ACCRUED EXPENSE	ACCRUED INCOME
IN ADVANCE (PREPAID)	PREPAID EXPENSE	INCOME RECEIVED IN ADVANCE

Three steps involved in the adjusting journal:

1. Identify the general ledger accounts that are involved. Determine their balances.

2. Apportion the amount into the appropriate:
   a) asset/liability portion
   b) income/expense portion.

3. Record the adjusting journal entry.

Before continuing with this topic, please complete the activity.

Activity

Indicate how each of the following adjusting transactions would be classified. Select from the following:

a) Prepaid expense
b) Accrued expense
c) Income received in advance
d) Accrued income.

Transactions:

1. A company has not yet paid water and electricity at year-end, R2 000.
2. Insurance premium in the amount of R750 was paid for the following financial year.
3. Interest on the fixed deposit of R1 200 has not yet been received from the bank at year-end.
4. Included in the revenue for the year is R5 000 that relates to the following financial year.

5.6 PREPARATION OF FINAL TRIAL BALANCE

5.6.1 Introduction

Even the smallest companies can have a detailed trial balance that expands into 20 or more pages. This needs to be 'regrouped' so that the user can make sense of these pages of data. Most software packages automatically group the sections together on the trial balance. We must, however, understand the process so that we can prepare the statements.

5.6.2 Classifying the trial balance

The work we have done on preparing our trial balance will be the building blocks for this section. For the purposes of the financial statements, we will use the trial balance before we journalise the profits to the equity.

This means that all the accruals and adjustments have been made, but the accounts have not been closed off yet. We require the detailed trial balance in order to draft the Statement of Comprehensive Income.

You should also refresh your knowledge of the various classifications of items into assets, liabilities and equity (i.e. profit or loss).

5.6.3 Methodology

Step one

When a trial balance is received with the request to draft a Statement of Comprehensive Income and a Statement of Financial Position, the first step is to classify the trial balance into the required sections so that it can be sorted and totalled by category. Those totals are then transferred to the financial statements. This is the crucial part of the work. Any errors here will be carried forward, so it is important to check that all is in order before proceeding to prepare financial statements.

Activity

Classify the following general ledger account balances in List A into the correct trial balance categories provided in List B below:

List A:

- Accounts receivable
- Accounts payable
- Accumulated depreciation
- Bank overdraft
- Cost of sales
- Depreciation
- Donations made
- Electricity and water
- Instalment sale agreements — 60-month term
- Insurance — motor vehicles
- Insurance payout received
- Interest paid — loans
- Interest received
- Inventory (stock)
- Office building at cost
- Legal fees

- Loans payable bank — five years
- Loans payable bank — immediate
- Motor vehicles at cost
- Profit on sale of motor vehicle
- Salaries and wages
- Sales made to customers
- Shares issued at proceeds value
- Telephone.

List B:

1. Share capital (owner's equity)
2. Assets: current (benefit that will be consumed within 12 months)
3. Assets: non-current (enduring benefit lasting more than 12 months)
4. Liabilities: current (obligation/debt to be paid within 12 months)
5. Liabilities: non-current (obligation/debt to be paid over a period greater than 12 months)
6. Income
7. Expenses.

Step two

The second step is to double-check that the trial balance is still in balance. If amounts were only categorised and not changed, there should be no problem with this step.

The basic templates for the Statement of Comprehensive Income and Statement of Financial Position follow below. Remember that, for management accounting purposes, every company has its own approved format that usually contains much more detail. All the formats will ultimately have the same information, so the following template is adequate.

Statement of Comprehensive Income			
	Period	**Period**	**Period**
Revenue			
Cost of sales			
Gross profit			
Other income			
Operating expenses			
Operating profit			
Finance cost			
Profit before taxation			

Statement of Comprehensive Income			
	Period	Period	Period
Taxation			
Profit for the year			

Statement of Financial Position			
	Period	Period	Period
ASSETS:			
Non-current assets:			
Property, plant and equipment			
Financial assets			
Current assets:			
Inventories			
Current tax receivable			
Trade and other receivables			
Cash and cash equivalents			
Total assets			
Equity and liabilities			
Equity:			
Share capital			
Retained income			
LIABILITIES:			
Non-current liabilities:			
Long-term loans			
Other long-term obligations			
Current liabilities:			
Trade and other payables			
Short-term loans			
Total liabilities			
Total equity and liabilities			

Step three

The final step is to confirm the period for which the information is required. Then start transferring information to the templates. MS Excel is a helpful tool in this respect.

5.6.4 A practical example

The preparation is best demonstrated by means of a practical example.

Grass Seed Sellers (Pty) Ltd supplies a patented seed for use on cricket fields. This seed is particularly resistant to Gauteng frost and handles the Cape winter rain very well. The bookkeeper of Grass Seed Sellers (Pty) Ltd has prepared the following trial balance. She does not know how to prepare a Statement of Comprehensive Income or a Statement of Financial Position and asks for your assistance in this regard. You are not required to process any journals to close the nominal section of the trial balance.

Grass Seed Sellers (Pty) Ltd Trial balance for month ending February 2023			
	Dr	Cr	Classification
Accounts payable		600	
Accounts receivable	500		
Accumulated depreciation — motor		480	
Accumulated depreciation — office		240	
Advertising and promotions	50		
Audit fees	50		
Bank balance		250	
Bank charges	10		
Cleaning cost	20		
Computer expenses	50		
Cost of sales	2 800		
Courier and postages	10		
Depreciation charge	240		
Depreciation charge — office	120		
Electricity and water	100		
Fixed assets — motor	1 200		
Fixed assets — office	600		
Insurance claims settled		35	
Insurance paid	50		

Grass Seed Sellers (Pty) Ltd Trial balance for month ending February 2023			
Interest paid — current	5		
Interest paid — loans	70		
Legal fees	30		
Long-term loan		700	
Motor vehicle expenses	30		
Printing and stationery	20		
Profit on sale of assets		20	
Rent paid	100		
Salaries and wages	200		
Sales		4 000	
Security expenses	60		
Share capital		100	
Staff training	30		
Stock — diesel	50		
Subscriptions	10		
Sundry income		20	
Telephones — cellphones	20		
Telephones — office	20		
	6 445	6 445	

The first step requires that we classify the trial balance into the categories that we will need for the financial statements. Attempt the classification above before you proceed to the answer.

Hint: use the template financial statements and the line descriptions as the classification headings. This will make it easier to transfer the data to the financial statements later.

The reclassified trial balance follows. Note that the trial balance still balances, completing the second step in the process. Should you have any differences in classification, refer to the glossary to review the definitions of accounts.

Grass Seed Sellers (Pty) Ltd Trial balance for month ending Feb 2023			
	Dr	Cr	Classification
Bank balance		250	Bank overdraft (current liabilities)
Cost of sales	2 800		Cost of sales
Interest paid (Current accounts)	5		Finance cost
Interest paid (loans)	70		Finance cost
Stock (diesel)	50		Inventories (current assets)
Advertising and promotions	50		Operating expenses
Audit fees	50		Operating expenses
Bank charges	10		Operating expenses
Cleaning cost	20		Operating expenses
Computer expenses	50		Operating expenses
Courier and postage	10		Operating expenses
Depreciation charge (motor vehicles)	240		Operating expenses
Depreciation charge (office equipment)	120		Operating expenses
Electricity and water	100		Operating expenses
Insurance paid	50		Operating expenses
Legal fees	30		Operating expenses
Motor vehicle expenses	30		Operating expenses
Printing and stationery	20		Operating expenses
Rent paid	100		Operating expenses
Salaries and wages	200		Operating expenses
Security expenses	60		Operating expenses
Staff training	30		Operating expenses
Subscriptions	10		Operating expenses
Telephones (cellphones)	20		Operating expenses
Telephones (office)	20		Operating expenses
Long-term loan		700	Other financial liabilities (non-current liabilities)
Insurance claims settled		35	Other income
Profit on sale of assets		20	Other income
Sundry income		20	Other income
Accumulated depreciation (motor vehicles)		480	Property, plant and equipment (non-current assets)

Grass Seed Sellers (Pty) Ltd Trial balance for month ending Feb 2023			
Accumulated depreciation (office equipment)		240	Property, plant and equipment (non-current assets)
Fixed assets (motor vehicles)	1 200		Property, plant and equipment (non-current assets)
Fixed assets (office equipment)	600		Property, plant and equipment (non-current assets)
Sales		4 000	Revenue
Shareholders' equity		100	Share capital
Accounts payable		600	Trade and other payables (current liabilities)
Accounts receivable	500		Trade and other receivables (current assets)
	6 445	**6 445**	

The **third and final step** in the process is to complete the financial statements by transferring the totals to the templates. To complete this, a few amounts must be added together. The biggest sections to be added are the total of the operating expenses (R1 220) and the total of the property, plant and equipment (R1 080). To aid presentation, the lines with no information have been hidden.

Statement of Profit or Loss and Other Comprehensive Income for the year ended 28 February 2023	
Revenue	4 000
Cost of sales	(2 800)
Gross profit	**1 200**
Other income	75
Operating expenses	(1 220)
Operating profit	**55**
Finance cost	(75)
Profit before taxation	**(20)**
Taxation	–
Profit/(loss) for year	**(20)**

Statement of Financial Position as at 28 February 2023	
ASSETS:	
Non-current assets	**1 080**
Property plant and equipment	1 080
Current assets	**550**
Inventories	50
Trade and other receivables	500
Total assets	**1 630**
EQUITY AND LIABILITIES	
Equity	**80**
Share capital	100
Retained income	(20)
Non-current liabilities:	**700**
Long-term loans	700
Current liabilities:	**850**
Trade and other payables	600
Bank overdraft	250
Total equity and liabilities	**1 630**

Summary

In this topic, it was explained that the business could have received the benefit of an expense item, although the expense has not yet been paid. The expense would only be paid in a subsequent accounting period.

If an expense was incurred during a specific accounting period, that expense must be recognised as such, because it will have an influence on the profit or loss for the specific accounting period. The opposite will also be true for income. Only income that has accrued to the business must be recognised. It is therefore necessary to identify, describe, and apply the different accounting concepts to the income and expenses of a business.

It was also explained in this topic that these adjustments need to be made for the accounting period. You need to know what these adjustments are, what accounts are applicable, and their influence on the profit and loss of a business. This is especially true on the adjustment for inventory and applicable accounts. The other specific adjustment we dealt with was depreciation.

Once you have made these adjustments and recorded them in a post–adjustment trial balance, it is time to draw up the Statement of Profit or Loss and Other Comprehensive Income, and the Statement of Financial Position.

Self-Assessment Questions

Use the templates below to draw up a general journal and general ledger for the questions below.

GENERAL JOURNAL			Debit	Credit

GENERAL LEDGER

Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount

1. The following is an extract from the pre-adjustment trial balance of Happy Feet for the year ending 30 September 2023.

Nominal section	Debit	Credit
Sales		100 000
Purchases	32 000	
Wages and salaries	16 000	
Repairs	25 000	
Inventory (opening)	20 000	
Cleaning	3 000	
Rent	24 000	
Income received		4 000
Rent income		30 000
Interest	2 000	
Advertising	12 000	

Additional information:

a) At year-end, the stock count reveals that Happy Feet has inventory worth R6 000 on hand.

b) Happy Feet is doing repairs to its warehouse. R25 000 was paid to the contractor to complete the repair work. At year-end, the contractor had only completed 55% of the repairs.

c) Happy Feet advertises in the local community paper. For a fee of R1 500 a month, the paper will run a Happy Feet ad each week.

d) Happy Feet leases part of its warehouse to a storage company. In terms of the rental agreement, the storage company pays Happy Feet R2 000 a month for use of the space.

d) Happy Feet earns commission on some of the items that it sells. Commission income for the year is R8 000. This has not yet been received by the principal.

You are required to:

1.1 Prepare the required adjustment journal entries.

1.2 Post the entries to the general ledger.

1.3 Close off all accounts.

2. Chitty Chitty owns the following assets:

a) A car costing R120 000 was bought on 1 March 2022. The car has a useful life of five years. The expected value of the car at the end of its useful life is R20 000. Chitty Chitty applies the straight-line method to depreciate cars.

b) A computer costing R50 000 was bought on 1 March 2022. It has a useful life of three years. Chitty Chitty applies the reducing balance method to depreciate computers, using 30%.

c) A piece of machinery costing R220 000 was bought on 31 December 2022. It has an expected useful life of six years. It is expected to have a value of R40 000 at the end of this period. Chitty Chitty applies the straight-line method to depreciate machinery.

Chitty Chitty has a year-end of 28 February.

Required:

2.1 Calculate the depreciation for each asset for the 2023 and 2024 year-ends.

2.2 Prepare the journal entries for each year.

2.3 Post the entries to the accumulated depreciation general ledger account.

Topic 6
Introduction to the preparation of financial statements

6.1 INTRODUCTION

This topic relates to the following module outcome:

5. Interpret the different types of financial statements of a business entity on a basic level.

In Topic 5, you learned how to deal with adjustments at year-end and how to draw up a post-adjustment trial balance. The question now remains: how do you use the information from the post-trial balance to draw up the financial statements? The knowledge you gained mastering Topics 1–5 will be invaluable when drawing up financial statements. The importance of understanding the accounting equation will now be highlighted.

The first step to drawing up financial statements will be the categorising of the post-adjustment trial balance into assets, liabilities, and equity (income and expenses). From this categorised information, you can transfer the totals to the financial statements.

In this topic, you will gain knowledge in the following areas:

1. Introduction to financial statements
2. Statement of Profit or Loss and Other Comprehensive Income
3. Statement of Financial Position (company and sole trader).

6.2 STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

6.2.1 Purpose

A Statement of Profit or Loss and Other Comprehensive Income:

- reflects the financial performance of the entity over a specific period.
- shows the income earned in that period, less expenses incurred in that period, and the resulting profit or loss.

6.2.2 The trading undertaking

According to the matching concept, income and expenses must be adjusted at the same time. This ensures that both income and expenses relate to the correct accounting period. These adjustments were covered in the previous topic. The Statement of Profit or Loss and Other Comprehensive Income is divided into a gross profit section (similar to the trading account) and a net profit section (similar to the profit and loss account).

The period covered by the Statement of Profit or Loss and Other Comprehensive Income must be reflected in its heading.

Table 6.1 An example of a Statement of Profit or Loss and Other Comprehensive Income for trading entity

ABC STORES Statement of Profit or Loss and Other Comprehensive Income for the month ended 31 March 2023			Section 1: heading
Sales		256 150	Section 2: Gross profit
Less: Cost of sales		(156 875)	
Opening inventory	31 375		
Purchases	169 000		
Freight on purchases	425		
Less: Closing inventory	(43 925)		
Gross profit		**99 275**	
Add: Other income		275	Section 3: Other income
Rent income	275		
Gross income		**99 550**	
Less: **Operating expenses**		**(45 769)**	Section 4: Expenses
Salaries	40 562		
Rent	3 890		
Electricity and water	568		
Telephone	749		
Operating profit		**53 781**	Section 5: Financing cost and Investment income
Less: Finance costs			
Add: Interest received			
Net profit for the month			Section 6: Profit/loss

You will notice from the heading that the Statement of Profit or Loss and Other Comprehensive Income only covers the period 1 to 31 March 2023. The format of the Statement of Profit or Loss and Other Comprehensive Income is very important.

- The first section is the heading, which reflects the name of the entity, the name of the statement, and the period that it covers.

- The second section illustrates the computation of gross profit. This includes sales less cost of sales or service fees received (only applicable to a service entity).

- In the third section, other operating income is shown (rent income, services rendered). This section reflects the individual income account balances and their combined total.

- This is followed by the fourth section. Here, operating expenses and all operating expenses account balances are shown, together with their total.

- The fifth section is the financing costs, which is for interest received and finance costs paid. This leaves us with net profit before tax, less tax, and finally, net profit after tax.

6.2.3 The service undertaking

This type of business does not trade and, hence, it will not have a gross profit section in the Statement of Profit or Loss and Other Comprehensive Income. No accounts linked to trading inventory will feature in the books (i.e. no sales, sales returns, purchases, or inventory).

Table 6.2 An example of a Statement of Profit or Loss and Other Comprehensive Income for a service entity

ABC SERVICES Statement of Profit or Loss and Other Comprehensive Income for the month ended 31 March 2023			Section 1: heading
Income		XXXX	
Revenue from services rendered	XXX		
Rent received	XXX		
Commission received	<u>XXX</u>		
Etc.			
			Section 2: Only profit-and-loss section
Less: **Expenses**		(XXXX)	
Wages and salaries	XXX		
Insurance	XXX		
Depreciation	XXX		
Telephone	XXX		
Water and electricity	XXX		
Advertising	<u>XXX</u>		
Etc.			
Net profit/loss		<u>XXX</u>	

6.2.3 The concept of reserves and retained income

At the end of the year, the business would have made a profit or loss for the year. What does the business do with this profit? There are two options: pay out a dividend to the shareholders (if it is a company) or retain the profit in the business, in order to fund new investment opportunities. This decision is made by the owners of the business. The profit retained in the business is called retained income/earnings.

In the ABC Stores example, a profit of R53 781 for the month was retained income. Retained income is money retained by the business and assists in funding assets purchased by the business. The other type of reserve is the specific reserve. These are allocations out of income before the profit is determined. The current year’s profit retained may be used for future financing (i.e. the replacing of fixed assets). These are usually shown as reserves under equity.

Activity

1. Discuss why businesses need to draft a set of financial statements.

2. Name components that form a set of financial statements.

3. What does the Statement of Profit or Loss and Other Comprehensive Income reflect?

4. Name the six sections of a Statement of Profit or Loss and Other Comprehensive Income.

5. When can the Statement of Financial Position and Statement of Profit or Loss and Other Comprehensive Income be drawn up?

6. List the differences between an asset, expense, liability, and income.

7. What options does a business have regarding its net profit at year-end?

You will need to understand, explain, and describe what items appear in a Statement of Comprehensive Income, and how to prepare and complete this statement.

6.3 THE STATEMENT OF FINANCIAL POSITION — COMPANY

A Statement of Financial Position:

- reflects all the entity's assets, liabilities and equity at a specific date.
- enables one to determine the owner's net worth i.e. assets less liabilities.

Note

This example shows what the Statement of Financial Position comprises. The information is disclosed somewhat differently in the annual financial statements, but this is merely a reorganisation of the information that follows.

Table 6.3 An example of a Statement of Financial Position for a company

ABC STORES STATEMENT OF FINANCIAL POSITION AT 31 MARCH 2023			Section 1: Heading
ASSETS			
Non-current assets		77 500	Section 2: Assets
Equipment at cost	150 000		
Less: depreciation	(72 500)		
Current assets		102 850	
Inventory	27 850		
Trade and other receivables	62 500		
Cash and cash equivalents	12 500		
TOTAL ASSETS		**R180 350**	
EQUITY AND LIABILITIES			
Equity and reserves		143 781	Section 3: Equity and reserves
Share capital	90 000		
Retained Income	53 781		
Non-current liabilities		24 169	Section 4: Liabilities
Long-term loans	24 169		
Current liabilities		12 400	
Trade and other payables	12 400		
TOTAL EQUITY AND LIABILITIES		**R180 350**	

The heading shows that the Statement of Financial Position has been drawn up at 31 March 2023.

The format of the Statement of Financial Position is very important. The first section is the heading, which reflects the name of the entity, the name of the statement, and the year-end. The second section is the asset section, where all the asset accounts are shown, reflecting the individual asset account balances and their total. These accounts are further classified as current and non-current assets.

The third section is the equity and reserves section, where the share capital accounts and retained profit/loss are reflected. This is followed by the fourth section, the liability section, where all of the liability account balances are shown, together with their total. These accounts are further classified as current and non-current liabilities.

Note

Although the format of the Statement of Financial Position is very important, **the statement must balance. Total assets must equal total equity and liabilities**.

The Statement of Financial Position is representative of the accounting equation, **assets = equity + liabilities**. If all the transactions have been recorded in terms of the double-entry concept and classified properly with reference to the accounting equation, the Statement of Financial Position will balance.

Example:

The following financial information was obtained from AAA (Pty) Limited for the year ended 31 December 2022.

AAA (Pty) Limited Trial balance as at 31 December 2022		
General ledger account	**Debit**	**Credit**
Sales		194 000
Commission earned		25 500
Cost of sales	98 000	
Depreciation	12 750	
Electricity	5 500	
Rent	12 000	
Stationery	1 500	
Salaries	48 000	
Furniture and fittings	127 500	
Accumulated depreciation: furniture and fittings		12 750
Bank	7 250	
Inventory	15 600	
Trade receivables	24 350	
Trade payables		35 200
Share capital		85 000
	R352 450	**R352 450**

Required:

1. Prepare the Statement of Profit or Loss and Other Comprehensive Income for the year ending 31 December 2022.

2. Prepare the Statement of Financial Position on 31 December 2022.

Do not refer to the solution before answering the question in full.

Answer:

AAA (PTY) LIMITED Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2022		
	R	R
Sales		194 000
Less: Cost of sales		(98 000)
Gross profit		**96 000**
Add: Other income		25 500
Commission earned	25 500	
Gross income		**121 500**
***Less:* Expenses:**		**(79 750)**
Depreciation	12 750	
Electricity	5 500	
Rent	12 000	
Stationery	1 500	
Salaries	48 000	
Net profit for the year		**41 750**

AAA (PTY) LIMITED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2022		
	R	R
ASSETS		
Non-current assets		**114 750**
Furniture and fittings at cost	127 500	
Less: Depreciation	(12 750)	
Current assets		**47 200**
Inventory	15 600	
Trade and other receivables	24 350	
Cash and cash equivalents	7 250	
Total assets		**R 161 950**
EQUITY AND LIABILITIES		
Capital and reserves		126 750
Capital	85 000	
Retained income	41 750	
Liabilities		35 200
Trade and other payables	35 200	
Total equity and liabilities		**R 161 950**

Example:

Jill's Dealers reached the end of their first financial year on 30 September 2023. The following trial balance was extracted from the accounting records at that date.

	Fol.	Debit	Credit
		R	R
STATEMENT OF FINANCIAL POSITION SECTION			
Capital	B1		250 000
Drawings	B2	22 400	
Equipment	B3	48 000	
Investment: fixed deposit (12%)	B4	100 000	
Trading inventory	B5	110 000	
Trade receivables	B6	44 880	
Trade payables	B7		30 210
Long-term loan: ABC Bank (14%)	B8		120 000
Bank	B9	127 150	
NOMINAL ACCOUNTS SECTION			
Sales	N1		382 500
Cost of sales	N2	190 000	
Sales returns	N3	21 500	
Rent paid	N4	36 000	
Interest on fixed deposit	N5		12 000
Interest on loan	N6	16 800	
Wages and salaries	N7	43 000	
Insurance	N8	11 000	
Stationery	N9	1 700	
Packing material	N10	2 050	
Discount allowed	N11	840	
Discount received	N12		360
Credit losses	N13	800	
Telephone	N14	5 320	
Water and electricity	N15	12 500	
Repairs	N16	1 130	
		795 070	**795 070**

Required:

1. Prepare the Statement of Profit or Loss and Other Comprehensive Income of Jill's Dealers for the year ending 30 September 2023.

2. Prepare the Statement of Financial Position of Jill's Dealers on 30 September 2023.

Do not refer to the solution before answering the question in full.

Answer:

Statement of Profit or Loss and Other Comprehensive Income of Jill's Dealers for the year ending 30 September 2023

	R	R
Sales (382 500 – 21 500)		361 000
Cost of sales		(190 000)
Gross profit		**171 000**
Operating expenses:		**(114 340)**
Rent paid	36 000	
Wages and salaries	43 000	
Insurance	11 000	
Stationery	1 700	
Packing materials	2 050	
Discount allowed	840	
Credit losses	800	
Telephone	5 320	
Water and electricity	12 500	
Repairs	1 130	
Operating profit		**56 660**
Net finance costs:		**(4 800)**
Interest on loan	(16 800)	
Interest on fixed deposit	12 000	
Net profit		**51 860**

Statement of Financial Position of Jill's Dealers on 30 September 2023	R	R
ASSETS		
Non-current assets:		**148 000**
Equipment	48 000	
Other financial assets (investments)	100 000	
Current assets:		**281 670**
Inventory (110 000 – 360)	109 640	
Trade and other receivables	44 880	
Cash and cash equivalents	127 150	
Total assets		**429 670**
EQUITY AND LIABILITIES		
Equity:		**279 460**
Capital (250 000 – 22 400)	227 600	
Retained income	51 860	
Non-current liabilities:		**120 000**
Long-term loan: ABC Bank (14%)	120 000	
Current liabilities:		**30 210**
Trade and other payables	30 210	
Total equity and liabilities		**429 670**

You will need to understand and explain which items appear in a Statement of Financial Position and how to prepare and complete this statement.

What is the purpose of drawing up a Statement of Financial Position?

You must understand that one can determine the financial position of a business at any given time; however, normally, this is done at the end of the financial year. Financial position means 'the worth of the business'. Or one could ask the question: 'what is the owner's real equity in the business?' If one sells all the assets of the business and pays all of the liabilities, what is left for the owner?

The Statement of Financial Position is nothing other than a detailed version of the accounting equation, which is indicated as:

Assets = Owner's equity + Liabilities

6.4 THE STRUCTURE OF THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME — SOLE PROPRIETOR

The Statement of Profit or Loss and Other Comprehensive Income for a company and a sole proprietorship will look the same. This is because both business types earn the same kind of revenue and incur the same kind of expenses. The only minor difference is that sole proprietorships, unlike companies, are not subject to taxation.

6.5 THE STRUCTURE OF THE STATEMENT OF FINANCIAL POSITION — SOLE PROPRIETOR

The difference between the Statement of Financial Position of a company and that of a sole proprietorship comes down to equity. A company issues shares in order to start its business. A company will therefore have **share capital** in its equity section. A sole proprietor provides capital to start his business. A sole proprietorship will therefore have **capital** in its equity section.

A sole proprietor may make withdrawals from the business. This is accounted for in an account called **Drawings**. This is the other difference between companies and sole proprietorships. Drawings is the only Statement of Financial Position account that is closed off to the capital account.

A company declares a dividend to return funds to its shareholders. The dividends will not be on the Statement of Financial Position, but in the Statement of Changes in Equity and in the notes to the financial statements.

Summary

In this topic, you would have drawn on your knowledge from studying Topics 1–5. You would have seen that all of this knowledge ends with the drawing up of a post-adjustment trial balance. The post-adjustment trial balance is the starting point for the drawing up of the financial statements that consist of the Statement of Profit or Loss and Other Comprehensive Income, and the Statement of Financial Position. You would have learned the different terminology that appears in the two financial statements.

There is a specific, prescribed method that must be adhered to when drawing up both statements. Certain categories of income and expenses must be grouped together to appear under different headings that are themselves grouped together. You will need to know how to calculate these different headings. Examples include cost of sales, gross profit, other income, and operating expenses in the Statement of Profit or Loss and Other Comprehensive Income.

This will allow the owner(s) at any given time to determine their real interest in the business. This information can be drawn from the Statement of Financial Position. The basis for this statement is the accounting equation.

You would have also learned how to distinguish between a Statement of Financial Position for a sole trader and that of a company, and how to draw up these statements. The main difference is between **capital** for a sole trader and **owner's equity** for a company.

Once these statements are finalised, what do we do with them? You have to know who the stakeholders in the business are and what they will do with the information gathered from the financial statements.

Self-Assessment Questions

1. From the trial balance presented below, prepare the Statement of Profit or Loss and Other Comprehensive Income, and the Statement of Financial Position for Capitalist (Pty) Ltd. The period covered by the trial balance is 12 months.

Capitalist (Pty) Ltd TRIAL BALANCE AS AT 30 JUNE 2023		
General ledger account	**Debit**	**Credit**
Sales		268 000
Rental income		15 600
Cost of sales	158 000	
Depreciation	16 750	
Electricity	10 500	
Rent	18 000	
Stationery	6 600	
Salaries	36 750	
Motor vehicles	150 500	
Accumulated depreciation: motor vehicles		35 750
Bank		2 300
Inventory	25 800	
Accounts receivable	44 500	
Accounts payable		45 750
Share capital		85 000
Retained income (at 01/07/2022)		15 000
	R467 400	**R467 400**

2. The following trial balance was extracted from the records of Lesleigh's Enterprises on 31 March 2023.

	Fol.	Debit	Credit
Statement of financial position section			
Bank	B1	122 000	
Capital	B2		200 000
Premises	B3	105 000	
Equipment	B4	65 000	
Accounts payable	B5		56 000
Consumable stores on hand	B6	940	
Long-term loan	B7		45 000
Accounts receivable	B8	15 200	
Accumulated depreciation: equipment	B9		1 083
Sundry payables	B10		443
Nominal accounts section			
Advertising expense	N1	3 900	
Fee revenue	N2		24 900
Salaries expense	N3	13 000	
Depreciation expense	N4	1 083	
Consumable stores expense	N5	860	
Interest expense	N6	443	
		327 426	**327 426**

Required:

2.1 Prepare the Statement of Profit or Loss and Other Comprehensive Income for Lesleigh's Enterprises for the year ended 31 March 2023.

2.2 Prepare a Statement of Financial Position as at 31 March 2023.

3. The following post-adjustment trial balance was obtained from the accounting records of Cele Merchants at 30 September 2023, the end of its financial year. All adjustments, except for the recognition of closing inventory, have been processed.

	Debit	Credit
Capital		210 000
Vehicles	160 200	
Accumulated depreciation: vehicles		53 400
Accounts receivable	59 900	
Bank	49 300	
Inventory (1/10/2022)	76 700	
Accounts payable		43 000
Investments (short-term)	33 400	
Sales		845 000
Purchases	471 000	
Railage inwards	11 300	
Discount allowed	9 800	
Salaries expense	208 000	
Discount received		18 700
Sundry expenses	83 500	
Railage outwards	7 000	
	1 170 100	**1 170 100**

A physical inventory count on 30 September 2023 revealed that the trading inventory on hand at that date had a cost of R96 100.

Required:

3.1 Prepare all of the necessary closing journal entries at 30 September 2023.

3.2 Prepare the Statement of Profit or Loss and Other Comprehensive Income of Cele Merchants for the year ended 30 September 2023.

3.3 Prepare the Statement of Financial Position as at 30 September 2023.

Glossary of terms

Account: this refers to a page in the bookkeeping book called the ledger. There are a number of these pages and each page will record similar transactions. For example, one page will record all sales, another will record all of the stationery bought (paper, pens, etc.) and yet another will record all of the office furniture bought (chairs, desks, etc.).

Accrued expenses (expenses payable): an accrued expense is one that has been incurred (the benefit has already been received), but payment has not yet been made and the debt is still owing (a creditor). Although no payment has been made, the prudence and accrual concept dictates that we accrue for these expenses as the expense has been incurred.

Accrued income: accrued income is the income equivalent of accrued expenses. Accrued income is that which has been earned, but payment has not yet been received. The debt is still owed to the business (a trade receivable). Although no payment has been received, the accrual concept dictates that we record this income as it accrues to a business.

Assets: assets are resources controlled by the business as a result of past events, from which future economic benefits are expected to flow to the business. They include items of value owned by the business (such as cash, money in the bank, and equipment). Assets also include items owing to the business (such as trade receivables). They are used, consumed, or sold by the business in order to create additional value by earning net income. Other examples of assets include land, inventory for resale, and consumable stores on hand (stationery, cleaning materials, and packing materials). There are two types of assets:

1. **Non-current assets**: land, equipment, and motor vehicles, etc. that are not intended for resale.
2. **Current assets**: inventory (i.e. stock), trade receivables (i.e. debtors), cash and cash equivalents (i.e. petty cash, cash float, etc.).

Assets that are not in cash form are relatively easily converted into cash. In other words, although the business has spent money buying the asset, it can sell that asset and convert it back into cash.

The question to ask yourself when deciding whether something is an asset or not is, can I sell this item for money? If the answer is 'yes', then that 'something' is an asset.

Balance: this refers to the difference between the total amount of the debits (the sum of the debits) and the total amount of the credits (the sum of the credits), with the balance on the right-hand side.

Bank reconciliation: the process in which the cash book (also known as the cash receipts and cash payments journal) is compared to the external bank statement. Differences are recorded in the reconciliation, explaining the amounts to be processed in either the bank statement or cash book. This allows the documents to balance.

Basic credits: these are items shown on the right-hand side of an account. Basic credits in bookkeeping represent all of the liabilities and all of the earnings.

Basic debits: these are items shown on the left-hand side of an account. Basic debits in bookkeeping represent all of the assets and all of the expenses.

Bookkeeping: this refers to the recording of transactions in a set of books. The recording is based on a double-entry principle in which each transaction has matching debit and credit entries (i.e. debit entry = credit entry).

Capital: this refers to the amount of money that the owner of the business invests in the business. Most businesses require a certain amount of money to start operations. This is referred to as capital.

Creditor (trade payable): this refers to the name of a person or business that is owed money. If the business owes money to Peter Williams, then Peter Williams is a creditor. Trade creditor accounts will have credit balances. Trade creditors (i.e. trade payables) are also liabilities of the business.

Debtor (trade receivable): this refers to the name of a person or business owing money to another person or business. If the business is owed money by John Slater, then John Slater is a trade debtor. Trade debtor accounts will have debit balances. Trade debtors (i.e. trade receivables) are also assets of the business. Trade receivables are basic debits.

Depreciable amount: the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation: depreciation is the allocation of the depreciable assets over their estimated useful life. Depreciation is a measure of wear and tear, consumption, or other loss of value in a non-current asset. This depreciation arises as a result of use, the lapsing of time, or obsolescence due to technological advancement or changes in the market. Depreciation is **not** a valuation tool. It allocates the cost to the correct accounting period. A number of methods exist: most commonly, the straight-line method, the reducing balance method, and the units-of-production method.

Drawings: this refers to what the owner of the business draws or takes out of the business, and could be in the form of either money or goods.

Earnings: earnings are also referred to as income. Income refers to all forms of incoming money. Earnings are basic credits.

Equity: equity is the residual (i.e. the remaining) interest in the assets of an enterprise after deducting all of its liabilities. This residual interest represents the amount of the owner's claim against the business if all of the assets are realised (i.e. sold) for cash at the amounts at which they are recorded, and all of the liabilities are discharged (i.e. paid) at the amounts at which they are recorded.

Expenses: expenses are the costs of assets consumed (i.e. used up) and the services used in order to earn revenue. Expenses may also be described as resources sacrificed in order to earn revenue. The resource sacrificed will be the cost of the asset consumed or the service used. Examples of expenses include electricity, salaries, depreciation, telephone, and cost of goods sold. Expenses are basic debits.

General ledger: this is the book (i.e. file) containing all of the various accounts (i.e. record of transactions) of the business. It is the book used to summarise all of these transactions. Information in the ledger comprises the debits and credits transferred from the journals. Sub-ledgers refer to the summary of the position per debtor and creditor in the case of accounts receivable and payable. The respective totals of each will tie up to the general ledger control account total for debtors and creditors.

Imprest system (for petty cash): according to this system, the money that the petty cashier would need during the month is determined beforehand and the amount is given to the cashier as an advance. At the end of the month, the amount paid out by the cashier is paid back, so that the balance of petty cash is the same at the end of the month as at the beginning of the month. The petty cash therefore starts with the same amount every month.

Income received in advance: this is when payment is received before the income is actually earned. A liability exists for the business to earn the income in some future period.

Journals: these are the books of prime entry, also known as the books of first entry. The recording of transactions in these books is the first step in the bookkeeping process. There are eight journals discussed in this text: cash receipts journal, cash payments journal, creditors journal, creditors allowances journal, debtors journal, debtors allowances journal, petty cash journal and general journal.

Ledger: this is the book (i.e. file) containing all of the various accounts (i.e. record of transactions) of the business. It is the book used to summarise all of these transactions. Information in the ledger comprises the debits and credits that are transferred from the journals.

Liabilities: liabilities are the present obligations of a particular business entity to transfer assets (usually by paying money) or to provide services to other entities in the future as a result of past transactions or events. Liabilities therefore represent claims against the assets of a business. These obligations will mainly be in respect of entities from which the business borrowed money, such as banks and other financial institutions, or entities from which it obtained credit, such as suppliers of goods or services.

Matching concept: revenue and expenses must be matched in the relevant accounting period. Expenses incurred in a period must relate to the same period in which the revenue is earned.

Posting: this refers to the transfer of entries from journals to ledgers.

Prepaid expenses: a prepaid expense is an expense that has been paid, but the related benefit is only received in a future period. The accrual concept dictates that we apportion this expense into the portion that relates to expenses that have been incurred, and the portion that relates to expenses that have not yet been incurred.

Prudence concept: this concept states that receipts are only recognised as income if the receipt is certain and all appropriate provision has been made for all liabilities in connection with expenses and losses. A profit is only recognised when it is made, but a loss is accounted for as soon as it becomes known.

Purchases: these are goods (i.e. merchandise) that are purchased with the intention of reselling them. If a business buys and sells motor vehicles, then a motor vehicle bought would be regarded as 'purchases'. If a business buys and sells stationery, then stationery bought would be regarded as 'purchases'. Unsold purchases are called 'trading inventory'.

Reserves and retained income (i.e. retained earnings): at the end of the year, the business will have profit or loss earned in the year. What does the business do with this profit? There are two options: pay out a dividend to the shareholders, or retain the profit in the business in order to fund further transactions. This retained profit is money in. This assists with funding assets in the business. If the profits are paid out as dividends, the money is **lost** to the business and has no use to the business at all.

Revenue: revenue is the gross inflow of cash or receivables arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services and from the use by others of the enterprise's resources. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them, and by the charges and rewards from the use of resources by them. It excludes amounts collected on behalf of third parties, such as Value-Added Tax (VAT).

Statement of Profit or Loss and Other Comprehensive Income: this statement reports the profit or loss for an entity over a specified period of time, normally a year. The result comprises all income less the expenses for the relevant period.

Statement of Financial Position: the statement reports the financial position of an entity at a specific point in time (normally at year-end). The financial position at this specific time comprises:

- the assets that belong to the entity.
- the liabilities owed by the entity.
- the owner's equity. What is the entity worth? To arrive at owner's equity, one deducts all liabilities from assets.

Statement of Cash Flows: this statement provides useful information on how an entity generates cash, and how an entity utilises cash in respect of the historical changes in cash and cash equivalents.

Transactions: these events may be for cash or credit. Any event that gives rise to a recording in the books of the entity is a transaction. Transactions also refer to operating activities.

Trial balance: this refers to a list of the balances in the ledger accounts, to check that the total amount of debits (i.e. the sum of the debit balances) equals the total amount of the credits (i.e. the sum of the credit balances). We test the arithmetical accuracy of entries made in the ledger accounts by drawing up the trial balance.

Varying balances system (for petty cash): according to this system, the petty cashier receives a cheque from the chief cashier when money is required. The balance of petty cash varies from one month to the next, as the money used during the month is credited against the petty cash balance, and the cash available at the end of the month is simply determined by balancing the account.

Answers to Self-Assessment Questions

TOPIC 1 SELF-ASSESSMENT ANSWERS

Multiple-choice questions

1. b)

2. c)

3. c)

4. d)

5. a)

6. R10 000

7. R12 000

8. R20 000

9. Revenue = R18 000
   Expenses = R11 000
   Net profit = R7 000

10. R11 000

11. R19 000 (22 000 − 14 000 + 26 000 + 3 500 − 10 000 − 8 500)

12.

	Assets	Equity	Liabilities
a)	+ 65 000	0	+ 65 000
b)	+ 200 000	+ 200 000	0
c)	+ 4 000 − 4 000	0	0
d)	+ 2 500 − 2 500	0	0

e)	− 1 200	0	− 1 200
f)	− 5 000	0	− 5 000

TOPIC 2 SELF-ASSESSMENT ANSWERS

1.

BLOSSOMS
CREDITORS JOURNAL
MONTH: SEPTEMBER 20XX CJ09

Inv. No.	Date	Details	Fol.	Trade creditors	VAT (Input)	Purchases	SUNDRIES		
							Fol.	Amt	Det
565	3	Budding Roses cc		11 343	1 480	9 863			
286	13	Roots (Pty) Ltd		1 083	141	942			
856	21	PB Garage		150				150	Petrol
				12 576	1 621	10 805		150	
				c/c					

BLOSSOMS
CREDITORS ALLOWANCES JOURNAL
MONTH: SEPTEMBER 20XX CAJ09

Credit Note No.	Date	Details	Fol.	Trade creditors	VAT (output)	Purchases	SUNDRIES		
							Fol.	Amt	Det
896	17	Roots (Pty) Ltd		108.30	14.13	94.17			
				108.30	13.30	95.00			
				c/c					

BLOSSOMS
DEBTORS JOURNAL
MONTH: SEPTEMBER 20XX DJ09

Invoice No.	Date	Details	Fol.	Trade debtors	VAT (output)	Sales
1	4	Mrs Greenfingers		5 643	736	4 907
2	19	Mrs Thorn		1 710	223	1 487
				7 353	959	6 394
				c/c		

BLOSSOMS DEBTORS ALLOWANCES JOURNAL MONTH: SEPTEMBER 20XX						DAJ09
Credit Note No.	Date	Details	Fol	Trade debtors	VAT (input)	Sales
1	15	Mrs Greenfingers		741	97	644
				741	97	644
				c/c		

BLOSSOMS CASH RECEIPTS JOURNAL MONTH: SEPTEMBER 20XX								CRJ09
Rec. No.	Date	Details	Bank (Dr)	VAT (Cr)	Sales (Cr)	Trade debtors (Cr)	SUNDRY	
							Fol.	Amt
1	1	Capital	10 000					10 000
2	11	Cash sales	3 420	446	2 974			
3	29	Mrs Greenfingers	4 902			4 902		
			18 322	446	2 974	4 902		10 000
			c/c					

BLOSSOMS CASH PAYMENTS JOURNAL MONTH: SEPTEMBER 20XX									CPJ09
Date	Payee	EFT No.	Bank (Cr)	VAT (Dr)	Purchases (Dr)	Trade creditors (Dr)	Wages (Dr)	SUNDRY	
								Fol.	Amt
7	Wages	1	990				990		
9	Office refreshments	2	456						456
20	Carnations	3	171	22	149				
25	Wages	4	990				990		
27	Budding Roses	5	11 343			11 343			

	cc (creditor)								
			13 950	22	149	11 343	1 980		456
			c/c						

BLOSSOMS GENERAL JOURNAL Month: SEPTEMBER 20XX GJ09				
Date	Details	Folio	Debit	Credit
20XX September 2	Furniture and fittings Capital: Mrs Blossom *Furniture and fittings brought in by owner*		15 000	 15 000

Notes on the solution above:

a) Petrol purchases are exempt from VAT.

b) The VAT levied on office refreshments is disallowed from deduction as an input.

2. a)

CASH PAYMENTS JOURNAL OF DUMBO JUNE 20XX CPJ06 Sundry accounts									
Doc. no.	Date	Payee	Bank				Amount	Fol.	Details
T	1	Cash	210.00				210.00	B1	Petty cash
T	16	Cash	60.00				60.00	B1	Petty cash
T	30	Cash	155.30				155.30	B1	Petty cash

PETTY CASH JOURNAL OF DUMBO JUNE 20XX PCJ06									
							Sundry accounts		
Doc. no.	Date	Details	Petty cash	Wages	Stationery	Postage	Amount	Fol.	Details
36	2	Pens and pencils	12.56		12.56				
37	7	Stamps	8.40			8.40			
38	9	Cleaning windows	30.00	30.00					
39	17	Railage	34.45				34.45	N7	Railage
40	19	Donation	50.00				50.00	N8	Donation
41	21	Postage	12.00			12.00			
42	25	Repairs	27.89				27.89	N9	Repairs
43	29	Cleaning store room	40.00	40.00					
			215.30	70.00	12.56	20.40	112.34		
			B1	N4	N5	N6			

2. b)

GENERAL LEDGER OF DUMBO
DUMBO STATEMENT OF FINANCIAL POSITION SECTION

Dr			BANK (B2)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
				20XX			
				June 1	Petty cash	PCJ1	210.00
				16	Petty cash	PCJ1	60.00
				30	Petty cash	PCJ1	155.30

Dr			PETTY CASH (B2)				Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX				20XX			
June 1	Bank	CPJ1	210.00	June	Total payments	PCJ1	215.30
	Bank	CPJ1	60.00	30	Balance	c/d	
16	Bank	CPJ1	155.30				210.00
			425.30				425.30
July 1							
	Balance	b/d	210.00				

NOMINAL SECTION

Dr				WAGES (N4)			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX June 30	Petty cash	PCJ1	70.00				

Dr				STATIONERY (N5)			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX June 30	Petty cash	PCJ1	12.56				

Dr				POSTAGE (N6)			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX June 30	Petty cash	PCJ1	20.40				

Dr				RAILAGE (N7)			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX June 17	Petty cash	PCJ1	34.45				

Dr				DONATION (N8)			Cr
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
20XX June 19	Petty cash	PCJ1	50.00				

Dr			REPAIRS (N9)				Cr
Date	**Details**	**Fol.**	**Amount**	**Date**	**Details**	**Fol.**	**Amount**
20XX June 25	Petty cash	PCJ1	27.89				

3. The errors are indicated on the table below:

							Sundry section		
Doc No	Date	Details	Petty cash	Wages	Stationery	Postage	Amount	Fol	Details
42	1	Courier Cost	89.00			98.00			
43	3	Elastic Bands	44.55		55.44				
44	5	Certified letters	39.98			nil			
46	9	Casual day stickers	120.00		120.00		120.00	A23	Staff Welfare
47	11	Coffee and tea	175.23				175.23	A23	Staff Welfare
48	12	Casual worker - cleaning	100.00	100.00					
49	18	Postage stamps	105.00			105.00			
50	22	Pencils	75.32		75.32				
51	23	Casual worker - cleaning	95.00	95.00		95.00			
Chq 12	25	Wages	8,000.00	8,000.00					
			8 844.08	8 195.00	250.76	298.00	295.23		

The corrected journal would be:

							Sundry section		
Doc No	Date	Details	Petty cash	Wages	Stationery	Postage	Amount	Fol	Details
42	1	Courier Cost	89.00			89.00			
43	3	Elastic Bands	44.55		44.55				
44	5	Certified letters	39.98			39.98			
45				Missing sequence. Ask staff to investigate					
46	9	Casual day stickers	120.00				120.00	I4	Staff Welfare
47	11	Coffee and tea	175.23				175.23	I4	Staff Welfare
48	12	Casual worker - cleaning	100.00	100.00					
49	18	Postage stamps	105.00			105.00			
50	22	Pencils	75.32		75.32				
51	23	Casual worker - cleaning	95.00	95.00					
		c/c	844.08	195.00	119.87	233.98	295.23		
			B 1	IS 1	IS 2	IS 3			

Comments:

1. A slip was excluded from the sequence — Number 45.

2. Slip 42: transposition error, R98.00.
3. Slip 43: transposition error, R55.44.
4. Slip 44: omitted from the analysis column.
5. Slip 46: R120 duplicated.
6. Slip 51: duplicated.
7. Cheque 12: transfer to the cash payments journal.
8. The journal now down- and cross-casts.
9. Folio reference details added.

4.

1.	ABC Wholesalers, your major client, has paid 50% of the credit sales delivered to him in November of last year. You are considering sending a harsh letter, as the terms at the time were 100% to be paid in January. You gave him the equivalent of the COD price at the time.	CRJ
2.	DEF traders returned two items sold on credit in December, with a request for credit. You agree to issue a credit note.	DAJ
3.	GHI Sales, one of your loyal clients, accidentally overpaid you, because you have a name similar to another firm. You agree to refund GHI the overpayment and must record the refund.	CPJ
4.	You realise that you have accidentally posted the depreciation in the wrong accounting period. It has to be corrected.	GJ
5.	You want to purchase goods on credit worth R100 from one of your trade creditors, JKL Suppliers. You place an order, but the supplier informs you that your credit has been revoked. You buy the same goods on credit from MNO, although they are more expensive.	CJ
6.	This is the second time this month that you have had returns from a certain product line. You decide to look at quality control. Reluctantly, you issue a credit note to the debtor, but only for 80% of the value, because part of the product line can still be used.	DAJ
7.	You have managed to restore your credit at JKL Suppliers (see 5), and they have a massive sale. You purchase sale items, paying cash.	CPJ
8.	You return goods purchased on credit and issue a request for credit, which the supplier honours.	CAJ
9.	You complain to MNO about their high prices (see 5), and you get a 5% discount and receive a credit note.	CAJ
10.	The owner decides that he is taking the old laptop home to use for his children's projects. He says that you must 'fix' the books.	GJ

11.	The bank pays you interest on a positive balance.	CRJ
12.	You make a sale on credit to a large customer on credit terms. He agrees to pay you within 45 days.	DJ
13.	You realise that you have received another order for the customer in 12, and you raise another invoice.	DJ
14.	You decide to buy pies for the office from petty cash.	PCJ
15.	You purchase non-sale merchandise on credit from JKL (see 5 and 7).	CJ

5.

Book of prime Entry	Source document	Primary total posted to which ledger account	DR/CR
Cash receipts journal	Receipts issued or CR entries on the bank statement	Bank	DR
Cash payments journal	Cheque counterfoils or DR entries on the bank statement	Bank	CR
Creditors journal	Original supplier's invoice	Trade creditors/accounts payable	CR
Creditors allowances journal	Original supplier's credit note	Trade creditors/accounts payable	DR
Debtors journal	Duplicate credit sales invoice	Trade debtors/accounts receivable	DR
Debtors allowance journal	Seller duplicate credit note issued	Trade debtors/accounts receivable	CR
Petty cash journal	Petty cash voucher	Petty cash	CR

Answers to Question 1 and 2:

GENERAL LEDGER

SALES 50							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
				20XX 30 Sep	Accounts receivable Bank	DJ1 CRJ1	6 450 3 000 9 450

PURCHASES 100							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX 30 Sep	Accounts payable Bank	CJ1 CPJ1	10 900 150 11 050				

WAGES 130							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX 30 Sep	Bank	CPJ1	1 980				

OFFICE REFRESHMENTS 135							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX 9 Sep	Bank	CPJ1	456				

PETROL 140							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX 21 Sep	Accounts payable	CJ1	150.00				

FURNITURE AND FITTINGS 200							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX							
1 Sep	Balance	b/d	12 000				
2 Sep	Capital	J1	15 000				
			27 000				

BANK ACCOUNT 250							
Debit							Credit
Date	Details	Folio	Amt.	Date	Details	Folio	Amt.
20XX				20XX	Total	CPJ1	12 536
1 Sep	Balance	b/d	792	30 Sep	payments		
					Balance	c/d	20 158
30 Sep	Total receipts	CRJ1	17 902				
			32 694				32 694
1 Oct	Balance	b/d	20 158				

ACCOUNTS RECEIVABLE 300							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
				20XX			
	Balance	b/d	6 865	30	Debtor allowances	DAJ1	650
	Sales	DJ1	6 450	Sep	Bank	CRJ1	4 902
					Balance	c/d	7 763
			13 315				13 315
	Balance	b/d	7 763				

ACCOUNTS PAYABLE 400							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
20XX				20XX			
30 Sep	Creditors allowances	CAJ1	95	1 Sep	Balance	b/d	3 657
				30 Sep	Purchases	CJ1	11 050
	Bank	CPJ1	9 950				
	Balance	c/d	4 662				
			14 707				14 707
				1 Oct	Balance	b/d	4 662

CREDITORS ALLOWANCES 102							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
				30 Sept	Accounts payable	CAJ1	95.00

Posting the entries to the purchases (100) account would also be correct.

DEBTORS ALLOWANCES 103							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
30 Sept	Accounts receivable	DAJ1	650				

Posting the entries to the sales (50) account would also be correct.

CAPITAL: MRS BLOSSOM 550							
Debit							Credit
Date	Details	Folio	Amount	Date	Details	Folio	Amount
				20XX			
				1 Sept	Balance	b/d	30 000
				1 Sept	Bank	CRJ1	10 000
				2 Sept	Furniture and fittings	J1	15 000
							55 000

ACCOUNTS RECEIVABLE LEDGER

MRS GREENFINGERS D10					
Debit					Credit
Date	Details	Folio	Debit	Credit	Balance
Sept 1	Balance	b/d			2 755.00
Sept 4	Invoice 1	DJ1	4 950.00		7 705.00
Sept 15	Credit note 14	DAJ1		650.00	7 055.00
Sept 29	Receipt 3	CRJ1		4 902.00	2 153.00

MRS THORN D20					
Debit					Credit
Date	Details	Folio	Debit	Credit	Balance
Sept 1	Balance	b/d			4 110.00
Sept 19	Invoice 2	DJ1	1 500.00		5 610.00

LIST OF DEBTORS

Mrs Greenfingers	D10	2 153.00
Mrs Thorn	D20	5 610.00
		7 763.00

ACCOUNTS PAYABLE LEDGER

BUDDING ROSES cc C10					
Debit					Credit
Date	Details	Folio	Debit	Credit	Balance
Sept 1	Balance	b/d			
Sept 3	Invoice 565	CJ1		9 950.00	9 950.00
Sept 27	Cheques 5	CPJ1	9 950.00		

ROOTS (PTY) LTD C20					
Debit					Credit
Date	Details	Folio	Debit	Credit	Balance
Sept 1	Balance	b/d			3 457.00
Sept 13	Invoice 286	CJ1		950.00	4 407.00
Sept 17	Credit note 896	CAJ1	95.00		4 312.00

PB GARAGE C30					
Debit					Credit
Date	Details	Folio	Debit	Credit	Balance
Sept 1	Balance	b/d			200.00
Sept 21	Invoice 856	CJ1		150.00	350.00

LIST OF CREDITORS		
Budding Roses	C10	nil
Roots (Pty) Ltd	C20	4 312.00
PB Garage	C30	350.00
		4 662.00

BLOSSOMS Trial balance for the month ending September 20XX			
Acc. No.	Account name	Dr	Cr
50	Sales		9 450
100	Purchases	11 050	
102	Creditors allowances		95
103	Debtors allowances	650	
130	Wages	1 980	
135	Office refreshments	456	
140	Petrol	150	
200	Furniture and fittings	27 000	
250	Bank	20 158	
300	Accounts receivable	7 763	
400	Accounts payable		4 662
550	Capital		55 000
		69 207	**69 207**

3. Accounting equation:

BLOSSOMS Trial balance for the month ending September 20XX			
Acc. No.	Acc. Name	Dr	Cr
50	Sales (equity)		9 450
100	Purchases (equity)	11 050	
102	Creditors allowances (equity)		95
103	Debtors allowances (equity)	650	
130	Wages (equity)	1 980	

BLOSSOMS Trial balance for the month ending September 20XX			
Acc. No.	**Acc. Name**	**Dr**	**Cr**
135	Office refreshments (equity)	456	
140	Petrol (equity)	150	
200	Furniture and fittings (asset)	27 000	
250	Bank (asset)	20 158	
300	Accounts receivable (asset)	7 763	
400	Accounts payable (liability)		4 662
550	Capital (equity)		55 000
		69 207	69 207
	Equity (capital)		55 000
	Profit/Loss (sales − purchases + creditors allowances − debtors allowances − wages − office refreshments − petrol)		(4 741)
	Owner's equity		50 259
1.	Liabilities (accounts payable)		4 662
2.	Assets (furniture and fittings + bank + accounts receivable)		54 921

4. **Multiple choice questions**:

4.1 b)
4.2 b)
4.3 d)
4.4 a)
4.5 b)
4.6 d)
4.7 b)
4.8 c)

5. **Indicate whether the following statements are true/false**:

5.1 True
5.2 False
5.3 False
5.4 True
5.5 False

5.6 False
5.7 True
5.8 True
5.9 False
5.10 True

TOPIC 4 SELF-ASSESSMENT ANSWERS

1.1

CASH BOOK OF SPENDERS (PTY) LTD MARCH 2023						
Receipts					Payments	
Date	Detail	Amount	Date	Detail	Ch. No.	Amount
01	**Balance**	**950.00**	**May 1**	Wages	239	600.00
02	Deposit	750.00	5	Purchases	240	1 500.00
09	Deposit	655.00	12	Rent	241	750.00
16	Deposit	1 560.00	16	Electricity	242	150.00
23	Deposit	900.00	21	Wages	243	600.00
28	Deposit	1 450.00	25	A. Creditor	244	950.00
			28	Drawings	245	500.00
			27	**Insurance**		**150.00**
			28	**Bank charges**		**50.00**
			30	**Balance**	**c/d**	**1 015.00**
		6 265.00				**6 265.00**
June 1	**Balance b/d**	**1 015.00**				

1.2

BANK RECONCILIATION STATEMENT OF SPENDERS (PTY) LTD FOR THE MONTH OF MARCH 2023	
Balance per bank statement	R765.00
Less outstanding EFTs	
EFT no. 244	(950.00)
EFT no. 245	(500.00)
Add outstanding deposits	
Deposit slip no. 0381	1 450.00
Balance as per cash book	**1 015.00**

2.1

CASH BOOK OF CHECKIT TRADERS DECEMBER 2022						
	Receipts				Payments	
Date	Detail	Amount	Date	Detail	EFT No.	Amount
01	**Balance (dr)**	**1 850.00**	02	Wages	1274	2 100.00
08	Deposit	1500.00	10	Electricity	1275	500.00
15	Deposit	1 800.00	15	A. Creditor	1276	3 500.00
22	Deposit	1 200.00	18	C. Debt	1277	2 300.00
30	Deposit	1 600.00	23	Wages	1278	1 700.00
20	**Deposit**	**500.00**	29	AC Supplies	1279	1 750.00
30	**Balance c/d**	**3550.00**	**30**	**Bank charges**		**150.00**
		12 000.00				**12 000.00**
			Jan 1	**Balance b/d (credit)**		**3550.00**

2.2

BANK RECONCILIATION STATEMENT OF CHECKIT TRADERS FOR THE MONTH OF DECEMBER 2022	
Balance per bank statement (overdrawn)	(3 800.00)
Less outstanding EFTs	
EFT no. 1265	(500.00)
EFT no. 1279	(1 750.00)
Add outstanding deposits:	
Deposit slip no. 0384	1 600.00
Add correction to be made by the bank	900.00
Cheque 1277 — correct amount	
Balance as per cash book (credit)	**(3 550.00)**

3. 3.1 a)
   3.2 c)
   3.3 b)
   3.4 d)
   3.5 a)
   3.6 d)
   3.7 c)
   3.8 a)
   3.9 b)
   3.10 b)

4. 4.1

Bank reconciliation of Chancers Limited for February 2023

Line	Description	Total
01	Balance per bank statement	10 000
02	Less outstanding EFTs:	
03	EFT no. 129	(850)
04	EFT no. 185	(750)
05	EFT no. 186	(300)
06	EFT no. 188	(100)
07	EFT no. 189	(200)
09	Add outstanding cash deposits (28 February)	3 000
10	Less deposit incorrectly recorded as R5 200 instead of R2 500	(2 700)

Line	Description	Total
11	Add EFT incorrectly debited twice on bank statement	500
12	Add unauthorised debit order — NKL Trading	600
13	**Balance per cash book**	**9 200**

4.2 At least inform the bank to ensure that it is resolved, to prevent the reconciling item from staying on the reconciliation forever.

4.3 The duplication could have been caused by a system glitch on the bank's side.

4.4 The business could query and ask the bank to reverse the debit order. This can be done either through banking apps, calling the bank's call centre, or walking into a bank branch.

4.5 R9 200, because it is the balance shown in the business bank account in the general ledger.

5. 5.1 True

5.2 False

5.3 True

5.4 False (both journals)

5.5 False

TOPIC 5 SELF-ASSESSMENT ANSWERS

1.1 Additional information:

a) The inventory adjustment is required so that Happy Feet correctly reflects its inventory on hand. It is also required so that cost of sales can be calculated.

GENERAL JOURNAL		Debit	Credit
2023 Sept 30	Cost of sales	20 000	
	Inventory		20 000
	Transfer of opening inventory to cost of sales		
	Inventory	6 000	
	Cost of sales		6 000
	Recognition of closing inventory		
	Cost of sales	32 000	
	Purchases		32 000
	Transfer of purchases to cost of sales		

Additional information:

b) Happy Feet has paid for 100% of the repairs to be done by the contractor. The contractor has only completed 55% of the repairs, so only 55% of the amount paid can be reflected as an expense in the current year. The remaining 45% will only be completed in the next year. Therefore, 45% of the R25 000 is a pre-payment.

GENERAL JOURNAL		Debit	Credit
2023 Sep 30	Prepaid expenses	11 250	
	Repairs		11 250
	25 000 × 45%		
	Adjusting repairs for prepaid portion of expense		

Additional information:

c) The annual expense for advertising should be R18 000 (R1 500 × 12). The expense recorded by Happy Feet is R12 000. The expense is therefore short and Happy Feet needs to accrue for the portion that has not been paid.

GENERAL JOURNAL		Debit	Credit
2023 Sept 30	Advertising	6 000	
	Accrued expenses		6 000
	18 000 – 12 000		
	Accrual for expenses utilised but not yet paid for		

Additional information:

d) Happy Feet has earned rental revenue of R24 000 (R2 000 × 12). Rent income recorded is R30 000. Happy Feet will only earn the excess portion in the next year.

GENERAL JOURNAL		Debit	Credit
2023 Sept 30	Rent income	6 000	
	Income received in advance		6 000
	30 000 – 24 000		
	Adjusting rent income that has not been earned.		

Additional information:

e) The trial balance shows no record of the commission income. The business has earned this income as it has sold the goods. An accrual must be made to correctly reflect this.

GENERAL JOURNAL		Debit	Credit
2023 Sept 30	Accrued income	8 000	
	Commission income		8 000
	Accrual for expenses utilised but not yet paid for.		

1.2 and 1.3

Sales							
Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Trading account		100 000	Sep 30	Balance		100 000

Purchases							
Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		32 000	Sep 30	Cost of sales		32 000

Wages and Salaries							
Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		16 000	Sep 30	Profit and loss		16 000

Repairs							
Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		25 000	Sep 30	Prepaid expenses		11 250
					Profit and loss		13 750
			25 000				25 000

Inventory							
Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		20 000	Sep 30	Cost of sales		20 000
	Cost of sales		6 000		Balance		6 000
			26 000				26 000

Oct 1	Balance		6 000				

Cleaning expense

Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		3 000	Sep 30	Profit and loss		3 000

Rent expense

Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		24 000	Sep 30	Profit & loss		24 000

Income received

Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Profit and loss		4 000	Sep 30	Balance		4 000

Rent income

Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Income received in advance		6 000	Sep 30	Balance		30 000
	Profit and loss		24 000				
			30 000				30 000

Interest expense

Debit				Credit			
Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Sep 30	Balance		2 000	Sep 30	Profit and loss		2 000

Advertising expense

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
Sep 30	Balance		12 000	Sep 30	Profit and loss		18 000
	Accrued expense		6 000				
			18 000				18 000

Cost of sales

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
Sep 30	Inventory		20 000	Sep 30			6 000
	Purchases		32 000		Trading account		46 000
			52 000				52 000

Commission income

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
Sep 30	Profit and loss		8 000	Sep 30	Accrued income		8 000

Prepaid expenses

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
Sep 30	Repairs		11 250				

Accrued expenses

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
				Sep 30	Advertising		6 000

Income received in advance

Date	Details	Fol.	Amount	Date	Details	Fol.	Amount
Debit				**Credit**			
				Sep 30	Rent income		6 000

Accrued income							
Debit				**Credit**			
Date	**Details**	**Fol.**	**Amount**	**Date**	**Details**	**Fol.**	**Amount**
Sep 30	Commission income		8 000				
Trading account							
Debit				**Credit**			
Date	**Details**	**Fol.**	**Amount**	**Date**	**Details**	**Fol.**	**Amount**
Sep 30	Cost of sales		46 000	Sep 30	Sales		100 000
	Profit and loss		54 000				
			100 000				100 000

Profit and loss account							
Debit				**Credit**			
Date	**Details**	**Fol.**	**Amount**	**Date**	**Details**	**Fol.**	**Amount**
Sep 30	Wages and salaries		16 000	Sep 30	Trading Account		54 000
	Repairs		13 750		Commission income		8 000
	Cleaning		24 000		Income received		4 000
	Rent		24 000		Rent income		24 000
	Interest		2 000		Retained loss		7 750
	Advertising		18 000				
			97 750				97 750

As additional practice, do the journal entries required to close off the books. You should come to the same result.

2.1

2023:

Car: the car was bought on 1 March 2022. The year-end is 28 February.

Mar, Apr, May, Jun, Jul, Aug, Sep, Oct, Nov, Dec, Jan, Feb.

The car has therefore been in use for an entire year. The depreciation should reflect this.

(120 000 – 20 000)/5 = R20 000

Computer: the computer was bought on 1 March 2022. The year-end is 28 February.

Mar, Apr, May, Jun, Jul, Aug, Sep, Oct, Nov, Dec, Jan, Feb.

The computer has therefore been in use for an entire year. The depreciation should reflect this.

50 000 × 30% = R15 000

Machinery: the machinery was bought on 31 December 2022. The year-end is 28 February.

Jan, Feb.

The machinery has only been used for two months. The depreciation needs to be apportioned to reflect this.

(220 000 – 40 000)/6 = 30 000
30 000 × 2/12 = R5 000

2024:

Car: the car is depreciating on the straight-line method; therefore, the depreciation for 2024 will be the same as the depreciation for 2023 = R20 000.

Computer: the computer is depreciated using the reducing balance method. The depreciation will change for 2024. The first step is to calculate the carrying value cost, less accumulated depreciation, and then apply the 30%.
(50 000 – 15 000) × 30% = R10 500

Machinery: the machinery is depreciated using the straight-line method. The depreciation for 2024 will not be the same as the depreciation for 2023, as the machinery was used for the full year in 2024.
(220 000 – 40 000)/6 = R30 000

2.2

GENERAL JOURNAL		Debit	Credit
2023 Feb 28	Depreciation	40 000	
	Accumulated depreciation: car		20 000
	Accumulated depreciation: computer		15 000
	Accumulated depreciation: machinery		5 000
	Depreciation on assets for the 2023 year		
2024 Feb 28	Depreciation	60 500	
	Accumulated depreciation: car		20 000
	Accumulated depreciation: computer		10 500
	Accumulated depreciation: machinery		30 000
	Depreciation on assets for the 2024 year		

2.3

Accumulated depreciation: car					
Debit			Credit		
Date	Details	Amount	Date	Details	Amount
			2023 Feb 28	Depreciation	20 000
			2024 Feb 28	Depreciation	20 000
					40 000

Accumulated depreciation: computer					
Debit			Credit		
Date	Details	Amount	Date	Details	Amount
			2023 Feb 28	Depreciation	15 000
			2024 Feb 28	Depreciation	10 500
					25 500

Accumulated Depreciation: machinery					
Debit			Credit		
Date	Details	Amount	Date	Details	Amount
			2023 Feb 28	Depreciation	5 000
			2024 Feb 28	Depreciation	30 000
					35 000

TOPIC 6 SELF-ASSESSMENT ANSWERS

1.

Capitalist (Pty) Ltd STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2022		
	R	R
Sales		268 000
Less: Cost of sales		(158 000)
Gross profit		110 000
Add: Other income		15 600
Rental income	15 600	
Income		125 600
Less: expenses:		(88 600)
Depreciation	16 750	
Electricity	10 500	
Rent	18 000	
Stationery	6 600	
Salaries	36 750	
Net profit for the year		37 000

Capitalist (Pty) Ltd STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2022		
ASSETS		
Non-current assets		114 750
Motor vehicles at cost	150 500	
Less: Accumulated depreciation	(35 750)	
Current assets		70 300
Inventory	25 800	
Accounts receivable	44 500	
Total assets		**185 050**
EQUITY AND LIABILITIES		
Equity		137 000
Ordinary share capital	85 000	
Retained profit (15 000 + 37 000)	52 000	
Current liabilities		48 050
Accounts payable	45 750	
Bank overdraft	2 300	
Total equity and liabilities		**185 050**

2.1

Lesleigh's Enterprises STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2023		
Income	**24 900**	
Fee revenue	24 900	
Less expenses	**(19 286)**	
Advertising	3 900	
Salaries	13 000	
Depreciation	1 083	
Consumable stores	860	
Finance costs	443	
Interest paid	443	
Net profit	**5 614**	

2.2

LESLEIGH'S ENTERPRISES STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2023		
ASSETS	**R**	**R**
Non-current assets		168 917
Premises	105 000	
Equipment (65 000 – 1 083)	63 917	
Current assets		138 140
Consumable stores	940	
Accounts receivable	15 200	
Bank	122 000	
Total assets		**307 057**
EQUITY AND LIABILITIES		
Equity		205 614
Capital	200 000	
Retained profit (from part A)	5 614	
Non-current liabilities		45 000
Long-term loan	45 000	
Current liabilities		56 443
Accounts payable	56 000	
Sundry payables	443	
Total equity and liabilities		**307 057**

3.1

General journal of Cele Merchants for September 2023

Date	Details	Debit	Credit
30	Trading account	559 000	
	Inventory		76 700
	Purchases		471 000
	Railage inwards		11 300
	(Closing transfers of opening inventory, cost of purchases and related inventory costs)		
	Sales	845 000	
	Inventory	96 100	
	Trading account		941 100
	(Closing transfer of sales revenue and		

	closing inventory)		
	Trading account	382 100	
	Profit and loss account		382 100
	(Transfer of gross profit) *(941 100 – 559 000)*		
	Profit and loss account	308 300	
	Discount allowed		9 800
	Salaries expense		208 000
	Sundry expenses		83 500
	Railage outwards		7 000
	(Closing transfers of other expenses)		
	Discount received	18 700	
	Profit and loss account		18 700
	(Closing transfer of other income)		
	Profit and loss account	92 500	
	Retained income		92 500
	(Transfer of net profit to equity) *(382 100 + 18 700 – 308 300)*		

3.2

Cele Merchants STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 2023		
Sales:		845 000
Cost of sales		(462 900)
Opening inventory	76 700	
Purchases	471 000	
Railage inwards	11 300	
Closing inventory	(96 100)	
Gross profit		**382 100**
Other income:		**18 700**
Discount received	18 700	
Gross income		**400 800**
Other expenses:		**(308 300)**
Discount allowed	9 800	
Salaries expense	208 000	
Sundry expenses	83 500	
Railage outwards	7 000	
Net profit for the year		**92 500**

3.3

CELE MERCHANTS STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2023		
ASSETS	R	R
Non-current assets:		**106 800**
Vehicles (160 200 – 53 400)	106 800	
Current assets:		**238 700**
Inventory	96 100	
Investments (short-term)	33 400	
Accounts receivable	59 900	
Bank	49 300	
Total assets		**345 500**
EQUITY AND LIABILITIES		
Equity:		**302 500**
Capital	210 000	
Retained income (from 2.1 and 2.2)	92 500	
Current liabilities:		**43 000**
Accounts payable	43 000	
Total equity and liabilities		**345 500**