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BASIC FINANCIAL ACCOUNTING

FOURTH EDITION

Willem Bosua and Madri Schutte

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Basic Financial Accounting

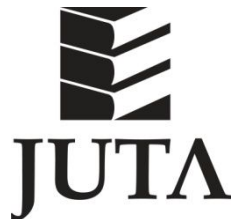
Fourth Edition

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Preface

A serious need exists among students who have not previously come into contact with financial accounting for an exposition of the basic principles of the subject. The authors hope that this publication will fulfil that need and also satisfy the requirements of a bridging course.

Not only is this publication ideal as an introduction for new students in this subject, but it will also be of great assistance to any person learning the basic maxims of accounting.

The fourth edition contains an expanded set of exercises in each chapter as well as an entirely new chapter on value-added tax.

May the contents of this book inspire a sincere interest in this subject.

Note

Solutions to all exercises are made available to lecturers at prescribing institutions. Please refer to www.jutaacademic.co.za for details.

Accounting equation

Specific outcomes

By the end of this module you should be able to:

1. Understand and explain the following concepts:
 - assets
 - liabilities
 - income
 - expenses.
2. Apply the double-entry principle.
3. Know what is meant by a “transaction”.
4. Indicate what the effect of a given transaction will be on the accounting equation.
5. Understand and explain the following concepts:
 - owner’s equity
 - debtors (trade receivables)
 - creditors (trade and other payables)
 - settlement discount granted
 - settlement discount received
 - returns.

1.1 What is accounting?

Accounting is the orderly and systematic recording of transactions within a business, during a certain period.

1.2 What is a transaction?

A transaction is an agreement between two parties where the one sells something to another party and this party has to pay for the goods purchased, or renders a service that can be expressed in terms of a monetary value.

1.3 Starting a business

In order to start a business, money is required. In accounting terms this money is called *capital*.

1.4 Capital

Any contribution to the business made by the owner.

1.5 Drawings

Any thing (assets, money, etc.) taken from the business by the owner.

For the successful operation of a business, the following items are necessary:

- buildings
- vehicles
- equipment
- inventory (articles you want to sell)
- personnel.

1.6 Grouping of items

All the items in a business can be divided into four groups: assets, liabilities, income and expenses (see page 23–24).

1.6.1 What is an asset?

An asset is something of value that is the property of the business. It should satisfy the following three requirements:

- Value – the item must have value.
- Ownership – the business must have a right of possession to the asset.
- Measurable cost – the asset must have been obtained at a measurable cost to the business.

Classification of assets

Non-current assets which consist of:

- *Fixed assets*: articles of value with a lifetime of more than one year. A fixed asset is used to earn income.
- *Investments*: money invested for a period of more than one year.

Current assets

- *Current assets*: articles of value with a lifetime of less than one year which are easily convertible into cash.

1.6.2 What is a liability?

A liability is the enforcement responsibility of a business to pay a certain amount to someone (creditor) to whom the business owes money, a creditor.

Classification of liabilities

- *Owner's equity*: this is the interest of the owner in the business. Owner's equity can also be expressed by the following equation:

$$\text{Owner's equity} = \text{Capital} + \text{Profit} - \text{Drawings}.$$
- *Long-term liabilities*: these are obligations negotiated by a business which are payable over a period of more than one year.
- *Current liabilities*: these are obligations negotiated by a business which are payable within one year.

Remember: Total assets = Total liabilities (liabilities + owner's equity)

In other words, the assets and liabilities of a business give us a picture of the financial position of the business at a certain time.

TOTAL ASSETS		
Fixed assets Land and buildings Furniture Equipment Machinery Vehicles	Investments Fixed deposit	Current assets Inventory Debtors (trade receivables) Petty cash Bank

TOTAL LIABILITIES		
Owner's equity Capital + Profit – Drawings	Long-term liabilities Loan (long term) Bond on property	Current liabilities Creditors (trade and other payables) Bank overdraft Loan (short term)

1.6.3 What is income?

The income of a business is the money received from its normal daily operations. In other words, the business receives a value in exchange for goods sold or services rendered.

1.6.4 What is an expense?

An expense is the amount spent by a business during its normal daily operations (excluding capital expenses).

Remember: Profit = Income – Expenses

The difference between the income and expenses gives us a picture of the financial results (gross profit and net profit) of a business during a certain period.

INCOME AND EXPENSES	
Expenses	Income
Cost of sales	Revenue
Interest paid	Interest received
Rent paid	Rent received
Electricity and water	Commission received
Credit losses	Services rendered
Settlement discount granted	Settlement discount received
Salaries	Dividends received
Depreciation	Profit with selling an asset
Insurance	Credit losses recovered
Fuel	
Repairs and maintenance	
Consumable goods	
Stationery	
Loss with selling an asset	

1.7 Explanation of concepts

1.7.1 Debtor

A debtor is a person who owes money to the business, in other words, the business has sold something to him on credit.

1.7.2 Creditor

A creditor is a person to whom the business owes money, in other words, the business has bought something from him on credit.

1.7.3 Settlement discount received

This refers to the discount the business receives if a debt to a creditor is paid on time.

1.7.4 Settlement discount granted

This refers to the discount granted to a debtor by the business if the debtor pays his debts to the business on time.

1.7.5 Credit losses

If a debtor is unable to pay his debt, the amount must be written off as irrecoverable (credit losses).

1.7.6 Depreciation

The amount by which the fixed assets are reduced on an annual basis.

1.7.7 Returns outwards

Returns outwards are damaged items which we send back to the supplier (creditor), i.e. we are the buyer/we bought.

1.7.8 Returns inwards

Returns inwards are damaged items which are sent back to us by the buyer (debtor), i.e. we are the seller/we sold.

1.8 The principle of double entry based on the principle of duality

1.8.1 Accounting equation

$$\text{Total assets} = \text{Total liabilities}$$

or $\text{Assets} = \text{Owner's equity} + \text{Liabilities}$

or $\text{Owner's equity} = \text{Assets} - \text{Liabilities}$

Remember: Owner's equity = Capital + Profit – Drawings

and **Profit = Income – Expenses**

1.8.2 The principle of double entry

According to the principle of double entry there is a corresponding credit for each debit. This means that each transaction influences the accounting equation twice.

Remember: Total debits = Total credits

A transaction can affect the accounting equation in one of the following ways:

	Owner's equity	=	Assets	–	Liabilities
1			+		+
2	+		+		
3			±		
4			–		
5	–		–		
6	–				+

1.8.3 The influence of a transaction on the accounting equation

Always ask yourself the following three questions before you determine the effect of a transaction on the equation:

- Which two accounts are involved in the transaction?
- What type of accounts are they (asset, liability, income or expense)?
- Did the asset, liability, income or expense increase or decrease?

Examples of transactions with assets and liabilities

Example:

In this example only transactions with assets and liabilities will be discussed.

Transaction number

- An owner, A, started a business and deposited R60 000 cash in the bank account of the business.
- Purchased land and buildings cash, R200 000.
- Purchased equipment cash, R10 000.
- Purchased furniture on credit from X, R15 000.
- Long-term loan from the NBS, R15 000.
- Purchased inventory on credit from Z, R12 000.
- Paid creditors by cheque, R15 000.
- Receipts from debtors in full settlement of their debts, R10 000.

	Owner's equity	=	Assets	-	Liabilities
1.	+60 000	=	+60 000	-	
2.		=	+200 000 -200 000	-	
3.		=	+10 000 -10 000	-	
4.		=	+15 000	-	+15 000
5.		=	+15 000	-	+15 000
6.		=	+12 000	-	+12 000
7.		=	-15 000	-	-15 000
8.		=	+ 10 000 -10 000	-	

Example:

In this example only transactions with income and expenses will be discussed.

Transaction number

1. Bought stationery from the ACN on credit, R500.
2. Paid salaries of personnel, R8 000.
3. Received interest on investment from the bank, R800.
4. Paid the water and electricity bills by cheque, R1 300.
5. Received R6 000 from A for services rendered during the month.

	Owner's equity	=	Assets	-	Liabilities
1.	-500	=		-	+500
2.	-8 000	=	-8 000	-	

3.	+800	=	+800	-	
4.	-1 300	=	-1 300	-	
5.	+6 000	=	+6 000	-	

Summary

1. All accounts can be classified into four basic groups, namely assets, liabilities, income and expenses.
2. In accounting everything must always balance. Therefore the accounting equation is: Assets = Owner's equity + Liabilities.
3. An increase in income reflects an increase in the owner's equity and a decrease in income reflects a decrease in the owner's equity.
4. If an expense increases, the owner's equity will decrease and if an expense decreases the owner's equity will increase.
5. Owner's equity = Capital + Profit - Drawings.
6. Profit = Income - Expenses.

Exercise 1.1

Classify the following items as either assets (A), liabilities (L), income (I) or expenses (E):

1. Bank
2. Capital
3. Buildings
4. Depreciation
5. Rent paid
6. Inventory
7. Transport costs
8. Repairs and maintenance
9. Services rendered
10. Revenue
11. Salaries and wages

A	L	I	E

4. Sold one of the vehicles on credit to C. Crog for R10 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

5. Obtained a long-term loan from the bank for R10 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

6. The owner withdrew R3 000 for his own use.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

7. C. Crog paid his debt of R10 000 to the business.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

8. Paid the amount due to G. Roux, R30 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

Exercise 1.3

Principle of double entry (income and expenses)

Indicate the influence of the following transaction on the accounting equation:

$$\begin{array}{c} \text{Owner's} \\ \text{equity} \\ \boxed{} \end{array} = \begin{array}{c} \text{Assets} \\ \boxed{} \end{array} - \begin{array}{c} \text{Liabilities} \\ \boxed{} \end{array}$$

1. Paid interest on a loan at NBS, R500.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

2. Received interest on an investment, R2 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

3. Paid for repairs to vehicles by cheque, R1 500.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

4. Sold merchandise on credit, R2 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

5. Paid the shop rent by cheque, R4 000.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

6. The debt of a debtor written off as irrecoverable, R500.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

7. Settlement discount granted to a debtor, R50.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

8. Paid the telephone account by cheque, R750.

$$\begin{array}{c} \text{O} \\ \boxed{} \end{array} = \begin{array}{c} \text{A} \\ \boxed{} \end{array} - \begin{array}{c} \text{L} \\ \boxed{} \end{array}$$

Exercise 1.4

What is the effect of the following transactions on the accounting equation?

$$\begin{array}{c} \text{Owner's} \\ \text{equity} \\ \boxed{} \end{array} = \begin{array}{c} \text{Assets} \\ \boxed{} \end{array} - \begin{array}{c} \text{Liabilities} \\ \boxed{} \end{array}$$

1. The owner withdrew R4 000 from the bank account of the business for his own use.
2. Paid a creditor R1 600 in full settlement of his account of R1 700.
3. Paid the wages of R11 000 for the month.
4. Interest paid on bank statement amounts to R56.
5. Sold an old vehicle for R12 000 cash.
6. Bought equipment on credit from Gauteng Stationers for R4 000.
7. Paid R1 000 interest on the loan to NSS bank.
8. Received R3 500 from a debtor in full settlement of an account of R3 560.

9. Sold inventory for cash, R2 200.
10. Invested R50 000 in a long-term investment with CCC Investments.

Exercise 1.5

What is the effect of the following transactions on the accounting equation?

$$\boxed{\text{Owner's equity}} = \boxed{\text{Assets}} - \boxed{\text{Liabilities}}$$

1. Sold inventory on credit to ZZ Busy Bee for R1 200.
2. Wrote off R300 from a debtor as a credit loss.
3. Depreciation on vehicles calculated at R15 000 for the year.
4. The owner took inventory with a cost price of R400 and a selling price of R600 for his own use.
5. Bought inventory for R10 000 cash.
6. Bank charges on bank statement amounts to a total of R358.
7. Paid the water and electricity account of R1 100.
8. Did repairs and maintenance to the offices and paid cash, R700.
9. Paid accounting fees for financial statements, R3 000.
10. Placed an advertisement in the local newspaper for a secretary vacancy. The account is due at the end of the month and amounts to R150.

Exercise 1.6

During March 20XX the following transactions occurred in the business of F & W Samray, a general dealer:

- 20XX
March
- 1 Mr Samray deposited an additional R20 000 cash in the bank account of the business.
 - 2 Paid for an advertisement in the Cape August (newspaper) per cheque, R75.
 - 6 Sold inventory on credit to R. Maposa, R10 000 (cost price R8 000).
 - 7 Received an account for repairs to the vehicle of the owner, R800. This amount is still payable by the business.
 - 10 Received a credit invoice from E. Terror for goods purchased, R15 000.
 - 12 Received a cheque from S. Vink in full settlement of his account, R800. S. Vink owed the business R850.

- 13 Paid a creditor, J. van As, R1 200 by cheque, after he granted the business a discount of R20.
- 20 Received a credit note from E. Terror for damaged goods sent back to him, R2 000.
- 25 Cash sale, R8 000 (cost price R6 000).
- 30 Received interest on a fixed deposit at the Uno Building Society, R2 000.

Required

1. Indicate which account is to be debited and which account credited as well as the source document applicable.
2. Indicate the influence of each transaction on the accounting equation.

Example:

20XX

March 31 Purchased a vehicle cash, R30 000

Date	Source Document	Account Dr	Account Cr	Amount	O	A	L
31	Cheque	Vehicles	Bank	30 000		±	

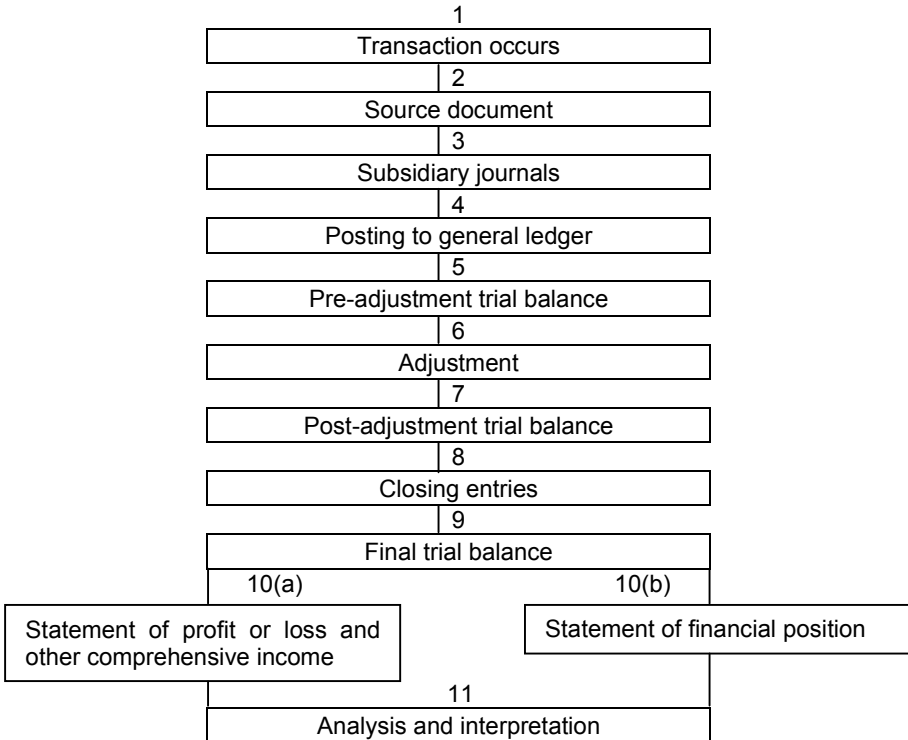
Ledger accounts

Specific outcomes

By the end of this module you should be able to:

1. Identify and present the accounting cycle.
2. Apply the double-entry system to the general ledger accounts.
3. Balance a general ledger account.
4. Identify the statement of profit or loss and other comprehensive income and statement of financial position accounts.
5. Draft a trial balance.
6. Draft an elementary statement of profit or loss and other comprehensive income and statement of financial position.

2.1 The accounting cycle



2.1.1 Transaction occurrence

Transactions occur daily in any business concern. A transaction is an agreement between two parties to make something happen. Cash is not necessarily involved. It could be that we:

- buy {
 - credit
 - cash
- sell {
 - credit
 - cash
- pay
- receive money
- return goods
- receive goods returned.

Transactions take place between the following parties:

- us and the owner
- us and the bank
- us and the debtor
- us and the creditor
- us and any other party, where “us” refers to the business concerned.

2.1.2 Source document

Under no circumstances may any entry be made in the records without a source document to substantiate the entry.

A specific source document is used for every type of transaction. It is also important to distinguish between an original and a duplicate source document.

Examples of source documents used:

- receipt – for cash received
- cash slip or cash register slip – for goods sold cash
- cheque – for payment of something (cash)
- invoice – credit purchase invoice for credit purchases
– credit sales invoice for credit sales
- credit note issued – for goods returned to us
- credit note received – for goods returned by us.

2.1.3 Subsidiary journals

The purpose of a subsidiary journal is to summarise transactions of the same type.

A distinction is made, for example, between a cash transaction and a credit transaction. A further distinction is made with regard to cash transactions, namely cash payments and cash receipts.

The following subsidiary journals are applicable:

- General Journal (GJ)
- Cash Receipts Journal (CRJ)
- Cash Payments Journal (CPJ)
- Debtors Journal (DJ)
- Creditors Journal (CJ)
- Debtors Allowance Journal (DAJ)
- Creditors Allowance Journal (CAJ)
- Petty Cash Journal (book) (PCJ).

2.1.4 General ledger accounts

The purpose of a general ledger account is to determine a balance for each account in the records.

An account is opened for every item, whether it is an asset, liability, income or expense, and the balance is determined for every account.

A balance is determined by calculating the difference between the debit side and the credit side of each account. The left-hand side of an account represents the debit side, and the right-hand side the credit side.

Example:

Debit	Vehicles	Credit
Left-hand side		Right-hand side

A general ledger account is in the shape of a ‘T’, with the name of the account at the top: ‘‘Vehicles’’ in this instance.

All transactions relating to vehicles (buying, selling, etc.) will be accounted for in this account to enable us to determine the balance at the end of a specific period.

2.1.5 Pre-adjustment trial balance

This represents a summary of all the debit and credit balances in the general ledger before any adjustments are made to these balances. It includes income, expense, and income and expense accounts.

2.1.6 Adjustments (see Module 5)

An adjustment is not a transaction that occurs, in other words, two parties are not involved.

An adjustment relates to the accounting policy of the business concern and/or compliance with International Financial Reporting Standards (IFRS). These adjustments are made at year-end.

Examples of adjustments:

- calculation of depreciation
- provision for credit losses
- other adjustments.

Adjustments are made in the general journal and the journal description acts as the source document. The entries in the general journal are posted to the general ledger account.

2.1.7 Post-adjustment trial balance

A post-adjustment trial balance is prepared after making all the necessary adjustments. It represents the final balances of all general ledger accounts and includes income, expense, asset and liability accounts.

2.1.8 Closing entries (see Module 6)

Closing entries are made using the general journal. All income and expense accounts are closed so that no balances remain in these accounts and a clean start can be made during the next financial year.

Income and expense accounts that influence gross profit close off against the trade account. All other income and expense accounts close off against the profit or loss account.

2.1.9 The final trial balance

After all the closing entries have been made, the only balances that remain in the general ledger are assets, liabilities, and the profit or loss as calculated in the profit or loss account. The final trial balance therefore consists of a summary of those balances that remain in the general ledger after all the closing entries have been made.

2.1.10 The statement of profit or loss and other comprehensive income (see Module 7)

The heading of the statement of profit or loss and other comprehensive income always reads as follows:

“Statement of profit or loss and other comprehensive income of ... *for the year ended ... 20XX*”

The purpose of the statement of profit or loss and other comprehensive income is to determine the gross and net profit of the business concern for a specific period. Only income and expenses appear in the statement of profit or loss and other comprehensive income.

2.1.11 The statement of financial position (see Module 7)

The heading of the statement of financial position always reads as follows:

“Statement of financial position of ... *at ... 20XX*”

Only assets and liabilities appear in the statement of financial position, which is the balance of these accounts at a specific date.

2.1.12 Analysis and interpretation

The final step in the accounting cycle is the analysis and interpretation of the information contained in the financial statements. This is done by calculating ratios and comparing the figures in the financial statements with those of other concerns or budgets previously drawn up.

2.2 Application of the double-entry system to the general ledger accounts

When a transaction occurs, the following must be identified:

1. Which two accounts are involved?

2. What type of account is it (asset, liability, income or expense)?
3. Did the asset, liability, income or expense increase or decrease?

Every general ledger account has a debit and a credit side, and is in the shape of a “T”. The debit side is on the left-hand side of the “T” and the credit side is on the right-hand side of the “T”.

Example:

+	Vehicles	-
Debit side		Credit side

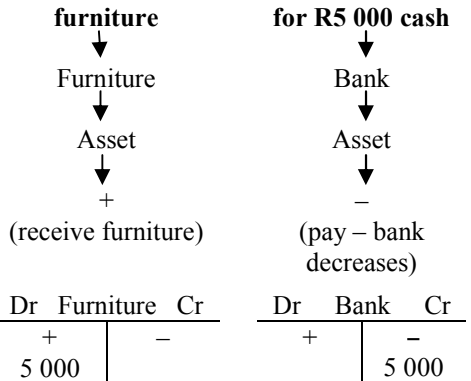
A general ledger account can be classified as either an asset, liability, income or expense, and functions as follows:

<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: left; width: 10%;">Dr</td> <td style="text-align: center; width: 80%;">Asset</td> <td style="text-align: right; width: 10%;">Cr</td> </tr> <tr style="border-top: 1px solid black;"> <td style="text-align: center;">+</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">-</td> </tr> </table>	Dr	Asset	Cr	+		-	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: left; width: 10%;">Dr</td> <td style="text-align: center; width: 80%;">Liability</td> <td style="text-align: right; width: 10%;">Cr</td> </tr> <tr style="border-top: 1px solid black;"> <td style="text-align: center;">-</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">+</td> </tr> </table>	Dr	Liability	Cr	-		+
Dr	Asset	Cr											
+		-											
Dr	Liability	Cr											
-		+											
<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: left; width: 10%;">Dr</td> <td style="text-align: center; width: 80%;">Expense</td> <td style="text-align: right; width: 10%;">Cr</td> </tr> <tr style="border-top: 1px solid black;"> <td style="text-align: center;">+</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">-</td> </tr> </table>	Dr	Expense	Cr	+		-	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: left; width: 10%;">Dr</td> <td style="text-align: center; width: 80%;">Income</td> <td style="text-align: right; width: 10%;">Cr</td> </tr> <tr style="border-top: 1px solid black;"> <td style="text-align: center;">-</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">+</td> </tr> </table>	Dr	Income	Cr	-		+
Dr	Expense	Cr											
+		-											
Dr	Income	Cr											
-		+											

Example:

Buy

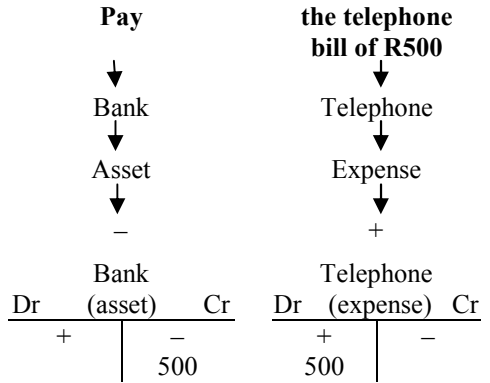
1. Identify the accounts involved
2. What is it?
3. Increase/decrease?



It is important to note that for every entry in the general ledger there must be a debit leg and a credit leg and they must balance.

Example:

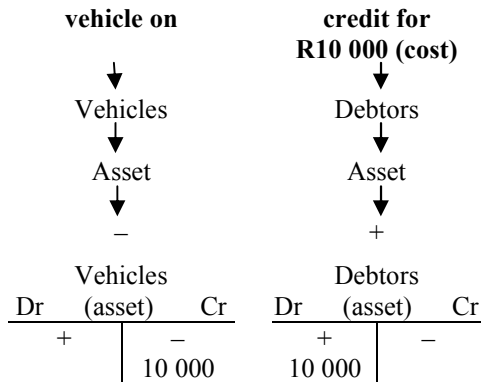
1. Identify the accounts involved
2. What is it?
3. Increase/decrease?



Example:

Sell an old

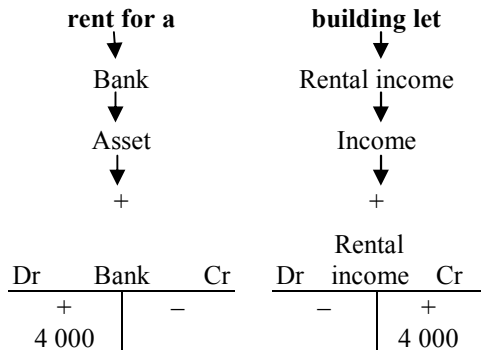
1. Identify the accounts involved
2. What is it?
3. Increase/decrease?



Example:

Receive R4 000

1. Identify the accounts involved
2. What is it?
3. Increase/decrease?



In the previous example you will notice that both bank and rental income increased. It is not relevant whether both accounts increased or decreased, or whether the one account increased and the other decreased. What is of importance is that every entry is represented by a debit leg and a credit leg.

The two ledger accounts involved (identified in the specific transaction) both have a description with the amount of the transaction. The two accounts say “hello” to each other.

Example:

Buy a vehicle for R65 000 cash.

<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%; text-align: left;">Dr</td> <td style="width: 40%; text-align: center;">Vehicle</td> <td style="width: 30%; text-align: right;">Cr</td> </tr> <tr> <td style="text-align: center;">+</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">-</td> </tr> <tr> <td style="padding-left: 20px;">Bank 65 000</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td></td> </tr> <tr> <td style="text-align: center;">↓</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td></td> </tr> </table>	Dr	Vehicle	Cr	+		-	Bank 65 000			↓			<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%; text-align: left;">Dr</td> <td style="width: 40%; text-align: center;">Bank</td> <td style="width: 30%; text-align: right;">Cr</td> </tr> <tr> <td style="text-align: center;">-</td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="text-align: center;">+</td> </tr> <tr> <td></td> <td style="border-left: 1px solid black; border-right: 1px solid black;"></td> <td style="padding-left: 20px;">Vehicle 65 000</td> </tr> </table>	Dr	Bank	Cr	-		+			Vehicle 65 000
Dr	Vehicle	Cr																				
+		-																				
Bank 65 000																						
↓																						
Dr	Bank	Cr																				
-		+																				
		Vehicle 65 000																				

This is the contra account (where the other leg of the double entry lies).

2.3 General ledger account balancing

The purpose of the general ledger account in “T” format is to determine the balance of the account, that is, the difference between the debit side and the credit side. Where the debit side is larger than the credit side, there is a debit balance and where the credit side is larger than the debit side, there is a credit balance.

Example:

+ Dr	Vehicles	- Cr
Bank	40 000	Debtors
Creditors	30 000	31/12 Balance
	70 000	b/o 60 000
	60 000	70 000
1/1 Balance	b/f 60 000	

Step 1

Leave a line open after the last entry.

Step 2

Draw two double lines on each side (debit and credit).

Step 3

Add the larger of the two sides (normally the side where the account increases) and write the total of the largest side between the single and double lines drawn on both sides.

Step 4

The double lines mean that all the figures above them add up to R70 000. In this example the credit side needs R60 000 to add up to R10 000. This R60 000 is called the balance brought over (b/o) and represents the amount by which the debit side exceeds the credit side.

This amount (R60 000) is written above the single and double lines on the credit side. Balances are determined at the end of each month or year, therefore the balance brought over should always carry a date (last day of the month [year]).

Step 5

The balance determined is then written on the debit side, under the double lines, and is called the balance brought forward (b/f). The balance brought forward will always carry a date, indicating the start of a new financial period.

The debit side exceeded the credit side by R60 000, therefore the next month/year will start with a debit balance of R60 000.

Example:

– Dr	Creditors	+ Cr	
Bank	5 000	Vehicles	40 000
Bank	6 000	Inventory	2 000
31/12 Balance	b/o 31 000		
	<u>42 000</u>		<u>42 000</u>
	1/1 Balance	b/f	<u>31 000</u>

Remember: The balance of an account normally appears on the side where the account increases:

- “Creditors” is a liability and increases on the credit side: therefore it has a credit balance.
- “Vehicles” is an asset and increases on the debit side: therefore it has a debit balance.

Identification of statement of profit or loss and other comprehensive income and statement of financial position accounts:

- Statement of profit or loss and other comprehensive income accounts consist of all income and expense accounts.

- Statement of financial position accounts consist of all the asset and liability accounts.

Refer to the list of examples of asset, liability, income and expense accounts below. Not all possibilities are listed.

2.4 Drafting of the trial balance

A trial balance has a debit column and a credit column. Balances of all general ledger accounts appear in the trial balance.

If the general ledger account has a debit balance, the amount of the balance is placed in the debit column, and if the account has a credit balance, the amount of the balance is placed in the credit column.

The debit and credit column totals form a trial balance and must always be the same (in balance). That is the principle of the double-entry system: for every debit there must be a credit.

The trial balance consists of two sections:

- The statement of financial position section for all the asset and liability balances.
- The statement of profit or loss and other comprehensive income section for all the income and expense balances.

Statement of financial position accounts		
Assets	+	Owner's equity + Liabilities
<u>Fixed assets</u>		1. Capital
<i>Non-current assets</i>		2. Drawings
1. Land & buildings		3. Profit
2. Furniture		
3. Equipment		Liabilities
4. Machinery		<i>Long-term liabilities</i>
5. Goodwill		1. Loan (longer than 12 months)
6. Patents		2. <i>Mortgage bond</i>
7. Trade marks		
8. Vehicles		<i>Current liabilities</i>
<u>Investments</u>		1. Creditors
1. Long-term investment longer than 12 months)		2. Bank overdraft
<u>Negative assets</u>		3. Accrued expenses
1. Provision for credit losses		4. Income received in advance
2. Accumulated depreciation		5. SARS

Statement of profit or loss accounts		
Expenses	+	Income
<p><i>Expenses</i></p> <ol style="list-style-type: none"> 1. Cost of sales 2. Purchases 3. Rent paid 4. Interest paid 5. Commission paid 6. Settlement discount granted 7. Credit losses 8. Salaries & wages 9. Tax 10. Licenses 11. Advertisements 12. Water & electricity 13. Telephone 14. Insurance 15. Stationery 16. Consumables 17. Repairs & maintenance 18. Fuel 19. Rent paid 20. Cleaning materials 	+	<p><i>Income</i></p> <ol style="list-style-type: none"> 1. Rent received 2. Interest received 3. Commission received 4. Sales 5. Tariff income 6. Services rendered 7. Credit losses recovered 8. Settlement discount received

Example:

Trial balance of AAA Dealers at 31.12.20XX

	Debit R	Credit R
<i>Statement of financial position section</i>		
Capital		76 700
Vehicles	40 000	
Bank	20 000	
Machinery	15 000	
Debtors	12 000	
<i>Statement of profit or loss and other comprehensive income section</i>		
Sales		90 000
Cost of sales	40 650	
Rent paid	36 000	
Interest received		2 000
Credit losses	700	
Depreciation	4 000	
Bank charges	350	
	168 700	168 700

2.5 Drafting of an elementary statement of profit or loss and other comprehensive income (see Module 7)

Only income and expense account balances appear in the statement of profit or loss and other comprehensive income.

The purpose of the statement of profit or loss and other comprehensive income is to calculate the profit or loss for a specific period.

The heading of the statement of profit or loss and other comprehensive income is therefore:

“Statement of profit or loss and other comprehensive income of ... for the year/month/period ended 31.12.20XX”

In other words, if the statement of profit or loss and other comprehensive income is drafted for a year, it will consist of all the income received and expenses incurred during that year.

The statement of profit or loss and other comprehensive income consists of two sections. In the first section, gross profit is calculated as follows:

Sales	XXX
– Cost of sales	(XXX)
Gross profit	<u>XXX</u>

Cost of sales consists of expenses related to sales, e.g. all costs incurred to purchase inventory, e.g. purchase of inventory, railage, import tax and duties.

In the second section, net profit is calculated, taking into account all other income and expenses (other than sales and cost of sales), e.g. interest paid, rent paid, rent received, etc.

These other income accounts are added to the gross profit, and the other expense accounts subtracted from gross profit in order to calculate net profit.

Example:

Statement of profit or loss and other comprehensive income of ABC Ltd., for the year ended 31 December 20XX

		R
Sales		100 000
Less: Cost of sales		42 000
Gross profit		<u>58 000</u>
Plus: Other income		8 800
Interest received	600	
Credit losses recovered	200	
Rent received	8 000	
		<u>66 800</u>
Less: Other expenses		(51 000)
Salaries and wages	20 000	
Rent paid	21 600	
Water and electricity	6 000	
Telephone	2 760	
Credit losses	2 760	
Net profit	640	
		<u><u>15 800</u></u>

2.6 Drafting of an elementary statement of financial position (see Module 7)

The statement of financial position consists of asset and liability accounts. A statement of financial position consists of two sections, namely “Assets” and “Equity and Liabilities”.

2.6.1 Assets

This section consists of:

1. Non-current assets (which are fixed assets with a lifespan > 12 months).
2. Investments (investments made for a period of 12 months and longer).
3. Current assets, which are all other assets (with a lifespan < 12 months).

2.6.2 Equity and liabilities

This section can be classified into three sub-sections, namely:

1. Equity
This is calculated as follows:
Capital + Profit – Drawings
2. Non-current liabilities
All liabilities payable after a period of 12 months and longer.
3. Current liabilities
All other liabilities payable within the next 12 months.

Example:

Statement of financial position of ... at 31 December 20XX

ASSETS	R	R	R
<i>Non-current assets</i>			
Fixed assets	Cost	Accumulated depreciation	Book value
Land and buildings	200 000	–	200 000
Vehicles	75 000	25 000	50 000
Machinery	46 000	16 000	30 000
			280 000

Basic Financial Accounting

Investment – FFB (longer than 12 months)		50 000
		330 000
<i>Current assets</i>		132 000
Inventory	17 000	
Trade receivables	40 000	
Bank	72 000	
Petty cash	3 000	
		462 000
EQUITY AND LIABILITIES		
<i>Equity</i>		160 000
Capital	100 000	
+ Net profits	80 000	
– Drawings	180 000	
	20 000	
<i>Non-current liabilities</i>		230 000
Mortgage	200 000	
Long-term loan (longer than 12 months)	30 000	
		72 000
<i>Current liabilities</i>		
Trade payables	57 000	
Loan (payable within 12 months)	15 000	
		462 000

The net profit indicated in the statement of financial position is the net profit as calculated in the statement of profit or loss and other comprehensive income. If a net loss was made, the figure would be deducted from capital, in other words:

Capital	XX
Less: Net loss	(<u>XX</u>)
	XX
Less: Drawings	(<u>XX</u>)

Summary

1. For each transaction that occurs, there will always be a debit and a credit entry.
2. Always ask the following three questions before entering the transaction in the general ledger:
 - Which two accounts are involved?
 - What type of account is it (asset, liability, income, expense)?
 - Did it increase or decrease?
3. A trial balance has a debit and a credit column. The accounts with credit balances are entered into the credit column, and the accounts with debit balances into the debit column. The two columns in the trial balance must always add up to the same amount (balance).
4. In the statement of profit or loss and other comprehensive income we calculate the gross and net profit for a specific period. Only income and expense accounts will appear in the statement of profit or loss and other comprehensive income.
5. The statement of financial position consists only of assets and liabilities. There are two sections in the statement of financial position:
 - Assets
 - Equity and liabilities.

Exercise 2.1

You have started your own motor vehicle repair business named ‘‘Moti-Moti’’.

The following transactions occur:

1. Deposited R40 000 in the business bank account as capital.
2. Bought tools on credit for R1 500.
3. Bought furniture on credit for R5 000.
4. Repaired a motor vehicle gearbox and received R2 500 for the service rendered.
5. Repaired a motor vehicle speed cable for R1 200. The client only paid within 45 days.
6. Paid the water and electricity bill of R600.
7. Received bank interest of R120.
8. Placed an advertisement to market the new business. The cost is R250 and will be paid in 30 days.
9. Bought stationery on credit for R200.
10. Bought spare parts costing R3 000.

Required

Record the above transactions in the general ledger.

Exercise 2.2

Draft a trial balance using the following information:

Balance each account first.

Dr	Capital	Cr	Dr	Vehicles	Cr
	Bank	100 000	Capital	30 000	
	Vehicles	30 000	Bank	14 000	

Dr	Bank	Cr
Capital	100 000	Vehicles
Trade receivables	8 000	Trade payables
Sales	20 000	Rent paid
		Commission paid
		Repairs
		Inventory
		Investment

Dr	Creditors	Cr
Bank	2 500	Inventory
Settlement discount received	100	

Dr	Rent paid	Cr	Dr	Land and buildings	Cr
Bank	4 600		Mortgage bond	60 000	

Dr	Inventory	Cr	Dr	Commission paid	Cr
Trade payables	12 000	Cost of sales	Bank	1 600	
Bank	16 000	8 000			

Dr	Repairs	Cr
Bank	1 200	

MODULE 2: Ledger accounts

<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: left;">Dr</td> <td style="width: 80%; text-align: center;">Investment</td> <td style="width: 10%; text-align: right;">Cr</td> </tr> <tr> <td style="border-right: 1px solid black;">Bank</td> <td style="text-align: right;">30 000</td> <td></td> </tr> </table>	Dr	Investment	Cr	Bank	30 000		<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: left;">Dr</td> <td style="width: 80%; text-align: center;">Settlement discount received</td> <td style="width: 10%; text-align: right;">Cr</td> </tr> <tr> <td style="border-right: 1px solid black;"></td> <td style="text-align: right;">Trade receivables</td> <td style="text-align: right;">100</td> </tr> </table>	Dr	Settlement discount received	Cr		Trade receivables	100			
Dr	Investment	Cr														
Bank	30 000															
Dr	Settlement discount received	Cr														
	Trade receivables	100														
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Dr	Sales	Cr														
	Bank	20 000														
	Trade payables	12 000														
Dr	Cost of sales	Cr														
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Dr	Trade payables	Cr														
Sales	12 000	Bank														
		8 000														
Dr	Mortgage bond	Cr														
	Land and buildings	60 000														

Exercise 2.3

Prepare a statement of profit or loss and other comprehensive income and a statement of financial position for LGI Electronics using the following balances, on 28 February 20XX.

	R
Capital	95 000
Vehicles (cost price)	60 000
Sales	110 000
Rent paid	12 000
Interest paid	2 000
Long-term loan	30 000
Trade payables	20 340
Trade receivables	17 360
Water and electricity	7 200
Telephone	5 040
Settlement discount received	1 560
Drawings	3 000
Machinery	25 000
Accumulated depreciation – machinery	5 000
Accumulated depreciation – vehicles	7 000

Investment (invested for 3 years)	10 000
Bank (overdraft)	13 000
Inventory	66 700
Commission received	1 400
Cost of sales	75 000

Exercise 2.4

The following list of balances was obtained from the books of R. Roadrunner as at 31 December 20XX:

	R
Capital: Roadrunner	143 100
Land and buildings	120 000
Vehicles	200 000
Inventory (31 December 20XX)	50 000
Bank	20 000
Petty cash	100
Trade and other payables	30 000
Trade receivables	40 000
Accumulated depreciation: vehicles	80 000
Revenue	450 000
Cost of sales	150 000
Interest received	5 000
Settlement discount granted	1 000
Settlement discount received	500
Credit losses	3 500
Salaries and wages	90 000
Rates and taxes	2 000
Rent paid	8 000

Interest paid	1 500
Stationery	2 500
Depreciation: vehicles	20 000

Required

1. Prepare a statement of profit or loss and other comprehensive income for the year ending 31 December 20XX.
2. Prepare a statement of financial position as at 31 December 20XX.

Subsidiary journals

Specific outcomes

By the end of this module you should be able to:

1. Identify the relevant transaction types and applicable source documents.
2. Record the transactions in the subsidiary journals:
 - General Journal
 - Cash Receipts Journal
 - Cash Payments Journal
 - Debtors Journal
 - Creditors Journal
 - Debtors Allowance Journal
 - Creditors Allowance Journal
 - Petty Cash Journal (book).

3.1 Identification of the relevant transaction type and source document

The two main types of transactions that exist are cash transactions and credit transactions. There are, however, transactions that occur that are neither cash nor credit, for example the recording of depreciation on fixed assets.

It is important to identify the relevant transaction type, as similar transactions are grouped together and written into one specific subsidiary journal.

The transaction type will also help with the identification of the source document used. Refer to the notes on source documents in Module 1.

3.1.1 Transaction types

1. Cash { Buy
Sell
2. Credit { Buy
Sell
3. Goods returned { Purchases
Sales
4. Petty cash transactions
5. Other.

3.2 Recording of transactions in the subsidiary journals

Eight subsidiary journals can be identified:

1. General Journal (GJ)
2. Cash Receipts Journal (CRJ)
3. Cash Payments Journal (CPJ)
4. Debtors Journal (DJ)
5. Creditors Journal (CJ)
6. Debtors Allowance Journal (DAJ)
7. Creditors Allowance Journal (CAJ)
8. Petty Cash Journal (book) (PCJ).

GJ Any type of transaction can be recorded.

CRJ Only cash receipt transactions.

Source document: receipt.

CPJ Only cash payment transactions.

Source document: cheque counterfoil (EFT).

DJ Only credit sales.

Source document: duplicate credit sales invoice.

CJ Only credit purchases.

Source document: original credit purchase invoice.

DAJ Returns of goods sold.

Source document: duplicate credit note/credit note issued.

CAJ Returns of goods purchased.

Source document: original credit note/credit note received.

PAJ Payments and receipts that influence petty cash.

Source document: petty cash voucher.

3.2.1 General Journal (GJ)

As mentioned before, any type of transaction can be recorded in the general journal. The general journal only indicates which account must be debited and credited.

When a question requires you to “journalise all the transactions”, all the transactions must be recorded in the general journal, irrespective of the fact that some transactions should be recorded in another subsidiary journal.

Alternatively, when a question requires you to “prepare all the subsidiary journals”, then only the transactions that are not recorded in another subsidiary journal must be recorded in the general journal. This means any transactions other than:

- cash receipts
- cash payments
- credit sales

- credit purchases
- sales returns
- purchase returns
- petty cash transactions.

Example:

The owner of a business takes a vehicle with a cost price of R15 000 for private use.

	Debit R	Credit R
<i>Journal</i>		
Drawings	15 000	
Vehicles		15 000
Owner took a vehicle		

The account that is debited is entered first, showing the amount in the debit column.

The account that is credited is entered second, and further to the right, showing the amount in the credit column.

The description of the transaction is entered at the bottom and is called the “narration”.

Remember: The general journal is only a subsidiary journal where transactions that occur are recorded. The entries in the general journal must still be posted to the general ledger.

Example: Posting from the journal to the ledger

<i>General journal</i>	Debit R	Credit R
1. Vehicles	40 000	
Bank		40 000
2. Bank	2 000	
Debtors		2 000

Postings to the general ledger

Vehicles		Bank
1. Bank 40 000		2. Debtors 2 000 1. Vehicles 40 000
Debtors		
	2. Bank 2 000	

3.2.2 Cash Receipts Journal (CRJ)

Only transactions where the business receives cash are recorded in the cash receipts journal. It is therefore a summary of all cash receipt transactions. The cash receipts journal contains a number of columns and these columns are opened for transactions that occur frequently in a month. The columns that are used will therefore differ from one business concern to another, and there are no fixed column allocations. The cash receipts journal actually represents the debit side of the bank account.

Example:

- 2/5 Sold inventory for cash, at a selling price of R600 and a cost price of R500.
- 4/5 Received R200 from a debtor.
- 6/5 Sold inventory for cash, R150, cost price, R120.
- 7/5 Received R450 for rent.

Cash receipts journal of “A” for May 20XX

Doc. no.	Date	Bank	Fol.	Debtors	Sales	Cost of sales	Sundries	Details of sundries
2111	2	600			600	500		
2112	4	200		200				
2113	6	150			150	120		
2114	7	450					450	Rent received
		1 400		200	750	620	450	
		B5		B2	N1	N2	N3	

The totals in each column are posted to the relevant general ledger account at the end of each month. Only the sundry column’s entries are posted individually to the general ledger because they may consist of entries that have to be posted to different accounts.

Posting to the general ledger

General ledger

Dr	Bank account			B5	Cr
20XX					
31/5	Cash receipts journal CRJ1	1 400			
Dr	Debtors control account			B2	Cr
				20XX	
			31/5	Bank	CRJ 200
Dr	Sales			N1	Cr
				20XX	
			31/5	Bank	CRJ 750
Dr	Cost of sales			N2	Cr
20XX					
31/5	Inventory	CRJ	620		
Dr	Inventory			B1	Cr
				20XX	
			31/5	Cost of sales	CRJ 620
Dr	Rent received			N3	Cr
				20XX	
			31/5	Bank	CRJ 450

3.2.3 Cash Payments Journal (CPJ)

Only transactions where cash is paid are recorded in the cash payments journal. It is therefore a summary of all cash payment transactions. Just as in the case of the cash receipts journal, the cash payments journal contains a number of columns for specific general ledger accounts.

Example:

- 2/5 Paid R100 to a creditor.
- 3/5 Paid R400 to a creditor.
- 9/5 Bought inventory for cash, R650.
- 11/5 Bought equipment for cash, R800.

Cash payments journal of "A" for May 20XX

Doc. no.	Date	Bank	Fol.	Creditors	Inventory	Sundries	Details of sundries
R123	2	100		100			
R124	3	400		400			
R125	9	650			650		
R126	11	800				800	Equipment
		1 950		500	650	800	
		B5		B3	B1	B6	B6

Posting to the general ledger

Dr	Bank			B5	Cr
			20XX		
			31/5	Cash receipts journal	CPJ 1 950

Dr	Creditors			B3	Cr
20XX					
31/5	Bank		500		

Dr	Inventory			B1	Cr
20XX					
31/5	Bank		650		

Dr	Equipment			B6	Cr
20XX					
31/5	Bank		800		

You will notice that both the cash receipts journal and the cash payments journal contain an inventory column. In this example an inventory account has been opened for both the CPJ and CRJ.

This has been done in the example for illustration purposes only. In a complete exercise there will be only one inventory account (and one of every other account). The total of every column, no matter in what subsidiary journal, will be posted to the relevant account in the general ledger.

3.2.4 Debtors Journal (DJ)

The debtors journal is a summary of all the transactions relating to the sale of goods or merchandise on credit. It is important to realise that an entry in the debtors journal does not mean that an account has already been credited or debited in the ledger. The source document used is a duplicate credit sales invoice/invoice issued.

Example:

5/5 Sold inventory on credit to A. Bom for R2 000, cost price R1 700.

8/5 Sold inventory on credit to G. Gaap for R5 000, cost price R4 200.

12/5 Sold inventory on credit to S. Spies for R800, cost price R500.

Debtors journal of "A" for May 20XX

Doc. no.	Date	Debtor	Fol.	Total	Sales	Cost of sales
001	5	A. Bom		2 000	2 000	1 700
002	8	G. Gaap		5 000	5 000	4 200
003	12	S. Spies		800	800	500
				7 800	7 800	6 400
				B1	N1	N2

Posting to the general ledger

Dr	Trading inventory				B1	Cr
				20XX		
				31/5	Cost of sales	DJ1 6 400
Dr	Debtors control				B2	Cr
20XX						
31/5	Sales	DJ1	7 800			
Dr	Sales				N1	Cr
				20XX		
				31/5	Debtors control	DJ1 7 800

Dr	Cost of sales			N2	Cr
20XX					
31/5	Trading inventory	DJ1	6 400		

3.2.5 Creditors Journal (CJ)

The creditors journal is a summary of all the credit transactions relating to purchases. It is important to know that the creditors journal is not limited only to the purchase of goods or merchandise on credit.

Remember: An entry in the creditors journal or debtors journal does not mean that an account has actually been debited or credited.

The source document used is an original credit purchase invoice/invoice received.

Example:

- 5/5 Bought inventory on credit from G. Roetz for R1 500.
- 8/5 Bought equipment on credit from V. Vamp for R800.
- 12/5 Bought a vehicle on credit from R. Rob for R14 200.
- 15/5 Bought stationery on credit from BNA for R100.

Creditors journal of “A” for May 20XX

Doc. no.	Date	Creditor	Fol.	Total	Trading inventory	Equipment	Sundries	Details of sundries
209	5	G. Roetz		1 500	1 500			
211	8	V. Vamp		800		800		
212	12	R. Rob	B5	14 200			14 200	Vehicles
214	15	BNA	N4	100			100	Stationery
				B3	B1	B4		

Posting to the general ledger

Dr	Creditors control account			B3	Cr
			20XX		
			31/5	Sundry purchases	DJ1 16 600

Dr	Trading inventory			B1	Cr
----	-------------------	--	--	----	----

20XX					
31/5	Creditors control	DJ1	1 500		

Dr	Equipment			B4	Cr
----	-----------	--	--	----	----

20XX					
31/5	Creditors control	DJ1	800		

Dr	Vehicles			B5	Cr
----	----------	--	--	----	----

20XX					
31/5	Creditors control	DJ1	14 200		

Dr	Stationery			N4	Cr
----	------------	--	--	----	----

20XX					
31/5	Creditors control	DJ1	100		

3.2.6 Debtors Allowance Journal (DAJ)

Sometimes goods sold on credit to a client are damaged during consignment, or the goods are not acceptable to the client. In such cases the goods are sent back to the consignor and the client receives credit for the goods returned.

The debtors allowance journal is only a summary of all the above-mentioned transactions.

The source document used is a credit note issued to the client.

Example:

14/5 Issue a credit note to A. Bom for R500, for goods returned, cost price R300.

18/5 G. Gaap returns goods to a value of R1 000. Issue a credit note.

Cost price of goods, R800.

19/5 Receive goods returned by S. Spies. Issue a credit note of R100.

Cost price R80.

Debtors allowance journal of "A" for May 20XX

C/n	Date	Debtor	Fol.	Total	Sales	Cost of sales
12	14	A. Bom		500	500	300
13	18	G. Gaap		1 000	1 000	800
14	19	S. Spies		100	100	80
				1 600	1 600	1 180

N3

N2

Posting to the general ledger

Dr		Trading inventory		B1	Cr
20XX					
31/5	Cost of sales	DAJ1	1 180		
Dr		Debtors control		B2	Cr
			20XX		
			31/5	Sales	
				DAJ1	1 600
Dr		Cost of sales		N2	Cr
			20XX		
			31/5	Trading inventory	DAJ1 1 180
Dr		Sales		B5	Cr
20XX					
31/5	Debtors control	DAJ1	1 600		

3.2.7 Creditors Allowance Journal (CAJ)

Goods purchased on credit from a supplier are sometimes damaged during consignment, or the goods are not acceptable to the buyer. In such cases the goods are sent back to the supplier and the buyer receives credit for the goods returned.

The creditors allowance journal is only a summary of the above-mentioned transactions.

The source document used is a credit note received from the supplier.

Example:

- 10/5 Received a credit note from G. Roetz for inventory returned to them, R300.
- 14/5 Return goods to V. Vamp and receive their credit note of R200.
- 16/5 Return faulty stationery to a value of R20 to BNA, and receive their credit note.

Creditors allowance journal of “A” for May 20XX

C/n	Date	Creditor	Fol.	Total	Trading inventory	Equipment	Sundries	Details of sundries
24	10	G. Roetz	N4	300	300			
25	14	V. Vamp		200		200		
26	16	BNA		20			20	Stationery
				520	300	200	20	
				B3	B1	B4		

Posting to the general ledger

Dr				Creditors control	B1	Cr
20XX						
31/5	Sundry returns	CAJ11	520			

Dr				Trading inventory	B1	Cr
				20XX		
				31/5	Creditors control	CAJ1 300

Dr				Equipment	B4	Cr
				20XX		
				31/5	Creditors control	CAJ1 200

Dr				Stationery	B5	Cr
				20XX		
				31/5	Creditors control	CAJ1 20

3.2.8 Petty Cash Journal (book) (PCJ)

Small payments are often made for items such as stamps, milk, tea, coffee, sugar, delivery of parcels, part-time labour, etc. Because it is not practical to make these payments by cheque, there is a need for a limited cash fund to pay these items in cash. The petty cash journal provides a record of such transactions. Cash is periodically transferred from the bank account of the business to petty cash in order to have cash available for the payment of small debts.

Only cash transactions are recorded in the petty cash journal (book).

The source document used is a petty cash voucher. You only need to know the purpose of the petty cash journal (book).

Example:

Transactions for B & J Distributors during the month of July 20XX:

- 1 Bought a vehicle from Cosmos Motors on credit for the amount of R22 000.
- 2 Sold inventory on credit to AZZ at a cost price of R200 and a selling price of R350.
- 3 Paid the telephone account for July, R260.
- 4 Received R600 from a debtor (ACE) in settlement of the account.
- 5 Sold inventory for cash to Cash Ltd., for R650. Cost price was R400.
- 6 Bought inventory on credit from Bargain Centre for R3 000.
- 7 Received R20 000 from the owner of the business, being an increase in capital.
- 8 Bought inventory on credit from Credit Ltd., for R1 200.
- 9 Received a credit note for R300 for goods returned by the business to Bargain Centre.
- 10 Sold an old vehicle on credit to Tikkie Ltd., for R10 000.
- 11 Issued a credit note of R50 for goods returned by AZZ.
- 12 Bought inventory from BB Ltd., for R3 000 cash.
- 13 Returned faulty inventory to Credit Ltd., and received their credit note for R240.
- 14 Sold inventory on credit to Nasie Ltd. for R700. Cost price was R600.
- 15 The owner of the business took inventory for private use.
Selling price R150.
Cost price R100.
- 16 Bought inventory for R2 200 and issued a cheque.

Required

1. Prepare all relevant subsidiary journals.
2. Do all the postings to the general ledger.
3. Prepare a trial balance.

Cash receipts journal of B & J Distributors for July 20XX

Doc. no.	Date	Bank	Fol.	Debtors	Sales	Cost of sales	Sundries	Details of sundries
	4	600		600				
	5	650			650	400		
	7	20 000					20 000	Capital
		21 250		600	650	400	20 000	

Cash payments journal of B & J Distributors for July 20XX

Doc. no.	Date	Bank	Fol.	Creditors	Trading inventory	Sundries	Details of sundries
	3	260				260	Telephone
	12	3 000			3 000		
	16	2 200			2 200		
		5 460			5 200	260	

Debtors journal of B & J Distributors for July 20XX

C/n	Date	Debtor	Fol.	Total	Sales	Cost of sales
	2	AZZ		350	350	200
	14	Nasie Ltd		700	700	600
				1 050	1 050	800

Debtors allowance journal of B & J Distributors for July 20XX

C/n	Date	Debtor	Fol.	Total	Sales	Cost of sales
	11	AZZ		50	50	20
				50	50	20

Creditors journal of B & J Distributors for July 20XX

Doc. no.	Date	Creditor	Fol.	Total	Trading inventory	Equipment	Sundries	Details of sundries
	1	Cosmos Motors		22 000			22 000	Vehicles
	6	Bargain Centre		3 000	3 000			
	8	Credit Ltd		1 200	1 200			
				26 200	4 200		22 000	

Creditors allowance journal of B & J Distributors for July 20XX

Doc. no.	Date	Creditor	Fol.	Total	Trading inventory	Equipment	Sundries	Details of sundries
	9	Bargain Centre		300	300			
	13	Credit Ltd		240	240			
				540	540			

General journal of B & J Distribution for July 20XX

	Debit R	Credit R
Tikkie Ltd. (Debtors)	10 000	
Vehicles		10 000
Drawings	100	
Inventory		100

General Ledger

Dr	Capital	Cr
	20XX	
	31/7 Bank	CRJ 20 000
		<u>20 000</u>

Dr	Drawings	Cr
20XX		
31/7 Creditors	CJ 100	
	<u>100</u>	

Dr	Vehicles	Cr
20XX	20XX	
31/7 Creditors	31/7 Debtors	DJ 10 000
	31/7 Balance	b/o 12 000
	<u>22 000</u>	<u>22 000</u>
20XX		
1/8 Balance	b/f 12 000	

Basic Financial Accounting

Dr				Bank				Cr
20XX				20XX				
31/7	Cash received	CRJ	21 250	31/7	Cash payments	CPJ	5 460	
				31/7	Balance	b/o	15 790	
			<u>21 250</u>				<u>21 250</u>	
20XX								
1/8	Balance	b/f	15 790					

Dr				Trading inventory				Cr
20XX				20XX				
31/7	Cost of sales	DAJ	20	31/7	Cost of sales	DJ	800	
	Creditors	CJ	4 200		Creditors returns	CAJ	540	
	Bank		5 200		Cost of sales	CRJ	400	
					Drawings	GJ	100	
				31/7	Balance	b/o	7 580	
			<u>9 420</u>				<u>9 420</u>	
20XX								
1/8	Balance	b/f	7 580					

Dr				Debtors				Cr
20XX				20XX				
31/7	Sales	DJ	1 050	July 31	Sales returns	DAJ	50	
	Vehicles	GJ	10 000		Bank	CRJ	600	
				31	Balance	b/o	10 400	
			<u>11 050</u>				<u>11 050</u>	
20XX								
1/8	Balance	b/f	10 400					

Dr				Creditors				Cr
20XX				20XX				
31/7	Inventory	CDJ	540	31/7	Creditors journal	DJ	26 200	
31/7	Balance	b/o	25 660					
			<u>26 200</u>				<u>26 200</u>	
20XX								
1/8	Balance	b/f	25 660					

Dr				Sales				Cr
20XX				20XX				
31/7	Debtors	DAJ	50	31/7	Debtors	DJ	1 050	
31/7	Balance	b/o	1 650		Bank	CRJ	650	
			<u>1 700</u>				<u>1 700</u>	
				20XX				
				1/8	Balance	b/f	1 650	

Dr				Cost of sales				Cr
20XX				20XX				
31/7	Inventory	DJ	800	31/7	Inventory	DAJ	20	
	Inventory	CRJ	400	31/7	Balance	b/o	1 180	
			<u>1 200</u>				<u>1 200</u>	
20XX								
1/8	Balance	b/f	1 180					

Dr				Telephone				Cr
20XX								
31/7	Cash payment	CPJ	260					
			<u>260</u>					

Trial balance of B & J Distributors on 31 July 20XX

	Debit R	Credit R
<i>Statement of financial position section</i>		
Capital		20 000
Bank	15 790	
Inventory	7 580	
Debtors	10 400	
Creditors		25 660
Drawings	100	
Vehicles	12 000	
<i>Statement of profit or loss and other comprehensive income</i>		
Sales		1 650
Cost of sales	1 180	
Telephone	260	
	<u>47 310</u>	<u>47 310</u>

Summary

Subsidiary journals

Cash transactions

Cash receipts
Cash payments
Petty cash journal (book)

Credit transactions

Debtors journal
Creditors journal
Debtors allowance journal
Creditors allowance journal

Exercise 3.1

Journalise the following transactions:

1. Paid the water and electricity, R400.
2. Received money from a debtor, R3 000.
3. Purchased a vehicle on credit from Cosmos for R24 000.
4. The owner of the business took a computer with a value of R800 for private use.
5. The owner of the business increased his capital with a cash amount of R5 000.
6. Sold goods on credit to J.J. Ltd. with a cost price of R200 and a selling price of R250.
7. Sold an old vehicle to the owner of the business for R5 000 cash.
8. Paid an amount of R550 to creditors.
9. Received an invoice from BB Ltd. for goods purchased, R3 000.
10. Returned goods with a cost price of R70 to creditors (BB Ltd.) and received the credit note.

Exercise 3.2

Record the following transactions in the correct columns, as in the given example below. Use the symbols “+” for an increase, “-” for a decrease and “0” when it remains the same. The columns O = owner’s equity, A = assets and L = liabilities.

Example:

The owner of B & J Distributors deposited R20 000 in the bank account of the business as his capital contribution.

Transaction no.	Subsidiary journal	Account debited	Account credited	Amount	O	A	L
1	Cash receipts journal	Bank	Capital	R20 000	+	+	0

Transactions

1. Purchased land and buildings on credit from M.G. Properties, R150 000.
2. Purchased inventory from Makro, R5 200 cash.
3. Paid salaries and wages by cheque, R12 800.
4. Cashed sales of inventory, R3 000.
5. Paid the annual insurance premium to C.E. Insurance company by cheque, R2 000.
6. Bought vehicles from Zero Garage, R60 000 cash.
7. Sold a used computer to a worker, R50 cash.
8. Purchased stationery on credit from Proes Street Stationeries, R350.
9. Paid the interest on the loan at Alpha Bank per cheque, R300.
10. Received a cheque of R500 from a debtor, A. Mans, in full settlement of his account of R520.
11. Paid our debt to a creditor, B. Ben, by cheque in full settlement of our account of R3 000.
12. Sold inventory on credit to C. Coetzee, R1 500.
13. Returned damaged goods to Makro, and received their credit note, R200.
14. Issued a credit note to C. Coetzee for damaged goods returned, R300.
15. The owner of B & J Distributors withdrew R2 000 cash for his own use.

Exercise 3.3

The following transactions took place during March 20XX at “Your Corporate AV Connection Ltd”

20XX

- March 2 Sold inventory on credit for R6 000 to Multi Broadcast. Cost price R4 800.
- 6 Sold inventory for R10 000 cash. Cost price R8 000.
- 8 Bought stationery for cash, R200.
- 9 Paid the rent for the month, R11 000.
- 10 Received R30 000 from debtors.

- 11 Bought inventory on credit from EGL worth R70 000.
- 12 Sold inventory on credit to Mario Distributors for R25 000. Cost price R18 000.
- 14 Bought a vehicle on credit from BP for R40 000.
- 18 Received a credit note for goods returned to EGI, R1 000.
- 19 Issued a credit note for goods returned by Multi Broadcast, R600. Cost price R450.
- 21 Paid salaries, R15 000.
- 24 Depreciation on vehicles for the month, R2 000.
- 26 Sold inventory for cash, R4 000. Cost price R2 600.
- 28 Bought inventory for cash, R5 000.

Required

- 1. Prepare all relevant subsidiary journals.
- 2. Do the posting to the general ledger.
- 3. Prepare a trial balance.

Exercise 3.4

The following transactions occurred in the books of Busy Operations Ltd. for the month of January 20XX:

- 1 Bought a vehicle on credit from Cosmos Car Sales for R14 995, invoice no. 1213.
- 2 Paid salary and wages with cheque no. 102, for R3 500.
- 6 Rent received for letting the ground floor, R1 200, receipt no. A64.
- 7 Sold an old computer for cash at the book value of R650, receipt no. A65.
- 9 Sold inventory to Super Slim, with cost price of R120 and selling price of R180, invoice no. A445.
- 12 Sold inventory for cash, R900, cost price was R700, receipt no A66.
- 16 Inventory bought from G.F. Distributors was defective. Goods were sent back and received their credit note no. F64 for the amount of R90.
- 18 Bought inventory for cash, R2 000, paid by cheque no. 103.
- 23 The owner took goods for his own use with a cost price of R80 and selling price of R95.
- 24 Bought inventory on credit from Freeky Fast, R850, invoice no. BB12.
- 27 Paid R2 000 to Aartjie Vaartjie in full settlement of his account of R2 020, paid by cheque no. 104.

- 28 Bought inventory from Bee-Bee for R7 000, received his invoice no. Z442.
- 29 The inventory received from Freeky Fast was the wrong colour. Sent it back and received credit note no. CT.147 for the amount of R250.
- 30 Sold inventory for cash, with a cost price of R155 and selling price of R200, receipt no. A67.
- 30 Sold inventory with a cost price of R500 to Cee-Cee for R650, invoice no. A446.
- 31 Super Slim is dissatisfied with some of the goods received on the 9th. Sent a credit note, no KTN40 for the amount of R75. These goods had a cost price of R60.
- 31 Received R100 from Super Slim in full settlement of his account, receipt no. A68.

The following list of balances appeared in the records on 1 January 20XX:

	Debit R	Credit R
Trade receivables	6 000	
Trade and other payables		7 000
Equipment	8 000	
Capital		15 900
Drawings	400	
Inventory	3 000	
Bank	5 500	
	22 900	22 900

Required

1. Open all the books of prime entry.
2. Post the entries to the general ledger.
3. Draw up the new trial balance.

Bank reconciliation statement

Specific outcomes

By the end of this module you should be able to:

1. Compare the cash receipts journal and the cash payments (or cash book) journal with the bank statement.
2. Do the supplementary cash book and the bank reconciliation.

4.1 Comparison of the CRJ and CPJ (cash book) with the bank statement

All cash transactions are recorded in the cash book or a CRJ and CPJ. At the end of each month a balance is calculated in the cash book, or the totals of the CRJ and CPJ are noted. NB: $CRJ + CPJ = \text{cash book}$

A bank statement is then received from the bank. The bank prepares the bank statement from their point of view, in other words, deposits made by a business will be credited on the bank statement (they owe the business the money). Similarly, cheques issued by the business will be debited on the bank statement (the business owes the bank money.)

Therefore, everything debited in the cash book or CRJ will be credited by the bank on the bank statement, and everything credited in the cash book or CPJ will be debited by the bank on the bank statement.

As soon as the bank statement has been received, it must be compared with the CRJ and the CPJ (or cash book). This is to ensure that everything that appears in the CRJ (or debit side of the cash book), also appears on the credit side of the bank statement, and everything that appears in the CPJ (or credit side of the cash book), also appears on the debit side of the bank statement.

There might be items that will not appear on the bank statement, e.g. a deposit made or a cheque issued at the end of the month which has not been deposited into the bank yet.

There might also be items that appear on the bank statement, but not in the CRJ and CPJ, for example:

- bank charges
- interest received/paid
- debit orders
- unpaid cheques etc.

4.2 Preparing the supplementary cash book and bank reconciliation

The purpose of a supplementary cash book is to arrive at a more complete cash book balance. All the items that appear on the bank statement, but not in the CRJ or CPJ (cash book), must be recorded in the supplementary cash book. When, after comparison with the bank statement, it is found that the CRJ or CPJ (cash book) contain errors, these errors must also be corrected in the supplementary cash book.

Similarly, all the items that appear in the CRJ and CPJ (cash book), but not on the bank statement, must be recorded in the bank reconciliation. Errors on the bank statement must also be recorded in the bank reconciliation. To summarise:

- A CRJ and CPJ (cash book) are prepared from the business's point of view to determine the bank balance.
- The bank prepares a bank statement from their point of view to determine how much money they owe the business or how much money the business owes them.
- On receipt of the bank statement, it is compared with the CRJ and CPJ (cash book).
- Errors made by the business, and items that appear on the bank statement but not in the CRJ and CPJ (cash book), are corrected and recorded in the supplementary cash book.
- Errors made by the bank, and items that appear in the CRJ and CPJ (cash book) but not on the bank statement, are corrected and recorded in the bank reconciliation.

Example:

Supplementary cash book of XX on X/X/20XX

Debit		Credit	
Balance b/f	XX	CPJ total	XX
CRJ total	XX	R/D cheque (P. Pompies)	XX
Deposit (rent)	XX	D/O (Water & electricity)	XX
Debit error	XX	Bank charges	XX
		Interest paid	XX
		Credit error	XX
		Balance b/o	XX
	XXX		XXX
Balance b/f	XX		
(this balance is transferred to the bank reconciliation statement)			

Bank reconciliation statement of XX on X/X/20XX

		Debit unfavourable R	Credit favourable R
Balance per bank statement		XX	XX
Debit outstanding cheques:	012	XX	
	014	XX	
Credit outstanding deposit			XX
Debit faulty deposit (bank recorded a deposit by another client on XX's statement)		XX	
Credit faulty cheque (bank recorded a cheque issued by another client on XX's statement)			XX
Credit faulty amount of deposit. The amount should have been R530, but was recorded as R305			225
The amount should have been R305, but was recorded as R530		225	
Balance per cash book (from supplementary cash book)		XX	
		XXX	XXX

Summary

The bank statements are received from the bank at the end of the month. The bank statements are compared with the bank account (CRJ and CPJ) and the necessary adjustments are made to calculate the correct adjusted balance for the bank account. After comparing and making adjustments, the supplementary cash book and bank reconciliation statement should have the same balance.

Supplementary cash book	Bank reconciliation statement
<p>Mistakes on the cash book (CPJ + CRJ)</p> <p>Amounts on the bank statement, not in the bank account, e.g.:</p> <ul style="list-style-type: none"> • bank charges • bank interest • debit order • dishonoured cheques. 	<p>Mistakes on the bank statement</p> <p>Amounts in the bank account, not on the bank statement, e.g.:</p> <ul style="list-style-type: none"> • cheque written out, not through the bank yet • deposit made, not through the bank yet.

Exercise 4.1

Cash book of Lourens & Co. for August 20XX

Dr						Cr				
Doc. no.	Date	Details	Fol.	Amount	Doc. no.	Date	Details	Fol.	Amount	
					Ch.					
1		Balance	b/f	479 30	188	1	Bill payable		280 00*	
2		Deposit		313 00	189	6	Purchases		494 00	
10		Deposit		587 30	190	10	B. Brown		176 55	
14		Bill payable		300 00	191	15	Transport costs		85 00	
20		Deposit		484 45			P. Pelsier (cheque refused)		65 00	
31		Deposit		296.65	192		Printing costs		110 00	
					193	20	Telephone		28 40	
					194	26	W. Willers		410 20	
					195	29	Salaries		520 00	
						31	Balance b/o		291 55	
				<u>2 460 70</u>					<u>2 460 70</u>	
1		Balance	b/f	291 55						

Bank statement of Lourens & Co. for August 20XX

Date	Transaction description	Debit	Credit	Balance
1	Balance			479 30 Cr
	Deposit (debtor)		181 94	661 24 Cr
2	Deposit (debtor)		313 00	974 24 Cr
3	Cheque no. 188	280 00		694 24 Cr
7	Cheque no. 189	494 00		200 24 Cr
	Cheque book fees	14 20		186 04 Cr
	Debit order (insurance)	166 40		19 64 Cr
10	Deposit		587 30	606 94 Cr
14	Debit order (salary)	300 00		306 94 Cr
	Cheque unpaid (P. Pelsler)	65 00		241 94 Cr
	Bank charges	1 10		240 84 Cr
	Deposit (bill receivable)		300 00	540 84 Cr
17	Cheque no. 743	112 80		428 04 Cr
	Cheque no. 190	176 55		251 49 Cr
20	Deposit		484 45	735 94 Cr
25	Deposit		321 04	1 056 98 Cr
	Cheque no. 191	85 00		971 98 Cr
28	Deposit (rent)		110 00	1 081 98 Cr
	Bank charges	8 50		1 073 48 Cr
31	Cheque no. 195	520 00		553 48 Cr
	Cheque unpaid (V. Vos)	25 49		527 99 Cr

Additional information

1. The deposit of R321,04 on 25 August is an error. It was a deposit for L. Lourens.
2. Cheque no. 743 on the 17th was issued by L. Lowies and recorded on the Lourens & Co. account by mistake.
3. Deposit on the 1st, was made by a debtor, A. Spies.

Required

Prepare the supplementary cash book and the bank reconciliation statement at the end of August 20XX.

Exercise 4.2

The following information was obtained after comparing the cash book of XYZ (Pty) Ltd., with their bank statement on 31 October 20XX.

	R
1. Cash book balance on 1.10.20XX.	110 (Dr)
2. Total of cash receipts.	6 430
Total of cash payments.	7 320
3. Unfavourable balance per bank statement.	1 167
4. The bank debited the company's account with a cheque drawn by VWX (Pty) Ltd., by mistake, R240.	
5. A deposit of R87 which was paid directly into the company's account by debtor D. Buys, has not yet been recorded in the books.	
6. Cheque no. 330 for R303, issued on 14 October 20XX, has not been presented to the bank for payment.	
7. A deposit of R400 recorded in the cash receipts journal does not appear on the bank statement.	
8. Bank charges of R32 and bank interest of R17 appear on the bank statement but have not been recorded in the records of XYZ (Pty) Ltd.	
9. No entry has been made in the company's records relating to a cheque returned by the bank and marked "refer to drawer". The cheque amounted to R88 and was received from S. van Wyk in settlement of his account.	

Required

1. Start with the given totals and complete the supplementary cash book.
2. Beginning with the balance per bank statement, prepare the bank reconciliation as at 31 October 20XX.

Exercise 4.3

The following information was obtained from the books of Gloss Distributors, after comparing the cash book with the bank statement on 30 April 20XX.

1. Balance on bank statement, R22 100 credit.
2. Total of cash receipts journal, R26 456.
3. Total of cash payments journal, R16 438.
4. Balance in cash book on 1/4/20XX, R8 300 debit.
5. A deposit of R4 000 does not appear in the cash receipts journal, but was made directly into the bank account of Gloss Distributors by a client.
6. Bank charges on bank statement amount to R463.
7. Interest received on bank statement, R125.
8. The following cheques were drawn on 30 April but were not on the bank statement: cheque 301 for R450 and cheque 302 for R1 670.
9. An amount of R550 was written in the cash receipts journal instead of the cash payments journal.
10. Insurance policy premium of R900 was paid by debit order.

Required

Compile the supplementary cash book and bank reconciliation statement on 30 April 20XX.

Exercise 4.4

The following information was taken from the records of Circle Ltd.

Abridged cash receipts journal for December 20XX

Date	Details	R Bank
1	M. Schutte	3 000
3	W. Bosua	7 500
4	Commission received	500
7	Rent received	4 000
8	M. Heyns	2 200
12	C. Jansen	2 800
		20 000

Abridged cash payment journal for December 20XX

Date	Details	Cheque no.	R Bank
4	D. Sheepers	150	500
7	Inventory	151	2 400
12	Water and lights	152	1 600
15	A. le Roux	153	80
16	Salaries and wages	154	1 250
18	Telephone	155	250
20	Rent paid	156	2 300
21	Inventory	157	3 700
23	Mooi Nooi	158	920
			13 000

Bank reconciliation statement, as at 30 November 20XX

	Debit R	Credit R
Balance per bank statement		4 900
Debit: Outstanding cheques		
No. 140	2 200	
No. 145	2 800	
No. 146	1 100	
Credit: Outstanding deposits		1 700
Balance per bank account	500	
	6 600	6 600

Bank statement for the month of December 20XX

Date	Details	Debit	Credit	Balance
1	Balance			4 800 Cr
1	Deposit		1 700	6 500
2	Deposit		3 000	9 500
4	Deposit		7 500	17 000
5	150	500		16 500
5	140	2 200		14 300
6	Deposit		500	14 800
8	146	1 000		13 800
9	151	2 400		11 400
10	Deposit		4 000	15 400
11	Deposit		1 200	16 600
13	152	1 600		15 000
16	153	80		14 920
16	154	1 520		13 670
20	155	250		13 420
24	157	7 300		6 120
26	D/O	170		5 950
30	Interest		25	5 975
31	Bank charges	430		5 545 Cr

Additional information

1. The deposit on 11 December was made by a debtor, Mr Barnard, who paid the amount directly into the business's bank account.
2. The correct amount of cheque no. 157 is R7 300.
3. The debit order is for insurance.

Required

Prepare the supplementary cash book and the bank reconciliation for December 20XX.

Year-end adjustments

Specific outcomes

By the end of this module you should be able to:

1. Understand the accounting concepts applicable to year-end adjustments.
2. Record and understand the following year-end adjustments:
 - prepaid expenses
 - accrued expenses
 - accrued income
 - income received in advance
 - inventory on hand
 - credit losses
 - provision for credit losses
 - depreciation.

5.1 Introduction

At the end of each financial period a business will prepare financial statements (statement of profit or loss and other comprehensive income and statement of financial position) to determine its financial results and financial position, respectively. Before these financial statements can be drawn up, all the year-end adjustments must be taken into account. Therefore:

- Year-end adjustments will only be taken into account at the end of the financial year.
- Year-end adjustments will be recorded by means of general journal entries.

Before we discuss the year-end adjustments, it is important that we first discuss the following accounting concepts.

5.2 Accounting concepts

5.2.1 The “going concern” concept

The “going concern concept” means that “the business entity will continue in operational existence for the foreseeable future”. This means that the business will

continue with its operations as is and will continue existing in the foreseeable future.

5.2.2 The “matching” or accruals concept

The matching concept means that “revenue and costs are accrued (that is, recognised as they are earned or incurred, not as money is received or paid), matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the statement of profit or loss and other comprehensive income for the period to which they relate”.

This means that income and expenses are recognised as they are earned or incurred and recorded in the financial statements of the period to which they relate.

5.2.3 The “consistency” concept

The consistency concept means that “there is consistency of accounting treatment of items within each accounting period and from one period to the next”.

5.2.4 The “prudence” concept

The prudence concept means that “revenue and profits are not anticipated, but are recognised by inclusion in the statement of profit or loss and other comprehensive income only when realised in the form of cash or of other assets, the ultimate cash realisation of which can be assessed with reasonable certainty. Provision is made for all known liabilities (expenses and losses) whether the amount of these is known with certainty or is a best estimate in the light of the information available”.

This means that income is not brought into account until it is realised, whilst expenses will be brought into account as soon as they are known.

5.3 Adjustments

5.3.1 Prepaid expenses

Prepayments are payments you have made in one accounting period even though some of it is only due in the next accounting period. Even though the expense was paid in full, only the part due for payment in the current accounting period should be matched against the income of the current accounting period.

Example:

The following examples are extracts from the trial balance of Khumalo Traders at 28 February 20XX, the end of their financial year.

Trial balance at 28 February 20XX

	Debit R	Credit R
Rent paid	13 000	

Additional information

The rent was paid until 31 March 20XX.

Required

Show the necessary general journal entry for the adjustment of rent paid.

Solution

General Journal

		Debit R	Credit R
February 20XX			
28/2	Prepaid expenses	1 000	
	Rent paid		1 000

Explanation

1. The rent was paid from 1 March 19XX to 31 March 20XX (13 months). Therefore the rent per month equals R1 000.
2. The amount of R1 000 which relates to the next accounting period, but has been paid in the current accounting period, is the prepaid expense. It is an expense that has been paid before the benefit of the payment had been received.
3. Rent paid, an expense account, is credited because it must decrease, while PREPAID EXPENSES is debited because it is an ASSET account which increased.
4. After the adjustment, the amount for rent paid in the statement of profit or loss and other comprehensive income will be R12 000 only, whilst the asset account, prepaid expenses of R1 000, will appear in the statement of financial position under current assets.

5.3.2 Accrued expenses

Accrued expenses are expenses that were incurred in the current accounting period but, due to certain circumstances, have not been paid. These expenses have to be written off against the income of the current accounting period even though they have not yet been paid.

Example:

Trial balance of Khumalo Traders at 28 February 20XX

	Debit R	Credit R
Telephone	2 800	

Additional information

The telephone account for February 20XX is still due, R1 500.

Required

Show the necessary general journal entry for the adjustment of the telephone account.

Solution

General Journal

	Debit R	Credit R
20XX 28/2 Telephone	1 500	
Accrued expenses		1 500

Explanation

1. The telephone account is debited because it is an expense account that increased.
2. ACCRUED EXPENSES are credited because it is a liability account that increased.
3. After the adjustment, the amount for the telephone in the statement of profit or loss and other comprehensive income will be R4 300 whilst the liability account, accrued expenses of R1 500, will appear in the statement of financial position under current liabilities.

5.3.3 Accrued income

Accrued income is income earned during a specific accounting period but not yet received. Accrued income falls into the same category as trade receivables, where you have delivered value but have not received your earnings from it. Like trade receivables, however, it is treated as a current asset in the statement of financial position and will be included with debtors under trade receivables.

Example

Trial balance at 28 February 20XX

	Debit R	Credit R
Rent received		11 000

Additional information

Rent was only received for eleven months.

Required

Show the necessary general journal entry for the adjustment of rent received.

Solution

General Journal

		Debit R	Credit R
20XX			
28/2	Accrued income	1 000	
	Rent received		1 000

Explanation

1. ACCRUED INCOME is debited because it is an asset account that increased.
2. Rent received is credited because it is an income account that increased.
3. After the adjustment, the amount for rent received in the statement of profit or loss and other comprehensive income will be R12 000, whilst the asset account, accrued income of R1 000, will appear in the statement of financial position under current assets.

5.3.4 Income received in advance

Income received in advance is when the business has received money before it has delivered the benefit of the payment. This places a burden on the business and actually becomes a liability to the business.

Example:

Trial balance at 28 February 20XX

	Debit R	Credit R
Rent received		14 000

Additional information

Rent was received on 1 March 19XX for the fourteen months until 30 April 20XX.

Required

Show the necessary general journal entry for the adjustment of rent received.

Solution

General journal

		Debit R	Credit R
20XX 28/2	Rent received Income received in advance	2 000	2 000

Explanation

1. Rent received is debited because it is an income account that decreased.
2. INCOME RECEIVED IN ADVANCE is credited because it is a liability account that increased.
3. After the adjustment, the amount for rent received in the statement of profit or loss and other comprehensive income will be R12 000 whilst the liability account, income of R2 000 received in advance, will appear in the statement of financial position under current liabilities.

5.3.5 Inventory on hand (not trading inventory)

Inventory on hand is when, during an inventory-taking at the end of a financial year, it is determined that there are still some consumable stores like stationery or packing materials on hand. These consumable stores on hand must be treated as inventory on hand, which is classified as a current asset.

Example:

Trial balance at 28 February 20XX

	Debit R	Credit R
Stationery	2 000	

Additional information

During an inventory count taken on 28 February 20XX it was determined that there was still stationery on hand to the value of R500.

Required

Show the necessary general journal entry for the adjustment of stationery.

Solution

General journal

		Debit R	Credit R
20XX			
28/2	Stationery on hand Stationery	500	500

Explanation

1. STATIONERY ON HAND is debited because it is an asset account that increased.
2. Stationery is credited because it is an expense account that decreased. The actual expense applicable for the financial year to be disclosed in the statement of profit or loss and other comprehensive income is only R1 500, whilst the R500 will be disclosed in the statement of financial position as a current asset.

5.3.6 Credit losses

When a debtor cannot pay his debt it must be written off.

Example:

Trial balance at 28 February 20XX

	Debit R	Credit R
Trade receivables	60 000	
Credit losses	500	

Additional information

A debtor, M. Mambo, cannot pay his debt of R2 000. It must be written off as credit losses irrecoverable.

Required

Show the necessary general journal entry for the adjustment of credit losses.

Solution

General journal

		Debit R	Credit R
20XX			
28/2	Credit losses	2 000	
	Trade receivables		2 000

Explanation

1. Credit losses are debited because it is an expense account that increased.
2. Trade receivables are credited because it is an asset account that decreased.
3. After the adjustment, the amount for credit losses in the statement of profit or loss and other comprehensive income will be R2 500, whilst trade receivables will appear in the statement of financial position under current assets as R58 000.

5.3.7 Provision for credit losses

Provision for credit losses is when management decides to create provision for the credit losses of trade receivables. This provision can be based on the average of the credit loss figures for the past two years. A provision for credit losses will be created to disclose a more realistic figure of trade receivables in the statement of financial position.

Provision for credit losses will be classified as a negative asset.

Created

Trial balance at 28 February 20XX

	Debit R	Credit R
Trade receivables	60 000	
Credit losses	2 000	

Additional information

Create a provision for credit losses of 5% of the outstanding trade receivables.

Required

Show the necessary general journal entry for the provision for credit losses.

Solution

General journal

		Debit R	Credit R
20XX 28/2	Credit losses Provision for credit losses	3 000	3 000

Explanation

1. Remember that the credit losses in the trial balance have already been subtracted from the trade receivables.
2. Credit losses are debited because it is an expense that increased, whilst provision for credit losses is credited because it is a negative asset that increased.
3. After the adjustment, the amount for credit losses in the statement of profit or loss and other comprehensive income will be R5 000, whilst the provision for credit losses of R3 000 will be subtracted from the trade receivables in the statement of financial position under current assets.

Increase/decrease

To increase or decrease an existing provision for credit losses, the same two accounts will always be involved, namely:

Credit losses DR]
 Provision for credit losses CR] INCREASE

Provision for credit losses DR]
 Credit losses CR] DECREASE

Explanation

1. How will you know whether there is an existing provision for a credit losses account? A provision for a credit losses account will appear in the trial balance.
2. If the existing provision for credit losses in the trial balance is R3 000, and according to the adjustment it must be increased to R4 000, the general journal entry will be as follows.

		Debit R	Credit R
Credit losses Provision for credit losses		1 000	1 000

3. If the existing provision for credit losses in the trial balance is R4 000, and according to the adjustment it must be decreased to R2 500, the general journal entry will be as follows.

	Debit R	Credit R
Provision for credit losses	1 500	
Credit losses		1 500

4. Remember, always take the difference between the new and existing amount to record the general journal entry. The new amount will always be subtracted from trade receivables in the statement of financial position.

5.3.8 Depreciation

Depreciation is the steady reduction of the original value of a fixed asset due to the normal wear and tear of everyday usage over a long period of time. Depreciation can be calculated according to various methods. We are not going to discuss these methods in this module. All you need to know is the general journal entry for the adjustment for depreciation.

The same two accounts will always be involved, namely:

	Debit R	Credit R
Depreciation	XXX	
Accumulated depreciation		XXX

Explanation

1. Depreciation is an expense account and accumulated depreciation is a NEGATIVE ASSET.
2. Depreciation will be disclosed in the statement of profit or loss and other comprehensive income, whilst accumulated depreciation will be subtracted from the cost price of fixed assets in the statement of financial position.

Remember

You are referred to Module 2, “The accounting cycle”.

After the adjustments have been taken into account, the new balances of the accounts involved will be determined and a post-adjustment trial balance prepared.

Summary

1. Adjustments are made at the end of a financial period by means of general journal entries.
2. The following are temporary accounts and must be cancelled by means of a reversed general entry at the beginning of the next financial year:

Pre-paid expenses	– ASSET
Accrued expenses	– LIABILITY
Income received in advance	– LIABILITY
Accrued income	– ASSET
Consumables at hand (stationery)	– ASSET
3. After the adjustments have been taken into account and posted to the general ledger, a post-adjustment trial balance must be prepared.
4. The information that appear in the post-adjustment trial balance will be used to prepare the statement of profit or loss and other comprehensive income and statement of financial position.

Exercise 5.1

The following adjustments appeared in the books of Fatima Traders for the financial year ending 28 February 20XX.

1. Accrued salaries, R10 000.
2. Insurance paid in advance, R3 000.
3. Rent received in advance, R2 000.
4. Nkomo Financial Services still owes us interest to the amount of R5 000 on our investment.
5. Create provision for credit losses of R2 000.
6. Depreciation to the amount of R12 500 must be written off for vehicles.

Required

Record the above-mentioned adjustments in the general journal of Fatima Traders.

Exercise 5.2

The following information was given to you at the financial year-end of Edcars Ltd. at 30 June 20XX.

Additional information

1. The June salary of one of the directors was not paid to him due to a mistake on the payroll, R150 000.
2. Foskini Ltd. still owes us R50 000 for services rendered to them on 10 June 20XX.

3. A debtor, S. Skosana, cannot pay his debt of R4 000. His debt must be written off.
4. During an inventory count, taken on 30 June 20XX, it was established that stationery to the value of R500 was still on hand.
5. On 1 January 20XX an amount of R1 800 was paid in respect of insurance for the twelve months ending 31 December 20XX.
6. Equipment must be depreciated at R10 000 per annum.

Required

The owner asks you to record the above-mentioned transactions (adjustments), where applicable, in the general journal.

Exercise 5.3

You receive the following pre-adjustment trial balance from Mavuzo Traders, as well as some additional information at the end of their financial year.

Trial balance for Mavusa Traders at 30 June 20XX

	Debit R	Credit R
Revenue		398 000
Cost of sales	140 000	
Telephone	3 000	
Salaries	115 000	
Rent received		70 000
Insurance	8 000	
Stationery	24 000	
Credit losses	3 000	
Commission received		20 000
Capital: Mavuso		95 000
Long-term loan		120 000
Furniture and equipment	360 000	
Accumulation depreciation: Furniture and equipment		60 000
Trade receivables	60 000	
Bank	50 000	
	763 000	763 000

Additional information

1. Accrued salaries, R20 000.
2. Prepaid insurance, R2 000.
3. Stationery on hand, R3 000.
4. A provision for credit losses of 2% of trade receivables must be created.

5. Commission received in advance, R5 000.
6. Accrued rent received, R8 000 (rent received in arrears).
7. Depreciation of 10% on the cost price of furniture and equipment must be taken into account.

Required

1. Show the general journal entries for the above-mentioned adjustments.
2. Prepare a post-adjustment trial balance.

Closing entries

Specific outcomes

By the end of this module you should be able to:

1. Know what is meant by a “closing entry”.
2. Know when to do closing entries.
3. Know why it is necessary to do closing entries.

6.1 The closing of income and expense accounts

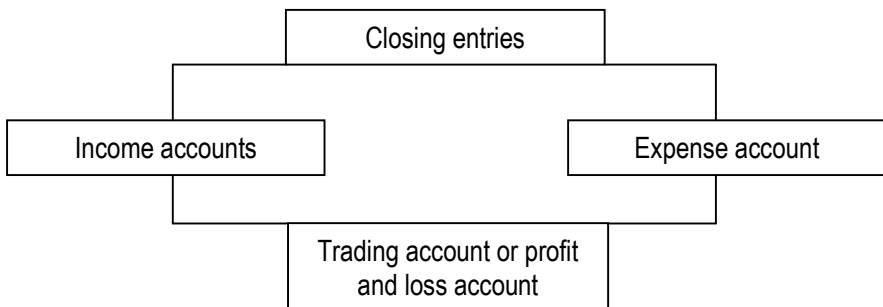
The word *closing* indicates what is to be done. The account must be balanced and “carried forward” to another account. But it must first be determined which account is to be balanced and to which account the balance must be transferred.

Closing entries can only be made to income and expense accounts and must be balanced against the trading account and profit and loss account.

Income and expense accounts are balanced at the end of a financial period. New income and expense accounts with a zero balance are opened at the beginning of a new financial period to determine a new profit or loss.

Journal entries are used to record closing entries. The journal entries must then be posted to the general ledger.

Journal entries must be made after all the adjustments have been taken into account. All the income and expense accounts that have an influence on the gross profit are balanced against the trading account, and all the other income and expense accounts which have an influence on the net profit, against the profit and loss account.



Example:
Closing entries

The following balances appeared in the trial balance of Z. Zapper at 28 February 20XX.

Trial balance at 28 February 20XX.

	Debit R	Credit R
Capital		100 000
Trade receivables	30 000	
Trade and other payables		20 000
Vehicles	150 000	
Revenue		180 000
Cost of sales	50 000	
Salaries or wages	30 000	
Rent received		12 000
Interest paid	10 000	
Insurance	20 000	
Water and lights	22 000	
	312 000	312 000

Required

1. Journal entries of the closing entries for the above accounts.
2. Post to the general ledger.

General journal – closing entries

			Debit R	Credit R
20XX 28/2	Revenue	N1	180 000	
	Trading account	N8		180 000
	Trading account	N8	50 000	
	Cost of sales	N2		50 000
	Profit and loss	N9	82 000	
	Salaries and wages	N3		30 000
	Interest paid	N5		10 000
	Insurance	N6		20 000
	Water and lights	N7		22 000
	Rent received	N4	12 000	
	Profit and loss	N9		12 000
	Trading account	N8	130 000	
	Profit and loss	N9		130 000
	Profit and loss	B1	60 000	
	Capital	N9		60 000

General ledger

Dr	Capital	B1	Cr
	20XX		
	1/2 Balance		100 000
	28/2 Profit and loss		60 000

Dr	Vehicles	B2	Cr
20XX			
1/2 Balance	150 000		

Dr	Trade receivables control	B3	Cr
20XX			
1/2 Balance	30 000		

Dr	Trade and other payables control	B4	Cr
	20XX		
	1/2 Balance		20 000

Basic Financial Accounting

Dr		Revenue			N1	Cr
20XX				20XX		
28/2	Trading acc.	GJ1	180 000	1/2	Balance	180 000

Dr		Cost of sales			N1	Cr
20XX				20XX		
1/2	Balance		50 000	28/2	Trading acc.	GJ1 50 000

Dr		Salaries and wages			N3	Cr
20XX				20XX		
1/2	Balance		30 000	28/2	Profit & loss	GJ1 30 000

Dr		Rent received			N4	Cr
20XX				20XX		
28/2	Profit & loss	GJ1	12 000	1/2	Balance	12 000

Dr		Interest paid			N5	Cr
20XX				20XX		
1/2	Balance		10 000	28/2	Profit & loss	GJ1 10 000

Dr		Insurance			N6	Cr
20XX				20XX		
1/2	Balance		20 000	28/2	Profit & loss	GJ1 20 000

Dr		Water and lights			N7	Cr
20XX				20XX		
1/2	Balance		22 000	28/2	Profit & loss	GJ1 22 000

Dr			Trading account		N7		Cr
20XX				20XX			
28/2	Cost of sales	GJ1	50 000	28/2	Revenue		180 000
	Profit & loss	GJ1	130 000				
			<u>180 000</u>				<u>180 000</u>

Dr			Profit and loss account		N7		Cr
20XX				20XX			
28/2	Salaries & wages	GJ1	30 000	28/2	Trading account	GJ1	130 000
	Interest paid	GJ1	10 000		Rent received	GJ1	12 000
	Insurance	GJ1	20 000				
	Water & lights	GJ1	22 000				
	Capital	GJ1	60 000				
			<u>142 000</u>				<u>142 000</u>

Summary

1. A debit balance on the trading account and profit and loss account represent a gross or net loss, whilst a credit balance represents a gross or net profit.
2. Only the following accounts will have balances after all the closing entries have been made: assets, owner's equity and liabilities (statement of financial position items).
3. The closing entries can only be made in respect of income and expense accounts.
4. Revenue and cost of sales are closed off against the trading account, where gross profit is calculated.
5. This gross profit is then carried forward to the profit and loss account against which all other income and expense accounts are closed off, to calculate net profit.
6. The net profit calculated in the profit and loss account is then carried over to the capital account.

Exercise 6.1

The following balances appeared in the pre-adjustment trial balance of Z. Zapper at 31 December 20XX.

	Debit R	Credit R
Capital		80 000
Machinery	20 000	
Furniture	10 000	
Inventory	5 000	
Trade receivables	10 000	
Trade and other payables		15 000
Revenue		50 000
Cost of sales	30 000	
Salaries	15 000	
Rent paid	12 000	
Interest received		4 000
Water and electricity	4 000	
Repairs	2 000	
Bank	41 000	
	149 000	149 000

Required

1. The necessary journal entries to record the closing entries of the above-mentioned accounts.
2. All the postings from the general journal to the trading account and the profit and loss account in the general ledger.
3. Show the closing entries for the balances on the trading account and profit and loss account.
4. Prepare a trial balance at 31 December 20XX of the remaining balances (statement of financial position items).

Exercise 6.2

The following balances were subtracted from the pre-adjustment trial balance of Vanity Tops Ltd. on 28 February 20XX.

	Debit R	Credit R
Investment	100 000	
Inventory	48 000	
Bank		17 000
Capital		228 000
Revenue		90 000
Salaries	20 000	
Cost of sales	55 000	
Trade and other payables		46 000
Trade receivables	35 000	
Vehicles	55 000	
Accumulated depreciation: vehicles		5 000
Furniture	44 000	
Accumulated depreciation: furniture		4 000
Depreciation	7 000	
Credit losses	700	
Drawings	14 000	
Water and electricity	2 300	
Rent	14 000	
Interest received		6 000
Interest paid	1 000	
	396 000	396 000

Required

1. The journal entries to record the closing entries of the above accounts.
2. The trading account and profit and loss account.
3. A trial balance on 28 February 20XX of the statement of financial position items.

Financial statements

Specific outcomes

By the end of this module you should be able to:

1. Draft a statement of profit or loss and other comprehensive income for a certain period.
2. Draft the statement of financial position on a specific date.
3. Understand what is reflected in the statement of profit or loss and other comprehensive income and the statement of financial position of a business.

7.1 Introduction

For the purpose of this course, the financial statements of a business consist of the statement of profit or loss and other comprehensive income and the statement of financial position.

Financial statements must be prepared once a year at the end of a financial period. The statement of profit or loss and other comprehensive income and statement of financial position form the last two components of the accounting cycle.

7.2 The statement of profit or loss and other comprehensive income

The statement of profit or loss and other comprehensive income of a business reflects the financial results of a business for a certain period. This period is known as the financial period.

The purpose of the statement of profit or loss and other comprehensive income is to determine whether a business has made a profit or a loss. This means that only income and expense accounts will appear in the statement of profit or loss and other comprehensive income.

The difference between the income and expense accounts is equal to the profit or loss. A profit will increase the owner's equity, whilst a loss will decrease the owner's equity.

Example: Statement of profit or loss and other comprehensive income of a service organisation

Statement of profit or loss and other comprehensive income of U. Schmidt, Doctor, for the year ending 31 December 20XX

<i>Income</i>		R
Services rendered		190 000
Interest received		1 000
		<u>191 000</u>
<i>Expenses</i>		145 500
Salaries	111 000	
Telephone	11 500	
Rent paid	16 000	
Transport costs	4 000	
Stationery	3 000	
Net income for the year		<u><u>45 500</u></u>

A service organisation renders a service; it does not trade a physical product.

Example: Statement of profit or loss and other comprehensive income of a trading organisation

Statement of profit or loss and other comprehensive income of Jolly Patrolly Traders for the year ending 28 February 20XX

Revenue		R
Less: Cost of sales		200 000
Gross profit		<u>90 000</u>
<i>Other income:</i>		
Interest received		2 000
		<u>112 000</u>
Less: Expenses		72 500
Salaries	19 000	
Bank charges	800	
Telephone	23 200	
Rent paid	18 000	
Credit losses	1 000	
Depreciation	6 000	
Stationery	4 500	
Net profit for the year		<u><u>39 500</u></u>

A trading organisation purchases goods or inventory with the aim of selling it at a profit. The difference between the earnings from revenue and the cost of the goods sold is called the gross profit.

7.3 The statement of financial position

The statement of financial position reflects the financial position of a business at a certain date. Only asset and liability accounts will appear in a statement of financial position. One can say that the statement of financial position is based on the accounting equation.

Remember: asset and liability accounts are not closed off at the end of a financial period but their balances are transferred to the next financial period as opening balances.

Example:

Statement of financial position of Technau General Dealers at 28 February 20XX

ASSETS	R		
<i>Non-current assets</i>			
<i>Fixed assets</i>			
	Cost price	Accumulated depreciation	Book Value
Land & buildings	250 000	–	250 000
Vehicles	80 000	20 000	60 000
	330 000	20 000	310 000
<i>Investments</i>			
Fixed deposit			50 000
			<hr/> 360 000
<i>Current assets</i>			33 000
Inventory		14 000	
Trade receivables		10 000	
Bank		9 000	
			<hr/> 393 000

EQUITY AND LIABILITIES

Capital and reserves		230 000
Capital	200 000	
+ Net profit	90 000	
	290 000	
– Drawings	60 000	
<i>Non-current liabilities</i>		60 000
Long-term loan Wesbank	60 000	
<i>Current liabilities</i>		103 000
Trade and other payables	50 000	
Loan	10 000	
SARS	43 000	
		393 000

Explanation

1. Trade receivables include the following accounts: Debtors, accrued income, prepaid expenses.
2. Trade and other payables include the following accounts: Creditors, accrued expenses, income received in advance.

Summary

1. The financial statements of a business are prepared for a certain period.
2. The details of the net income/loss during the past financial period are captured in the statement of profit or loss and other comprehensive income.
3. The statement of financial position is a statement that indicates the financial position of an entity at a certain time.
4. The financial statements of a business are based on historical information.

Exercise 7.1

The following trial balance at 30 June 20XX is presented to you. You are required to prepare a proper statement of profit or loss and other comprehensive income.

Trial balance of YDM Distributors at 30 June 20XX

	Debit R	Credit R
Revenue		166 450
Cost of sales	69 200	
Commission received		6 800
Bank charges	1 600	
Rent	11 400	
Telephone	3 200	
Salaries and wages	26 000	
Repairs	14 600	
Water and lights	7 000	
Fuel and oil	2 600	
Bank	37 650	
	173 250	173 250

Exercise 7.2

Use the information in the following trial balance to prepare a statement of financial position at 31 December 20XX

Trial balance of Robeen Ltd. at 31 December 20XX

	Debit R	Credit R
Motor vehicles	80 000	
Trade receivables	125 000	
Capital		100 000
Net profit for the year		65 000
Inventory on hand – 31 December 20XX	11 000	

Mortgage loan		140 000
Trade and other payables		15 000
Drawings	12 000	
Bank	36 000	
Fixed deposit: Landbank	56 000	
	320 000	320 000

Exercise 7.3

The following trial balance was extracted from the books of Express for Less. You are required to prepare the statement of profit or loss and other comprehensive income for the year ending 28 February 20XX, as well as the statement of financial position at 28 February 20XX.

Trial balance of Express for Less at 28 February 20XX

	Debit R	Credit R
Capital		194 245
Maintenance and repairs	6 295	
Rates and taxes	9 190	
Drawings	31 920	
Wages	29 960	
Credit losses	485	
Rent received		123 474
Interest paid	18 225	
Land and buildings at cost price	298 000	
Office furniture at cost price	14 900	
Trade receivables	9 870	
Trade and other payables		21 890
Insurance	5 250	

18% Mortgage on land and buildings		135 000
Accumulated depreciation: office furniture		3 500
Bank	54 014	
	478 109	478 109

Exercise 7.4

The following balances were taken from the books of Ferro Disks on 28 February 20X1.

	R
Office equipment at cost	3 000
Accumulated depreciation: office equipment	1 500
Delivery vehicles at cost	112 000
Accumulated depreciation: delivery vehicles	7 000
Trading inventory: 28 February 20X1	61 200
Trade receivables	13 000
Provision for credit losses	400
Bank	30 040
Capital: Ferro	177 000
Drawings: Ferro	24 000
Trade and other payables	41 400
Cost of sales	152 500
Salaries	11 400
Rent paid	3 480
Advertisements	1 200
Insurance	960
Municipal costs	1 280
Sundry operating costs	240
Revenue	187 000

Additional information

1. Accrued salaries, R2 000.
2. Prepaid insurance, R120.
3. The balance for rent paid includes an amount of R1 000 for March 20X1.

4. The provision for credit losses must be 5% of the trade receivables on 28 February 20X1.
5. Depreciation on office equipment and vehicles must be provided at 5% of the cost price.

Required

1. Journalise all adjustments.
2. Prepare a post-adjustment trial balance.
3. Prepare a statement of profit or loss and other comprehensive income and a statement of financial position for the year ended 28 February 20X1.

Exercise 7.5

The following information was obtained from the accounting records of Brando Traders on 28 February 20X1, the end of the accounting period of the entity.

Pre-adjustment trial balance of Brando Traders at 28 February 20X1

	Debit R	Credit R
STATEMENT OF FINANCIAL POSITION SECTION		
Capital		66 100
Drawings	16 000	
Vehicles	100 000	
Equipment (at cost price)	40 000	
Accumulated depreciation: vehicles		36 000
Accumulated depreciation: equipment		8 000
Loan: WIN Bank		20 000
Fixed deposit: ZON Bank	15 000	
Trade receivables control	5 200	
Trading inventory (28/2/20X1)	17 800	
Bank	4 300	
Trade and other payables control		3 800
Provision for credit losses		300
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME SECTION		
Revenue		250 000
Cost of sales	150 000	
Carriage of sales	550	
Rent expense	15 600	

Stationery	3 800	
Insurance	4 800	
Settlement discount granted	350	
Credit losses	400	
Water and electricity	10 800	
Settlement discount received		180
Credit losses recovered		220
	384 600	384 600

Adjustments

1. A physical stocktaking showed stationery at hand, R200.
2. Depreciation must be provided for as follows:
 - Vehicles: 20% per annum on the cost price.
 - Equipment: 10% per annum on the cost price.
3. The loan from WIN Bank was obtained on 31 December 20XX. Interest was payable at the end of each six months at 15% per annum. As yet no interest was paid.
4. The fixed deposit was made on 1 September 20XX. The interest rate amounted to 10% per annum. As yet no interest was received.
5. An additional amount of R200 must be written off as irrecoverable.
6. Adjust the provision for credit losses to 5% of trade receivables.
7. Insurance included an amount of R1 800 in respect of additional insurance taken out and paid for the period 1 January 20X1 until 31 December 20X1.

Required

1. Show the necessary general journal entries for the above-mentioned adjustments.
2. Prepare the statement of profit or loss and other comprehensive income for the year ended 28 February 20X1.
3. Prepare the statement of financial position as at 28 February 20X1.

Introduction to VAT

Specific outcomes

At the end of this module you should be able to:

1. State who must register for VAT.
2. State the difference between input and output VAT.
3. Identify transactions where VAT is charged.
4. Identify transactions where VAT is claimed back.
5. Calculate the VAT portion from inclusive amounts.
6. Understand the legal implications of VAT.

8.1 Introduction

When a business is registered for VAT and charges VAT on its sales, such a business can claim the VAT it has paid back from the South African Revenue Service. The business keeps accurate records of how much VAT it is paying on purchases and how much VAT it is charging on sales. Its VAT documents are kept and stored safely.

In this chapter we will give you some background information on VAT. This will help you to understand how it is recorded in the business accounts.

8.2 What is VAT?

VAT stands for “Value Added Tax”. It is a tax on the value-added portion of sales.

What is meant by “value added”? This refers to the profit portion of a sale. For example:

A manufacturer, Mojani Traders, produces shoes and the cost price of the material was R1 000 to which they added the VAT payable (VAT 14%).

Material cost (including VAT 14%)	R1 140
Less VAT that can be reclaimed ($1\ 140 \times \frac{14}{100}$)	R 140
Net cost to Mojani Traders	<u><u>R1 000</u></u>
Value added (after labour and profit)	R1 000
Selling price (excluding VAT)	<u><u>R2 000</u></u>
VAT charged ($\frac{14}{100} \times 2\ 000$)	R 280
Total price to customer (including VAT)	<u><u>R2 280</u></u>

So, VAT of R140 was paid by the business. The business charged VAT of R280 on the selling price. The difference between the VAT charged on sales and the VAT paid on purchases goes to the South African Revenue Service.

$$\therefore R280 - R140 = R140$$

When a business sells goods that are subject to VAT, the VAT is charged to the customer.

If the customer uses these goods in his business, he can claim the VAT back.

The VAT charged on the sales invoice is called *output VAT* and the VAT claimed back is called *input VAT*.

What is output and input VAT?

Output VAT: VAT charged on anything that goes **out** of a business, including sales of goods and fixed assets.

Input VAT: VAT paid on anything that comes **into** a business.

The difference between the output VAT and the input VAT is what the South African Revenue Service receives (or pays out).

8.3 Registration for VAT

Any enterprise that provides over R1 000 000 worth of taxable goods and services a year *must* register for VAT.

An enterprise that provides less than this may register if it wants to, and if it meets certain conditions.

A business that is not registered for VAT cannot charge VAT on its sales. It must still pay VAT on its purchases but cannot claim this VAT back. Only a business registered for VAT may reclaim its input VAT.

8.4 At what rate is VAT paid?

This depends on the item. VAT is charged on most items at the *standard rate*. This rate is set by the South African Revenue Service (presently 14%). Goods on which VAT is charged at this rate are called standard-rated.

- **Zero-rated** – Some items such as exported goods and petrol attract VAT at a zero rate – 0%. Zero-rated goods are still taxable but at a rate of zero. Certain essential foods are also zero-rated as a way of providing VAT relief for people with low incomes.
- **Exempt** – Some items are exempt (excluded) from VAT, for example interest on loans.

8.5 How to identify transactions where VAT is charged

The basic rule is that VAT should be charged at the standard rate on all supplies of goods and services by a business registered for VAT (i.e. a registered vendor).

You should be aware of the exceptions to this rule. Certain items are exempt from VAT or attract VAT at 0%.

The difference is important when you want to reclaim input VAT on purchases.

If you operate a concern that provides VAT-exempt items such as rented accommodation, you *cannot* reclaim the VAT (input VAT) paid on the purchases used to provide the items.

If you operate a concern that provides zero-rated goods such as petrol and certain foodstuffs, you *can* reclaim VAT paid on your purchases.

8.5.1 Examples of VAT-exempt items

VAT is not charged on these items:

- Interest on loans, overdrafts, mortgage bonds
- Life assurance premiums
- Pension and provident fund contributions
- Payments into medical aid funds
- Rent charged for accommodation
- Taxi, bus and train fares
- School fees
- Salaries
- Donations
- Cash withdrawals by the owner.

8.5.2 Examples of zero-rated items

VAT is not charged on these items (but you may claim the input VAT on purchases used to supply them):

- Exported goods
- Petrol
- Some foods such as brown bread and maize meal
- Sale of a business.

8.6 How to calculate VAT

• Calculating VAT from an amount exclusive of VAT

If a product such as genuine leather boots imported from Italy, has a price before VAT of say R1 000 and VAT is to be added, then you simply multiply the price by the standard rate (presently 14%).

$$\text{VAT} = \text{R1 000} \times 14\% = \text{R140}$$

The total amount charged will then be:

$$\text{R1 000} + \text{R140} = \text{R1 140}$$

• Calculating VAT from an amount inclusive of VAT

Suppose that you know the total price charged and you want to find out the price before VAT was added. Many people make the mistake of calculating 14% of the total price and then deducting this amount from it.

Let's see what happens when you do this.

$$\text{R1 140} \times 14\% = \text{R159.60}$$

$$\text{R1 140} - \text{R159.60} = \text{R980.40}$$

This way obviously doesn't work – we should get back to the original price of R1 000.

To calculate the VAT charged from a VAT inclusive amount you multiply the inclusive amount by $100/(100 + \text{VAT rate})$.

In our case this is $100/(100 + 14)$ or $\frac{100}{114}$

$$\text{R1 140} \times \frac{100}{114} = \text{R1 000} \text{ which is correct.}$$

You can also work out the amount of VAT if you use the formula $\frac{14}{114}$ This is called the VAT fraction.

$$R1\ 140 \times \frac{14}{114} = R140 \text{ which is the VAT added.}$$

What is VAT inclusive and VAT exclusive?

VAT exclusive – No VAT has been added to the sales value.

VAT inclusive – VAT of 14% has already been added to the sales value.

To summarise:

- To work out the *original price* (if the amount is inclusive of VAT), we use the formula:

$$\frac{100}{114} \times \frac{\text{amount}}{1}$$

- To work out the *amount of VAT* added in a VAT inclusive amount, we use the formula:

$$\frac{14}{114} \times \frac{\text{amount}}{1}$$

8.7 Calculating VAT due to, or receivable from SARS

Suppose a business sells goods for R12 540 including VAT in a two-month period.

It buys goods worth R10 260 over the same period (including VAT).

What amount will it pay to or receive from the Receiver for the period?

To find the output VAT, multiply R12 540 by the VAT fraction:

$$R12\ 540 \times \frac{14}{114} = R1\ 540$$

To find the input VAT, multiply R10 260 by the VAT fraction:

$$R10\ 260 \times \frac{14}{114} = R1\ 260$$

$$\begin{aligned} \text{VAT payable} &= \text{Output VAT} - \text{input VAT} \\ &= R1\ 540 - R1\ 260 \\ &= \underline{R\ 280} \rightarrow \text{Payable to SARS} \end{aligned}$$

8.7.1 Recording VAT

Record the sales and purchases transactions above in the general ledger.

	Sales		Cr		Dr		VAT		Cr
	Bank		11 000		Bank		Bank		
					(VAT input)	1 260	(VAT output)	1 540	
					Balance	<u>280</u>	Balance	<u>280</u>	
						<u>1 540</u>	VAT payable to	SARS	<u>1 540</u>
							Balance	280	
							VAT payable to	SARS	
Dr	Bank	Cr	Dr	Purchases	Cr				
Sales	12 540	Purchases	10 260	Bank	9 000				

Summary

- To calculate the VAT amount charged from an inclusive amount, multiply the VAT inclusive amount by the VAT fraction, which is the VAT rate/100 + VAT rate. Assuming a VAT rate of 14%, the VAT fraction is $\frac{14}{114}$.
- To calculate the output VAT, multiply total sales inclusive of VAT charged, by the VAT fraction.
- To calculate input VAT, multiply total purchases inclusive of VAT paid, by the VAT fraction.

Exercise 8.1

Customer	Value of goods sold (excl. VAT)	VAT	Total amount invoiced
Pierce	R10 000		
Anneh	R25 000		
Micke	R50 000		
Niche	R18 000		

Exercise 8.2

Customer	Value of goods sold (excl. VAT)	VAT	Total amount invoiced
Tobile			R15 000
Beaty			R12 000
Cyril			R22 000

Exercise 8.3

Customer	Value of goods sold (excl. VAT)	VAT	Total amount invoiced
Princess Klaas		R 200 R1 800	

Exercise 8.4

The following transactions took place during January 20XX in the business of A. Amos. VAT of 14% is included in all prices where applicable.

20XX

- Jan 1 Sold merchandise on credit to C. Carlos, R22 800.
- 2 Bought inventory for R18 000.
- 3 Purchased stationery cash, R1 400 .
- 4 Paid salaries for the month, R36 000.

Required

1. Calculate the amount of VAT included in each transaction.
2. Indicate whether it is input or output VAT.

Exercise 8.5

The following transactions occurred during January 20XX in the business of Dunlopp (Pty) Ltd.

20XX

- Jan 1 Cash sales according to cash register roll, R3 000.
- 2 The owner borrowed R7 000 from Union Bank and deposited the cash in the current account of the business.
- 3 Purchased merchandise on credit from Firestone, R2 350.
- 4 A debtor, Zala's, debt of R300 must be written off as irrecoverable.

Basic Financial Accounting

- 5 The owner withdrew R600 cash to pay his private telephone account.
- 6 Received a credit note from Firestone for damaged goods returned, R350.
- 7 The bank charges on the bank statement amounted to R75.

Required

Calculate VAT for each transaction.

Notes

Notes

Notes

Notes
