Only Study Guide for

FAC1502

FINANCIAL ACCOUNTING I:
Financial Accounting Concepts, Principles and Procedures

Department of Financial Accounting
University of South Africa, Pretoria

Revised edition 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2013, 2014, 2016, 2017

Printed and published by the
University of South Africa
Muckleneuk, Pretoria

FAC1502/1/2018

70539340

3B2

ACN-Style

CONTENTS

Aims of this module

After having studied this module, you should be able to

- apply the basic principles of accounting
- gather, process and record relevant information and prepare basic statement of profit or loss and other comprehensive income (income statement), statement of changes in equity and statement of financial position (balance sheet)
- record assets properly and be accountable for assets
- record liabilities properly and be accountable for liabilities
- keep proper records to ascertain the financial performance and financial position of sole proprietors and non-profit entities
- prepare proper books from incomplete records

NOTE

ALL REFERENCES TO ‘‘ACCOUNTING’’ IN THIS STUDY GUIDE MEANS ‘‘FINANCIAL ACCOUNTING’’.

INTRODUCTION AND OVERVIEW OF THE MODULE

We would like to welcome you as a student to Module I (FAC1502) of the Accounting I course. This is the second module of a series of modules presented by the Department of Financial Accounting at UNISA. The title of this module is *Accounting concepts, principles and procedures.*

The courses in the Department of Financial Accounting are presented to degree level (i.e. with Accounting III as a major subject). This, together with another major and other subjects, will enable you to obtain either the BCom or BCompt degree. You may, having completed the BCom or BCompt degree, study further in accounting by studying the BCom/BCompt (honours) degree and thereafter the MCom/MCompt and DCom/DCompt degrees. This will take quite a number of years and hard work, but it is possible! The ultimate goal of many students in accounting is to become accountants and to follow the BCompt route.

Your first milestone will, however, be to master (i.e. to pass) Accounting FAC1502. You must, therefore, ensure that you understand and know everything contained in this module as everything is important. It is not only required of you to know it for the examination, but you WILL need it in future modules or in your everyday walk of life (if you do not study accounting further).

You may ask: Why is it necessary to study accounting? The most important reason will be: To account for income and expenditure, and for assets and liabilities. You may say: I do not earn an income or incur expenses, or I do not owe money or own assets. Our question will be in turn: What about your pocket money, remuneration for work or part time work, your study bursary or study loan (which is not an income, but a liability) or what about your clothes, books and stationery you had to buy for your studies? You have to account for the value of all of it. This does not only apply to your personal case, but especially to the business you own or the organisation where you work.

Many persons and/or organisations fall into financial difficulties or even go bankrupt and people land in jail as a result of their lack of knowledge of accounting. We would like to help you to prevent this.

Now that you know WHY you must study Accounting, what are the aims of the Accounting FAC1502 module?

Refer again to the **Aims of this module**, specified above.

Study activities

In this study guide a variety of exercises are given. You should do these exercises by yourself also and compare your attempt with the solutions given in the study guide. It also contains self-evaluation questions, to encourage your active participation in the learning process. These are a combination of reading, studying, doing and thinking activities that are presented in a flexible manner. This will enable you to absorb the knowledge content of the topic, to practice your understanding and to direct your thoughts.

This is important because as you encounter these study activities and actually perform them, you will become directly involved in controlling the extent and the quality of your learning experience. In short, how much and how well you learn, will depend on the extent of your progress through the study activities, and the quality of your effort.

In cases where exercises are given, the questions should be answered **without reference to the study material.** You should then mark your answer against the answer given in the study guide. Where your answer differs from that given in the study guide, ask yourself why?, how?, when?, where? what did I do wrong? If more than 25% is incorrect, try again to answer the question without referring to the study guide or your previous attempt. Accounting is very much a practical subject; the more you practice, the better.

Meaning of words

Outcomes are communicated and assessment criteria are phrased in terms of what you should be able to do. This involves the use of action words, describing what you must *do* in the learning activity.

The following list of words includes examples of the action words that you will encounter in this module. (You need not study this.)

Meaning of action words

	WORD	**MEANING**
1	Read	So as to obtain a broad and basic background, knowledge or information; do not study.
2	Read thoroughly	Necessary theory that needs to be clearly understood. You may be assessed on this theory through short questions.
3	Study	Learn with the view of gaining the highest level of understanding and mastery which is necessary for examinations, further study and/or career. You will not be required to give a definition of a concept in the examinations. You will, however be required to apply the theory in the correct accounting format and to follow the correct steps/ procedures. For example, the layout and terminology to be used in the preparation of financial statements are prescribed. You may not use any other formats.
4	Prepare	You must make ready or complete what is required on the basis of previous study.

TOPIC A

THE BASIC PRINCIPLES AND SPHERES OF ACCOUNTING

Learning outcome

The learner should be able to describe, calculate and record the financial performance and financial position of a sole proprietor, by using the basic accounting equation and the double-entry system to record the various types of transactions.

CONTENTS

STUDY UNIT

1

The nature of accounting theory, principles, accounting policy, practice and procedures

Learning outcome

You are able to explain what is meant by the nature of accounting theory, principles, accounting policy, practice and procedures.

Contents

KEY CONCEPTS

- financial information
- decision making
- nature of accounting
- unit of measurement
- forms of ownership
- fields of accounting
- accounting principles
- international financial reporting standards
- accounting statements
- accounting policy
- going concern
- qualitative characteristics
- elements of financial statements

BEFORE CONTINUING, STUDY TUTORIAL LETTER 101 UP TO THE FIRST ASSIGNMENT.

1.1 Introduction

In this module, we introduce you to the concepts, principles and procedures of accounting. The first two study units are included mainly to give you some background knowledge. At first, the information may appear to be rather confusing, but if you follow the study guide step by step, working through all the examples in the prescribed book and exercises in this study guide, the methods and procedures will become clear. To master this subject, **you must get as much practise as you can** – so start early in the semester.

Over the centuries, accounting developed in conjunction with and as part of the economic system and it performs an extremely useful and important function in society.

Through the ages, records were always kept by hand, but nowadays computers are being used increasingly. Whichever method is used, the basic principles remain unchanged, since all activities in a business are still expressed in terms of money and are recorded. However, it is necessary to know the procedures used in a manual system in order to understand how a computerised accounting system works.

Read paragraph 1.1 of the prescribed book.

GOLDEN RULE

Accounting CAN NOT be studied by merely reading/memorising. You need to practise, practise and practise again!

1.2 What is accounting?

1.2.1 Definition

Study paragraph 1.2 of the prescribed book.

Accounting is therefore a process consisting of the following three activities:

- identifying those events that are evidence of economic activity (transactions) relevant to the particular business or entity
- recording the monetary value of the economic events (transactions) in order to provide a permanent history of the financial activities of a business. Recording involves keeping a chronological diary of measured events in an orderly and systematic manner and classifying and summarising economic events
- communicating the recorded information to interested users. This information is communicated through the preparation and distribution of accounting reports, the most common of which are known as financial statements.

Read paragraphs 1.3 and 1.4 of the prescribed book.

GOLDEN RULE

Accounting records transactions in order to provide useful information for decision making.

1.2.2 The nature of accounting

Accounting is a specialised means of communication which is used to convey a specialised message about an entity's finances. The recipient of this specialised message (the user of financial information) must understand it otherwise the information that is conveyed has no value.

Accounting uses words and figures to convey financial information to the users of such information. As you progress with your study of accounting you will become familiar with the meaning of these words and figures, which are also known as the concepts, principles and procedures of accounting. This knowledge will ultimately help you understand the message contained in financial statements.

Each and every person who is involved in an entity uses financial information to a greater or lesser degree. Each of us also needs to know something about accounting to manage our personal financial affairs. Financial resources are limited or scarce, and if we are going to spend them we must plan properly. Knowledge of accounting is therefore also useful in this area.

Accounting is therefore a ''language'' used to convey financial information to interested parties.

Read paragraph 1.7 in the prescribed book **thoroughly**.

1.3 Universal accounting denominator

The common unit of measurement in accounting is money and in the RSA, the currency is known as the rand. All an entity's transactions are converted into monetary values before being processed. Using money as the common denominator, however, gives rise to two important limitations:

- Not all events can be expressed in monetary terms.
- The value of money is unstable and is influenced by many economic factors such as inflation.

1.4 Forms of ownership

The form of a business ownership refers to the way in which a business is owned and managed – how the original funds for starting the business were raised and how the profits, losses and risks in the business are divided.

In the RSA, there are four main forms of ownership, namely:

- sole traders
- partnerships
- close corporations
- companies

Apart from these main forms of entities, non-profit entities can also be distinguished.

Study paragraph 1.5 and **read** paragraph 1.6 **thoroughly** in the prescribed book.

1.5 Users of financial information

Financial information is required by many users, who analyse the information for various decision-making purposes. The following are the most common users of this information:

1.5.1 Investors

1.5.2 Employees

1.5.3 Lenders

1.5.4 Suppliers and other trade creditors

1.5.5 Customers

1.5.6 Government and their agencies

1.5.7 Public

Study paragraphs 1.8 to 1.11 in the prescribed book.

1.6 The fields of accounting

Users of financial information can be subdivided into the following two categories:

- internal users – for example, management and employees
- external users – for example, investors, creditors and government

Two fields of accounting have developed as a result of this distinction between the users of the information. Financial accounting is concerned with the provision of financial information to mainly external parties, while management accounting is concerned with the provision of financial information to people within the entity.

1.6.1 Financial accounting

This field of accounting is concerned with recording transactions and preparing the financial statements for the entity as a whole. Financial accounting is governed by international financial reporting standards (IFRS), which consists of external standards which must be adhered to. These standards ensure the comparability of financial statements between entities.

1.6.2 Management accounting

Management accounting provides financial information for specific purposes. Managers use this information in their decision making, which leads to the attainment of the objectives of the entity. Without this financial information, it would be difficult for management to manage effectively.

In this course we will be concentrating on financial accounting.

Study paragraph 1.12 and **read** paragraph 1.18 in the prescribed book.

GOLDEN RULE

Financial statements must reveal a fair presentation of the financial position, financial performance and cash flow of an entity.

1.7 Accounting principles

In this study unit we turn our attention to the theory of accounting. You may well ask: ''Why? Accounting is supposed to be a practical subject''. This is true, but no subject that is logically structured can exist without a theoretical foundation.

The techniques used in the practice of accounting are based on conceptual and theoretical ideas. These ideas are generally known as accounting principles.

1.8 Accounting policy

Situations often occur in our everyday lives that are repetitive (ie they are always the same), but they would each have a different outcome if we were to act differently each time. If we do not have some kind of **guideline** on how we should act in such cases, our actions would probably be inconsistent. Our friends would think we were unreliable. If we lay down a guideline so that we always act the same way in a particular situation, we can say that we are determining a **policy** for our actions, which will result in our actions being consistent.

We encounter precisely the same situation in accounting. Transactions of a repetitive nature frequently occur, and the requirement of consistency means that an entity has to establish an accounting policy to determine exactly how such transactions should be treated. Accounting policy is thus a set of decisions about how the entity will handle the same type of transaction in order to achieve a consistent result.

1.9 Disclosure of accounting policy

Since an accounting policy represents an entity's decisions about situations which it could deal with in various ways, it has to disclose its accounting policy in its financial statements. For example, an entity has to indicate what basis it has used to deal with the depreciation of property, plant and equipment.

1.10 International Financial Reporting Standards (IFRS)

This is the next important concept that you will encounter in your accounting studies. For the sake of conciseness, we will refer to this as IFRS.

If everyone were to develop his or her own language and grammatical rules, communication would break down. We therefore have generally applicable language and grammar rules.

Accounting, as a specialised medium of communication, has precisely the same problem. If each entity were to prepare financial reports according to its own accounting rules and its interpretation of accounting theory and principles, chaos would result in the world of economics and business.

A **foundation** has therefore been developed over the years for the measurement and disclosure of the results of financial events (transactions).

This foundation is a general framework and encompasses, in broad terms, accounting concepts, principles, methods and procedures collectively known as IFRS.

> In this study guide, we will sometimes disclose more information in the financial statements than is required by IFRS. This is done to provide more detail and to help you understand certain concepts.

1.11 Accounting standards and statements

1.11.1 Introduction

The objective of creating **accounting standards** for particular issues (eg for the treatment of taxation in financial statements) is to limit the variety of available accounting practices, but without striving for strict uniformity or creating a set of rigid rules for all circumstances. The ultimate aim of accounting standards is to encourage widespread use of particular standards in financial reporting and to eliminate undesirable alternatives.

1.11.2 The Conceptual Framework for Financial Reporting 2010

Bear in mind that the framework is not a standard. It is a **framework** ‘‘... which sets out the objectives and concepts which underlie the preparation and presentation of financial statements ...’’.

1.11.2.1 The objective of financial statements

Study paragraph 1.9 in the prescribed book again.

1.11.2.2 Underlying assumption

According to the framework, there is one underlying assumption for financial statements.

This is:

(1) the going concern.

Study paragraph 1.13 in the prescribed book.

1.11.2.3 The qualitative characteristics of financial statements

The fundamental qualitative characteristics are:

(1) relevance
(2) faithful representation

Further enhancements to the qualitative characteristics of financial information are:

(1) comparability
(2) verifiability
(3) timeliness
(4) understandability

Study paragraph 1.14 in the prescribed book.

1.11.2.4 The elements of financial statements

GOLDEN RULE

The following are elements of financial statements:

- Elements that measure the financial position (assets = equity + liabilities):

  (1) assets
  (2) liabilities
  (3) equity

- Elements that measure profitability (profit or loss = increase or decrease in equity):
  (4) income
  (5) expenses

Study paragraph 1.15 in the prescribed book.

1.11.2.5 Recognition and measurement of the elements of financial statements

Study paragraphs 1.16 to 1.18 in the prescribed book.

1.12 Exercise and solution

We end this study unit with a few revision questions. It is in your own interest to try to answer these by referring to the study unit or prescribed book.

Exercise

(1) Discuss the nature of accounting.
(2) What is the common unit of measurement in accounting?
(3) Name the four main forms of ownership.
(4) Discuss the different users of financial information.
(5) Differentiate between financial accounting and management accounting.
(6) Name the qualitative characteristics of financial information.
(7) Define the concept of accounting policy.
(8) What is meant by disclosure of accounting policy?
(9) Describe the concept of international financial reporting standards.
(10) Discuss the underlying assumption of financial statements.
(11) Name the fundamental qualitative characteristics of financial statements.
(12) Name the elements of financial statements.

Solution

(1) Refer to paragraph 1.2.2.
(2) The common unit of measurement in accounting is money.
(3) Sole trader
Partnership
Close Corporation
Company
(4) See section 1.5.
(5) See section 1.6.
(6) See section 1.14.3 in the prescribed text book.
(7) See section 1.8 in the study guide.
(8) See section 1.9 in the study guide.
(9) See section 1.10 in the study guide.
(10) See section 1.13 in the prescribed book.
(11) Relevance
Faithful representation

(12) Assets
Liabilities
Equity
Income
Expenses

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- describe the importance of financial information as a basis for decision making?
- discuss the different users of financial information and their needs?
- state the different forms of ownership?
- discuss the nature of accounting?
- explain the difference between financial and management accounting?
- name the qualitative characteristics of financial statements?
- explain what is meant by the accounting policy?
- explain what is meant by the disclosure of the accounting policy?
- explain what is meant by the international financial reporting standards?
- explain what is meant by the accounting standards and statements?

STUDY UNIT

2

The financial position

Learning outcome

Students should be able to describe what the primary purpose of accounting is and what is understood by the double entry system. They should also be able to calculate the financial position of an entity and the elements of the basic accounting equation.

Contents

KEY CONCEPTS

- Accounting entity
- Accounting equation
- Financial position
- Assets
- Liabilities
- Equity
- Double-entry
- Net worth

2.1 Introduction

The primary purpose of accounting is to give information on the financial **position** and the financial **result** of an entity. This study unit deals with the key elements of the financial position.

Read paragraph 2.1 of the prescribed book.

2.2 Accounting entity

Every entity for which separate financial records are kept is an accounting entity. It is extremely important to see the business as a separate entity from its owners because transactions entered into by the entity have to be dealt with from the point of view of the entity whose books are being done.

Study paragraph 1.6 (again) as well as paragraph 2.2 of the prescribed book.

2.3 Financial position

The financial position of the entity is described in terms of assets and interests at a **given time**. They are reflected in a statement of financial position, which is essentially an accounting report on the financial position of an entity. The statement of financial positon communicates relevant financial information to the owners, creditors and other interested parties.

Study paragraph 2.6 of the prescribed book.

2.4 Net asset value

The difference between the value of assets owned by an entity and the liabilities it has incurred represents net asset value. If we express this as an equation, then

ASSETS − LIABILITIES = NET ASSET VALUE

The net asset value represents the portion by which the assets exceed the liabilities. Net asset value is therefore also called **EQUITY**.

Study paragraph 2.3 of the prescribed book.

2.5 Application of the basic accounting equation (BAE)

Exercise 1

The assets of Maxi Services amount to R30 000 and its liabilities (creditors) to R5 000. Calculate the equity.

We use the BAE. The amounts which are given are substituted for the appropriate symbol and the unknown symbol is calculated.

A = E + L
E = A – L
= R30 000 – R5 000
= R25 000

Exercise 2

T Tom is the owner of Zebra Services which offers a carpet cleaning service. On 30 November 20.1 Zebra Services owns equipment amounting to R100 000. Clients owe R40 000 for services rendered and Zebra Services owes R20 000 to a supplier for parts purchased. Zebra Services also has R10 000 in cash in the bank.

Show the BAE for Zebra Services and determine the equity.

Step 1: Identify the assets

Equipment = R100 000
Trade receivables = R40 000
Cash = R10 000

Step 2: Identify the liabilities

Trade payables = R20 000

Substitute these amounts into the equation:

A = E + L
E = A – L
= R(100 000 + 40 000 + 10 000) – R20 000
= R130 000

Zebra Service's financial position can also be presented in the form of statement of financial position (previously known as balance sheet) as follows:

ZEBRA SERVICES

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET) AS AT 30 NOVEMBER 20.1

ASSETS	R	EQUITY AND LIABILITIES	R
Equipment	100 000	Equity	130 000
Trade receivables	40 000	Trade payables	20 000
Cash in bank	10 000		
	150 000		150 000

COMMENT

This statement of financial position (balance sheet) is in a basic form. Later we will deal with statements of financial positions (balance sheets) in more detail.

Study paragraph 2.5 and 2.6 of the prescribed book.

2.6 The double-entry system

The double-entry system is based on the fact that every transaction affects two or more items in the BAE. In principle it means that each transaction must be recorded in such a way that the equation remains in balance. The dual effect which each transaction has on the elements of the BAE is the fundamental principle on which all entries in an accounting system are based.

Study paragraphs 2.4, 2.6 and 2.7 of the prescribed book.

2.7 Revision exercises and solutions

2.7.1 Revision exercise 1

(1) Define the concept of an accounting entity.
(2) Describe the financial position of an entity in terms of the BAE.
(3) Explain the nature of

(a) assets
(b) equity
(c) liabilities

(4) Name two sources of financing.
(5) What is meant by the double-entry system?

Solution: Revision exercise 1

(1) An accounting entity is any entity for which separate financial records are kept.

(2) ASSETS = EQUITY + LIABILITIES

(3) (a) *Assets* are the possessions of the entity.
(b) *Equity* is the interest which the owner has in the business and which the entity therefore owes to him.
(c) *Liabilities* are creditors' interests or interests of parties other than the owner(s). Liabilities are therefore the debts of the entity.

(4) The owner
Trade payables

(5) In principle it means that every transaction has a dual effect on the elements of the BAE and that after every transaction the BAE **must** remain in balance.

2.7.2 Revision exercise 2

Calculate the missing figures using the BAE.

			R
(1)	Bank	=	4 000
	Vehicles	=	5 000
	Equipment	=	7 000
	Capital	=	?
(2)	Capital	=	150 000
	Loan	=	50 000
	Bank	=	?
	Machinery	=	190 000
(3)	Bank	=	5 000
	Trade receivables	=	15 000
	Buildings	=	100 000
	Furniture	=	40 000
	Trade payables	=	50 000
	Capital	=	?
(4)	Capital	=	60 000
	Loan	=	10 000
	Trade payables	=	6 000
	Assets	=	?

Solution: Revision exercise 2

(1) A = E + L
E = A – L
= R(4 000 + 5 000 + 7 000) – R0
= R16 000

(2) A = E + L
R190 000 + Bank = R(150 000 + 50 000)
Bank = R(150 000 + 50 000) – R190 000
= R10 000

(3) A = E + L
E = A – L
= R(5 000 + 15 000 + 100 000 + 40 000) – R50 000
= R160 000 – R50 000
= R110 000

(4) A = E + L
= R60 000 + R(10 000 + 6 000)
= R76 000

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- describe the primary purpose of accounting?
- describe an entity?
- describe the financial position of the entity?
- describe the double-entry system?
- calculate the elements of the basic accounting equation?

STUDY UNIT

3

The financial performance (result)

Learning outcome

Students should be able to apply the concepts of income and expenditure to determine the gross and net profits (or losses) and the effect thereof on equity.

Contents

KEY CONCEPTS

- Financial result
- Profit/loss
- Income
- Expenditure

3.1 Introduction

In paragraph 2.3 we discussed the first component of the primary goal of accounting, which is to determine the financial position of an entity as it is reflected in the statement of financial position. In this study unit we discuss the second component of this primary goal, namely the **financial performance** of the entity, and indicate how it is reflected in the form of a statement of profit or loss and other comprehensive income.

Study paragraph 3.1 in the prescribed book.

3.2 The financial performance (result)

The financial result of an entity is measured in terms of the profit or loss which the entity has made over a specific period, which is referred to as the **financial period** and which is normally a year. An entity makes a profit when the income it has earned is more than the expenditure it has incurred in generating or producing that income. The difference between the income and expenditure is known as the profit or loss. Profit is the owner's reward for the capital he or she has invested and the entrepreneurial spirit he or she has shown. It therefore increases the equity.

3.3 Income

The objective of every entity is to earn as large an **income** as possible.

Study paragraph 3.2.1 of the prescribed book.

3.4 Expenditure

Expenditure is incurred to earn income.

Study paragraph 3.2.2 of the prescribed book.

3.5 Influence of profit or loss on equity

Income (profit) increases and expenditure (losses) decreases the owner's interest.

Study paragraph 3.3 of the prescribed book.

Exercise

The financial position (BAE) of T Payn, an attorney, on 28 February 20.0 is as follows:

A	=	E + L
R50 000	=	R30 000 + R20 000

For the year ended 28 February 20.1 he had the following income and expenditure:

	R
Income received	180 000
Salaries expense	100 000
Administrative costs	20 000
Insurance expense	10 000

Calculate T Payn's equity on 28 February 20.1.

We use the equation which we discussed in paragraph 2.4 and 4.3:

Profit = Income – Expenditure

= R180 000 – R(100 000 + 20 000 + 10 000)
= R180 000 – R130 000
= R50 000

E = R30 000 + R50 000
= R80 000

COMMENTS

- *Capital plus profit together form the equity of the owner. See the above exercise — R(30 000 + 50 000) = R80 000.*
- *Profit is income minus expenditure.*

3.6 Statement of profit or loss and other comprehensive income (income statement) (financial peformance)

The financial performance is measured in the statement of comprehensive income of an entity (previously known as the income statement).

Study paragraph 3.4 of the prescribed book.

3.7 Statement of changes in equity

Study paragraph 3.5 of the prescribed book.

3.8 Accounting policies and explanatory notes

Study paragraphs 3.6 and 3.7 of the prescribed book.

3.9 Revision exercises and solutions

3.9.1 Revision exercise 1

(1) How is the financial performance (result) calculated in accounting terms? Which financial report reflects the financial performance?
(2) Give three examples of income.

(3) Give three examples of expenditure.
(4) How is profit/loss determined for a financial period?
(5) Does a loss increase or decrease the equity of the owner?

Solution: Revision exercise 1

(1) Income minus expenditure. The statement of profit or loss and other comprehensive income reflects the financial performance.
(2) Refer to paragraph 3.3.
(3) Refer to paragraph 3.4.
(4) Expenditure is subtracted from income. Refer to paragraph 3.2.
(5) A loss decreases equity.

3.9.2 Revision exercise 2

On 28 February 20.2 Alpha Services showed the following income and expenditure for the financial year.

	R
Income received	850 000
Salaries	520 000
Wages	50 000
Telephone expenses	4 000
Stationery	2 000
Interest received	1 000
Insurance	12 000

Calculate the net profit/loss of Alpha Services on 28 February 20.2.

Solution: Revision exercise 2

Income	= Income received + Interest received
	= R(850 000 + 1 000)
	= R851 000
Expenditure	= Salaries + Wages + Telephone + Stationery + Insurance
	= R(520 000 + 50 000 + 4 000 + 2 000 + 12 000)
	= R588 000
Profit	= Income – Expenditure
	= R851 000 – R588 000
	= R263 000

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- describe the concept income?
- describe the concept expenditure?
- calculate the profit (or loss)?
- calculate the effect of profit/loss on equity?

STUDY UNIT

4

The double-entry system and the accounting process

Learning outcome

Students should be able to analyse and record transactions in the books of an entity and prepare financial statements.

Contents

KEY CONCEPTS

- Debit and credit
- Transactions
- Effect on financial position
- T-account
- Ledger
- Contra account
- Folio number
- Trial balance

4.1 Introduction

We mentioned the double-entry system in paragraph 2.6 in the study guide — read that paragraph again. To make a double-entry correctly, you need a good working knowledge of the appropriate names for different things in accounting and particularly the concepts of "debit" and "credit". It is very important that you master this study unit since it explains the foundation on which the accounting system is built.

Read paragraph 4.1 of the prescribed book.

4.2 The double-entry system

At this stage we are simply using the accounting equation as a teaching aid to explain the analysis of transactions. The BAE **does not** form part of a formal accounting system.

To make a double-entry you must:

- Think about what the effect of the transaction is going to be on the BAE, in other words, how it is going to affect the financial position of the entity.
- Identify the components (accounts) which are involved, that is the components which will have the desired effect on the equation.

- Determine which account(s) has/have to be debited and which account(s) has/have to be credited.
- Be sure that the amount(s) debited are equal to the amount(s) credited.
- Be able to indicate the date of the transaction.
- Indicate the name of the contra ledger account in the account in which you are doing the entry. The contra account is the other account which is involved in the transaction: the one account refers to the other.
- Indicate the folio number of the subsidiary journal.

4.3 The effect of transactions on the basic accounting equation (BAE)

A transaction is an agreed upon transfer of value from one party to another which affects (changes) the amount, nature or composition of an entity's assets, liabilities or equity. In other words it affects the BAE. Entering into a transaction gives rise to the first step in the accounting cycle, namely the completion of a source document.

Transactions may

- affect assets and/or equity and/or liabilities
- generate income or give rise to expenditure

Study paragraph 4.2 of the prescribed book.

4.4 Transactions which affect only assets, equity and liabilities

Below we give practical examples of transactions which affect only assets or interests. (**A "+" indicates an increase and a "−" indicates a decrease.)**

Study paragraphs 4.2.1 to 4.2.4 of the prescribed book.

4.4.1 Capital contributions

Transaction 1 Feb 20.1	T Tom decided to start a carpet-cleaning business called Fix-'n-Mat. He withdrew R130 000 from his personal savings account and deposited it in Fix-'n-Mat's bank account.

Analysis	(1) The asset **"Bank"** increases by R130 000 and there is now money in Fix-'n-Mat's bank account. (2) The owner, T Tom, provides Fix-'n-Mat with funds and increases his interest in Fix-'n-Mat. The equity **"Capital"** increases by R130 000.

	ASSETS	=	**EQUITY**	+	**LIABILITIES**
	Bank		**Capital**		
	R		**R**		**R**
Previous balances	0		0		0
This transaction	+ 130 000		+ 130 000		0
New balances	130 000	=	130 000	+	0

COMMENTS

- *In an entity which has not yet entered into any transaction, the elements of the equation will always be 0.*
- *The terms "bank" and "capital" in the analysis are actually names of accounts.*
- *The investment of capital is usually the first transaction.*
- *Capital may be contributed in the form of cash or any other asset (eg furniture). **"Furniture"** instead of **"Bank"** will then increase.*
- *The BAE balances after the transaction.*

4.4.2 Acquisition of loans

Transaction 2 Feb 20.1	Fix-'n-Mat obtained a loan of R25 000 with a payback period of more than a year from ABC Bank. The amount was paid into its bank account.

Analysis	(1) The asset **"Bank"** increases by R25 000. (2) ABC Bank now has a claim against or an interest in Fix-'n-Mat and a liability, namely a **"Loan: ABC Bank"**, comes into being.

	ASSETS	=	EQUITY	+	LIABILITIES
	Bank		**Capital**		**Loan: ABC Bank**
	R		**R**		**R**
Balances brought down	130 000		130 000		0
Transaction	+ 25 000		0		+ 25 000
New balances	155 000	=	130 000	+	25 000

COMMENTS

- *The results of the first transaction form the balances which are brought down in this transaction.*
- *Liabilities arise when another party or institution supplies funds (make loans) to the entity.*
- *Amounts (in this case R25 000) are **added** to both the left-hand side and the right-hand side of the BAE.*
- *The BAE balances after the transaction.*

4.4.3 Purchase of assets for cash

Transaction 6 Feb 20.1	Fix-'n-Mat bought equipment from XY Furnishers for R100 000 and paid by cheque.

Analysis	(1) The asset **''Bank''** decreases by R100 000 since money has been withdrawn. (2) The asset **''Equipment''** increases.

	ASSETS		=	EQUITY	+	LIABILITIES
	Equip-ment	**Bank**		**Capital**		**Loan: ABC Bank**
	R	**R**		**R**		**R**
Balances brought down	0	155 000		130 000		25 000
Transaction	+100 000	– 100 000		0		0
New balances	100 000	55 000	=	130 000	+	25 000

COMMENTS

- *Assets now consist of **bank** and **equipment.***
- *The left-hand side of the equation increases and decreases. One asset is exchanged for another asset.*
- *The BAE balances after the transaction.*

4.4.4 Buying assets on credit (debt)

Transaction 10 Feb 20.1	Fix-'n-Mat bought furniture for R2 000 on credit from Joc Limited.

Analysis	(1) The asset **''Furniture''** increases by R2 000. (2) A liability, **''Trade payables''**, comes into being.

	ASSETS			=	EQUITY	+	LIABILITIES	
	Furniture	**Equipment**	**Bank**		**Capital**		**Loan: ABC Bank**	**Trade pay-ables**
	R	**R**	**R**		**R**		**R**	**R**
Balances brought down	0	100 000	55 000		130 000		25 000	0
Transaction	+2 000	0	0		0		0	+2 000
New balances	2 000	100 000	55 000	=	130 000	+	25 000	2 000

COMMENTS

- *Assets may also be bought on credit and a creditor comes into being.*
- *The transaction is recorded when it is entered into and not when the payment is made.*
- *The left-hand side and the right-hand side of the BAE increase.*
- *The BAE balances after the transaction.*

4.4.5 Payments to creditors

Transaction 11 Feb 20.1	Fix-'n-Mat paid Joc Limited's account of R2 000.

Analysis	(1) The asset **"Bank"** decreases by R2 000. (2) The liability, **"Trade payables"** (liability), decreases by R2 000.

	ASSETS			=	EQUITY	+	LIABILITIES	
	Furniture	**Equipment**	**Bank**		**Capital**		**Loan: ABC Bank**	**Trade payables**
	R	**R**	**R**		**R**		**R**	**R**
Balances brought down	2 000	100 000	55 000		130 000		25 000	2 000
Transaction	0	0	−2 000		0		0	−2 000
New balances	2 000	100 000	53 000	=	130 000	+	25 000	0

COMMENTS

- *The left-hand side and the right-hand side of the BAE decrease.*
- *The BAE balances after the transaction.*

4.4.6 Withdrawals by owner

Transaction 12 Feb 20.1	The owner withdrew R1 000 for his own use.

Analysis	(1) Fix-'n-Mat's **"Bank"** decreases by R1 000. (2) T Tom's **"Capital"** (equity) in Fix-'n-Mat decreases by R1 000.

	ASSETS			=	EQUITY	+	LIABILITIES	
	Furniture	Equipment	Bank		Capital		Loan: ABC Bank	Trade pay-ables
	R	R	R		R		R	R
Balances brought down	2 000	100 000	53 000		130 000		25 000	0
Transaction	0	0	–1 000		–1 000		0	0
New balances	2 000	100 000	52 000	=	129 000	+	25 000	0

COMMENTS

- *Withdrawals are the opposite of capital contributions and reduce capital. Remember, withdrawals are **not** expenditure.*
- *Where the entity pays **personal** expenses of the owner's, it is also treated as a withdrawal.*
- *The left-hand side and the right-hand side of the BAE are reduced.*
- *The BAE balances after the transaction.*

4.5 Transactions which give rise to income and expenditure

4.5.1 Income (cash)

Transaction 13 Feb 20.1	Fix-'n-Mat provided services for a client S Silver and received a cheque for R1 000.

Analysis	(1) The asset **"Bank"** increases by R1 000. (2) The fee which Fix-'n-Mat earns is an income. **Equity** therefore increases by R1 000.

	ASSETS			=	EQUITY		+	LIABILITIES	
	Furniture	Equipment	Bank		Capital	Income/ Expend-iture		Loan: ABC Bank	Trade pay-ables
	R	R	R		R	R		R	R
Balances brought down	2 000	100 000	52 000		129 000	0		25 000	0
Transaction	0	0	+1 000		0	+1 000		0	0
New balances	2 000	100 000	53 000	=	129 000	1 000	+	25 000	0

COMMENTS

- *Income earned increases the equity. It is the objective of the entity to earn income for the entrepreneur.*
- *The left-hand side and the right-hand side of the BAE increase.*
- *The BAE balances after the transaction.*

4.5.2 Expenditure (cash)

Transaction 16 Feb 20.1	Fix-'n-Mat paid wages by cheque, R800.

Analysis	(1) The asset **''Bank''** decreases by R800. (2) Wages are an expenditure item and the **equity** decreases by R800.

	ASSETS			=	EQUITY		+	LIABILITIES	
	Furniture	**Equipment**	**Bank**		**Capital**	**Income/ Expenditure**		**Loan: ABC Bank**	**Trade payables**
	R	**R**	**R**		**R**	**R**		**R**	**R**
Balances brought down	2 000	100 000	53 000		129 000	1 000		25 000	0
Transaction	0	0	–800		0	–800		0	0
New balances	2 000	100 000	52 200	=	129 000	200	+	25 000	0

COMMENTS

- *In essence expenditure incurred decreases income and therefore also decreases the equity.*
- *The left-hand side and the right-hand side of the BAE decrease.*
- *The BAE balances after the transaction.*

4.5.3 Income (credit)

Transaction 18 Feb 20.1	Fix-'n-Mat provided services worth R6 000 to C Canon on credit.

Analysis	(1) C Canon becomes a debtor of Fix-'n-Mat. The asset **''Trade receivables''** comes into being and increases by R6 000. (2) **''Income received''** are an income item and equity increases by R6 000.

	ASSETS				=	EQUITY		+	LIABILITIES	
	Trade receivables	Furniture	Equipment	Bank		Capital	Income/ Expenditure		Loan: ABC Bank	Trade payables
	R	R	R	R		R	R		R	R
Balances brought down	0	2 000	100 000	52 200		129 000	200		25 000	0
Transaction	+ 6 000	0	0	0		0	+6 000		0	0
New balances	6 000	2 000	100 000	52 200	=	129 000	6 200	+	25 000	0

COMMENTS

- *Organisations or clients who owe money to an entity are known as debtors and arise from the entity rendering services or goods on credit.*
- *The left-hand side and the right-hand side of the BAE increase.*
- *The realisation principle applies here, and the income is shown as having been earned on 18 February when the service was provided and not when the cash is received.*

4.5.4 Expenditure (credit)

Transaction 21 Feb 20.1	Fix-'n-Mat placed an advertisement in a local newspaper for R200. Payment was due only in 30 days.

Analysis	(1) The liability **"Trade payables"** increases by R200. (2) **"Advertisements"** are an expenditure item and the equity decreases by R200.

	ASSETS				=	EQUITY		+	LIABILITIES	
	Trade receivables	Furniture	Equipment	Bank		Capital	Income/ Expenditure		Loan: ABC Bank	Trade payables
	R	R	R	R		R	R		R	R
Balances brought down	6 000	2 000	100 000	52 200		129 000	6 200		25 000	0
Transaction	0	0	0	0		0	– 200		0	+ 200
New balances	6 000	2 000	100 000	52 200	=	129 000	6 000	+	25 000	200

COMMENTS

- *Expenditure may also be incurred on credit (for goods/services received).*
- *The organisations to which money is owed are known as creditors.*
- *The right-hand side of the BAE increases* ***and*** *decreases.*
- *The expenditure is shown on 21 February 20.1 and not only when it is paid.*
- *The BAE balances after the transaction.*

4.5.5 Payments received from debtors

Transaction 28 Feb 20.1	C Canon settled his account in part, R2 000.

Analysis	(1) The asset **"Bank"** increases by R2 000. (2) The asset **"Trade receivables"** decreases by R2 000.

	ASSETS				=	EQUITY		+	LIABILITIES	
	Trade receivables	Furniture	Equipment	Bank		Capital	Income/ Expenditure		Loan: ABC Bank	Trade payables
	R	R	R	R		R	R		R	R
Balances brought down	6 000	2 000	100 000	52 200		129 000	6 000		25 000	200
Transaction	–2 000	0	0	+ 2 000		0	0		0	0
New balances	4 000	2 000	100 000	54 200	=	129 000	6 000	+	25 000	200

COMMENTS

- *This transaction affects assets only.*
- *The left-hand side of the BAE increases* ***and*** *decreases.*
- *The BAE balances after the transaction.*

4.6 Summary of transactions

Fix-'n-Mat's transactions for February 20.1 can now be summarised as follows:

	ASSETS				=	INTERESTS				
						EQUITY		+	LIABILITIES	
Date	Trade receivables	Furniture	Equipment	Bank		Capital	Income/ Expenditure		Loan: ABC Bank	Trade payables
20.1	R	R	R	R		R	R		R	R
Feb										
1				+130 000		+130 000				
2				+25 000					+25 000	
6			+100 000	–100 000						
10		+2 000								+2 000
11				–2 000						–2 000
12				–1 000		–1 000				
13				+1 000			+1 000			
16				–800			–800			
18	+6 000						+6 000			
21							–200			+200
28	–2 000			+2 000						
	+4 000	+2 000	+100 000	+54 200	=	+129 000	+6 000	+	+25 000	+200

160 200 = 135 000 + 25 200

= 160 200

COMMENT

- *Note that these totals correspond to the closing balances in paragraph 4.5.5 above.*

4.7 Basic form of a statement of financial position (previously known as the balance sheet)

Now we are going to prepare a statement of financial position using the totals of the BAE (see paragraph 4.6). The basic form of the statement of financial position is based on the BAE. You have already come across a very simple statement of financial position in paragraph 2.5. A statement of financial position is a report and in essence is a formal presentation of the elements of the BAE.

FIX-'N-MAT
STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1

ASSETS	**Note**		**R**
Non-current assets			102 000
Equipment		100 000	
Furniture		2 000	
Current assets			58 200
Trade and other receivables		4 000	
Cash and cash equivalents		54 200	
Total assets			160 200
EQUITY AND LIABILITIES			
Total equity			135 000
Capital		135 000	
Non-current liabilities			25 000
Long-term borrowings		25 000	
Current liabilities			200
Trade and other payables		200	
Total equity and liabilities			160 200

COMMENTS

- *The statement of financial position balances and shows the same totals as the BAE.*
- *Note the heading — the statement of financial position is prepared to reflect the financial position* ***on a specific date.***
- *The withdrawals are subtracted from the capital. As mentioned, withdrawals are* ***not*** *an expenditure item.*
- *The equity in the BAE is also R135 000.*

4.8 Revision exercises and solutions

4.8.1 Revision exercise 1

D Paulus started a television antenna installation business on 1 June 20.1. The following transactions took place during the first month:

Transactions:

June	1	Cash in the bank deposited as opening capital, R25 000.
	2	D Paulus made his private equipment available to the business, R9 000.
	3	Additional equipment purchased and paid for by cheque, R12 000.
	4	Installation fees for work done on account for Kannadrift Municipality, R4 200.
	6	Vehicle purchased on credit from Virginia Cars Limited, R22 400. This vehicle was financed by obtaining a loan from Crown Bank at an interest rate of 9% per annum.
	17	Kannadrift Municipality paid R2 200 on their account.
	28	Wages paid, R4 000.
	29	Cheque drawn for private use, R1 300.
	30	Paid R9 000 to Virginia Cars Limited on their account.

Required:

Using the basic accounting equation, analyse the abovementioned transactions as follows:

NB: (1) Show the effect of each transaction on the basic accounting equation with a plus sign (+) for an increase and a minus sign (–) for a decrease.
(2) Balance the equation.

Example: On 1 July 20.1 D Paulus received R2 000 in cash for an installation done for Cook Financing Corporation.

Date	Basic accounting equation A	= E	+ L
20.1	**R**	**R**	**R**
July 1	+ 2 000	+ 2 000	0

Solution: Revision exercise 1

D PAULUS

Date	Basic accounting equation A	= E	+ L
20.1	**R**	**R**	**R**
June 1	+ 25 000	+25 000	
2	+ 9 000	+ 9 000	
3	+ 12 000		
	– 12 000		
4	+ 4 200	+ 4 200	
6	+ 22 400		+22 400
17	+ 2 200		
	– 2 200		
28	– 4 000	– 4 000	
29	– 1 300	– 1 300	
30	– 9 000		–9 000
Total	46 300	32 900	13 400

$\underbrace{32\,900 \quad 13\,400}_{46\,300}$

4.8.2 Revision exercise 2

The following transactions during January 20.1 relate to F Fox, an attorney.

Date	Transactions	Amount
20.1		**R**
Jan 3	F Fox deposited as opening capital	20 000
	Paid rental for January 20.1	2 300
4	Bought law library on credit from Book Limited	24 000
5	Bought a computer for cash from Leo Limited	1 700
6	Provided services for cash	7 200
9	Debited D Dunn with fees for services rendered	8 318
10	Leo Limited repaired equipment on credit	100
13	F Fox drew a cheque for private use	1 234
18	F Fox received commission on a property transaction	1 350
29	Paid the following by cheque	
	(i) Salaries	8 350
	(ii) Leo Limited (on account)	100
30	Received payment from D Dunn on his account	1 500

Required:

(1) Analyse the above transactions in tabular form as follows:

ASSETS				=	EQUITY		+	LIABILITIES
Date	**Library and Equip-ment**	**Trade receiv-ables**	**Bank**		**Capital**	**Income/ Expendi-ture**		**Trade payables**
Total				=			+	

(2) Prepare the statement of financial position of F Fox at 31 January 20.1.

Solution: Revision exercise 2

F FOX

(1) ACCOUNTING EQUATION

ASSETS				=	EQUITY		+	LIABILITIES
Date	Library and Equipment	Trade receivables	Bank		Capital	Income/ Expenditure		Trade payables
20.1	**R**	**R**	**R**		**R**	**R**		**R**
Jan 3			+20 000		+20 000			
			−2 300			−2 300		
4	+24 000							+ 24 000
5	+ 1 700		−1 700					
6			+7 200			+7 200		
9		+8 318				+8 318		
10						− 100		+ 100
13			−1 234		−1 234			
18			+1 350			+1 350		
29			−8 350			−8 350		
			− 100					− 100
30		−1 500	+1 500					
Total	+25 700	+6 818	+16 366	=	+18 766	+6 118	+	+24 000

R48 884 R48 884

F FOX

(2) STATEMENT OF FINANCIAL POSITION AS AT 31 JANUARY 20.1

	Note		R
ASSETS	**Note**		**R**
Non-current assets			25 700
Equipment		1 700	
Library		24 000	
Current assets			23 184
Trade and other receivables		6 818	
Cash and cash equivalents		16 366	
Total assets			48 884
EQUITY AND LIABILITIES			
Total equity			24 884
Capital		24 884	
Current liabilities			24 000
Trade and other payables		24 000	
Total equity and liabilities			48 884

4.9 The general ledger account

Up to now we have dealt only with asset, liability and equity items appearing in a statement of financial position or BAE.

We recorded transactions in columns in the summary of the BAE to show their effect on a specific asset, equity or liability item. We had columns for debtors, furniture, equipment, capital and so on. But it is impractical to prepare a new equation after every new transaction — just think what would happen in a business with thousands of transactions! To avoid this we are now going to open an **account** in the general ledger for every column of the BAE. We speak of the **general ledger** because there are also subsidiary ledgers, which we will explain later.

An account is opened in the general ledger for every asset, liability and equity item. Every account appears on its own on a page in the ledger and each account is given a number, which is known as a **folio number**.

An account is an accounting record in which all transactions relating to a specific item are recorded.

Study paragraphs 4.3 to 4.3.1 in the prescribed book.

4.9.1 Assets

Study paragraph 4.3.1 in the prescribed book.

4.9.2 Equity and liabilities

Study paragraphs 4.3.2 to 4.3.5 in the prescribed book.

4.10 Balancing an account

With what you have learnt about an account, we now know that an account may have entries on the debit or the credit side or on both sides.

Study paragraph 4.4 in the prescribed book.

NB:
The closing balance of the previous period becomes the opening balance of the next period.

- c/d = carried down, which indicates the amount to be carried down to the following month
- b/d = brought down, which indicates that the amount has been brought down from the previous month

4.11 Schematic representation

EQUITY		= ASSETS	– LIABILITIES
Dr Equity accounts Cr		Dr Asset accounts Cr	Dr Liability accounts Cr
Expenditure accounts	Income accounts		
+ ‖ –	– ‖ +	+ ‖ –	– ‖ +
Debit to increase	Credit to increase	Debit to increase	Credit to increase
Balance = Debit	***Balance = Credit***	***Balance = Debit***	***Balance = Credit***

Balances closed off to:
a) Trading account and/or
b) Profit or Loss account: Profit to Capital account

Dr Drawings Cr		Dr Capital Cr	
+ Debit to increase	– Credit to decrease	– Debit to decrease	+ Credit to increase
Balance = Debit		***Balance = Credit***	
Balance to capital account			

PREPARE: a) Statement of profit or loss and other comprehensive income
b) Statement of changes in Equity

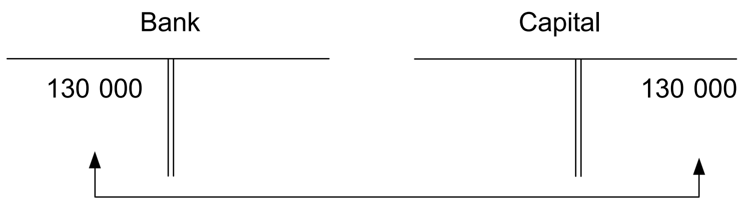
Use these balances and the result of the Statement of changes in equity to
PREPARE: the statement of financial position and Notes
Balances are the opening balances for the next financial year

- *The top level of the schematic representation shows the basic accounting equation (BAE).*
- *The second level of the schematic representation shows how each of the components of the BAE becomes part of the account system. The left-hand side of the account is known as the debit side (Dr) and the right-hand side as the credit side (Cr).*
- *The total of the amounts on the debit side of an asset account is usually larger than that on the credit side. The account will therefore usually have a debit balance (brought down). The total of the amounts on the credit side of a liability account is usually larger than that on the debit side. The account will therefore usually have a credit balance (brought down).*
- *The capital account reflects the equity of the owner at the date of the statement of financial position. The balance on this account is the result of income, expenditure, drawings and capital investment. These components are all dealt with separately in the accounting system.*
  - *Additional capital contributions and income increase equity.*
  - *Drawings and expenditure decrease equity.*
  - ***But note: drawings is not an expenditure and therefore does not reduce the profit.***
- *The left hand side (Equity section) forms the basis for the preparation of the statement of profit or loss and other comprehensive income and the statement of changes in equity.*
- *The capital (Equity section) and the right hand side (ASSETS and LIABILITIES) form the basis for the preparation of the statement of financial position.*

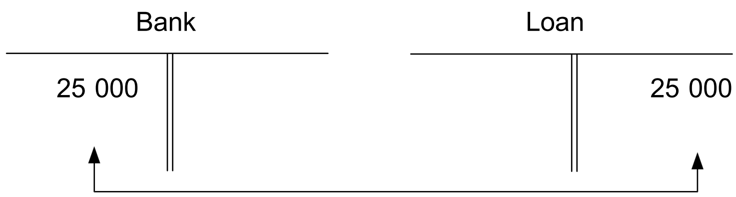
4.12 Recording of transactions in ledger accounts

When we enter a transaction in a ledger account, we have to ask ourselves: Which accounts are affected? In answer to this question, we are now going to record the transactions in paragraphs 4.4 and 4.5 in the ledger accounts (T-accounts).

Transaction
(4.4.1)



(4.4.2)



(4.4.3)

Equipment		Bank	
100 000			100 000

(4.4.4)

Furniture		Trade payables (Joc Ltd)	
2 000			2 000

(4.4.5)

Bank		Trade payables (Joc Ltd)	
	2 000	2 000	

(4.4.6)

Bank		Drawings	
	1 000	1 000	

COMMENT

All drawings by the owner are recorded in a separate account, namely ***''Drawings''****, and not directly in the capital account. Drawings is a disbursement of the profit to the owner and is not expenses resulting from business operations.*

(4.5.1)

Bank		Income (fees)	
1 000			1 000

(4.5.2)

Bank		Wages	
	800	800	

(4.5.3)

Trade receivables (C Canon)	
6 000	

Income (fees)	
	6 000

(4.5.4)

Trade payables	
	200

Advertisements	
200	

(4.5.5)

Bank	
2 000	

Trade receivables (C Canon)	
	2 000

4.13 The general ledger

In the previous example two accounts were opened each time for each transaction. In practice all transactions which affect, say, bank are summarised in one account for bank. Given the information we have above, the accounts will take the following form. Each one is closed off and the balance determined.

> **GOLDEN RULE**
>
> Assets (eg Bank) increase on the Debit (Dr) side and decrease on the Credit (Cr) side of the account.

Dr Bank **Cr**

Date	Details	Fol	Amount	Date	Details	Fol	Amount
20.1			**R**	**20.1**			**R**
Feb 1	Capital		130 000	Feb 6	Equipment		100 000
2	Loan:ABC Bank		25 000	11	Trade payables		2 000
13	Income received		1 000	12	Drawings		1 000
28	Trade receivables		2 000	16	Wages		800
				28	Balance	c/d	54 200
			158 000				158 000
20.1							
Mar 1	Balance	b/d	54 200				

Dr		Equipment					Cr
20.1			**R**				
Feb 6	Bank		100 000				

Dr		Furniture					Cr
20.1			**R**				
Feb 10	Creditors		2 000				

Dr		Trade receivables					Cr
20.1			**R**	**20.1**			**R**
Feb 18	Income received		6 000	Feb 28	Bank		2 000
					Balance	c/d	4 000
			6 000				6 000
20.1 Mar 1	Balance	b/d	4 000				

GOLDEN RULE

Equity (eg Capital) and Liabilities (eg Creditors) increase on the credit (Cr) side and decrease on the debit (Dr) side of the account.

GOLDEN RULE

Income (eg Sales) increases equity and are credited (Cr) to the particular income account.

GOLDEN RULE

Expenses (eg Wages) decreases equity and are debited (Dr) to the particular expense account.

Dr Capital **Cr**

				20.1			**R**
				Feb 1	Bank		130 000

Dr Drawings **Cr**

20.1			**R**				
Feb 12	Bank		1 000				

Dr Loan: ABC Bank **Cr**

				20.1			**R**
				Feb 2	Bank		25 000

Dr Trade payables **Cr**

20.1			**R**	**20.1**			**R**
Feb 11	Bank		2 000	Feb 10	Furniture		2 000
28	Balance c/d		200	21	Advertisements		200
			2 200				2 200
				20.1			
				Mar 1	Balance b/d		200

Dr Wages **Cr**

20.1			**R**				
Feb 16	Bank		800				

Dr Advertisements **Cr**

20.1			**R**				
Feb 21	Creditors		200				

Dr Income (fees) **Cr**

				20.1			**R**
				Feb 13	Bank		1 000
				18	Debtors		6 000
							7 000

COMMENT

- *Note that the details of an item in a ledger account is simply the name of the other ledger account involved in the transaction. This other ledger account is known as the contra ledger account.*

4.14 The trial balance

Study paragraph 4.5 of the prescribed book.

A trial balance is a list of the balances brought down (b/d) of the accounts in the general ledger on a specific date.

GOLDEN RULE

The balance ''brought down'' (b/d) must be used to prepare the trial balance.

The following trial balance has been prepared from the ledger accounts in paragraph 4.13.

FIX-'N-MAT

TRIAL BALANCE AS AT 28 FEBRUARY 20.1

	Dr	Cr
	R	**R**
Bank	54 200	
Equipment	100 000	
Furniture	2 000	
Trade receivables	4 000	
Capital		130 000
Drawings	1 000	
Loan		25 000
Trade payables		200
Wages	800	
Advertisements	200	
Income received		7 000
	162 200	162 200

GOLDEN RULE

Asset and expense accounts have debit (Dr) balances brought down (b/d) and are entered on the debit side of the trial balance.

GOLDEN RULE

Equity (capital), liability and income accounts have credit (Cr) balances brought down (b/d) and are entered on the credit side of the trial balance.

COMMENTS

- *The trial balance balances.*
- *Note that an account with a debit balance (brought down) is shown on the debit side of the trial balance and an account with a credit balance (brought down) on the credit side.*
- *If we compare the totals of the trial balance with the totals of the columns of the BAE (see paragraph 4.6), we note the following:*
  - *Capital in the BAE is R129 000. In the trial balance capital, R130 000 (Cr), and drawings, R1 000 (Dr), are shown separately. This also gives a net total of R129 000.*
  - *Income less expenditure = R6 000. If the expenses in the trial balance, namely wages and advertisements with debit balances of R800 and R200 respectively, are subtracted from the income, namely fees with a credit of R7 000, the net amount is R(7 000 − 1 000) = R6 000 credit, which corresponds to the income in the BAE.*

4.15 Preparing financial statements

In this module we deal with the statement of financial position, statement of profit or loss and other comprehensive income and statement of changes in equity as well as some of the notes. The statement of cash flows will be dealt with in FAC1601.

As mentioned previously, the trial balance serves as a basis for preparing a statement of profit or loss and other comprehensive income, statement of changes in equity, and statement of financial position. The trial balance represents the information in the ledger. The statement of profit or loss and other comprehensive income shows the entity's financial result and the statement of financial position shows its financial position.

Study paragraphs 4.6 and 4.7 of the prescribed book.

4.15.1 The statement of profit or loss and other comprehensive income

We now use the information from the trial balance in paragraph 4.14 above to prepare a statement of profit or loss and other comprehensive income for Fix-'n-Mat.

FIX-'N-MAT

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE MONTH ENDED 28 FEBRUARY 20.1

	Note	R
Revenue		7 000
Distribution, administrative and other expenses		(1 000)
Wages		800
Advertisements		200
Profit for the period		6 000
Other comprehensive income for the period		—
Total comprehensive income for the period		6 000

COMMENTS

- *Note the title. A statement of profit or loss and other comprehensive income is prepared for **a period ended**, not on a certain date.*
- *The profit for the period as determined in the statement of profit or loss and other comprehensive income corresponds to the income/expenditure column in the BAE.*
- *The income and expenditure accounts are called **nominal accounts**.*

GOLDEN RULE

Revenue (comprising income accounts) less expenses result in a profit or loss.

4.15.2 The statement of changes in equity

This statement shows all the changes in equity which have occurred during the financial period. The purpose of the statement of changes in equity is to reconcile the equity at the beginning of the financial period with the equity at the end of the financial period. The balance of the equity at the end of the financial period is then shown in the statement of financial position. Equity will be discussed in more detail later in this study guide.

FIX-'N-MAT

STATEMENT OF CHANGES IN EQUITY FOR THE MONTH ENDED 28 FEBRUARY 20.1

	Capital
	R
Balance at 1 February 20.1	130 000
Total comprehensive income for the period	6 000
Drawings	(1 000)
Balance at 28 February 20.1	135 000

GOLDEN RULE

The profit increases equity and a loss decreases equity.

COMMENTS

- *Note that the statement of changes in equity is prepared for **a period ended** and not on a specific date.*
- *The equity at the end of the month corresponds to the net total in the BAE in paragraph 4.6.*

GOLDEN RULE

The balance at the end of the period on the statement of changes in equity must be the same as the ''capital'' reflected in the statement of financial position.

4.15.3 The statement of financial position

Before we prepare a statement of financial position, please refer to paragraph 2.5 and also to the statement of financial position for Fix-'n-Mat which we compiled in paragraph 4.7.

We will now show the statement of financial position of Fix-'n-Mat in narrative form and in compliance with IFRS.

FIX-'N-MAT

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1

	Note	R
ASSETS		
Non-current assets		102 000
Property, plant and equipment	3	102 000
Current assets		58 200
Trade and other receivables		4 000
Cash and cash equivalents (bank)		54 200
Total assets		160 200
EQUITY AND LIABILITIES		
Total equity		135 000
Capital		135 000
Total liabilities		25 200
Non-current liabilities		25 000
Long-term borrowings		25 000
Current liabilities		200
Trade and other payables		200
Total equity and liabilities		160 200

COMMENTS

- *See paragraph 4.15.4, Notes, for the calculation of property, plant and equipment.*
- *The total assets of R160 200 corresponds to the total as shown in the BAE in paragraph 4.6.*
- *The total equity and liabilities of R160 200 corresponds to the total as shown in the BAE in paragraph 4.6.*
- *Words and figures between brackets is for explaining purposes only and do not form part of any financial statement.*

GOLDEN RULES

- ASSETS are, at this stage, grouped into non-current and current assets.
- Non-current assets do not change often and are used in ordinary business, production or to render services.
- Current assets change after every operating transaction, thus very often.
- EQUITY (the interest of the owner(s) in the entity) comprise, at this stage, of capital only.
- LIABILITIES comprise, at this stage, non-current and current liabilities
- Non-current liabilities are to be paid after 12 months and do not change often. Current liabilities are short term, change often and must be repaid within 12 months.

4.15.4 Notes

Additional information on items appearing in the financial statements is given in the notes to the financial statements.

These explanatory notes are shown after the statement of cash flows. We do not deal with the statement of cash flows in this module and will therefore show the notes after the statement of profit or loss and other comprehensive income.

Note number 1 is used to reveal the accounting policies of the business. Now let us prepare the notes of Fix-'n-Mat.

FIX 'N MAT

NOTES FOR THE MONTH ENDED 28 FEBRUARY 20.1

1. Accounting policy:

   The financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.
2. Revenue represents fees earned for services rendered to clients.

3.

Property, plant and equipment	**Equipment**	**Furniture**	**Total**
	R	**R**	**R**
Carrying amount: Beginning of period	—	—	—
Cost	—	—	—
Accumulated depreciation	—	—	—
Additions	100 000	2 000	102 000
Depreciation	—	—	—
Carrying amount: End of period	100 000	2 000	102 000
Cost	100 000	2 000	102 000
Accumulated depreciation	—	—	—

No depreciation was written off during this financial period.

4.16 Summary

We began by explaining the financial position (statement of financial position) and financial performance (statement of profit or loss and other comprehensive income) and then went back to how we enter into a transaction to set the accounting process in motion.

4.17 Revision exercises and solutions

4.17.1 Revision exercise 1

(1) Name the three groups of accounts in the general ledger.
(2) What is the difference between the total debits and the total credits of an account called?
(3) How do we test the arithmetical accuracy of transactions in the general ledger?

Solution: Revision exercise 1

(1) • Assets
- Liabilities
- Equity, which includes:
  - capital
  - drawings
  - income
  - expenditure

(2) Balance
(3) By preparing a trial balance

4.17.2 Revision exercise 2

List each of the following ledger accounts under one of the categories in the table below. "Furniture" is inserted as an example.

ASSETS		EQUITY			LIABILITIES	
Non-current assets	**Current assets**	**Capital**	**Income**	**Expenditure**	**Non-current liabilities**	**Current liabilities**
Furniture						

Ledger accounts to be classified:

(a) Land and buildings
(b) Bond
(c) Petty cash
(d) Postage
(e) Interest income
(f) Vehicles
(g) Salaries
(h) Trade receivables
(i) Trade payables
(j) Bank overdraft
(k) Income received
(l) Electricity deposit
(m) Drawings
(n) Subscriptions (e.g. Membership fees)

Solution: Revision exercise 2

	ASSETS		EQUITY			LIABILITIES	
	Non-current assets	**Current assets**	**Capital**	**Income**	**Expenditure**	**Non-current liabilities**	**Current liabilities**
(a)	Land and buildings						
(b)						Bond	
(c)		Petty cash					
(d)					Postage		
(e)				Interest income			
(f)	Vehicles						
(g)					Salaries		
(h)		Trade receivables					
(i)							Trade payables
(j)							Bank overdraft
(k)				Income received			
(l)		Electricity deposit					
(m)			Drawings				
(n)					Subscriptions		

4.17.3 Revision exercise 3

The following transactions during February 20.1 relate to G Goodman, a dentist:

Date	Transactions	Amount
20.1		**R**
Feb 1	G Goodman deposited as opening capital	50 000
2	G Goodman transferred personal equipment to his firm	6 000
4	Paid rental for February by cheque	8 000
6	Bought furniture on credit from Badman	12 000
8	Rendered services on credit to R Rudman	30 000
12	G Goodman drew a cheque for private use	1 000
16	Issued a cheque to Badman in part payment of their account	5 000
20	Rendered services for cash to C Coleman	7 000
27	Received payment from R Rudman on his account	1 300
28	Paid the following by cheque:	
	(i) Salaries	10 000
	(ii) Wages	2 000
	(iii) Telephone	500

Required:

Record the above transactions using a table as illustrated in the following example:

Feb 28 G Goodman paid the water and electricity account by cheque — R600.

Date	General ledger		A	=	E	+	L	
20.1 Feb	Account debited	Account credited	Dr	Cr	Dr	Cr	Dr	Cr
			R	R	R	R	R	R
28	Water and electricity	Bank		600	600			

Solution: Revision exercise 3

G GOODMAN

Date	General ledger		A =		E +		L	
20.1 Feb	Account debited	Account credited	Dr	Cr	Dr	Cr	Dr	Cr
			R	R	R	R	R	R
1	Bank	Capital	50 000			50 000		
2	Equipment	Capital	6 000			6 000		
4	Rent expenses	Bank		8 000	8 000			
6	Furniture	B Badman	12 000					12 000
8	R Rudman	Income received	30 000			30 000		
12	Drawings	Bank		1 000	1 000			
16	B Badman	Bank		5 000			5 000	
20	Bank	Income received	7 000			7 000		
27	Bank	R Rudman	1 300	1 300				
28	Salaries	Bank		10 000	10 000			
	Wages	Bank		2 000	2 000			
	Telephone expenses	Bank		500	500			

4.17.4 Revision exercise 4

The following transactions during October 20.1 relate to Witblits Electricians:

Date	Transactions	Amount
20.1		**R**
Oct 1	W Blits, the owner, deposited as opening capital	10 000
	Obtained loan from SA Bank	6 000
3	Bought equipment on credit from Sparks Dealers	1 000
9	Issued a cheque for an advertisement in a local newspaper	200
12	Paid the telephone account by cheque	75
13	Received a cheque from H House for services rendered	500
17	Drew a cheque for private use	2 000
24	As an additional capital contribution W Blits transfered his motor vehicle to the business	9 000
27	Paid salaries by cheque	2 000
30	Issued a cheque to SA Bank as a repayment on the loan	1 500

Required:

Prepare the following in the accounting records of Witblits Electricians:

(1) The appropriate ledger accounts which reflect the above transactions, properly balanced/closed on 31 October 20.1.

NB: Indicate the correct contra ledger account.

(2) The trial balance on 31 October 20.1.

Solution: Revision exercise 4

WITBLITS ELECTRICIANS

(1) GENERAL LEDGER

Dr Capital: W Blits **Cr**

				20.1			**R**
				Oct 1	Bank		10 000
				24	Vehicles		9 000
							19 000

Dr Drawings: W Blits **Cr**

20.1			**R**				
Oct 17	Bank		2 000				

Dr Equipment (at cost) **Cr**

20.1			**R**				
Oct 3	Sparks Dealers		1 000				

Dr Vehicles (at cost) **Cr**

20.1			**R**				
Oct 24	Capital: W Blits		9 000				

Dr Bank **Cr**

20.1			**R**	**20.1**			**R**
Oct 1	Capital		10 000	Oct 9	Advertisements		200
	Long-term loan		6 000	12	Telephone expenses		75
13	Income received		500	17	Drawings: W Blits		2 000
				27	Salaries		2 000
				30	Long-term loan		1 500
				31	Balance	c/d	10 725
			16 500				16 500
20.1							
Nov 1	Balance	b/d	10 725				

Dr Long-term borrowing (SA Bank) **Cr**

20.1			**R**	**20.1**			**R**
Oct 30	Bank		1 500	Oct 1	Bank		6 000
31	Balance	c/d	4 500				
			6 000				6 000
				20.1			
				Nov 1	Balance	b/d	4 500

Dr Sparks Dealers **Cr**

				20.1			**R**
				Oct 3	Equipment		1 000

Dr Advertisements **Cr**

20.1			**R**				
Oct 9	Bank		200				

Dr Income received **Cr**

				20.1			**R**
				Oct 13	Bank		500

Dr Salaries **Cr**

20.1			**R**				
Oct 27	Bank		2 000				

Dr Telephone expenses **Cr**

20.1			**R**				
Oct 12	Bank		75				

WITBLITS ELECTRICIANS

(2) TRIAL BALANCE AS AT 31 OCTOBER 20.1

	Dr R	Cr R
Capital — W Blits		19 000
Drawings — W Blits	2 000	
Equipment (at cost)	1 000	
Vehicles (at cost)	9 000	
Bank	10 725	
Long-term loan (SA Bank)		4 500
Sparks Dealers		1 000
Income received		500
Advertisements	200	
Salaries	2 000	
Telephone expenses	75	
	25 000	25 000

4.17.5 Revision exercise 5

The following transactions during March 20.1 relate to P Victor, an attorney:

Date	Transactions	Amount
20.1		**R**
Mar 3	P Victor opened his firm of attorneys and deposited as opening capital	12 000
4	Paid rental for March	1 000
5	Bought a photocopier from Foto-Kop on credit	8 000
	Paid Foto-Kop by cheque	2 000
15	Rendered services on credit to U Wright	3 000
18	Received a cheque from U Wright	1 800
21	Bought stationery from AA Dealers on credit	3 000
23	Deposited cash received for services rendered to U Wrong	1 200
25	Paid on account to AA Dealers	1 500
30	Paid salaries by cheque	400
31	P Victor drew a cheque for private use	1 000

Required:

(1) Record the above transactions using a table as illustrated in the following example:

20.1
March 3 Paid telephone account by cheque — R1 000.

ASSETS				=	EQUITY +	LIABILITIES	
Date	Bank	Trade receiv-ables	Equip-ment		Capital	Income/ Expendi-ture	Trade payables
20.1	**R**	**R**	**R**		**R**	**R**	**R**
March 3	–1 000					–1 000	
Totals	–1 000					–1 000	

(2) Prepare the statement of changes in equity of P Victor for the month ended 31 March 20.1.

(3) Prepare P Victor's statement of financial position as at 31 March 20.1 in narrative form.

(4) Show the accounting policy and the property, plant and equipment notes.

Solution: Revision exercise 5

P VICTOR

(1) TRANSACTION ANALYSIS

ASSETS				=	EQUITY		+	LIABILITIES
Date	**Bank**	**Trade receivables**	**Equipment**		**Capital**	**Income/ Expenditure**		**Trade payables**
20.1	**R**	**R**	**R**		**R**	**R**		**R**
Mar 3	+ 12 000				+ 12 000			
4	– 1 000					– 1 000		
5			+ 8 000					+ 8 000
	– 2 000							– 2 000
15		+ 3 000				+ 3 000		
18	+ 1 800	– 1 800						
21						– 3 000		+ 3 000
23	+ 1 200					+ 1 200		
25	– 1 500							– 1 500
30	– 400					– 400		
31	– 1 000				– 1 000			
	+ 9 100	+ 1 200	+ 8 000	=	+ 11 000	– 200	+	+ 7 500

R18 300 R18 300

P VICTOR

(2) STATEMENT OF CHANGES IN EQUITY FOR THE MONTH ENDED 31 MARCH 20.1

	Capital R
Capital contribution from owner	12 000
Total comprehensive loss for the period	(200)
Drawings	(1 000)
Balance at 31 March 20.1	10 800

P VICTOR

(3) STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20.1

ASSETS	Note	R
Non-current assets		8 000
Property, plant and equipment	2	8 000
Current assets		10 300
Trade and other receivables		1 200
Cash and cash equivalents (bank)		9 100
Total assets		18 300
EQUITY AND LIABILITIES		
Total equity		10 800
Capital		10 800
Current liabilities		7 500
Trade and other payables		7 500
Total equity and liabilities		18 300

P VICTOR

(4) NOTES FOR THE MONTH ENDED 31 MARCH 20.1

1. Accounting policy:

The financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

2.

Property, plant and equipment	**Equipment**	**Total**
	R	**R**
Carrying amount: Beginning of period	—	—
Cost	—	—
Accumulated depreciation	—	—
Additions	8 000	8 000
Depreciation	—	—
Carrying amount: End of period	8 000	8 000
Cost	8 000	8 000
Accumulated depreciation	—	—

No depreciation was written off during the month.

SELF-ASSESSMENT

Now that you have studied this study unit, can you prepare the following:

- ledger accounts?
- a trial balance?
- a basic statement of profit or loss and other comprehensive income?
- a statement of changes in equity?
- a basic statement of financial position?
- certain notes to the financial statements?

TOPIC B

COLLECTING AND PROCESSING THE ACCOUNTING DATA OF ENTITIES

Learning outcome

The learner should be able to collect, process, adjust (where necessary) and record financial information in order to complete the statement of profit or loss and other comprehensive income (thereby calculating the gross and net profits) and statement of changes in equity for the financial period and the statement of financial position at the end of the financial period, of a sole proprietor.

CONTENTS

STUDY UNIT

5

Processing accounting data

Learning outcome

Students should be able to prepare all the journals, posting to ledger accounts and to prepare a trial balance.

Contents

KEY CONCEPTS

- Source documents
- Accounting cycle
- Cash receipts journal
- Cash payments journal
- Purchases journal
- Purchases returns journal
- Sales journal
- Sales returns journal
- General journal
- Output VAT
- General ledger
- Trade receivables ledger
- Trade payables ledger
- Comprehensive taxation
- Vendor
- Taxable supplies
- Exempted supplies
- Settlement discount
- Value added tax (VAT)
- Input VAT

5.1 Introduction

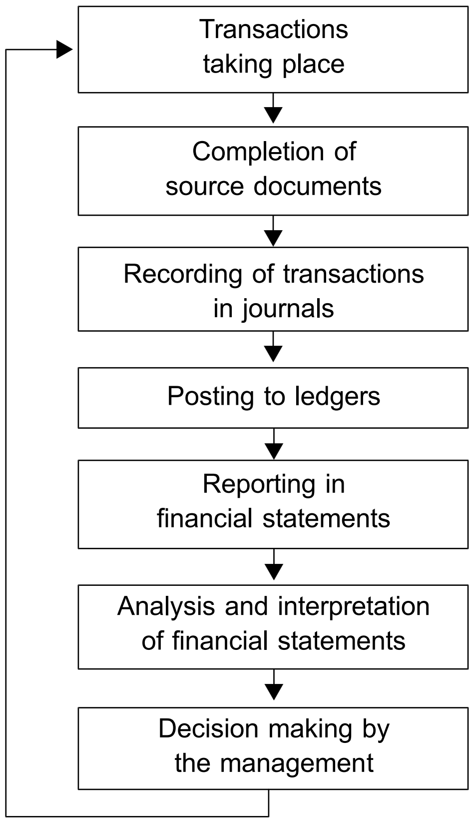
In the previous study units you learnt how to analyse transactions and to determine their effect on the basic accounting equation. We then recorded all the transactions in the accounts in the general ledger and we explained the principle of the double-entry system and emphasised how important it is. This created a framework in which to study the processing of accounting data in greater detail and this is what we are going to look at next.

Study paragraph 5.1 of the prescribed book.

5.2 The accounting cycle

Accounting data are processed within a definite framework which is known as the accounting cycle.

The following diagram shows the accounting cycle:



5.3 Books of first entry: journals

Because of the large number of transactions that take place in an entity, it is not practical to record each transaction directly in the ledger. This makes the ledger very bulky and unmanageable and in a manual system it means that only one person can write up the books.

This led to the use of subsidiary journals or books of first entry in which transactions of the same type are grouped together and analysed before being recorded in summarised form in the ledger. A journal is thus a link between source documents and the ledger. **No transaction may be recorded in the ledger before it has been recorded in a journal.**

> **Study** paragraph 5.2 of the prescribed book.

5.4 Types of journals

There are various types of journals or books of first entry but for the time being we will be concentrating on the following:

- **the cash receipts journal and the cash payments journal** in which all cash transactions are recorded
- **the purchases journal and the purchases returns journal** in which all credit purchases and returns of credit purchases are recorded
- **the sales journal and the sales returns journal** in which all credit sales and returns of credit sales are recorded
- **the general journal** in which transactions are recorded which are not recorded in one of the other journals, for example the correction of errors and the writing off of credit losses (bad debts)

5.5 Cash journals

5.5.1 Cash receipts journal

All moneys received which is deposited in the entity's bank account is recorded in the cash receipts journal. At the end of the month only one amount, which represents the entire month's cash receipts, is debited to the bank account. The other column totals represent the contra accounts and are credited to such accounts. The amounts in the sundry accounts column are credited individually to the relevant accounts.

> **Study** paragraph 5.3.1 of the prescribed book.

Let us now go back to the information we had for Fix-'n-Mat in study unit 4. Fix-'n-Mat's cash receipts journal and ledger accounts would look as follows:

FIX-'N-MAT

CASH RECEIPTS JOURNAL — FEBRUARY 20.1 *CRJ1*

Document number	Day	Details	Analysis of receipts	Bank	Current income	Sundry accounts: Amount	Sundry accounts: Fol	Sundry accounts: Details
			R	R		R		
Rec 1	1	T Tom	130 000	130 000		130 000		Capital
2	2	ABC Bank	25 000	25 000		25 000		Loan: ABC Bank
3	13	S Silver	1 000	1 000	1 000			
4	28	C Canon	2 000	2 000		2 000		C Canon
				158 000	1 000	157 000		

Dr		Bank		Cr
20.1		**R**		
Feb 28	Receipts	158 000		

Dr		Capital		Cr
	20.1			**R**
	Feb 1	Bank		130 000

Dr		Fees earned		Cr
	20.1			**R**
	Feb 18	....		....
	28	Bank		1 000

Dr		Loan: ABC Bank		Cr
	20.1			**R**
	Feb 2	Bank		25 000

Dr		C Canon		Cr
20.1		**20.1**		**R**
Feb 18	....	Feb 28	Bank	2 000

COMMENTS

- *Source documents for entries in the cash receipts journal are the cash register roll, duplicate receipts, duplicate cash invoices and duplicate deposit slips.*
- *The cash receipts for the month are recorded and analysed in date order.*
- *Each amount received during the day is not banked immediately. Receipts are first recorded in the analysis of receipts column and the amount which is banked for that day is recorded in the bank column.*
- *Check the addition in the columns by cross-casting. In other words, when the totals of the analysis columns are added, they must equal the total in the bank column.*
- *Entries in the sundry accounts column are posted individually to the general ledger.*
- *Only the totals of the other columns are posted.*
- *The cash receipts journal is a book of first entry. The double-entry system has to be applied in the general ledger.*
- *The amounts are not recorded individually again in the bank account in the general ledger. Note that the credit entries in the accounts add up to R158 000, which corresponds to the debit entry in the bank account.*
- *The number and headings of columns in the journal will depend on the frequency of occurrence of transactions and can differ from one entity to the other.*

5.5.2 Cash payments journal

All cash payments, that is payments by cheque, are recorded in the cash payments journal. At the end of the month only one amount, which represents the entire month's cash payments, is credited to the bank account. The other column totals represent the contra accounts and are debited to such accounts. The amounts in the sundry accounts column are debited individually to the relevant accounts.

Study paragraph 5.3.2 of the prescribed book.

Fix-'n-Mat's cash payments journal and ledger accounts would look as follows:

FIX-'N-MAT

CASH PAYMENTS JOURNAL — FEBRUARY 20.1 *CPJ1*

Cheque number	Day	Details	Bank	Wages	Sundry accounts Amount	Fol	Details
			R	R	R		
1	6	XY Furnishers	100 000		100 000		Equipment
2	11	Joc Limited	2 000		2 000		Joc Limited
3	12	Cash	1 000		1 000		Drawings
4	16	Cash	800	800			
			103 800	800	103 000		

Dr Bank **Cr**

20.1		R	20.1		R
Feb 28			Feb 28	Payments	103 800

Dr Equipment **Cr**

20.1		R			
Feb 6	Bank	100 000			

Dr Wages **Cr**

20.1		R			
Feb 28	Bank	800			

Dr Joc Limited **Cr**

20.1		R	20.1		
Feb 11	Bank	2 000	Feb 10 ...		...

Dr Drawings **Cr**

20.1		R			
Feb 12	Bank	1 000			

The complete bank account will now take the following form:

Dr Bank **Cr**

20.1			R	20.1			R
Feb 28	Receipts	CRJ1	158 000	Feb 28	Payments	CPJ1	103 800
					Balance	c/d	54 200
			158 000				158 000
20.1							
Mar 1	Balance	b/d	54 200				

Note that this balance is the same as the bank balance we calculated using the BAE in paragraph 4.6 and the bank account in paragraph 4.13 of study unit 4.

COMMENTS

- *Source documents for entries in the cash payments journal are cheque counterfoils and debit notes, or the bank statement issued by the bank.*
- *Entries are recorded and analysed in the cash payments journal in the same order as the cheque numbers.*
- *The amount which is written on the cheque is the amount which is recorded in the bank column.*
- *Check whether the adding of the columns is correct by cross-casting. In other words, when the totals of the analysis columns are added, they must equal the total of the bank column.*

- *Entries in the sundry accounts column are posted individually to the general ledger.*
- *Only the totals of the other columns are posted.*
- *The amounts are not recorded individually again in the bank account in the general ledger.*
- *The cash payments journal is a book of first entry. The double-entry system has to be applied in the general ledger.*
- *More analysis columns can be included as is required by the organisation.*

Exercise 5.1

Ms Beauty Baloyi opens a hairdressing salon, Beauty's Hair, on 1 June 20.3 and enters into the following transactions during June:

20.3

Jun	1	Deposited R10 000 in the business's bank account Paid the month's rental by cheque to Huurtru, R1 000. Paid the water and electricity deposit, R500.
	2	Bought R2 500 worth of equipment and R845 worth of consumable inventory from Head Suppliers and paid by cheque, R3 345.
	5	Fees received for services rendered, R350.
	7	Drew a cheque and paid the assistant's wages, R200.
	10	Cash banked for services rendered, R556.
	14	Drew a cheque for R500 to pay the week's wages, R200, the remainder being for Ms Baloyi's own use.
	15	Cash register roll total for services rendered, R642.
	17	Bought stationery from Office Suppliers, R80 and paid by cheque.
	19	Fees received for services rendered, R438.
	21	Paid the week's wages, R200.
	22	Bought shampoo and other requirements from Head Suppliers and paid by cheque, R550.
	24	Cash register roll total for services rendered, R387.
	25	Issued a cheque to Telkom to pay the telephone account, R260, which included installation costs of R180.
	28	Cashed a cheque for R1 500. R1 300 was for the owner's own use and R200 was for wages.
	30	Cash banked for services rendered, R875.

Required:

(1) Prepare the cash receipts journal for Beauty's Hair for June 20.3.

(2) Prepare the cash payments journal for Beauty's Hair for June 20.3.

(3) Show the postings from these journals to the general ledger accounts.

(4) Prepare the trial balance as at 30 June 20.3.

BEAUTY'S HAIR

(1) CASH RECEIPTS JOURNAL — JUNE 20.3 *CRJ1*

Document number	Day	Details	Analysis of receipts	Bank	Current income	Sundry accounts Amount	Fol	Details
Rec 1	1	B Baloyi	10 000	10 000		10 000	B4	Capital
CRR 1	5	Service fee	350	350	350			
CRR 2	10	Service fee	556	556	556			
CRR 3	15	Service fee	642	642	642			
CRR 4	19	Service fee	438	438	438			
CRR 5	24	Service fee	387	387	387			
CRR 6	30	Service fee	875	875	875			
				13 248	3 248	10 000		
				B3	N1			

(CRR = Cash register roll)

BEAUTY'S HAIR

(2) CASH PAYMENTS JOURNAL — JUNE 20.3 *CPJ1*

Cheque number	Day	Details	Bank	Consumable inventory	Wages	Sundry accounts Amount	Fol	Details
1	1	Huurtru	1 000			1 000	N2	Rental expenses
2		City Treasurer	500			500	B2	Water and electricity deposit
3	2	Head Suppliers	3 345	845		2 500	B1	Equipment
4	7	Cash	200		200			
5	14	Cash	500		200	300	B5	Drawings
6	17	Office Suppliers	80			80	N3	Stationery
7	21	Cash	200		200			
8	22	Head Suppliers	550	550				
9	25	Telkom	260			260	N4	Telephone expenses
10	28	Cash	1 500		200	1 300	B5	Drawings
			8 135	1 395	800	5 940		
			B3	N5	N6			

BEAUTY'S HAIR

(3) GENERAL LEDGER

Dr Equipment **B1** **Cr**

20.3			**R**				
Jun 2	Bank	CPJ1	2 500				

Dr Water and electricity deposit **B2** **Cr**

20.3			**R**				
Jun 1	Bank	CPJ1	500				

Dr Bank **B3** **Cr**

20.3			**R**	**20.3**			**R**
Jun 30	Receipts	CRJ1	13 248	Jun 30	Payments	CPJ1	8 135
					Balance	c/d	5 113
			13 248				13 248
20.3							
Jul 1	Balance	b/d	5 113				

Dr Capital **B4** **Cr**

				20.3			**R**
				Jun 1	Bank	CRJ1	10 000

Dr Drawings **B5** **Cr**

20.3			**R**				
Jun 14	Bank	CPJ1	300				
28	Bank	CPJ1	1 300				
			1 600				

Dr Current income **N1** **Cr**

				20.3			**R**
				Jun 30	Bank	CRJ1	3 248

Dr Rental expenses **N2** **Cr**

20.3			**R**				
Jun 1	Bank	CPJ1	1 000				

Dr Stationery **N3** **Cr**

20.3			**R**				
Jun 17	Bank	CPJ1	80				

Dr Telephone expenses **N4** **Cr**

20.3			**R**				
Jun 25	Bank	CPJ1	260				

Dr		Consumable inventory				N5	Cr
20.3			**R**				
Jun 30	Bank	CPJ1	1 395				

Dr		Wages				N6	Cr
20.3			**R**				
Jun 30	Bank	CPJ1	800				

BEAUTY'S HAIR

(4) TRIAL BALANCE AS AT 30 JUNE 20.3

	Fol	**Debit**	**Credit**
		R	**R**
Equipment	B1	2 500	
Water and electricity deposit	B2	500	
Bank	B3	5 113	
Capital	B4		10 000
Drawings	B5	1 600	
Current income	N1		3 248
Rental expenses	N2	1 000	
Stationery	N3	80	
Telephone expenses	N4	260	
Consumable inventory	N5	1 395	
Wages	N6	800	
		13 248	13 248

COMMENTS

- *The B numbers indicate the statement of financial position accounts and the N numbers, the nominal accounts. Nominal accounts are income and expenditure accounts while statement of financial position accounts are capital, asset and liability accounts.*
- *In the folio column in the ledger, the cash receipts or cash payments journal is given as a reference, but in the details column the names of the contra ledger accounts are entered.*
- *The summarising effect of the subsidiary journals can be clearly seen in the ledger. Note the entries in the bank account and the current income account.*

5.6 Credit journals and the general journal

5.6.1 Introduction

In many business entities goods are bought and sold on credit. In the process, accounts have to be opened for debtors and creditors. If all these accounts are included in the general ledger, the same sort of problem arises that we have already mentioned — the ledger becomes too bulky and unmanageable and in a manual system only one person can write up the books. For this reason a **trade receivables ledger** and a **trade payables ledger** are opened in which the individual debtors' and creditors' accounts are kept. A single account is then held in the general ledger for debtors, namely a **trade receivables control account**, and one for creditors, namely a **trade payabless control account**. This means that the entire accounting system is adapted to make provision for the control accounts. In the cash receipts journal and the cash payments journal provision is made for additional columns for trade receivables control and trade payables control.

You can read more about the trade receivables control and the trade payables control accounts in study units to follow,

Study paragraph 5.3.3 of the prescribed book.

5.6.2 Inventory systems

We distinguish between the periodic inventory system and the perpetual inventory system, which will be dealt with in detail in study unit 7. At this stage all you need to know is that inventory in trade (merchandise) which is purchased has to be debited to a **purchases** account if a **periodic system** is being used. Provision must therefore be made for a purchases column in the subsidiary journal. If a **perpetual inventory** system is used, inventory in trade (merchandise) is debited to the **inventory account** and an inventory column is required instead of a purchases column in the subsidiary journals.

5.6.3 Purchases journal and purchases returns journal

Merchandise purchased on credit is recorded in the purchases journal. At the end of the month only the total credit purchases for the month is debited to the purchases account and credited to the trade payables control account. If some of the goods are returned, they are recorded in the purchases returns journal.

NB: For the purpose of this module, only **merchandise purchased on credit** is recorded in the purchases journal. All other credit purchases are recorded in the general journal.

Trade discount is often allowed by a wholesaler to a retailer. The discount percentage that is agreed upon, is calculated and deducted on the cash or credit invoice. The net amount on the invoice is recorded as the amount of purchases in the accounting records of the purchaser. Thus, the **trade** discount amount is never recorded in the accounting records of the purchaser.

To encourage a debtor to pay his/her account within a certain period, a **cash** discount option is given to the debtor. If the account is settled within the stipulated period, the discount will be recorded in the settlement discount granted account in the sellers' accounting records and the settlement discount received account in the buyers' accounting records. The full amount of the invoice must be paid if the account is not settled within the stipulated period.

Study paragraphs 9.3 and 13.6 of the prescribed book.

A purchases journal and purchases returns journal have the following formats:

ABC DEALERS

PURCHASES JOURNAL — MAY 20.3 *PJ5*

Invoice No	Day	Details	Fol	Purchases	Trade payables
				R	R
1534	3	Grand Wholesalers	CL2	1 258	1 258
1535	7	XY Company	CL3	983	983
1536	11	AA Limited	CL1	2 324	2 324
1537	14	XY Company	CL3	437	437
1538	21	XY Company	CL3	1 212	1 212
1539	25	Grand Wholesalers	CL2	538	538
1540	30	AA Limited	CL1	215	215
				6 967	6 967

ABC DEALERS

PURCHASES RETURNS JOURNAL — MAY 20.3 *PRJ5*

Credit note No	Day	Details	Fol	Purchases returns	Trade payables
				R	R
C115	10	Grand Wholesalers	CL2	158	158
C116	27	XY Company	CL3	114	114
				272	272

GENERAL LEDGER

Dr Purchases **Cr**

20.3		**R**			
May 31	Creditors	6 967			

Dr Trade payables control **Cr**

20.3		**R**	**20.3**		**R**
May 31	Purchases returns	272	May 31	Purchases	6 967

Dr Purchases returns **Cr**

			20.3		**R**
			May 31	Creditors	272

TRADE PAYABLES LEDGER

Date	Details	Fol	Debit	Credit	Balance
20.3			R	R	R
May					

AA Limited **CL1**

Date	Details	Fol	Debit	Credit	Balance
11	Inv 1536	PJ5		2 324	2 324
30	Inv 1540	PJ5		215	2 539

Grand Wholesalers **CL2**

Date	Details	Fol	Debit	Credit	Balance
3	Inv 1534	PJ5		1 258	1 258
10	Credit note C 115	PRJ5	158		1 100
25	Inv 1539	PJ5		538	1 638

XY Company **CL3**

Date	Details	Fol	Debit	Credit	Balance
7	Inv 1535	PJ5		983	983
14	Inv 1537	PJ5		437	1 420
21	Inv 1538	PJ5		1 212	2 632
27	Credit note C 116	PRJ5	114		2 518

COMMENTS

- *The source documents for entries in the purchases journal are **original invoices**. Because these invoices come from different businesses, they are renumbered consecutively.*
- *The source documents for entries in the purchases returns journal are the **original** credit notes received from the creditors and they must be renumbered consecutively.*
- *Entries are recorded and analysed in date order in the purchases journal and purchases returns journal.*
- *The creditor's name and the amount for which purchases or returns were made must be clearly shown.*
- *Only the totals of the columns are posted to the general ledger.*
- *The amounts in the purchases and the creditors columns are the same in the purchases journal because we are still ignoring VAT. The same applies for purchases returns.*
- *The creditors' accounts are individually credited in the trade payables ledger with purchases and debited with returns. A three-column ledger is preferable to the traditional T-account format because the balance can be calculated after each transaction.*
- *The total of all the balances of the individual creditor's accounts **must** correspond with the balance of the trade payables control account.*
- *The purchases journal and purchases returns journal are books of first entry. The double-entry procedure has to be applied in the general ledger.*

5.6.4 Sales journal and sales returns journal

Merchandise sold on credit is recorded in the sales journal. At the end of the month only the total credit sales for the month are credited to the sales account and debited to the trade receivables control account. If the debtors return some of the goods, they are recorded in the sales returns journal.

NB: For the purposes of this module, only **merchandise** sold on credit is recorded in the sales journal. All other credit sales are recorded in the general journal.

Study paragraphs 5.3.3.3 and 5.3.3.4 of the prescribed book.

A sales journal and sales returns journal have the following formats:

ABC DEALERS

SALES JOURNAL — MAY 20.3 *SJ3*

Invoice No	Day	Details	Fol	Sales	Debtors
				R	R
2018	2	M Moloi	DL4	268	268
2019	5	A Abdul	DL1	315	315
2020	12	G Green	DL3	424	424
2021	14	E Els	DL2	176	176
2022	17	G Green	DL3	587	587
2023	21	M Moloi	DL4	643	643
2024	29	E Els	DL2	269	269
2025	30	A Abdul	DL1	103	103
				2 785	2 785

ABC DEALERS

SALES RETURNS JOURNAL — MAY 20.3 *SRJ3*

Credit Note No	Day	Details	Fol	Sales returns	Trade receiv-ables
				R	**R**
D223	8	M Moloi	DL4	75	75
D224	19	G Green	DL3	114	114
D225	21	E Els	DL2	92	92
				281	281

GENERAL LEDGER

Dr Sales **Cr**

			20.3		**R**
			May 31	Trade receiv-ables	2 785

Dr Trade receivables control **Cr**

20.3		**R**	**20.3**		**R**
May 31	Sales	2 785	May 31	Sales returns	281

Dr Sales returns **Cr**

20.3		**R**			
May 31	Trade receiv-able	281			

TRADE RECEIVABLES LEDGER

Date	Details	Fol	Debit	Credit	Balance
20.3			**R**	**R**	**R**
May					

A Abdul DL1

5	Inv 2019		315		315
30	Inv 2025		103		418

E Els DL2

14	Inv 2021		176		176
21	Credit Note no D225			92	84
29	Inv 2024		269		353

G Green DL3

12	Inv 2020		424		424
17	Inv 2022		587		1 011
19	Credit Note no D224			114	897

M Moloi DL4

2	Inv 2018		268		268
8	Credit Note no D223			75	193
21	Inv 2023		643		836

COMMENTS

- *The source documents for entries in the sales journal are the* ***duplicates of sales invoices.***
- *The source documents for entries in the sales returns journal are the duplicates of credit notes issued to the debtors.*

- *The debtor's name and the amount of the transaction should be clearly indicated.*
- *Entries are recorded and analysed in date order in the sales journal and sales returns journal.*
- *Only the totals of the columns are posted to the general ledger.*
- *The amounts in the sales and the debtors columns are the same in the sales journal and sales returns journal, because we are still ignoring VAT. The effect of VAT will be explained later.*
- *The debtors' accounts are debited individually in the trade receivables ledger with sales, and credited with sales returns.*
- *The total of all the balances of the individual debtor's accounts* ***must*** *correspond with the balance of the trade receivables control account.*
- *The sales journal and sales returns journal are books of first entry; it is, in other words, a summary of sales and returns. The double-entry system has to be applied in the general ledger.*

5.6.5 General journal

All transactions which cannot be entered in one of the journals which we have discussed are entered in the **general journal.** Examples are credit losses (bad debts) which are written off, interest on debtors' accounts, errors which are corrected and year-end adjustments (which will be discussed in a later study unit).

Study paragraph 5.3.3.5 of the prescribed book.

NB: Purchases and sales of goods **other than merchandise** are recorded in the general journal for the purposes of this module.

A general journal takes the following form:

ABC DEALERS

GENERAL JOURNAL — MAY 20.3 *J3*

Date	Particulars	Fol	Debit	Credit
			R	R
5	Vehicles		43 000	
	ABC Bank			43 000
	Delivery vehicle bought on credit per invoice F147 from ORA Motors. The delivery vehicle was financed by obtaining a loan from ABC Bank at an interest rate of 9% per annum			
16	Packaging material		430	
	Stationery			430
	Packaging material per invoice Z214 incorrectly debited to stationery account			
18	Credit losses (Bad debts)		84	
	F Field			84
	F Field's balance written off as irrecoverable			

COMMENTS

- *The account which is entered first is the account which has to be debited in the general ledger.*
- *The narration is very important since it gives the reason for the entry and must also*

refer to source documents.

- *The general journal is a book of first entry. The double-entry system has to be applied in the general ledger.*
- *Theoretically all transactions can be recorded in the general journal.*

5.7 The trial balance

For each transaction, the debit entry must equal the credit entry. The total of all the debit balances should, therefore, correspond to the total of all the credit balances. A list of balances is prepared periodically to determine whether any errors have been made. This list of balances is called a trial balance.

Study paragraph 4.5 of the prescribed book again.

5.8 Revision exercise and solution

On 1 March 20.5 A Apple opened a supermarket under the tradename AA Supermarket. He decided to use the periodic inventory system and entered into the following transactions during March 20.5:

20.5

March 1 A Apple deposited R50 000 in the entity's current bank account as a capital contribution.

Paid rental by cheque to JHB Letting Agents, R2 000.

Bought shop equipment from EQUIP on credit, R10 000 and paid R1 000 as a deposit.

Issued a cheque to City Treasurer to pay the water and electricity deposit, R1 000.

2 Purchased merchandise on credit from TR Wholesalers, R23 541.

Purchased packaging material from S Suppliers and paid by cheque, R468.

3 Drew a cash cheque for cash float, R500.

4 Cash sales on opening day, R18 674.

5 Purchased merchandise on credit from the following wholesalers:

BB Dealers	R7 832
DBN Distributors	R6 965

6 Sublet a storeroom to G Gold and received his cheque for R250.

Cash sales per cash register roll, R12 455.

10 Drew a cheque to pay wages, R1 200.

12 Issued invoices to the following people for goods sold:

B Blue	R478
S Silver	R693.

13 Purchased merchandise from Z Zulu and paid by cheque, R5 378.

14 Purchased a computer from HI Q, R5 260. Issued a cheque for R1 478, which included a deposit of R1 000 and R478 for paper and computer supplies.

20.5

March	15	Sold on credit to the following people: G Green R324. R Red R299.
	16	Cash sales, R8 790.
	17	Drew a cash cheque for the following: Wages R1 500. Owner's own use R1 000.
	19	Received a cheque from B Blue, R200.
	20	Purchased merchandise from TR Wholesalers and paid by cheque, R2 675. Merchandise sold for cash, R12 570.
	21	Goods sold on credit: B Blue R362. R Red R178.
	23	S Silver paid R100 on his account. Cash sales, R10 238.
	24	Paid R550 to The Newsmaker for placing advertisements. Drew cash to pay wages, R1 500.
	25	Purchased stationery on credit from HI Q, R267. Issued a receipt to R Red for R299 in part payment of his account.
	27	Issued cheques to the following people in part settlement of their accounts: TR Wholesalers R20 000 BB Dealers R 6 000 DBN Distributors R 5 000 HI Q R 1 000
	29	Credit sales to S Silver, R262. He paid R200 on his account. Cash sales, R16 742.
	30	Issued cheques for the following: L Lemon, the manager's salary, R2 500 EQUIP on account, R1 000 JHB Letting Agents for rental for April, R2 000
	31	Issued a cheque to Telkom to pay the telephone account, R595 Cash sales, R15 284 Issued receipts to the following debtors for money received on their accounts: G Green R324 B Blue R640 Cashed a cheque for R3 000, to pay wages of R1 500, and the balance was for the owner's own use.

Required:

Prepare the following:

(1) The subsidiary journals of AA Supermarket for March 20.5

(2) The general, trade receivables and trade payables ledgers of AA Supermarket for March 20.5

(3) The trial balance of AA Supermarket as at 31 March 20.5
Ignore VAT.

Solution: Revision exercise

AA SUPERMARKET

(1) SUBSIDIARY JOURNALS

(a) CASH RECEIPTS JOURNAL — MARCH 20.5 *CRJ1*

Document number	Day	Details	Fol	Analysis of receipts	Bank	Sales	Trade receivables control	Sundry accounts		
								Amount	Fol	Details
				R	R	R	R	R		
Rec 1	1	A Apple		50 000	50 000			50 000	B7	Capital
CRR 1	4	Sales		18 674	18 674	18 674				
Rec 2	6	G Gold		250				250	N2	Rental income
CRR 2		Sales		12 455	12 705	12 455				
CRR 3	16	Sales		8 790	8 790	8 790				
Rec 3	19	B Blue	DL1	200	200		200			
CRR 4	20	Sales		12 570	12 570	12 570				
Rec 4	23	S Silver	DL2	100			100			
CRR 5		Sales		10 238	10 338	10 238				
Rec 5	25	R Red	DL4	299	299		299			
Rec 6	29	S Silver	DL2	200			200			
CRR 6		Sales		16 742	16 942	16 742				
CRR 7	31	Sales		15 284		15 284				
Rec 7		G Green	DL3	324			324			
Rec 8		B Blue	DL1	640	16 248		640			
					146 766	94 753	1 763	50 250		
					B5	N1	B3			

(b) CASH PAYMENTS JOURNAL — MARCH 20.5 *CPJ1*

Cheque number	Day	Details	Fol	Bank	Trade payables control	Purchases	Wages	Sundry accounts		
								Amount	Fol	Details
				R	R	R	R	R		
001	1	JHB Letting Agents		2 000				2 000	N8	Rental expenses
002		EQUIP	CL4	1 000	1 000					
003		City Treasurer		1 000				1 000	B2	Water and electricity deposit
004	2	S Suppliers		468				468	N5	Packaging material
005	3	Cash		500				500	B4	Cash float
006	10	Cash		1 200			1 200			
007	13	Z Zulu		5 378		5 378				
008	14	HI Q	CL5	1 478	1 000			478	N4	Stationery
009	17	Cash		2 500			1 500	1 000	B8	Drawings
010	20	TR Wholesalers		2 675		2 675				
011	24	The Newsmaker		550				550	N6	Advertisements
012		Cash		1 500			1 500			
013	27	TR Wholesalers	CL1	20 000	20 000					
014		BB Dealers	CL2	6 000	6 000					
015		DBN Distributors	CL3	5 000	5 000					
016		HI Q	CL5	1 000	1 000					
017	30	L Lemon		2 500				2 500	N7	Salaries
018		EQUIP	CL4	1 000	1 000					
019		JHB Letting Agents		2 000				2 000	N8	Rental expenses
020	31	Telkom		595				595	N9	Telephone expenses
021		Cash		3 000			1 500	1 500	B8	Drawings
				61 344	35 000	8 053	5 700	12 591		
				B5	B6	N3	N10			

(c) **PURCHASES JOURNAL — MARCH 20.5** *PJ1*

Invoice no	Day	Details	Fol	Purchases	Trade payables
A0001	2	TR Wholesalers	CL1	23 541	23 541
A0002	5	BB Dealers	CL2	7 832	7 832
A0003		DBN Distributors	CL3	6 965	6 965
				38 338	38 338
				N3	B6

(d) **SALES JOURNAL — MARCH 20.5** *SJ1*

Invoice No	Day	Details	Fol	Sales	Trade receivables
F001	12	B Blue	DL1	478	478
F002		S Silver	DL2	693	693
F003	15	G Green	DL3	324	324
F004		R Red	DL4	299	299
F005	21	B Blue	DL1	362	362
F006		R Red	DL4	178	178
F007	29	S Silver	DL2	262	262
				2 596	2 596
				N1	B3

(e) **GENERAL JOURNAL — MARCH 20.5** *J1*

Date	Details	Fol	Debit	Credit
			R	**R**
1	Equipment	B1	10 000	
	EQUIP/Trade payables control	B6		10 000
	Shop equipment bought on credit per invoice Z001			
14	Equipment	B1	5 260	
	HI Q/Trade payables control	B6		5 260
	Computer bought on credit per invoice Z002			
25	Stationery	N4	267	
	HI Q/Trade payables control	B6		267
	Stationery bought on credit per invoice Z003			

AA SUPERMARKET

(2) LEDGERS

(a) GENERAL LEDGER

Dr Equipment (at cost) **B1** **Cr**

20.5			**R**				
Mar 1	Trade payables control	J1	10 000				
14	Trade payables control	J1	5 260				
			15 260				

Dr Water and electricity deposit **B2** **Cr**

20.5			**R**				
Mar 1	Bank	CPJ1	1 000				

Dr Trade receivables **B3** **Cr**

20.5			**R**	**20.5**			**R**
Mar 31	Sales	SJ1	2 596	Mar 31	Bank	CRJ1	1 763
					Balance	c/d	833
			2 596				2 596
20.5							
Apr 1	Balance	b/d	833				

Dr Cash float **B4** **Cr**

20.5			**R**				
Mar 3	Bank	CPJ1	500				

Dr Bank **B5** **Cr**

20.5			**R**	**20.5**			**R**
Mar 31	Receipts	CRJ1	146 766	Mar 31	Payments	CPJ1	61 344
					Balance	c/d	85 422
			146 766				146 766
20.5							
Apr 1	Balance	b/d	85 422				

Dr Trade payables **B6** **Cr**

20.5			**R**	**20.5**			**R**
Mar 31	Bank	CPJ1	35 000	Mar 1	Equipment	J1	10 000
	Balance	c/d	18 865	14	Equipment	J1	5 260
				25	Stationery	J1	267
				31	Purchases	PJ1	38 338
			53 865				53 865
				20.5			
				Apr 1	Balance	b/d	18 865

Dr Capital **B7** **Cr**

				20.5			**R**
				Mar 1	Bank	CRJ1	50 000

Dr Drawings **B8** **Cr**

20.5			**R**				
Mar 17	Bank	CPJ1	1 000				
31	Bank	CPJ1	1 500				
			2 500				

Dr Sales **N1** **Cr**

				20.5			**R**
				Mar 31	Trade receivables	SJ1	2 596
					Bank	CRJ1	94 753
							97 349

Dr Rental income **N2** **Cr**

				20.5			**R**
				Mar 6	Bank	CRJ1	250

Dr Purchases **N3** **Cr**

20.5			**R**				
Mar 31	Trade payables	PJ1	38 338				
	Bank	CPJ1	8 053				
			46 391				

Dr Stationery **N4** **Cr**

20.5			**R**				
Mar 14	Bank	CPJ1	478				
25	Trade payables control	J1	267				
			745				

Dr Packaging material **N5** **Cr**

20.5			**R**				
Mar 2	Bank	CPJ1	468				

Dr Advertisements **N6** **Cr**

20.5			**R**				
Mar 24	Bank	CPJ1	550				

Dr Salaries **N7** **Cr**

20.5			**R**				
Mar 30	Bank	CPJ1	2 500				

Dr Rental expenses **N8** **Cr**

20.5			**R**				
Mar 1	Bank	CPJ1	2 000				
30	Bank	CPJ1	2 000				
			4 000				

Dr		Telephone expenses				N9	Cr
20.5			**R**				
Mar 31	Bank	CPJ1	595				

Dr		Wages				N10	Cr
20.5			**R**				
Mar 31	Bank	CPJ1	5 700				

(b) TRADE RECEIVABLES LEDGER

B Blue DL1

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 12	Invoice F001	SJ1	478		478
19	Receipt No 3	CRJ1		200	278
21	Invoice F005	SJ1	362		640
31	Receipt No 8	CRJ1		640	—

S Silver DL2

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 12	Invoice F002	SJ1	693		693
23	Receipt No 4	CRJ1		100	593
29	Invoice F007	SJ1	262		855
	Receipt No 6	CRJ1		200	655

G Green DL3

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 15	Invoice F003	SJ1	324		324
31	Receipt No 7	CRJ1		324	—

R Red DL4

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 15	Invoice F004	SJ1	299		299
21	Invoice F006	SJ1	178		477
25	Receipt No 5	CRJ1		299	178

Debtors list	**R**	
S Silver	655	
R Red	178	
	833	**Corresponds to the balance of account B3.**

GOLDEN RULE

The total of all the balances of the individual debtor acconts in die subsidiary trade receivables ledger MUST equal the balance of the trade receivables control account in the general ledger.

(c) TRADE PAYABLES LEDGER

TR Wholesalers CL 1

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 2	Invoice A0001	PJ1		23 541	23 541
27	Cheque 013	CPJ1	20 000		3 541

BB Dealers CL 2

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 5	Invoice A0002	PJ1		7 832	7 832
27	Cheque 014	CPJ1	6 000		1 832

DBN Distributors CL 3

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 5	Invoice A0003	PJ1		6 965	6 965
27	Cheque 015	CPJ1	5 000		1 965

EQUIP CL 4

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 1	Invoice Z001	J1		10 000	10 000
	Cheque 002	CPJ1	1 000		9 000
30	Cheque 018	CPJ1	1 000		8 000

HI Q CL 5

Date	Details	Fol	Debit	Credit	Balance
20.5			**R**	**R**	**R**
Mar 14	Invoice Z002	J1		5 260	5 260
	Cheque 008	CPJ1	1 000		4 260
25	Invoice Z003	J1		267	4 527
27	Cheque 016	CPJ1	1 000		3 527

Creditors list	**R**	
TR Wholesalers	3 541	
BB Dealers	1 832	
DBN Distributors	1 965	
EQUIP	8 000	
HI Q	3 527	
	18 865	**Corresponds to the balance of account B6**

GOLDEN RULE

The total of the individual creditor accounts in the subsidiary trade payables ledger MUST equal the balance of the trade payables control account in the general ledger.

AA SUPERMARKET

(3) TRIAL BALANCE AS AT 31 MARCH 20.5

	Fol	Debit	Credit
		R	R
Equipment (at cost)	B 1	15 260	
Water and electricity deposit	B 2	1 000	
Trade receivables control	B 3	833	
Cash float	B 4	500	
Bank	B 5	85 422	
Trade payables control	B 6		18 865
Capital	B 7		50 000
Drawings	B 8	2 500	
Sales	N 1		97 349
Rent income	N 2		250
Purchases	N 3	46 391	
Stationery	N 4	745	
Packaging material	N 5	468	
Advertisements	N 6	550	
Salaries	N 7	2 500	
Rental expenses	N 8	4 000	
Telephone expenses	N 9	595	
Wages	N10	5 700	
		166 464	166 464

5.9 Settlement discount

5.9.1 Settlement discount granted

Discount is often offered to debtors in order to encourage quick settlement of their debts within the stated credit term. The credit term will be shown on the credit invoice.

Study paragraph 9.3 of the prescribed book.

5.9.2 Settlement discount received

Discount is often received from creditors in order to encourage quick settlement of our outstanding account.

Study paragraph 13.6 of the prescribed book.

5.10 Value-Added Tax (VAT)

5.10.1 Background

Study paragraphs 5.4 and 5.5 of the prescribed book.

VAT is levied at every point in the chain of production and distribution. Value-Added Tax is based on a tax credit system which allows every producer or distributor along the chain to recover the Value-Added Tax which was previously paid by the business. The tax borne by each producer or distributor, through whose hands the goods or services have passed, before reaching the end user, is in effect the tax on the value added by the business.

The tax that must eventually (every two months) be paid to the South African Revenue Service (SARS) is the tax on the supply of goods (sales) and/or services rendered **by** the entity (OUTPUT VAT) **less** the tax paid by the entity on the goods (purchases) and/or services supplied **to** the entity (INPUT VAT).

GOLDEN RULES

- OUTPUT VAT is the tax levied (charged) by the entity on sales of goods or services rendered by the business.
- INPUT VAT is the tax paid (or payable) on goods delivered and/or services rendered *to* the entity, including imports. Deductions for input tax will only be allowed if a proper tax invoice is received and kept.
- OUTPUT VAT minus INPUT VAT = amount payable/refundable, i.e. the amount payable to the South African Revenue Services (SARS) or the amount that can be claimed from SARS.

Value-Added Tax (VAT) can only be charged by persons who, in terms of the Act, are registered as VAT vendors. Registration is compulsory if a person carries on an entity and the total value of his supplies for a 12 month period exceeds or is likely to exceed a stipulated (in the Act) amount.

An entity may also register voluntarily if its sales or service rendered are less than the stipulated amount.

The stipulated amount excludes tax, exempted supplies and abnormal receipts.

If an entity is not registered, no output tax may be charged and no deduction for input tax can be claimed.

The onus is on the entity to register where necessary and this must be done within 21 days of becoming liable to register.

5.10.2 Tax period

A tax period is allocated to each entity. The return submitted by the entity must cover the period allocated.

Some entities registered for VAT (vendors) must submit their returns every two months for those two months. Some entities must complete and submit their returns for unequal months, i.e. January, March, May, etc., others for equal months, i.e. February, April, etc.

5.10.3 Accounting bases

There are only two bases allowed for the calculation of the VAT liability, namely:

- the invoice basis
- the payments basis

Under the invoice basis tax is accounted for on

- the issue of an invoice or
- the receipt of payment, whichever comes first

Under the payments basis tax is accounted for when payments are made (purchases) and payments are received (sales).

Certain requirements have to be met before a vendor may use the payments basis.

Exercise 5.2

To grasp the principles of VAT, work through the following exercise thoroughly. VAT at 14% is applicable.

The following information relates to Rundu Dealers, who is registered as a VAT vendor and who use the periodic inventory system: (The VAT period of the business ends on unequal months.)

(a) TRIAL BALANCE AS AT 28 FEBRUARY 20.4

	Debit	Credit
	R	R
Capital		177 150
Land and buildings	144 200	
Equipment	29 700	
Inventory — 1 November 20.3	19 200	
Bank	4 467	
W Wolf	1 583	
L Lion	770	
T Tiger		2 310
VAT input	2 715	
VAT output		2 925
Sales		86 400
Purchases	45 650	
Distribution, administration and other expenses	20 500	
	268 785	268 785

(b) TRANSACTIONS FOR MARCH 20.4

March 1 Cash sales, R15 504.
5 Paid the account of T Tiger by cheque after deducting R114 discount.
7 Received a cheque from W Wolf for R1 469 in full settlement of his account.
Received a cheque from L Lion for R713 and allowed R57 discount.
12 Received an account from Stationers Ltd for the printing of documents, R684.
13 Credit sales:
— L Lion R2 280
— W Wolf R1 140
14 Sold an old computer to O Old for R285 and received his cheque for the amount due.
Cash sales, R6 840.
21 Issued a credit note to L Lion for an overcharge on the invoice of the 13th, R57.
23 Paid C Cheetah by cheque for carriage on goods purchased, R1 140.
28 Received a credit invoice from T Tiger for goods purchased, R14 535.
29 Issued cheques for salaries and wages, R5 746 and for purchases from B Bam R7 980.
30 Issued a debit note to T Tiger for goods returned to him, R798.

Required:

(1) Record the above transactions in the following subsidiary journals, properly totalled, of Rundu Dealers for March 20.4:

(a) Cash receipts journal (analysis columns for bank, sales, VAT output, trade receivables, VAT input (Dr), settlement discount granted and sundries)

(b) Cash payments journal (analysis columns for bank, purchases, trade payables, settlement discount received, VAT input, VAT output (Cr) and sundries)

(c) Sales journal (analysis columns for VAT output, sales and trade receivables)

(d) Purchases journal (analysis columns for VAT input, purchases and trade payables)

(e) Sales returns journal (analysis columns for VAT output, sales returns and trade receivables)

(f) Purchases returns journal (analysis columns for VAT input, purchases returns and trade payables)

(g) General journal

(2) Post the entries recorded above to the VAT input and VAT output accounts. Close off these accounts to the VAT control account. Balance the VAT control account at 31 March 20.4, the end of the business' VAT period.

Solution Exercise 5.2

RUNDU DEALERS

(1) SUBSIDIARY JOURNALS

(a) CASH RECEIPTS JOURNAL — MARCH 20.4

CRJ2

Date	Details	Fol	Bank	Sales	Trade receiv-ables	VAT input	VAT output Dr	Settlement discount granted Dr	Sundry accounts Amount	Sundry accounts Fol	Sundry accounts Details
			R	R	R	R	R	R	R		
1	Sales		15 504	13 600			1 904				
7	W Wolf		1 469		1 583	(14*)#		(100)			
	L Lion		713		770	(7)#		(50)			
14	O Old		285				35		250		Equipment
	Sales		6 840	6 000			840				
			24 811	19 600	2 353	(21)	2 779	(150)	250		
						L15	L16				

* Discount includes 14% VAT therefore

$$\frac{R114}{1} \times \frac{14}{114} = R14$$

VAT input is debited. See # under comments on p. 88

(b) CASH PAYMENTS JOURNAL — MARCH 20.4

CPJ2

Date	Details	Fol	Bank	Purchases	Trade payables	VAT input	VAT output Cr	Settlement discount received	Sundry accounts Amount	Sundry accounts Fol	Sundry accounts Details
			R	R	R	R	R	R	R		
5	T Tiger		2 196		2 310		(14*)	(100)			
23	C Cheetah		1 140			140			1 000		Carriage on purchases
29	Cash		5 746						5 746		Salaries and wages
	B Bam		7 980	7 000		980					
			17 062	7 000	2 310	1 120	(14)	(100)	6 746		
						L15	L15				

* Discount includes 14% VAT therefore

$$\frac{R114}{1} \times \frac{14}{114} = R14$$

(c) SALES JOURNAL — MARCH 20.4 *SJ2*

Date	Details	Fol	VAT output	Sales	Trade receivables
			R	**R**	**R**
13	L Lion		280	2 000	2 280
	W Wolf		140	1 000	1 140
			420	3 000	3 420
			L16		

(d) PURCHASES JOURNAL — MARCH 20.4 *PJ2*

Date	Details	Fol	VAT input	Purchases	Trade payables
			R	**R**	**R**
28	T Tiger		1 785	12 750	14 535
			1 785	12 750	14 535
			L15		

(e) SALES RETURNS JOURNAL — MARCH 20.4 *SRJ2*

Date	Details	Fol	VAT output	Sales returns	Trade receivables
			R	**R**	**R**
21	L Lion		7	50	57
			7	50	57
			L16		

(f) PURCHASES RETURNS JOURNAL — MARCH 20.4 *PRJ2*

Date	Details	Fol	VAT input	Purchases returns	Trade payables
			R	**R**	**R**
30	T Tiger		98	700	798
			98	700	798
			L15		

(g) GENERAL JOURNAL — MARCH 20.4 **J2**

Date	Detail	Fol	Debit	Credit
			R	R
12	Printing		600	
	VAT input	L15	84	
	Stationers Ltd/Trade payables control			684
	Account received for printing			
31	VAT control	L17	5 627	
	VAT input	L15		5 627
	Transfer of VAT input to the VAT control account			
	VAT output	L16	6 131	
	VAT control	L17		6 131
	Transfer of VAT output to the VAT control account			

NB: The last two journal entries can only be done **after** the VAT input account and the VAT output account in the general ledger have been completed. It is in fact the "balances" of these two accounts that are transferred to the VAT control account.

RUNDU DEALERS

(2) General ledger

Dr VAT input **L15** **Cr**

20.4			R	20.4			R
Mar 1	Balance	b/d	2 715	Mar 31	Trade payables control	PRJ2	98
31	Bank	CPJ2	1 120		VAT control	J2	5 627
	Trade receivables control	CRJ2	21				
	Trade payables control	PJ2	1 785				
	Trade payables control	J2	84				
			5 725				5 725

Dr VAT output **L16** **Cr**

20.4			R	20.4			R
Mar 31	Trade receivables control	SRJ2	7	Mar 1	Balance	b/d	2 925
	VAT control	J2	6 131	31	Bank	CRJ2	2 779
					Trade receivables control	SJ2	420
					Trade payables control	CPJ2	14
			6 138				6 138

Dr VAT control **L17** **Cr**

20.4			R	20.4			R
Mar 31	VAT input	J2	5 627	Mar 31	VAT output	J2	6 131
	Balance	c/d	504				
			6 131				6 131
				20.4			
				Apr 1	Balance	b/d	504*

* A cheque must be issued to the South African Revenue Service for this amount before 25 April 20.4

- *Calculation of VAT on all amounts which include 14% VAT is:*

		%	or	R
Amount without VAT	=	*100*		*1,00*
VAT	=	*14*		*0,14*
$\therefore$ *Amount VAT inclusive*	=	*114*		*1,14*

To calculate an amount if VAT was included
$\frac{14}{114}$ *x Amount given*

Example: Amount received on 1 March 20.4 = R15 504 (including VAT). (See cash receipts journal.)
VAT $= \frac{14}{114} \times$ *R15 504 = R1 904*
SALES $= \frac{100}{114} \times$ *R15 504 = R13 600*
or
SALES = R15 504 $\div$ *R1,14 = R13 600.*

- *VAT on cash sales is credited to the VAT output account because Rundu Dealers received VAT for payment to the South African Revenue Service.*
- *VAT on credit sales is credited to the VAT output account.*
- *VAT on cash purchases is debited to the VAT input account.*
- *VAT on credit purchases is debited to the VAT input account.*
- *VAT on sales returns is debited to the VAT output account. (To cancel the VAT output portion of the sales returned.)*
- *VAT on purchases returns is credited to the VAT input account. (To cancel the VAT input portion of the purchases returned.)*
- *# VAT on settlement discount granted to debtors is debited to the VAT input account (to reduce the amount owed to the South African Revenue Service).*
- *VAT on settlement discount received from creditors is credited to the VAT output account (to increase the amount owed to the South African Revenue Service).*
- *The balances of the VAT input and VAT output accounts are transferred to the VAT control account to determine what amount must be paid to or to be claimed from the South African Revenue Service.*
- *When the difference between the debit and credit sides of the VAT control is a:*
  - ***credit**, the difference is payable to the South African Revenue Service (current liability)*
  - ***debit**, the difference is refundable by the South African Revenue Service (current asset)*

NB: *VAT is charged on services, for example telephone account, water and electricity account and repairs.*

5.11 Revision exercise and solution

The following information relates to Sunshine Glass Traders, who is registered as a VAT vendor. The periodic inventory system and control accounts are in use: (The VAT period of the business ends on equal months.)

SUNSHINE GLASS TRADERS

(a) TRIAL BALANCE AS AT 31 JANUARY 20.4

	Fol	Debit	Credit
		R	R
Land and buildings (at cost)	B1	60 000	
Furniture (at cost)	B2	5 320	
Inventory: Trading	B3	6 536	
Trade receivables control	B4	2 431	
Bank	B5	2 554	
Trade payables control	B6		6 075
Capital	B7		75 000
Drawings	B8	3 884	
VAT input	B9	4 337	
VAT output	B10		4 527
Sales	N1		13 569
Purchases	N2	9 855	
Rent income	N3		800
Packaging material	N4	964	
Telephone expenses	N5	483	
Water and electricity	N6	1 247	
Settlement discount granted	N7	170	
Settlement discount received	N8		210
Wages	N9	2 150	
Stationery	N10	250	
		100 181	100 181

(b) Transactions, 14% VAT inclusive, for February 20.4:

			R
Feb	1	The owner, S Shine, increased his capital contribution	15 000
		Paid the City Council for water and electricity	3 078
	3	Purchased merchandise from Glasco Ltd and paid by cheque	8 778
		Purchased merchandise on credit from Ferguson Limited	9 120
		Sold trading inventory on credit to J Jason	13 680
	4	Purchased a desk on credit from City Furnitures	3 534
	6	Purchased receipt books and pens from Pen and Pencil and paid by cheque	228
		Drew a cheque for the week's wages	954
	8	Paid Glasco Ltd on account	3 992
		Received discount	228
	10	Cash sales of merchandise	3 876
	12	Issued a credit note to J Jason for an overcharge on the 3rd	114
		Drew a cheque for the week's wages	940
	15	Cash sales	2 394
		Received a cheque from J Jason	5 988
		Settlement discount granted to him	342

Feb 18	Sold goods on credit to F Brown	4 560
	Cash purchases of trading inventory	2 736
	Purchased glassware on credit from Glasco Ltd	5 700
20	Returned damaged goods to Glasco Ltd	570
21	Drew a cheque for wages	989
	Received damaged goods returned by F Brown and issued a credit note	228
25	Cash sales	6 156
	Received a payment from F Brown	2 552
	Discount allowed to him	228
26	Drew a cheque for wages	945
	Issued a cheque to Telkom to pay the telephone account	570
	Received an account from Printo Limited for the printing of documents	798
27	Purchased inventory on credit from Glasco Ltd	3 420
	Paid Ferguson Limited by cheque and received R285 discount	5 490
28	Paid the owner's house instalment by cheque to HP Bank	2 500
	Received a cheque from Z Zittace for rental	912

Required:

(1) Record the above transactions in the following subsidiary journals of Sunshine Glass Traders for February 20.4:

(a) Cash receipts journal (analysis columns for bank, sales, VAT output, trade receivables, settlement discount granted, VAT input (Dr) and sundries)

(b) Cash payments journal (analysis columns for bank, purchases, trade payables, settlement discount received, wages, VAT input, VAT output (Cr) and sundries)

(c) Sales journal (analysis columns for trade receivables, VAT output and sales)

(d) Purchases journal (analysis columns for trade payables, VAT input and purchases)

(e) Sales returns journal (analysis columns for trade receivables, VAT output and sales returns)

(f) Purchases returns journal (analysis columns for trade payables, VAT input and purchases returns)

(g) General journal

(2) Post the entries recorded in the subsidiary journals to the relevant accounts in the general ledger of Sunshine Glass Traders. (All the accounts must be properly balanced/totalled at 28 February 20.4.) Close the VAT input and VAT output accounts and transfer the balances to the VAT control account.

NB: (a) Remember to enter the balances at 31 January 20.4 in the applicable ledger accounts.

(b) The first word(s) of each entry must indicate the contra ledger account.

(3) Prepare the trial balance of Sunshine Glass Traders as at 28 February 20.4.

SOLUTION: Revision exercise

SUNSHINE GLASS TRADERS

(1) SUBSIDIARY JOURNALS

(a) CASH RECEIPTS JOURNAL – FEBRUARY 20.4

CRJ2

Date	Details	Fol	Bank	Sales	Trade receivables	Settlement discount granted Dr	VAT input Dr	VAT output	Sundry accounts		
									Amount	Fol	Details
			R	R	R	R	R	R	R		
1	S Shine		15 000						15 000	B7	Capital
10	Cash		3 876	3 400				476			
15	Cash		2 394	2 100				294			
	J Jason		5 988		6 330	(300)	(42)				
25	Cash		6 156	5 400				756			
	F Brown		2 552		2 780	(200)	(28)				
28	Z Zittace		912					112	800	N3	Rental income
			36 878	10 900	9 110	(500)	(70)	1 638	15 800		
			B5	N1	B4	N7	B9	B10			

(b) CASH PAYMENTS JOURNAL — FEBRUARY 20.4

CPJ2

Date	Details	Fol	Bank	Purchases	Trade payables	Wages	Settlement discount received	VAT input	VAT output	Sundry accounts		
									Cr	Amount	Fol	Details
			R	R	R	R	R	R	R			
1	City Council		3 078					378		2 700	N6	Water and electricity
3	Glasco Ltd		8 778	7 700				1 078				
6	Pen and Pencil		228					28		200	N10	Stationery
	Cash		954			954						
8	Glasco Ltd		3 992		4 220		(200)		(28)			
12	Cash		940			940						
18	Cash		2 736	2 400				336				
21	Cash		989			989						
26	Cash		945			945						
	Telkom		570					70		500	N5	Telephone expenses
27	Ferguson Ltd		5 490		5 775		(250)		(35)			
28	HP Bank		2 500							2 500	B8	Drawings
			31 200	10 100	9 995	3 828	(450)	1 890	(63)	5 900		
			B5	N2	B6	N9	N8	B9	B8			

(c) SALES JOURNAL — FEBRUARY 20.4

SJ2

Date	Details	Fol	Trade receivables	VAT output	Sales
			R	R	R
3	J Jason		13 680	1 680	12 000
18	F Brown		4 560	560	4 000
			18 240	2 240	16 000
			B4	B10	N1

(d) PURCHASES JOURNAL — FEBRUARY 20.4 *PJ2*

Date	Details	Fol	Trade payables	VAT input	Purchases
			R	R	R
3	Ferguson Limited		9 120	1 120	8 000
18	Glasco Ltd		5 700	700	5 000
27	Glasco Ltd		3 420	420	3 000
			18 240	2 240	16 000
			B6	B9	N2

(e) SALES RETURNS JOURNAL — FEBRUARY 20.4 *SRJ2*

Date	Details	Fol	Trade receivables	VAT output	Sales returns
			R	R	R
12	J Jason		114	14	100
21	F Brown		228	28	200
			342	42	300
			B4	B9	N11

(f) PURCHASES RETURNS JOURNAL — FEBRUARY 20.4 *PRJ2*

Date	Details	Fol	Trade payables	VAT input	Purchases returns
			R	R	R
20	Glasco Ltd		570	70	500
			570	70	500
			B6	B9	N12

(g) GENERAL JOURNAL — FEBRUARY 20.4 *J2*

Date	Details	Fol	Debit	Credit
			R	R
4	Furniture	B2	3 100	
	VAT input	B	434	
	City Furnitures/Trade payables control	B6		3 534
	Desk purchased on credit			
26	Printing	N13	700	
	VAT input	B9	98	
	Printo Limited/Trade payables control	B6		798
	Printing of documents on credit			
28	VAT output	B10	8 426	
	VAT control	B11		8 426
	Transfer of VAT output to the VAT control account			
	VAT control	B11	8 999	
	VAT input	B9		8 999
	Transfer of VAT input to the VAT control account			

(2) GENERAL LEDGER

Dr Land and buildings (at cost) **B1** **Cr**

20.4			**R**				
Feb 1	Balance	b/d	60 000				

Dr Furniture (at cost) **B2** **Cr**

20.4			**R**				
Feb 1	Balance	b/d	5 320				
4	City Furnitures	J2	3 100				
			8 420				

Dr Inventory: Trading **B3** **Cr**

20.4			**R**				
Feb 1	Balance	b/d	6 536				

Dr Trade receivables control **B4** **Cr**

20.4			**R**	**20.4**			**R**
Feb 1	Balance	b/d	2 431	Feb 28	Bank and discount	CRJ2	9 110
28	Sales	SJ2	18 240		Sales returns	SRJ2	342
					Balance	c/d	11 219
			20 671				20 671
20.4							
Mar 1	Balance	b/d	11 219				

Dr Bank **B5** **Cr**

20.4			**R**	**20.4**			**R**
Feb 1	Balance	b/d	2 554	Feb 28	Total payments	CPJ2	31 200
28	Total receipts	CRJ2	36 878		Balance	c/d	8 232
			39 432				39 432
20.4							
Mar 1	Balance	b/d	8 232				

Dr Trade payables control **B6** **Cr**

20.4			**R**	**20.4**			**R**
Feb 28	Bank and discount	CPJ2	9 995	Feb 1	Balance	b/d	6 075
	Purchases returns	PRJ2	570	4	Furniture	J2	3 534
	Balance	c/d	18 082	26	Printing	J2	798
				28	Purchases	PJ2	18 240
			28 647				28 647
				20.4			
				Mar 1	Balance	b/d	18 082

Dr Capital **B7** **Cr**

			R	**20.4**			**R**
				Feb 1	Balance	b/d	75 000
					Bank	CRJ2	15 000
							90 000

Dr			Drawings			B8	Cr
20.4			**R**				
Feb 1	Balance	b/d	3 884				
28	Bank	CPJ2	2 500				
			6 384				

Dr			VAT input			B9	Cr
20.4			**R**	**20.4**			**R**
Feb 1	Balance	b/d	4 337	Feb 28	Trade payables control	PRJ2	70
4	Trade payables control	J2	434		VAT control	J2	8 999
26	Trade payables control	J2	98				
28	Bank	CPJ2	1 890				
	Trade receivables control	CRJ2	70				
	Trade payables control	PJ2	2 240				
			9 069				9 069

Dr			VAT output			B10	Cr
20.4			**R**	**20.4**			**R**
Feb 28	Trade receivables control	SRJ2	42	Feb 1	Balance	b/d	4 527
	VAT control	J2	8 426	28	Trade receivables control	SJ2	2 240
					Bank	CRJ2	1 638
					Trade payables control	CPJ2	63
			8 468				8 468

Dr			VAT control			B11	Cr
20.4			**R**	**20.4**			**R**
Feb 28	VAT input	J2	8 999	Feb 28	VAT output	J2	8 426
					Balance	c/d	573
			8 999				8 999
20.4							
Mar 1	Balance	b/d	573				

Dr			Sales			N1	Cr
				20.4			**R**
				Feb 1	Balance	b/d	13 569
				28	Bank	CRJ2	10 900
					Trade receivables control	SJ2	16 000
							40 469

Dr			Purchases			N2	Cr
20.4			**R**				
Feb 1	Balance	b/d	9 855				
28	Bank	CPJ2	10 100				
	Trade payables control	PJ2	16 000				
			35 955				

Dr			Rental income			N3	Cr
				20.4			**R**
				Feb 1	Balance	b/d	800
				28	Bank	CRJ2	800
							1 600

Dr			Packaging material			N4	Cr
20.4			**R**				
Feb 1	Balance	b/d	964				

Dr			Telephone expenses			N5	Cr
20.4			**R**				
Feb 1	Balance	b/d	483				
26	Bank	CPJ2	500				
			983				

Dr			Water and electricity			N6	Cr
20.4			**R**				
Feb 1	Balance	b/d	1 247				
	Bank	CPJ2	2 700				
			3 947				

Dr			Settlement discount granted			N7	Cr
20.4			**R**				
Feb 1	Balance	b/d	170				
28	Trade receivables control	CRJ2	500				
			670				

Dr			Settlement discount received			N8	Cr
				20.4			**R**
				Feb 1	Balance	b/d	210
				28	Trade payables control	CPJ2	450
							660

Dr			Wages			N9	Cr
20.4			**R**				
Feb 1	Balance	b/d	2 150				
28	Bank	CPJ2	3 828				
			5 978				

Dr		Stationery				N10	Cr
20.4			**R**				
Feb 1	Balance	b/d	250				
6	Bank	CPJ2	200				
			450				

Dr		Sales returns				N11	Cr
20.4			**R**				
Feb 28	Trade receivables control	SRJ2	300				

Dr		Purchases returns				N12	Cr
				20.4			**R**
				Feb 28	Trade payables control	PRJ2	500

Dr		Printing				N13	Cr
20.4			**R**				
Feb 26	Printo Limited	J2	700				

(3) TRIAL BALANCE AS AT 28 FEBRUARY 20.4

	Fol	Debit	Credit
		R	R
Land and buildings at cost	B1	60 000	
Furniture at cost	B2	8 420	
Inventory: Trading	B3	6 536	
Trade receivables control	B4	11 219	
Bank	B5	8 232	
Trade payables control	B6		18 082
Capital	B7		90 000
Drawings	B8	6 384	
VAT control	B11	573	
Sales	N1		40 469
Purchases	N2	35 955	
Rental income	N3		1 600
Packaging material	N4	964	
Telephone expenses	N5	983	
Water and electricity	N6	3 947	
Settlement discount granted	N7	670	
Settlement discount received	N8		660
Wages	N9	5 978	
Stationery	N10	450	
Sales returns	N11	300	
Purchases returns	N12		500
Printing	N13	700	
		151 311	151 311

COMMENTS

- *After the journal entries have been posted to the VAT input account and the VAT output account in the general ledger, the "balances" on these accounts must be transferred to the VAT control account. This means that the general journal entries on 28 February 20.4 can only be done after the "balances" on these accounts have been calculated.*
- *The VAT control account has a debit balance, which is refundable by the South African Revenue Service.*
- *VAT is not included in the amount credited to sales as this is not an income for the business but must be paid over to the South African Revenue Service.*
- *The debtors owe the VAT-inclusive amount to the business.*
- *The same reasoning applies to creditors and purchases.*

SELF-ASSESSMENT

Having studied this study unit, can you:

- prepare the following books, taking Value-Added Tax into account?
  - cash receipts journal
  - cash payments journal
  - purchases journal
  - purchases returns journal
  - sales journal
  - sales returns journal
  - general journal
- post to the following ledgers?
  - general ledger
  - Trade receivables ledger
  - Trade payables ledger
- prepare a trial balance?

STUDY UNIT

6

Adjustments

Learning outcome

Students should be able to do year-end adjustments to balances in the books of an entity.

Contents

KEY CONCEPTS

- Adjustment
- Closing
- Prepaid expenses
- Accrued expenses
- Consumable inventory adjustments
- Income received in advance
- Credit losses (Bad debts)
- Settlement discount
- Depreciation
- Accumulated depreciation
- Asset contra account
- Carrying amount
- Pre-adjustment trial balance
- Post-adjustment trial balance
- Post-closing trial balance

6.1 Introduction

An entity usually does business on a permanent basis without any interruptions. We also know that its owners and managers need regular information on its financial results and financial position. The life of an entity is therefore divided into equal periods (financial periods), usually of 12 months, and the profit or loss is determined for that period.

Thus far it was assumed that all transactions recorded were in respect of the specific financial period. The closing off of accounts and the determination of the profit, were recorded under this assumption. This does not always happen and the accounts (and eventually statements) have sometimes to be **adjusted** to ‘‘correct’’ the balances in accounts before the final accounts and financial statements can be prepared.

For more accurate financial statements at the end of a financial period, additional entries, which do not originate from source documents, may therefore be necessary.

Study paragraphs 6.1 to 6.4 of the prescribed book.

The three steps relating to adjustments mentioned in paragraph 6.3 (and further on) can be extended to **five** steps:

Step 1: Identify the accounts that must be adjusted.
Step 2: Determine how the accounts would be affected and what the balances of these accounts should be.
Step 3: Calculate the amount(s) involved in the adjustment.
Step 4: Record the necessary adjustments in the general journal and past the entries to the ledger(s)
Step 5: Ensure that the new balances of the accounts are now correct.

6.2 Short-term adjustments

Short-term adjustments have to do with the apportionment of income and expenditure to consecutive periods within a year. This is income which is received in one period but which is earned in an earlier or a later period. The same applies to expenses which are incurred in another period.

6.2.1 Prepaid expenses

Study paragraph 6.3.5.2 in the prescribed book.

A prepaid expense is an expense which has been paid during the current financial period, where all or part of the expense relates to a future financial period. For example, insurance expenses are usually payable in advance. When the financial year of a business entity ends, it is therefore possible that a portion of the insurance expense relates to the next financial period. An adjustment is therefore necessary to match only that portion of the expense which relates to the current financial period against the income for that period.

On 2 January 20.1 Xa-Xa Dealers paid a new annual insurance premium of R2 400. Its financial year ends on 28 February 20.1. Using this information we can work out that the actual amount it spent on insurance up to and including 28 February was only R400, which is R2 400 ÷ 12 = R200 per month for two months, namely January and February. The R2 000 which was paid in advance represents an asset at that point. The apportionment of the amount between asset and expenditure elements will be as follows: R400 is an expenditure item in respect of insurance for the current financial year. This amount must appear in the profit and loss account and the statement of profit or loss and other comprehensive income. The R2 000 is a prepaid expense and therefore represents an amount that will be used in future. It must appear on the statement of financial position of 28 February 20.1 and is therefore a short-term (current) asset.

GOLDEN RULE

One entry or ''leg'' of the adjustment journal always affects a nominal account and thereby the trading account or profit or loss account. The other entry or ''leg'' of the journal always affects a statement of financial position account.

Accounting entries

The debit balance in the expense account for insurance has to be reduced by R2 000. To **reduce** an expense account, a **credit** entry has to be made. The balance of the insurance account will then reflect the actual expense, namely R400, and this amount can be written off against the profit or loss account. The prepaid amount of R2 000 is a **temporary asset** on the date of the statement of financial position and it is **debited** in the prepaid expense account and shown on the statement of financial position under current assets.

JOURNAL ENTRIES

ADJUSTMENT ENTRY: 28 FEBRUARY 20.1 *J1*

Prepaid expenses	GL55	2 000	
Insurance	GL40		2 000
Adjustment of insurance account			

CLOSING TRANSFER: 28 FEBRUARY 20.1 *J2*

Profit or loss Insurance *Transfer of insurance to profit or loss account*	GL60 GL40	400	 400

GENERAL LEDGER

Dr Insurance **40** **Cr**

20.1			**R**	**20.1**			**R**
Jan 2	Bank	CPJ	2 400	Feb 28	Prepaid expenses	J1	2 000
					Profit or loss	J2	400
			2 400				2 400

Dr Prepaid expenses **55** **Cr**

20.1			**R**				
Feb 28	Insurance	J1	2 000				

Dr Profit or loss (extract) **60** **Cr**

20.1			**R**				
Feb 28	Insurance	J2	400				

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

	R
Current assets	xxxx
Prepayments	2 000

6.2.2 Accrued expenses

An accrued expense is an expense which relates to the current financial period, but which is still unpaid at the end of that period.

On 28 February 20.1, the end of its financial year, Xa-Xa Dealers' water and electricity account shows expenses of R2 880. On closer examination Xa-Xa's accountant establishes that the February water and electricity account of R360 has not been taken into account. With this information the actual expenditure on water and electricity for the year can be determined, namely R2 880 + R360 = R3 240. The apportionment of the item between actual expenditure and amount owing (liability) will be as follows: R3 240 was the actual expenditure (to be reflected in the profit or loss account and statement of profit or loss and other comprehensive income) and R360 is still owed (to be reflected in the statement of financial position) and must be paid at a future date.

Accounting entries

The debit balance on the water and electricity expense account has to be increased by R360. To **increase** an **expense account**, a **debit** entry has to be made. The balance on the water and electricity account will now reflect the actual expenditure, namely R3 240. This amount can be written off against the profit and loss account. The outstanding amount of R360 is a **liability** on the date of the statement of financial position and it is credited in the accrued expense account and is shown on the statement of financial position under current liabilities.

JOURNAL ENTRIES

J5

ADJUSTMENT ENTRY — 28 FEBRUARY 20.1			
Water and electricity	GL41	360	
Accrued expenses	GL56		360
Adjustment of water and electricity account			

CLOSING TRANSFER — 28 FEBRUARY 20.1

J6

Profit or loss	GL60	3 240	
Water and electricity	GL41		3 240
Closing of water and electricity account to profit or loss account			

GENERAL LEDGER

Dr Water and electricity **41** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	2 880	Feb 28	Profit or loss	J6	3 240
	Accrued expenses	J5	360				
			3 240				3 240

Dr Accrued expenses **56** **Cr**

				20.1			**R**
				Feb 28	Water and electricity	J5	360

Dr Profit or loss (extract) **60** **Cr**

20.1			**R**				
Feb 28	Water and electricity	J6	3 240				

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

	R
Current liabilities	xxxx
Trade and other payables	xxxx
Accrued expenses	360

6.2.3 Consumable inventory adjustments

Study paragraph 6.3.2 of the prescribed book.

On 28 February 20.1, the end of its financial year, Xa-Xa Dealers' stationery account shows that stationery to the value of R500 was purchased during the year. At a physical count it is determined that R150's worth of stationery is still on hand. With this information the actual expenditure on stationery can be calculated, namely R500 − R150 = R350. The apportionment of the item between actual expenditure (profit and loss account and statement of profit or loss and other comprehensive income) and the asset element (statement of financial position) will be as follows: R350 represents expenditure on stationery while R150 represents the value of the stationery that will be used in the future.

Accounting entries

The debit balance in the stationery expense account has to be reduced by R150. To **reduce** an **expense account** a **credit** entry has to be made. The balance on the stationery account will now show the actual expenditure, namely R350. This amount can now be written off against the profit or loss account. The stationery on hand, worth R150, is an **asset** on the date of the statement of financial position and is debited in the stationery on hand account and is shown in the statement of financial position under current assets.

JOURNAL ENTRIES

ADJUSTMENT JOURNAL — 28 FEBRUARY 20.1 *J3*

Inventory: Stationery Stationery *Adjustment of stationery account*	GL57 GL42	150	 150

CLOSING TRANSFER — 28 FEBRUARY 20.1 *J4*

Profit or loss Stationery *Closing of stationery account*	GL60 GL42	350	 350

GENERAL LEDGER

Dr Stationery **42** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	500	Feb 28	Inventory: Stationery	J3	150
					Profit or loss	J4	350
			500				500

Dr Inventory: Stationery **57** **Cr**

20.1			**R**				
Feb 28	Stationery	J3	150				

Dr		Profit or loss (extract)				60	Cr
20.1			**R**				
Feb 28	Stationery	J4	350				

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

	R
Current assets	xxxx
Inventories	xxxx
Stationery	150

6.2.4 Income received in advance

Study paragraph 6.3.4.2 in the prescribed book.

Income received in advance is income which has been received during the current financial period but relates to a future financial period. Only the portion relating to the current financial period must be recorded as income, and an adjustment is necessary for the portion received in advance.

On 28 February 20.1, the end of its financial year, Xa-Xa Dealers' rental income account shows that R10 400 was received. Xa-Xa Dealers rent out a part of their building for R800 a month. On closer investigation it is established that the rental for March 20.1 has already been received.

With this information the actual income received in rental for the year can be determined, that is R10 400 − R800 = R9 600 (= R800 × 12).

The apportionment of the item between actual income and the liability (amount owing) component will be as follows: R9 600 is the actual income and R800 is due to the lessee because it was paid in advance. Differently stated, the income has not yet been earned.

Accounting entries

The credit balance in the rental income account has to be reduced by R800. To **reduce** an **income account** a **debit** entry has to be made. The balance on the rental income account will now show the actual income, namely R9 600. This amount can now be written off against the profit or loss account. The amount received in advance is a **liability** on the date of the statement of financial position and is credited in the income received in advance account and shown in the statement of financial position under current liabilities.

JOURNAL ENTRIES

ADJUSTMENT JOURNAL — 28 FEBRUARY 20.1 *J9*

Rental income	GL44	800	
Income received in advance	GL59		800
Adjustment of rental income account			

CLOSING TRANSFER — 28 FEBRUARY 20.1 *J10*

Rental income Profit or loss *Closing of rental income to profit or loss account*	GL44 GL60	9 600	 9 600

GENERAL LEDGER

Dr Rental income **44** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Income received in advance	J9	800	Feb 28	Balance	b/d	10 400
	Profit or loss	J10	9 600				
			10 400				10 400

Dr Income received in advance **59** **Cr**

				20.1			**R**
				Feb 28	Rental income	J9	800

Dr Profit or loss (extract) **60** **Cr**

				20.1			**R**
				Feb 28	Rental income	J10	9 600

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

	R
Current liabilities	xxxx
Income received in advance	800

6.2.5 Accrued income

Study paragraph 6.3.4.1 in the prescribed book.

Accrued income is income which relates to the current financial period but which has not yet been received.

On 28 February 20.1, the end of its financial year, Xa-Xa Dealers' commission income account shows an income of R2 200. On closer examination it is established that an amount of R200 earned in commission has not yet been received.

With this information the actual income in commission can be determined. It is R2 200 + R200 = R2 400. The apportionment of the item between actual earnings in commission and the associated asset (the commission which has not yet been received) will be as follows: R2 400 which has actually been earned and R200 which is still to be received.

Accounting entries

The credit balance in the commission income account has to be increased by R200. To **increase** an **income account** another **credit** entry has to be made. The balance on the commission income account will now reflect the actual income, namely R2 400. This amount can now be written off against the profit or loss account. The outstanding amount of R200 is an **asset** on the day of the statement of financial position and is shown under current assets in the statement of financial position.

JOURNAL ENTRIES

ADJUSTMENT JOURNAL — 28 FEBRUARY 20.1 *J11*

Accrued income Commission income *Adjustment of commission income account*	GL61 GL45	200	 200

CLOSING TRANSFER — 28 FEBRUARY 20.1 *J12*

Commission income Profit or loss *Closing of commission income to profit or loss account*	GL45 GL60	2 400	 2 400

GENERAL LEDGER

Dr Commission income **45** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Profit or loss	J12	2 400	Feb 28	Balance	b/d	2 200
					Accrued income	J11	200
			2 400				2 400

Dr Accrued income **61** **Cr**

20.1			**R**				
Feb 28	Commission income	J11	200				

Dr Profit or loss (extract) **60** **Cr**

				20.1			**R**
				Feb 28	Commission income	J12	2 400

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

	R
Current assets	xxx
Trade and other receivables	xxx
Accrued income	200

6.2.6 Credit losses (Bad debts)

Study paragraph 6.3.3 in the prescribed book.

On 25 January 20.1 Xa-Xa Dealers receive a notification that a debtor, A Boeka, is insolvent. On closer investigation it is established that the debtor still owes R230.

With this information an adjustment must be made in A Boeka's account. The outstanding amount of R230 must be removed from his account and shown as an expense or loss.

The assets will therefore decrease and an expense or loss component, namely credit losses, will come into being.

Accounting entries

The debit balance of R230 on A Boeka's account has to be written off, since he is insolvent and cannot pay. To reduce an **asset account,** a **credit** entry has to be made. A Boeka's account in the trade receivables ledger will be credited and will now show no balance. The trade receivables' control account in the general ledger must also be credited and the credit losses account debited. The debt which cannot be paid is an expense/loss and is written off against the profit and loss account at the end of the financial year.

JOURNAL ENTRIES

GENERAL JOURNAL — 25 JANUARY 20.1 *J13*

Credit losses (Bad debts)	GL62	230	
A Boeka/Trade receivables control	DL2/GL6		230
Write off debtor's account as irrecoverable			

CLOSING TRANSFER — 28 FEBRUARY 20.1 *J14*

Profit or loss	GL60	230	
Credit losses	GL62		230
Closing of credit losses to profit or loss account			

GENERAL LEDGER

Dr Credit losses (Bad debts) **62** **Cr**

20.1			**R**	**20.1**			**R**
Jan 25	Trade receivables control(A Boeka)	J13	230	Feb 28	Profit or loss	J14	230

Dr Profit or loss (extract) **60** **Cr**

20.1			**R**				
Feb 28	Credit losses	J14	230				

Dr Trade receivables control **6** **Cr**

20.0				**20.1**			**R**
Mar 1	Balance	b/d	xxxx	Jan 25	Credit losses	J13	230

TRADE RECEIVABLES LEDGER

Dr		A Boeka					2	**Cr**
20.1			**R**	**20.1**			**R**
Jan 25	Balance	b/d	230	Jan 25	Credit losses	J13	230

In study unit 9 the writing off of credit losses is explained in detail. The above solution is done according to method 2 as explained in paragraph 9.4.5.

6.2.7 Allowance for settlement discount

Study paragraph 9.3 of the prescribed book.

6.3 Long-term adjustments (depreciation)

Study paragraph 6.3.1 in the prescribed book.

Business entities buy tangible assets (property, plant and equipment) which are not for resale, but are used in the operation of the business. As these assets are used, they decrease in value. This decline in value is charged against the profits of the business and is spread (apportioned) over the expected useful life of the asset.

The apportionment of the cost of the asset usually takes the form of depreciation entries.

Xa-Xa Dealers bought machinery to the value of R80 000 during the year. On 28 February 20.1, the end of its financial year, an amount of R12 000 has to be written off as depreciation.

With this information an adjustment can be made in the books. An expense, namely depreciation of R12 000, is created. Instead of crediting the machinery account, a special account known as **accumulated depreciation: machinery account** is credited. The account is known as an **asset contra account.**

Accounting entries

Depreciation is an expense to the entity and the depreciation account will therefore be debited with R12 000. The expense will then be written off against the profit and loss account. The apportionment of the depreciation is credited in the **asset contra account,** namely accumulated depreciation: machinery. The accumulated depreciation is subtracted from the cost price of the machinery to determine the **carrying amount** of the machinery. The carrying amount is shown under non-current assets in the statement of financial position and is part of property, plant and equipment.

JOURNAL ENTRIES

ADJUSTMENT JOURNAL — 28 FEBRUARY 20.1 *J15*

Depreciation	GL46	12 000	
Accumulated depreciation: machinery	GL63		12 000
Adjustment to make provision for depreciation			

CLOSING TRANSFER — 28 FEBRUARY 20.1 *J16*

Profit or loss Depreciation *Closing of depreciation to the profit or loss account*	GL60 GL46	12 000	 12 000

GENERAL LEDGER

Dr Depreciation **46** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Accumulated depreciation: machinery	J15	12 000	Feb 28	Profit or loss	J16	12 000

Dr Accumulated depreciation: machinery **63** **Cr**

				20.1			**R**
				Feb 28	Depreciation	J15	12 000

Dr Profit or loss (extract) **60** **Cr**

20.1			**R**				
Feb 28	Depreciation	J16	12 000				

XA-XA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1 (extract)

ASSETS	**Note**	**R**
Non-current assets		
Property, plant and equipment	3	68 000

XA-XA DEALERS

NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.1

Property, plant and equipment	**Machinery**	**Total**
Carrying amount: Beginning of year	—	—
Cost	—	—
Accumulated depreciation	—	—
Additions	80 000	80 000
Disposals	—	—
Depreciation	(12 000)	(12 000)
Carrying amount: End of year	68 000	68 000
Cost	80 000	80 000
Accumulated depreciation	(12 000)	(12 000)

6.4 Preparation of the trial balance

It is important to be able to identify at what stage in the accounting process a trial balance is prepared.

A trial balance is prepared as many times as it is required, but at least every month. At the end of the financial year, as many as three trial balances are prepared.

6.4.1 Pre-adjustment trial balance

This is the trial balance which is compiled to test the correctness of the entries after the posting from the subsidiary journals to the general ledger (the same as the usual monthly trial balance). Its purpose is to test whether the requirements of the double-entry system have been met because if the trial balance does not balance at this stage, the statement of financial position will not balance either.

6.4.2 Post-adjustment trial balance

Study paragraph 6.4 in the prescribed book.

This is the trial balance which is compiled after all the journalised adjustments have been posted to the general ledger.

6.4.3 Post-closing trial balance

This is the trial balance which is compiled after the closing journal entries have been posted to the ledger. In this trial balance all the nominal accounts are closed and the profit or loss as well as drawings are transferred to the capital account. All that remains in the trial balance at this stage are the assets, liabilities and equity accounts. These are the accounts which appear as items in the statement of financial position.

6.5 Revision exercise and solution

The following information relates to A Abbo:

Balances at 30 June 20.2 (extract)

	Debit	**Credit**
	R	**R**
Rental income		6 600
Stationery	350	
Water and electricity	1 800	
Commission income		5 600
Credit losses	280	
Accumulated depreciation: machinery		30 000
Trade receivables control	11 150	
Machinery at cost	200 000	

ADDITIONAL INFORMATION:

(a) Only 11 months' rental was received.
(b) Stationery on hand on 30 June 20.2 amounted to R50.
(c) R600 commission was received in advance.
(d) An additional amount of R150 must be written off as irrecoverable.
(e) Provision must be made for depreciation of R30 000 on machinery.
(f) June 20.2's water and electricity account of R160 has not yet been paid.

Required:

(1) Open the above accounts in the general ledger.

(2) Record the adjustments and post to the general ledger accounts.

(3) Record the closing journals and show the partial profit or loss account in the ledger.

(4) Show the necessary items in the partial statement of financial position.

(5) Show the property, plant and equipment note.

Solution: Revision exercise

NB: Only one set of accounts is used. The journal entries after the accounts must also be posted to the same set of accounts.

A ABBO

(1) GENERAL LEDGER

Dr Rental income **1** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Profit or loss	J2	7 200	June 30	Balance	b/d	6 600
					Accrued income	J1	600
			7 200				7 200

Dr Stationery **2** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Balance	b/d	350	Jun 30	Inventory: Stationery	J1	50
					Profit or loss	J2	300
			350				350

Dr Water and electricity **3** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Balance	b/d	1 800	Jun 30	Profit or loss	J2	1 960
	Accrued expenditure	J1	160				
			1 960				1 960

Dr Commission income **4** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Income received in advance	J1	600	Jun 30	Balance	b/d	5 600
	Profit or loss	J2	5 000				
			5 600				5 600

Dr		Credit losses (Bad debts)				5	Cr
20.2			R	20.2			R
Jun 30	Balance	b/d	280	Jun 30	Profit or loss	J2	430
	Trade receivables control	J1	150				
			430				430

Dr		Accumulated depreciation: machinery				6	Cr
				20.2			R
				Jun 30	Balance	b/d	30 000
					Depreciation	J1	30 000
							60 000

Dr		Trade receivables control				7	Cr
20.2			R	20.2			R
Jun 30	Balance	b/d	11 150	Jun 30	Credit losses (Bad debts)	J1	150
					Balance	c/d	11 000
			11 150				11 150
20.2							
Jul 1	Balance	b/d	11 000				

Dr		Machinery (at cost)				8	Cr
20.2			R				
Jun 30	Balance	b/d	200 000				

Dr		Accrued income				9	Cr
20.2			R				
Jun 30	Rental income	J1	600				

Dr		Inventory: Stationery				10	Cr
20.2			R				
Jun 30	Stationery	J1	50				

Dr		Accrued expenditure				11	Cr
				20.2			R
				Jun 30	Water and electricity	J1	160

Dr		Income received in advance				12	Cr
				20.2			R
				Jun 30	Commission income	J1	600

Dr		Depreciation				13	Cr
20.2			**R**	**20.2**			**R**
Jun 30	Accumulated depreciation	J1	30 000	June 30	Profit or loss	J2	30 000

Dr		Profit or loss (extract)				14	Cr
20.2			**R**	**20.2**			**R**
Jun 30	Stationery	J2	300	Jun 30	Rent income	J2	7 200
	Water and electricity	J2	1 960		Commission income	J2	5 000
	Credit losses	J2	430				
	Depreciation	J2	30 000				

A ABBO

(2) GENERAL JOURNAL

ADJUSTMENT ENTRIES: 30 JUNE 20.2 *J1*

		R	R
Accrued income	GL9	600	
Rental income	GL1		600
To adjust the above			
Inventory: Stationery	GL10	50	
Stationery	GL2		50
To adjust the above			
Commission income	GL4	600	
Income received in advance	GL12		600
To adjust the above			
Credit losses	GL5	150	
Trade receivabels control	GL7		150
To adjust the above			
Depreciation	GL13	30 000	
Accumulated depreciation: machinery	GL6		30 000
To make provision for depreciation			
Water and electricity	GL3	160	
Accrued expenditure	GL11		160
To adjust the above			

A ABBO

(3) Closing transfers *J2*

		R	R
Rental income	GL1	7 200	
Commission income	GL4	5 000	
Profit or loss	GL14		12 200
Closing off of accounts against the profit or loss account			
Profit or loss	GL14	32 690	
Stationery	GL2		300
Water and electricity	GL3		1 960
Credit losses	GL5		430
Depreciation	GL13		30 000
Closing off of accounts against the profit or loss account			

A ABBO

(4) STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.2 (extract)

ASSETS	**Note**	**R**
Non-current assets		140 000
Property, plant and equipment	1	140 000
Current assets		X XXX
Inventories		50
Trade and other receivables R(11 000 + 600)		11 600
EQUITY AND LIABILITIES		
Current liabilities		XXX
Trade and other payables		160
Income received in advance		600

A ABBO

(5) NOTES FOR THE YEAR ENDED 30 JUNE 20.2

Property, plant and equipment	**Machinery**	**Total**
	R	**R**
Carrying amount:		
Beginning of the period	170 000	170 000
Cost	200 000	200 000
Accumulated depreciation	(30 000)	(30 000)
Depreciation	(30 000)	(30 000)
Carrying amount:		
End of the period	140 000	140 000
Cost	200 000	200 000
Accumulated depreciation	(60 000)	(60 000)

SELF-ASSESSMENT

Now that you have studied this study unit can you:

- list the accounts and items which have to be adjusted?
- record the adjustments in respect of the following?
  - short-term adjustments such as

    prepaid expenses
    accrued expenses
    consumable inventory adjustments
    income received in advance
    accrued income
    Credit losses (Bad debts)

  - long-term adjustments such as depreciation
- calculate the amounts in question?
- record the necessary entries in the books?
- prepare a pre-adjustment, a post-adjustment and a post-closing trial balance?
- show the effect of adjustments in the statement of profit or loss and other comprehensive income and statement of financial position?

STUDY UNIT

7

The closing-off procedure, determining profit of an entity and preparing financial statements

Learning outcome

Students should be able to complete the closing-off procedure, determine the profit or loss of an entity and prepare more advanced financial statements.

Contents

KEY CONCEPTS

- Financial period
- Nominal accounts
- Cost of sales
- Gross profit
- Profit for the year/period
- Inventory (merchandise, trading goods)
- Perpetual inventory system
- Periodic inventory system
- Closing entries
- Trading account, profit or loss account
- Statement of profit or loss and other comprehensive income, statement of changes in equity, statement of financial position and notes.

7.1 Introduction

This study unit will give you the background knowledge which you require to prepare the financial statements of a service entity and a trading concern.

With the accounting entries we have dealt with so far, you already know how to determine:

- the owner's capital
- the entity's assets (including trading inventory and cash)
- the entity's liabilities
- income and expenditure accounts (nominal accounts), which include the following in the case of a trading concern:
  - merchandise sales
  - merchandise purchases
  - all other expenditure
  - other income

Since the preparing of financial statements goes hand in hand with the closing off procedure every financial year, we will explain the closing entries which have to be made annually. ***All the nominal accounts (income and expenditure) are closed off and they provide the details for compiling the statement of profit or loss and other comprehensive income.***

The accounts which remain in the trial balance after closing, namely the assets, liabilities and capital accounts, form the basis of the information which is included in the statement of financial position.

Study paragraph 7.1 of the prescribed book.

7.2 Financial performance of a service entity

Study paragraph 7.2 of the prescribed book.

7.3 Components of the financial performance of an entity

As you already know, the most important question is, ‘‘How has the business fared financially?’’ Has it made a profit or a loss? The calculations are made for a specific financial period, usually a year. We now turn our attention to the following aspects:

7.3.1 Gross profit

This is the difference between **sales** and the **‘‘cost price of sales’’.** The relevant accounts are closed off to the **trading account**.

7.3.2 Profit for the year/period

This is the amount which remains from the gross profit after all expenditure necessary to manage the business has been subtracted and other income has been added. These income and expenditure accounts are closed off and transferred to the **profit or loss account.**

7.3.3 Cost price of sales

Before determining the cost price of sales, we need to look at inventory. The merchandise inventory which an entity buys during a financial period is not necessarily all sold during that period. The inventory still in the entity at the beginning of the accounting period is known as the opening inventory and that at the end of the period as the closing inventory.

> **Study** paragraph 7.3.1 of the prescribed book.

7.4 Inventory systems (trading inventory)

Depending on the nature of the entity, the type of merchandise sold and the level of computerisation in the entity, an entity can either use a **perpetual** (continuous) inventory system or a **periodic** inventory system. Thusfar we have worked with the periodic inventory system.

With a perpetual inventory system the entity will keep a continuous track of inventory levels for the different inventory items it sells. This method is ideally suited to an entity that sells items that can be easily identified, measured and a value attached to them. The use of scanners and bar codes enables many entities to apply this method of inventory recording.

> **Study** paragraph 7.3.2 of the prescribed book.

7.4.1 The perpetual (continuous) inventory system

Under the perpetual inventory system, the purchase of inventory is recorded directly into the inventory account at cost price. At the time of sale, the cost price of the goods sold is transferred from the inventory account to the cost of sales account.

The accounting entries under such a system can be summarised as follows (VAT is ignored in these examples):

Purchase of inventory for cash:

Dr	Inventory	(because the asset **inventory** increases.)
Cr	Bank	(because the asset **bank** decreases when money is paid out.)

The transaction is recorded in the cash payments journal at cost price.

Purchase of inventory on credit:

Dr	Inventory	(see above.)
Cr	Trade payables and	(because a liability is created or increased.)
Cr	Trade payables control	

The transaction is recorded in the purchases journal at cost price.

Sale of merchandise for cash:

Dr	Bank	(an asset increases with money received) (selling price)
Cr	Sales	(an income which increases equity) (selling price)
Dr	Cost of sales	(an expense that decreases equity) (cost price)
Cr	Inventory	(an asset decreases) (cost price)

The transaction is recorded in the cash receipts journal.

It is important to note that the difference between the cost of sales and the selling price is the gross profit which is the amount by which the equity increases.

Merchandise sold on credit:

Dr	Debtor and	(an asset is created or increased) (selling price)
Dr	Debtors control	
Cr	Sales	(see above) (selling price)
Dr	Cost of sales	(see above) (cost price)
Cr	Inventory	(see above) (cost price)

The transaction is recorded in the sales journal.

When merchandise is returned by a debtor:

Dr	Sales returns	(this has the opposite effect of sales on equity – it decreases equity) (selling price)
Cr	Debtor and	(the asset decreases because the debtor owes the business less) (selling price)
Cr	Debtors control	
Cr	Cost of sales	(this has the opposite effect on equity to the effect when merchandise was sold) (cost price)
Dr	Inventory	(the asset increases by the amount of the merchandise returned) (cost price)

The transaction is recorded in the sales returns journal.

Merchandise returned, previously sold for cash:

If the business has a policy of not repaying cash, a credit note will be issued to the client that can be exchanged for other merchandise.

If the business is willing to refund the cash:

Dr	Sales returns	(see above) (selling price)
Cr	Bank	(the asset bank will decrease to cancel the previous increase) (selling price)

The transaction is recorded in the cash payments journal.
To reinstate the merchandise as part of inventory:

Dr	Inventory	(the asset inventory increases) (cost price)
Cr	Cost of sales	(see above) (cost price)

The transaction is recorded in the general journal

When merchandise is returned to a creditor:

Dr	Creditor and	(because the liability decreases) (cost price)
Dr	Creditors control	
Cr	Inventory	(an asset is decreased – there is less inventory because of the goods returned) (cost price)

The transaction is recorded in the purchases returns journal.

From the above discussion it is clear that the cost price of merchandise sold is recorded at the same time as the sale of the merchandise. This procedure enables the entity to determine the gross profit on each sale and to keep a continuous record of the Rand value of the inventory that has not yet been sold.

However, it remains necessary to do a physical inventory count at least once a year, usually at the end of the financial year. Theoretically the result of the inventory count should yield the same result as the balance on the inventory account. This seldom happens. Some of the main reasons why there is a difference are the theft of inventory, breakages, leakages, and evaporation. This loss of inventory will, of course, not be recorded in the inventory account and will only be detected when a physical count of inventory is done.

GOLDEN RULES

- Perpetual inventory system: Cost of sales is determined with every sales transaction: Debit: Cost of sales, Credit: Inventory with the cost value of the sales.
- Perpetual inventory system: No purchases or purchases returns accounts are kept (see paragraph 7.4.2)
- Perpetual inventory system: A physical inventory count will only disclose shortages (or surpluses) in inventory.

Exercise 7.1

The following exercise illustrates the perpetual inventory system:

	R
Inventory on 1 January 20.1	10 000
Transactions for year up to 31 December 20.1	
Credit purchases	50 000
Cash purchases	40 000
Credit sales (mark-up on cost price is 25%)	75 000
Cash sales (mark-up on cost price is 25%)	25 000

Solution Exercise 7.1

Accounting entries which have to be made

(1) In the perpetual inventory system inventory is an asset. Inventory on hand and inventory which is **purchased** are therefore debited in the **asset** account, inventory, at **cost price** and the contra account such as creditors or bank is credited.

(2) When goods (merchandise) are sold, the sales account (income) is credited with the **selling price** and the contra account such as debtors or bank is debited.

(3) Goods (merchandise) are taken out of the inventory (asset) account at **cost price** (inventory account is credited) and debited to the **cost of sales** (expense) **account.**

LEDGER ENTRIES

GENERAL LEDGER

Dr Inventory **Cr**

20.1			**R**	**20.1**			**R**
Jan 1	Balance	b/d	10 000	Dec 31	Cost of sales		60 000
Dec 31	Trade payables control		50 000		Cost of sales		20 000
	Bank		40 000		Balance	c/d	20 000
			100 000				100 000
20.2							
Jan 1	Balance	b/d	20 000				

Dr Sales **Cr**

20.1			**R**	**20.1**			**R**
Dec 31	Trading account		100 000	Dec 31	Trade receivables control		75 000
					Bank		25 000
			100 000				100 000

Dr Cost of sales **Cr**

20.1			**R**	**20.1**			**R**
Dec 31	Inventory		60 000	Dec 31	Trading account		80 000
	Inventory		20 000				
			80 000				80 000

Dr Trading account **Cr**

20.1			**R**	**20.1**			**R**
Dec 31	Cost of sales		80 000	Dec 31	Sales		100 000
	Profit or loss (Gross profit*)		20 000				
			100 000				100 000

* The gross profit is the difference between sales and cost of sales. The gross profit is transferred to the profit or loss account. Where cost of sales is more than sales, the result is a gross loss.

COMMENTS

- *When determining the cost of sales, it is important to establish whether the mark-up was made on the* ***cost price*** *or the* ***selling price*** *since the price that applies is taken to be 100 (100%).*
  Suppose the mark-up of 25% is on the ***cost price*** *as in the above exercise.*

  Thus:

		%
Cost price	=	*100*
Mark-up	=	*25*
Selling price	=	*125*

The cost price in Rand will obviously be less than the selling price.

Therefore:

Multiply by the smaller figure (100) and divide by the larger figure (125).

To calculate the cost of sales of R75 000

$$\frac{100}{125} \times \frac{75\,000}{1}$$

Cost price = R60 000

If the mark-up of 25% is on the ***selling*** *price:*

		%
Selling price	=	*100*
Mark-up	=	*25*
Cost price	=	*75*

The cost price will again be less than the selling price.

Thus: $\frac{75}{100} \times \frac{75\,000}{1}$

Cost price = R56 250

- *The gross profit, which is also called the trading profit, is determined in the trading account.*
- *The details which are required to calculate the gross profit or loss are transferred to the trading account by means of the general journal:*
  - *The sales account is debited and the trading account is credited (sales are closed).*
  - *The cost of sales account is credited (the account is closed) and the trading account is debited. The balance on the trading account represents the gross profit or loss.*
- *The closing balance of the inventory account (asset) represents the closing inventory.*

7.4.2 The periodic inventory system

Under the periodic inventory system, the purchase of inventory is **not recorded in the inventory account.** A separate account, known as the **purchases account**, is used to record these purchases. It follows that if inventory is returned, for one reason or another, to the seller, the return of inventory cannot be recorded in the inventory account but must be recorded in a separate account known as the **purchases returns account**.

As a result of the above procedure it should be clear that under a periodic inventory system, the cost of sales is not determined at the time of the recording of the sale. The cost of sales can thus only be determined at the end of the financial period after a physical inventory count has been done.

The cost price of inventory sold during an accounting period will thus be determined as follows:

Cost price of inventory at the beginning of the financial year (closing inventory of previous year)

Add: Cost price of inventory purchased during the financial year. (This is the total amount spent on purchases)

Less: Cost price of inventory at the end of the financial year, determined by a physical inventory count. (This is the unsold inventory)

The accounting entries associated with a periodic inventory system can be summarised as follows (VAT is ignored in the examples):

Purchase of inventory for cash:

Dr	Purchases	(under the periodic inventory system, purchases are regarded as an expense that reduces equity)
Cr	Bank	(the asset bank decreases when money is paid out)

The transaction is recorded in the cash payments journal at cost price.

Purchase of inventory on credit:

Dr	Purchases	(see above)
Cr	Trade payables and	(creditors is a liability account which is created or increased)
Cr	Trade payables control	

The transaction is recorded in the purchases journal at cost price.

Sale of merchandise for cash:

Dr	Bank	(the asset increases with the money received)
Cr	Sales	(an income account which increases equity)

The transaction is recorded in the cash receipts journal at selling price.

Sale of merchandise on credit:

Dr	Trade receivables and	(an asset which is created or increased)
Dr	Trade receivables control	
Cr	Sales	(see above)

The transaction is recorded in the sales journal at selling price.

When merchandise is returned by a debtor:

Dr	Sales returns	(equity decreases)
Cr	Trade receivables and	(the asset decreases)
Cr	Trade receivables control	

The transaction is recorded in the sales returns journal at selling price.

Merchandise returned, previously sold for cash:

The policy of the business would determine whether a credit note will be issued (refer to the perpetual inventory system) or whether the cash will be refunded to the client.

The entry for a cash refund will be as follows:

Dr	Sales returns	(the equity decreases)
Cr	Bank	(the asset bank will decrease to cancel the previous increase)

The transaction is recorded in the cash payments journal.

When inventory is returned to a creditor:

Dr	Trade payables and	(the liability decreases)
Dr	Trade payables control	
Cr	Purchase returns	(the actual purchase is reduced)

The transaction is recorded in the purchases returns journal at cost price.

Physical inventory count at the end of the financial year:

Dr	Inventory	(an asset account which is created with the inventory on hand at the end of the financial year)
Cr	Trading account	(a nominal account which is used to determine the gross profit and which increases equity if a gross profit is made)

The transaction is recorded in the general journal.

From the above summary it is clear that, under a periodic inventory system, there is no cost of sales account but a purchases account and that the column headings of subsidiary journals will have to be adapted to accommodate this inventory system. Some of the accounts kept in the general ledger will also have to be changed when the periodic inventory system is in use.

It is very important, in assignments and in the examination, to make sure that you know which inventory system a business uses as this will determine how the subsidiary journals and the general ledger will be laid out.

GOLDEN RULES

- Periodic inventory system: Purchases and purchases returns accounts are kept. These accounts are closed off (made NIL), at the end of the financial period, to the Trading account.
- Periodic inventory system: NO cost of sales account is kept. Cost of sales is determined via entries in the Trading account.
- Periodic inventory system: A physical inventory count is essential.

Exercise 7.2

We use the information from the previous exercise **except** that in this system (periodic system) the closing inventory on 31 December 20.1 is determined first; it is R20 000.

Solution Exercise 7.2

Accounting entries which have to be made

(1) The opening balance on the inventory account (asset) is held in the books throughout the financial period, which is usually a year, without any other entries.

(2) Inventory purchased is recorded (debited) at **cost** price in the **purchases** account (expenditure) and the contra account, for instance creditors or bank, is credited. The purchases account is closed off at the end of the financial year, to the trading account by means of a general journal entry (debit trading account and credit purchases account).

(3) When goods are sold, the sales account (income) is credited with the **selling** price and the contra account, say bank or debtors, is debited.

(4) A physical inventory count is undertaken to determine the closing inventory (usually at cost price — R20 000 in the exercise). To record this figure, the inventory account is debited and the trading account is credited. At this point, you should have a look at the trading account in the ledger. In this system a cost of sales account is **not** kept.

(5) As the opening inventory is either sold or included in the closing inventory, it must be ''transferred''. The inventory account is therefore credited and the trading account debited. This means that the opening inventory is added to purchases. Closing inventory is deducted (the trading account is credited) and the cost of sales is thus calculated.

COMMENTS

- *Determining cost of sales and gross profit*

	R
Opening inventory at cost price	*10 000*
Plus: Purchases at cost price	*90 000*
Inventory available for sale at cost price	*100 000*
Less: Closing inventory at cost price	*20 000*
Cost of sales	*80 000*
Gross profit	*20 000**
Sales	*100 000*

* *Balancing figure*

- *When determining the gross profit, the required details are transferred to the trading account:*
  - *The inventory account is credited and the trading account is debited with the opening inventory (transfer of **opening** inventory).*
  - *The purchases account is credited and the trading account is debited (purchases account is closed).*
  - *The sales account is debited and the trading account is credited (sales account is closed).*

The closing inventory is given (see accounting entry 4 above) and has already been entered in the inventory account and the trading account.

GENERAL LEDGER

Dr Inventory **Cr**

20.1			**R**	**20.1**			**R**
Jan 1	Balance	b/d	10 000	Dec 31	Trading account		10 000
20.1							
Dec 31	Trading account		20 000				

Dr Purchases **Cr**

20.1			**R**	**20.1**			**R**
Dec 31	Creditors control		50 000	Dec 31	Trading account		90 000
	Bank		40 000				
			90 000				90 000

Dr		Sales					Cr
20.1			**R**	**20.1**			**R**
Dec 31	Trading account		100 000	Dec 31	Trade receivables control		75 000
					Bank		25 000
			100 000				100 000

Dr		Trading account					Cr
20.1			**R**	**20.1**			**R**
Dec 31	Inventory (opening)		10 000	Dec 31	Sales		100 000
	Purchases		90 000		Inventory (closing)		20 000
	Profit or loss (gross profit)*		20 000				
			120 000				120 000

* Balancing figure

COMMENTS

- *The gross profit calculated is the same for both systems (see * above and in the previous example).*
- *The main differences between the two systems are:*
  - *(1) In the **perpetual inventory system, purchases** are recorded at cost price in the **inventory** account (asset) and a cost of sales account is kept during the financial period.*
  - *(2) In the **periodic inventory system, purchases** are recorded in the **purchases** account (expenditure) and the cost of sales is calculated, by implication, in the trading account.*

7.4.3 Additional purchase costs

Study paragraph 7.3.2.2 of the prescribed book.

Carriage on purchases and railage are examples of expenses that an entity may have to pay in order to transport the inventory which has been purchased to the premises of the entity. Custom and excise duties may also have to be incurred when inventory is imported.

When the **perpetual** (continuous) inventory system is used, carriage on purchases, and the like, is debited directly to the inventory account, since the cost of sales must be brought into account with each sales transaction and carriage constitutes an integral part of the cost per unit.

When the **periodic** inventory system is used, all purchases of inventory during a financial year are debited to the purchases account. Consequently this account will show the total of all purchases at the end of the financial year. Carriage on purchases (paid for in cash, as well as on credit) by an entity which uses this inventory system, will be debited to the carriage on purchases account. This account will show the total amount spent for transporting inventory to the premises of the entity. When the cost of sales is calculated at the end of the financial year, carriage on purchases must also be taken into account. Custom and excise duties will be treated in a similar manner.

The following illustration will demonstrate how accounts under the different inventory systems will be affected when additional purchase costs are incurred:

Transaction	Perpetual inventory system	Periodic inventory system
Payment of delivery costs on inventory purchased	Dr Inventory Cr Bank or Cr Trade payables (and trade receivables control) if on credit	Dr Carriage on purchases Cr Bank or Cr Trade payables (and trade receivables control) if on credit

Use the following information from the books of Gogo Dealers to calculate the cost of sales:

	R
Inventory (1 January 20.1)	95 000
Purchases	260 000
Carriage on purchases	3 600

A physical inventory count on 31 December 20.1 indicated that inventory on hand amounted to R80 000.

Solution:

	R
Inventory (1 January 20.1)	95 000
Add: Purchases	260 000
Carriage on purchases	3 600
	358 600
Less: Inventory (31 December 20.1)	80 000
Cost of sales	278 600

7.4.4 Drawings and donations of inventory

Drawings and donations of inventory are recorded by means of the general journal at cost price.

Please study the following table carefully:

Transaction	Perpetual inventory system	Periodic inventory system
Inventory taken by owner for personal use	Dr Drawings Cr Inventory	Dr Drawings Cr Purchases
Donation of inventory	Dr Donations Cr Inventory	Dr Donations Cr Purchases

Drawings and donations are not exempted from VAT. The VAT is, however, calculated on the cost price and must be credited to the VAT output account.

7.5 Closing-off of nominal accounts

Study paragraph 7.3 of the prescribed book again.

We have worked through the accounting cycle up to the trial balance. This means that we have tested the arithmetic of our accounts while bearing in mind the shortcomings of a trial balance. As mentioned previously, the main purpose of an entity is to make a profit. To determine the financial result of an entity, the nominal accounts are closed by means of closing journals and transferred to the trading account (a nominal account) **in the case of trading entities** and/or to the profit or loss account.

The gross profit, as determined, is debited to the trading account and credited to the profit or loss account (a nominal account). All the other nominal accounts with credit balances such as rental income and discount received, are debited (closed off) and the profit or loss account is credited.

Similarly, all expense accounts with debit balances such as telephone expenses, rental expenses and salaries, are credited (closed off) and the profit or loss account is debited.

The difference between the debit and credit sides of the profit or loss account results in the profit or loss which is, in turn, transferred to the capital account. The profit or loss account is therefore, also closed off.

Remember that the trading account and the profit or loss account form part of the accounting system.

By using the information in the following trial balance, the closing off of the nominal accounts at the end of the accounting period, will be explained.

TOEKELA DEALERS

PRE-CLOSING TRIAL BALANCE AS AT 31 January 20.1

	Fol	Dr	Cr
		R	R
Capital	B 1		103 400
Drawings	B 2	3 000	
Bank	B 3	4 250	
Inventory – 1 February 20.0	B 4	5 000	
Vehicles (at cost)	B 5	91 000	
Equipment (at cost)	B 6	19 500	
Trade receivables control	B 7	10 100	
Trade payables control	B 8		14 700
Sales	N 1		77 500
Sales returns	N 2	1 500	
Purchases	N 3	52 500	
Purchases returns	N 4		2 500
Rent income	N 5		600
Stationery	N 6	150	
Wages	N 7	10 550	
Water and electricity	N 8	950	
Credit losses (Bad debts)	N 9	300	
Settlement discount granted	N10	150	
Settlement discount received	N11		250
		198 950	198 950

Because of the presence of a purchases account, we know that the periodic inventory system is in use.

On 31 January 20.1 a physical inventory count was done and the value of the inventory was found to be R8 000 according to the inventory list. Remember that this amount still has to be recorded in the books.

> **GOLDEN RULES**
>
> All nominal accounts (i.e. income or revenue and expense acounts) MUST be closed off (made NIL) at the end of the financial period to either the Trading account or the Profit or Loss account.
>
> Only entities that trade i.e. buy and sell merchandise, will have a Trading account.

7.5.1 Trading account

As mentioned previously, the **gross profit** is calculated in the **trading account**. The details required to do this calculation are:

- opening inventory at cost price
- purchases at cost price
- closing inventory at cost price
- sales at selling price
- cost price of goods sold

In accounting terms the calculation would take the following form:

Opening inventory + purchases (all at cost price) – closing inventory (at cost price) = cost price of goods sold.

Gross profit = sales – cost price of goods sold.

Using the details from a previous exercise, we have the following:

R10 000 + R90 000 – R20 000 = R80 000 (cost price of sales)
Gross profit = R100 000 – R80 000
= R20 000

The cost price of goods sold is influenced by all the expenses incurred up to the point where the goods are offered for sale. It includes costs such as carriage on purchases, customs duty, dock dues and freight. Such costs increase the cost prices of goods sold and therefore reduce the gross profit.

Closing inventory

In practice it seldom happens that an entity sells all the available inventory, that is opening inventory and purchases, and that there is **no** closing inventory. If this does happen, the closing inventory is simply left out of the calculation. The closing inventory is actually counted, a list is made and it is valued at cost price or market price, whichever is the lower. It is then recorded in the books by means of a general journal entry. Since the closing inventory is an asset, the inventory account is debited.

The necessary details such as opening inventory, purchases and sales, are transferred from the nominal ledger accounts to the trading account by means of closing transfers in the general journal.

The **gross profit** is obtained when the "balance" on the trading account is determined. The journal entries for the closing transfers are given after the following ledger accounts.

TOEKELA DEALERS

GENERAL LEDGER

Dr Capital **B1** **Cr**

				20.1			**R**
				Jan 31	Balance	b/d	103 400

Dr		Drawings				B2	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	3 000	Jan 31	Capital	J3	3 000

Dr		Bank				B3	Cr
20.1			**R**				
Jan 31	Balance	b/d	4 250				

Dr		Inventory				B4	Cr
20.0			**R**	**20.1**			**R**
Feb 1	Balance	b/d	5 000	Jan 31	Trading account	J1	5 000
20.1							
Jan 31	Trading account	J1	8 000				

Dr		Vehicles (at cost)				B5	Cr
20.1			**R**				
Jan 31	Balance	b/d	91 000				

Dr		Equipment (at cost)				B6	Cr
20.1			**R**				
Jan 31	Balance	b/d	19 500				

Dr		Trade receivables control				B7	Cr
20.1			**R**				
Jan 31	Balance	b/d	10 100				

Dr		Trade payables control				B8	Cr
				20.1			**R**
				Jan 31	Balance	b/d	14 700

Dr		Sales					Cr
20.1			**R**	**20.1**			**R**
Jan 31	Sales returns	J	1 500	Jan 31	Balance	b/d	77 500
	Settlement discount granted	J	150				
	Trading account	J	75 850				
			77 500				77 500

Dr		Sales returns				N2	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	1 500	Jan 31	Sales	J1	1 500

Dr			Purchases			N3	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	52 500	Jan 31	Purchases returns	J	2 500
					Settlement discount received	J	250
					Trading account	J	49 750
			52 500				52 500

Dr			Purchases returns			N4	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Purchases	J1	2 500	Jan 31	Balance	b/d	2 500

Dr			Rent income			N5	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Profit or loss	J2	600	Jan 31	Balance	b/d	600

Dr			Stationery			N6	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	150	Jan 31	Profit or loss	J2	150

Dr			Wages			N7	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	10 550	Jan 31	Profit or loss	J2	10 550

Dr			Water and electricity			N8	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	950	Jan 31	Profit or loss	J2	950

Dr			Credit losses (Bad debts)			N9	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	300	Jan 31	Profit or loss	J2	300

Dr			Settlement discount granted			N10	Cr
20.1			**R**	**20.1**			**R**
Jan 31	Balance	b/d	150	Jan 31	Sales	J2	150
			150				150

Dr			Settlement discount received		N11		Cr
20.1			**R**	**20.1**			**R**
Jan 31	Purchases	J	250	Jan 31	Balance	b/d	250
			250				250

Dr			Trading account		N12		Cr
20.1			**R**	**20.1**			**R**
Jan 31	Inventory (opening)	J	5 000	Jan 31	Sales	J	75 850
	Purchases	J	49 750		Inventory		
	Profit or loss				(closing)	J	8 000
	(Gross profit)	J	29 100				
			83 850				83 850

COMMENTS

CLOSING TRANSFERS OF SETTLEMENT DISCOUNT:

(1) Settlement discount granted transferred to sales:

To transfer settlement discount granted to the sales account the sales account is debited and the settlement discount granted account is credited (thus the account is closed)

20.1		**R**	**R**
Jan 31	*Sales*	*150*	
	Settlement discount granted		*150*
	Closing transfer of settlement discount granted		

(2) Settlement discount received transferred to purchases:

To transfer settlement discount received to the purchases account the settlement discount received account is debited (thus the account is closed) and the purchases account is credited.

20.1		**R**	**R**
Jan 31	*Settlement discount received*	*250*	
	Purchases		*250*
	Closing transfer of settlement discount received		

CLOSING TRANSFERS TO THE TRADING ACCOUNT:

(1) To transfer the opening inventory to the trading account, the inventory account is credited (account is closed) and the trading account is debited by means of a closing transfer in the general journal

20.1			**R**	**R**
Jan 31	*Trading account*	*N12*	*5 000*	
	Inventory	*B4*		*5 000*
	Closing transfer of opening inventory			

(2) To transfer purchases to the trading account, the purchases account is credited (account is closed) and the trading account is debited.

20.1			**R**	**R**
Jan 31	*Trading account*	*N12*	*49 750*	
	Inventory	*N3*		*49 750*
	Closing transfer of purchases account			

(3) To transfer sales returns to the trading account, sales returns is credited (account is closed) and the trading account is debited.

J1

20.1			**R**	**R**
Jan 31	*Sales*	*N12*	*1 500*	
	Sales returns	*N2*		*1 500*
	Closing transfer of sales returns			

(4) To transfer sales to the trading account, sales are debited (account is closed) and the trading account is credited.

20.1			**R**	**R**
Jan 31	*Sales*	*N1*	*75 850*	
	Trading account	*N12*		*75 850*
	Closing transfer of sales account			

(5) To transfer purchases returns to the trading account, purchases returns are debited (account is closed) and the trading account is credited.

J1

20.1			**R**	**R**
Jan 31	*Purchase returns*	*N4*	*2 500*	
	Purchases	*N12*		*2 500*
	Closing transfer of purchases returns			

(6) To record the closing inventory, which is an asset, in the books, the inventory account is debited and the trading account is credited.

J1

20.1			**R**	**R**
Jan 31	*Inventory*	*B4*	*8 000*	
	Trading account	*N12*		*8 000*
	To record the closing inventory in the books			

(7) The trading account is now balanced. The result (balance) is the ***gross profit,*** *namely R29 100, which is transferred by means of a closing transfer to the profit or loss account, where the* ***profit*** *is determined.*

20.1			**R**	**R**
Jan 31	*Trading account*	*N12*	*29 100*	
	Profit or loss	*N13*		*29 100*
	Closing transfer of gross profit to profit or loss account			

(8) *Instead of all the separate closing transfers, a combined entry can be made with the same effect.*

General journal *J1*

20.1			**R**	**R**
Jan 31	*Sales*	*N 1*	*75 850*	
	Inventory (closing)	*B 4*	*8 000*	
	Inventory (opening)	*B 4*		*5 000*
	Purchases	*N 3*		*49 750*
	Trading account	*N12*		*29 100**
	Closing off and transfer of above accounts to trading account			

* *Balancing figure between debits and credits*

The amount of R29 100 is NOT credited in itself to the trading account. Each entry is shown separately in the trading account (being contra entries). This will in effect credit the trading account with the R29 100.

GOLDEN RULE

The trading account, being also a nominal account, is closed off to the profit or loss account. (See the schematic representation.)

7.5.2 Profit or loss account

As mentioned previously, the profit is calculated in the profit or loss account.

The details required to do this calculation are:

- the gross profit
- all business expenditure
- all business income

Dr Profit or loss **N13** **Cr**

20.1			**R**	**20.1**			**R**
Jan 31	Stationery	J	150	Jan 31	Trading account (Gross profit)	J	29 100
	Wages	J	10 550		Rent income	J	600
	Water and electricity	J	950				
	Credit losses	J	300				
	Capital (Total comprehensive income for the year)	J	17 750				
			29 700				29 700

COMMENTS

Closing journal entries

(1) *The gross profit has already been transferred.*

(2) *To transfer the expenditure accounts to the profit and loss account, the expenditure accounts such as stationery, wages, and water and electricity are credited (accounts are closed) and the profit and loss account is debited with each account individually. This is done so that the expenditure on each item can readily be identified.*

CLOSING TRANSFERS OF EXPENDITURE

J2

20.1			**R**	**R**
Jan 31	*Profit or loss*	*N13*	*150*	
	Stationery	*N6*		*150*
	Closing transfer			
	Profit or loss	*N13*	*10 550*	
	Wages	*N7*		*10 550*
	Closing transfer			
	Profit or loss	*N13*	*950*	
	Water and electricity	*N8*		*950*
	Closing transfer			
	Profit or loss	*N13*	*300*	
	Credit losses (Bad debts)	*N9*		*300*
	Closing transfer			

(3) To transfer the income accounts to the profit or loss account, the income accounts such as rental income and commission received are debited (accounts are closed) and the profit or loss account is credited.

CLOSING TRANSFERS OF INCOME *J2*

20.1			**R**	**R**
Jan 31	*Rental income*	*N5*	*600*	
	Profit or loss	*N13*		*600*
	Closing transfer			

(4) Instead of all the individual closing transfers, a combined entry can be made, for instance:

GENERAL JOURNAL *J2*

20.1			**R**	**R**
Jan 31	*Rental income*	*N5*	*600*	
	Profit or loss	*N13*	*11 350**	
	Stationery	*N6*		*150*
	Wages	*N7*		*10 550*
	Water and electricity	*N8*		*950*
	Credit losses (Bad debts)	*N9*		*300*
	Closing off the above accounts against the profit and loss account			

** Balancing figure between debits and credits. Remember that the amounts in the nominal accounts are shown separately in the profit or loss account, which means that the amount of R11 350 is not posted in itself to the account.*

(5) *The profit or loss is the result ("balance") of the profit or loss account.*
(6) *To transfer the profit due to the owner to the capital account, the profit or loss account is debited (account is closed) and the capital account is credited (equity increases).*

> ***GOLDEN RULE***
>
> *The profit or loss account, also being a nominal account, is closed off to the capital account. The profit or loss must be disclosed in the statement of changes in equity. (See the schematic representation.)*

CLOSING TRANSFER OF PROFIT FOR THE YEAR/PERIOD *J3*

20.1			**R**	**R**
Jan 31	*Profit or loss*	*N13*	*17 750*	
	Capital	*B1*		*17 750*
	To transfer profit to capital			

(7) *If the entity suffers a loss, the profit or loss account is credited and the capital account is debited (equity decreases).*

(8) *At the same time the owner owes the amount in the drawings account to the entity. To bring this debt into account, the drawings account is closed against the capital account by crediting drawings and debiting the capital account (equity decreases).*

GENERAL JOURNAL *J3*

20.1			**R**	**R**
Jan 31	*Capital*	*B1*	*3 000*	
	Drawings	*B2*		*3 000*
	To close drawings			

(9) *The complete capital account will then look like this:*

Dr *Capital* **B1** **Cr**

20.1			**R**	**20.1**			**R**
Jan 31	*Drawings*	*J3*	*3 000*	*Jan 31*	*Balance*	*b/d*	*103 400*
	Balance	*c/d*	*118 150*		*Profit or loss*	*J3*	*17 750*
			121 150				*121 150*
				20.1			
				Feb 1	*Balance*	*b/d*	*118 150*

(10) *Post-closing trial balance*

At this stage a post-closing trial balance can be prepared. This trial balance contains the balances of all those accounts the balances of which are to be carried forward to the following financial period. These balances are used to prepare the statement of financial position.

In the above example this trial balance is as follows (note that there are NO nominal account balances, or a balance for the Drawings account, any more, as they have been closed off):

POST-CLOSING TRIAL BALANCE AS AT 31 JANUARY 20.1

	Fol	Dr	Cr
		R	R
Capital	*B1*		*118 150*
Bank	*B3*	*4 250*	
Inventory	*B4*	*8 000*	
Vehicles (at cost)	*B5*	*91 000*	
Equipment (at cost)	*B6*	*19 500*	
Trade receivables control	*B7*	*10 100*	
Trade payables control	*B8*		*14 700*
		132 850	*132 850*

GOLDEN RULE

The post closing trial balance contains only balances of statement of financial position accounts — no nominal accounts.

7.6 Preparation of financial statements

The financial statements of an entity do not form part of the ledger accounts of the entity, but are prepared from the information in the accounts and the balances of such accounts. The statements are prepared separately from the accounting records.

Study paragraph 7.3.4 of the prescribed book.

7.6.1 The statement of profit or loss and other comprehensive income (financial performance)

The information in the **trading** and **profit or loss** accounts is communicated to interested parties by means of the **statement of profit or loss and other comprehensive income.**

TOEKELA DEALERS

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 JANUARY 20.1

	Notes	R
Revenue	2	75 850
Cost of sales		(46 750)
Opening inventory		5 000
Net purchases		49 750
		54 750
Closing inventory		(8 000)
Gross profit		29 100
Other income:		600
Rental income		600
		29 700
Distribution, administrative and other expenses		(11 950)
Stationery		150
Wages		10 550
Water and electricity		950
Credit losses (Bad debts)		300
Profit for the year		17 750
Other comprehensive income for the year		—
Total comprehensive income for the year		17 750

GOLDEN RULE

The statement of profit or loss and other comprehensive income is prepared from information in the trading account and profit or loss account. (See schematic representation.)

7.6.2 The statement of changes in equity

The statement of changes in equity was discussed in paragraph 4.15.2. Please study this paragraph again. This statement is prepared from the information in the **capital account.**

TOEKELA DEALERS

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 JANUARY 20.1

	Capital R
Balance at 1 February 20.0	103 400
Total comprehensive income for the year	17 750
Drawings	(3 000)
Balance at 31 January 20.1	118 150

GOLDEN RULE

The statement of changes in equity is prepared from the information in the capital account. (See schematic representation.)

7.6.3 The statement of financial position

The statement of financial position is compiled from those accounts which are not closed in the process of determining the profit/loss of the entity. These accounts are either assets, liabilities or equity accounts (the balances of these accounts appearing in the post-closing trial balance). All the nominal accounts (expenditure and income) are closed. In the statement of financial position a summary is made of all the entity's assets and liabilities based on the accounting equation, A = E + L.

A statement of financial position shows the entity's financial **position** on a **specific** date, whereas the profit or loss account or statement of profit or loss and other comprehensive income shows the financial **result over a financial period**. The change in equity from one financial period to the following financial period is reflected in the statement of changes in equity.

TOEKELA DEALERS

STATEMENT OF FINANCIAL POSITION AS AT 31 JANUARY 20.1

ASSETS	**Note**	**R**
Non-current assets		110 500
Property, plant and equipment	3	110 500
Current assets		22 350
Inventories		8 000
Trade and other receivables		10 100
Cash and cash equivalents		4 250
Total assets		132 850
EQUITY AND LIABILITIES		
Total equity		118 150
Capital		118 150
Current liabilities		14 700
Trade and other payables		14 700
Total equity and liabilities		132 850

COMMENTS

- *When the totals of the different assets are calculated and added together, the result is equal to:*
  - *the equity, plus*
  - *the totals of the different liabilities which are calculated and added together (In the example there is only one short-term liability, namely creditors.)*
- *Remember that the balances in the statement of financial position are the opening balances of the ledger accounts for the next financial period.*

- *There are usually more items under trade and other receivables and trade and other payables than merely debtors and creditors. These items will be listed under trade and other receivables and trade and other payables and will be added up to give the total for trade and other receivables and trade and other payables.*

GOLDEN RULE

The statement of financial position is prepared from the balances in the post-closing trial balance **after** the note on property, plant and equipment has been prepared.

7.6.4 Notes

1 Accounting policy: The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

2 Income represents net sales to third parties.

3

Property, plant and equipment	Equipment	Vehicles	Total
	R	R	R
Carrying amount:			
Beginning of year	19 500	91 000	110 500
Cost	19 500	91 000	110 500
Accumulated depreciation	(—)	(—)	(—)
Depreciation	(—)	(—)	(—)
Carrying amount:			
End of year	19 500	91 000	110 500
Cost	19 500	91 000	110 500
Accumulated depreciation	(—)	(—)	(—)

No depreciation was written off during the financial year.

GOLDEN RULE

The note on ''property, plant and equipment'' reflects all changes in all non-current assets and the associated accumulated depreciation accounts.

GOLDEN RULE

The total of the ''carrying amount: end of year'' must be the same as the amount disclosed as ''property, plant and equipment'' under ''non-current assets'' in the statement of financial position.

7.7 Gross profit percentage

An entity calculates its gross profit separately because it gives an indication of its performance in its major activity, namely selling goods at a profit, apart from all the other activities in which it engages to support this primary activity.

Study paragraphs 7.3.3 and 7.4 of the prescribed book.

COMMENT

The gross profit is normally expressed as a percentage of either the selling price or the cost price of goods sold.

$$\frac{\textit{Gross profit}}{\textit{Selling price}} \times \frac{100}{1} = \frac{29\ 000}{76\ 000} \times \frac{100}{1}$$

$$= 38{,}2\%$$

$$\frac{\textit{Gross profit}}{\textit{Cost of sales}} \times \frac{100}{1} = \frac{29\ 000}{47\ 000} \times \frac{100}{1}$$

$$= 61{,}7\%$$

Entities usually have a price policy which sets a certain gross profit percentage as an objective. The selling price is determined by adding this profit percentage to the cost price of merchandise. At the end of the period management can compare the actual result (gross profit percentage) with the theoretical percentage (ie the profit-taking policy), or the result can be compared with the results of other years, or with those of other entities in the industry.

7.8 Integrated example

The following information pertains to Hot-Rod Dealers:

HOT-ROD DEALERS

(1) PRE-ADJUSTMENT TRIAL BALANCE AS AT 31 DECEMBER 20.4

	Fol	Debit	Credit
		R	R
Capital	GL 1		250 000
Drawings	GL 2	4 400	
Land and buildings (at cost)	GL 3	180 000	
Vehicles (at cost)	GL 4	120 000	
Furniture (at cost)	GL 5	15 000	
Inventory: Trading — 1 Jan 20.4	GL 6	4 000	
Trade receivables control	GL 7	40 140	
Bank	GL 8	5 900	
Accumulated depreciation: vehicles	GL 9		26 000
Accumulated depreciation: furniture	GL10		3 000
Trade payables control	GL11		50 750
Sales	GL12		253 615
Sales returns	GL13	615	
Carriage on sales	GL14	670	
Commission income	GL15		480
Rental income	GL16		2 860
Purchases	GL17	170 550	
Purchases returns	GL18		550
Carriage on purchases	GL19	400	
Credit losses (Bad debts)	GL20	230	
Insurance	GL21	2 750	
Packaging material	GL22	800	
Salaries	GL23	38 500	
Water and electricity	GL24	3 300	
		587 255	587 255

(2) ADDITIONAL INFORMATION:

(a) Inventory on 31 December 20.4

	R
Trading inventory	6 500
Packaging material	175

(b) Debtor S Sorry is insolvent; his debt of R140 has to be written off as irrecoverable.

(c) An employee is on leave and his January 20.5 salary of R1 500 has been paid to him in advance.

(d) Delivery fees of R100 on purchases have not been paid yet.

(e) An insurance premium of R250 per month has been paid until the end of March 20.5.

(f) Rent income has been paid until the end of January 20.5.

(g) R880 commission was earned on 28 December 20.4; the amount is still outstanding.

(h) Provision must be made for depreciation as follows:

Vehicles — R15 750
Furniture — R 1 275

Required:

(1) Open the accounts of Hot-Rod Dealers in the general ledger with the given balances.

(2) Record the adjustments in the general journal and post to the ledger accounts.

(3) Record the closing journal entries. Post to the ledger and show the trading account and profit or loss account for the year ended 31 December 20.4.

(4) Prepare a post-closing trial balance as at 31 December 20.4.

(5) Prepare the statement of profit or loss and other comprehensive income of Hot-Rod Dealers for the year ended 31 December 20.4.

(6) Prepare the statement of changes in equity for the year ended 31 December 20.4.

(7) Prepare the statement of financial position of Hot-Rod Dealers as at 31 December 20.4.

(8) Prepare the following notes:

(a) Accounting policy

(b) Property, plant and equipment.

Solution: Integrated example

Please note: Only one set of general ledger accounts is used. The journal entries after the accounts, must be posted to the same set of accounts.

HOT-ROD DEALERS

(1) GENERAL LEDGER (POSTINGS INCLUDED)

Dr Capital 1 **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Drawings	J2	4 400	Dec 31	Balance	b/d	250 000
	Balance	c/d	273 610		Profit or loss	J2	28 010
			278 010				278 010
				20.5			
				Jan 1	Balance	b/d	273 610

Dr Drawings 2 **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	4 400	Dec 31	Capital	J2	4 400

Dr Land and buildings (at cost) 3 **Cr**

20.4			**R**				
Dec 31	Balance	b/d	180 000				

Dr Vehicles (at cost) 4 **Cr**

20.4			**R**				
Dec 31	Balance	b/d	120 000				

Dr Furniture (at cost) 5 **Cr**

20.4			**R**				
Dec 31	Balance	b/d	15 000				

Dr		Inventory: Trading				6	Cr
20.4			R	**20.4**			R
Jan 1	Balance	b/d	4 000	Dec 31	Trading account	J2	4 000
Dec 31	Trading account	J2	6 500		Balance	c/d	6 500
			10 500				10 500
20.5							
Jan 1	Balance	b/d	6 500				

Dr		Trade receivables control				7	Cr
20.4			R	**20.4**			R
Dec 31	Balance	b/d	40 140	Dec 31	Credit losses (Bad debts)	J1	140
					Balance	c/d	40 000
			40 140				40 140
20.5							
Jan 1	Balance	b/d	40 000				

Dr		Bank				8	Cr
20.4			R				
Dec 31	Balance	b/d	5 900				

Dr		Accumulated depreciation: vehicles				9	Cr
20.4			R	**20.4**			R
				Dec 31	Balance	b/d	26 000
					Depreciation	J1	15 750
							41 750

Dr		Accumulated depreciation: furniture				10	Cr
20.4			R	**20.4**			R
				Dec 31	Balance	b/d	3 000
					Depreciation	J1	1 275
							4 275

Dr		Trade payables control				11	Cr
				20.4			R
				Dec 31	Balance	b/d	50 750

Dr		Sales				12	Cr
20.4			R	**20.4**			R
Dec 31	Sales returns	J2	615	Dec 31	Balance	b/d	253 615
	Trading account	J2	253 000				
			253 615				253 615

Dr		Sales returns				13	Cr
20.4			R	**20.4**			R
Dec 31	Balance	b/d	615	Dec 31	Sales	J2	615

Dr			Carriage on sales			14	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	670	Dec 31	Profit or loss	J2	670

Dr			Commission income			15	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Profit or loss	J2	1 360	Dec 31	Balance	b/d	480
					Accrued income	J1	880
			1 360				1 360

Dr			Rental income			16	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Income received in advance	J1	220	Dec 31	Balance	b/d	2 860
	Profit or loss	J2	2 640				
			2 860				2 860

Dr			Purchases			17	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	170 550	Dec 31	Purchases returns	J2	550
					Trading account	J2	170 000
			170 550				170 550

Dr			Purchases returns			18	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Purchases	J2	550	Dec 31	Balance	b/d	550

Dr			Carriage on purchases			19	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	400	Dec 31	Trading account	J2	500
	Accrued expenses	J1	100				
			500				500

Dr			Credit losses (Bad debts)			20	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	230	Dec 31	Profit or loss	J2	370
	Trade receivables	J1	140				
			370				370

Dr Insurance **21** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	2 750	Dec 31	Prepaid expenses	J1	750
					Profit or loss	J2	2 000
			2 750				2 750

Dr Packaging material **22** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	800	Dec 31	Inventory: Packaging material	J1	175
					Profit or loss	J2	625
			800				800

Dr Salaries **23** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	38 500	Dec 31	Prepaid expenses	J1	1 500
					Profit or loss	J2	37 000
			38 500				38 500

Dr Water and electricity **24** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Balance	b/d	3 300	Dec 31	Profit or loss	J2	3 300

Dr Prepaid expenses **25** **Cr**

20.4			**R**				
Dec 31	Salaries	J1	1 500				
	Insurance	J1	750				
			2 250				

Dr Accrued income **26** **Cr**

20.4			**R**				
Dec 31	Commission income	J1	880				

Dr		Income received in advance				27	Cr
				20.4			**R**
				Dec 31	Rent income	J1	220

Dr		Accrued expenses				28	Cr
				20.4			**R**
				Dec 31	Carriage on purchases	J1	100

Dr		Inventory: Packaging material				29	Cr
20.4			**R**				
Dec 31	Packaging material	J1	175				

Dr		Depreciation				30	Cr
20.4			**R**	**20.4**			**R**
Dec 31	Accumulated depreciation: vehicles	J1	15 750	Dec 31	Profit or loss	J2	17 025
	Accumulated depreciation: furniture	J1	1 275				
			17 025				17 025

HOT-ROD DEALERS

GENERAL JOURNAL

(2) ADJUSTMENT ENTRIES — 31 DECEMBER 20.4 *J1*

		R	R
Inventory: Packaging material	GL29	175	
Packaging material	GL22		175
Packaging material on hand at 31 December 20.4			
Credit losses (Bad debts)	GL20	140	
Trade receivables control	GL 7		140
Write S Sorry's debt off as irrecoverable			
Prepaid expenses	GL25	1 500	
Salaries	GL23		1 500
Salaries prepaid			
Carriage on purchases	GL19	100	
Accrued expenses	GL28		100
Carriage on purchases still payable			

		R	R
Prepaid expenses	GL25	750	
Insurance	GL21		750
Insurance prepaid for 3 months			
Rental income	GL16	220	
Income received in advance	GL27		220
Rent received in advance for January 20.5			
Accrued income	GL26	880	
Commission income	GL15		880
Commission earned not yet received			
Depreciation	GL30	17 025	
Accumulated depreciation: vehicles	GL 9		15 750
Accumulated depreciation: furniture	GL10		1 275
Provision for depreciation			

HOT-ROD DEALERS

GENERAL JOURNAL

(3) CLOSING ENTRIES — 31 DECEMBER 20.4 *J2*

		R	R
Purchases returns	GL18	550	
Purchases	GL17		550
Closing transfer of purchases returns			
Sales	GL12	615	
Sales returns	GL13		615
Closing transfer of sales returns			
Inventory: Trading (closing)	GL 6	6 500	
Sales	GL12	253 000	
Trading account	GL31		259 500
Closing off and transfer of accounts to trading account			
Trading account	GL31	174 500	
Inventory: Trading (opening)	GL 6		4 000
Purchases	GL17		170 000
Carriage on purchases	GL19		500
Closing off and transfer of accounts to trading account			
Trading account	GL31	85 000	
Profit or loss	GL32		85 000
Transfer of gross profit			
Commission income	GL15	1 360	
Rental income	GL16	2 640	
Profit or loss	GL32		4 000
Closing off of accounts against profit or loss account			

		R	R
Profit or loss	GL32	60 990	
Salaries	GL23		37 000
Water and electricity	GL24		3 300
Carriage on sales	GL14		670
Insurance	GL21		2 000
Packaging material	GL22		625
Credit losses	GL20		370
Depreciation	GL30		17 025
Closing off of accounts against profit or loss account			
Profit or loss	GL32	28 010	
Capital	GL 1		28 010
Transfer of profit to capital			
Capital	GL 1	4 400	
Drawings	GL 2		4 400
Close off drawings against capital			

HOT-ROD DEALERS

GENERAL LEDGER

Dr Trading account **31** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Inventory:			Dec 31	Sales	J2	253 000
	Trading (opening)	J2	4 000		Inventory:		
	Purchases	J2	170 000		Trading (closing)	J2	6 500
	Carriage on purchases	J2	500				
	Profit or loss (gross profit)	J2	85 000				
			259 500				259 500

Dr Profit or loss **32** **Cr**

20.4			**R**	**20.4**			**R**
Dec 31	Salaries	J2	37 000	Dec 31	Trading account (gross profit)	J2	85 000
	Water and electricity	J2	3 300		Commission income	J2	1 360
	Carriage on sales	J2	670		Rental income	J2	2 640
	Insurance	J2	2 000				
	Packaging material	J2	625				
	Credit losses (Bad debts)	J2	370				
	Depreciation	J2	17 025				
	Capital (Total comprehensive income for the year)	J2	28 010				
			89 000				89 000

HOT-ROD DEALERS

(4) POST-CLOSING TRIAL BALANCE AS AT 31 DECEMBER 20.4

	Fol	Debit	Credit
		R	R
Capital	GL 1		273 610
Land and buildings (at cost)	GL 3	180 000	
Vehicles (at cost)	GL 4	120 000	
Furniture (at cost)	GL 5	15 000	
Inventory: Trading	GL 6	6 500	
Packaging material	GL29	175	
Trade receivables control	GL 7	40 000	
Bank	GL 8	5 900	
Accumulated depreciation: vehicles	GL 9		41 750
Accumulated depreciation: furniture	GL10		4 275
Trade payables control	GL11		50 750
Prepaid expenses	GL25	2 250	
Accrued income	GL26	880	
Income received in advance	GL27		220
Accrued expenses	GL28		100
		370 705	370 705

HOT-ROD DEALERS

(5) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.4

	R
Revenue	253 000
Cost of sales	(168 000)
Inventory (1 January 20.4)	4 000
Net purchases	170 000
Carriage on purchases	500
	174 500
Inventory (31 December 20.4)	(6 500)
Gross profit	85 000
Other income	4 000
Rental income	2 640
Commission income	1 360
	89 000
Distribution, administrative and other expenses	(60 990)
Salaries	37 000
Water and electricity	3 300
Carriage on sales	670
Insurance	2 000
Packaging material	625
Credit losses (Bad debts)	370
Depreciation (R15 750 + R1 275)	17 025
Profit for the year	28 010
Other comprehensive income for the year	—
Total comprehensive income for the year	28 010

COMMENTS

- *Revenue are sales less sales returns R (253 615 – 615) = R253 000.*
- *Net purchases are purchases less purchases returns R (170 550 – 550) = R170 000.*

HOT-ROD DEALERS

(6) STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.4

	Capital R
Balance at 1 January 20.4	250 000
Total comprehensive income for the year	28 010
Drawings	(4 400)
Balance at 31 December 20.4	*273 610

* Capital account

HOT-ROD DEALERS

(7) STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.4

ASSETS	**Note**	**R**
Non-current assets		268 975
Property, plant and equipment	2	268 975
Current assets		55 705
Inventories R(6 500 + 175)		6 675
Trade and other receivables R(40 000 + 880)*		40 880
Prepayments		2 250
Cash and cash equivalents		5 900
Total assets		324 680
EQUITY AND LIABILITIES		
Total equity		273 610
Capital		273 610
Current liabilities		51 070
Trade and other payables R(50 750 + 100)#		50 850
Income received in advance		220
Total equity and liabilities		324 680

* Trade receivables R40 000 + Accrued income R880 = R40 880.
# Trade payables R50 750 + Accrued expenses R100 = R50 850.

HOT-ROD DEALERS

(8) NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

1 Accounting policy:

1.1 The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards appropriate to the business of the entiity.

1.2 Property, plant and equipment are shown at cost less accumulated depreciation. Land and buildings are classified as investment properties and are not depreciated.

2

Property, plant and equipment	Land and buildings	Vehicles	Furniture	Total
	R	R	R	R
Carrying amount:				
Beginning of year	180 000	94 000	12 000	286 000
Cost	180 000	120 000	15 000	315 000
Accumulated depreciation	(—)	(26 000)	(3 000)	(29 000)
Depreciation	(—)	(15 750)	(1 275)	(17 025)
Carrying amount:				
End of year	180 000	*78 250	*10 725	268 975
Cost	180 000	120 000	15 000	315 000
Accumulated depreciation	(—)	(41 750)	(4 275)	(46 025)

* Combination of ASSET account and Accumulated Depreciation on ASSET account

7.9 Revision exercises and solutions

7.9.1 Revision exercise 1

(1) Name the two descriptions of profit and the names of the accounts in which each is determined.
(2) What details are necessary to determine the cost of sales?
(3) What two inventory systems are used mainly in practice?
(4) Name the main differences between the two inventory systems.
(5) Calculate the cost price of goods which were sold for R150 000 if the profit mark-up was 20% on the cost price.
(6) Calculate the cost price of goods which were sold for R150 000 if the profit mark-up was 20% on the selling price.
(7) What statement reflects the position of an entity's assets and liabilities?

Solution: Revision exercise 1

(1) Gross profit/Trading account
Profit/Profit or loss account
(2) Opening inventory
Purchases
All other purchase related costs
Closing inventory
(3) Perpetual inventory system
Periodic inventory system
(4) Perpetual inventory system:
(a) Purchases of trading inventory are entered in the inventory account.
(b) Purchase related costs are recorded in the inventory account.
(c) The cost of sales account is updated during the financial period.

Periodic inventory system:

(a) Purchases of trading inventory are recorded in the purchases account.
(b) Purchase related costs are recorded in accounts for each specific type of cost
(c) The cost price of sales *may* be determined in the trading account.

(5)

	%
Cost price	100
Profit mark-up	20
Selling price	120

If the selling price is R120, the cost price is R100

If the selling price is R150 000 the cost price is $\frac{100}{120} \times 150\ 000$

= R125 000

(6)

	%
Selling price	100
Profit mark-up	20
Cost price	80

If the selling price is R100, the cost price is R80

If the selling price is R150 000, the cost price $\frac{80}{100} \times 150\ 000$

= R120 000

(7) Statement of financial position

7.9.2 Revision exercise 2

Record each of the transactions listed below under the appropriate column heading in a business that uses:

(1) a perpetual inventory system
(2) a periodic inventory system

NB: Ignore VAT

		Account in general ledger to be		**Assets**		=	**Equity**		+	**Liabilities**	
No	**Subsidiary journal**	**debited**	**credited**	+	–		–	+		–	+

Transactions:

1 Purchased inventory on credit, R4 000.
2 Paid carriage on purchases by cheque, R400.
3 Purchased inventory and paid by cheque, R8 000.
4 Sold half of the inventory on hand for cash, R10 000.
5 Inventory with a cost price of R1 000 was sold on credit for R2 100.
6 Inventory purchased on credit was returned to the seller, R200.

Solution: Revision exercise 2

(1) ENTITY USING A PERPETUAL INVENTORY SYSTEM

		Account in general ledger to be		Assets		=	Equity		+	Liabilities	
No	Subsidiary journal	debited	credited	+	–		–	+		–	+
1	Purchases journal	Inventory		4 000							
			Trade payables control								4 000
2	Cash payments journal	Inventory		400							
			Bank		400						
3	Cash payments journal	Inventory		8 000							
			Bank		8 000						
4	Cash receipts journal	Cost of sales					6 200				
			Inventory		6 200						
		Bank		10 000							
			Sales					10 000			
5	Sales journal	Cost of sales					1 000				
			Inventory		1 000						
		Trade receivables control		2 100							
			Sales					2 100			
6	Purchases returns journal		Inventory		200						
		Trade payables control								200	

(2) ENTITY USING A PERIODIC INVENTORY SYSTEM

		Account in general ledger to be		Assets		=	Equity		+	Liabilities	
No	Subsidiary journal	debited	credited	+	–		–	+		–	+
1	Purchases journal	Purchases					4 000				
			Trade payables control								4 000
2	Cash payments journal	Carriage on-purchases					400				
			Bank		400						
3	Cash payments journal	Purchases					8 000				
			Bank		8 000						
4	Cash receipts journal	Bank		10 000							
			Sales					10 000			
5	Sales journal	Trade receivables control		2 100							
			Sales					2 100			
6	Purchases returns journal	Trade payables control								200	
			Purhcases returns					200			

7.9.3 Revision exercise 3

Calculate the gross profit of Zetta Traders for the year ended 30 June 20.2. Zetta Traders use the periodic inventory system.

	R
Opening inventory on 1 July 20.1	6 000
Total purchases	100 000
Total sales	140 000
Closing inventory (valued on 30 June 20.2)	10 000

Solution: Revision exercise 3

	R
Opening inventory	6 000
Plus: Purchases	100 000
Goods available for sale	106 000
Less: Closing inventory	10 000
Cost of goods sold	96 000

Gross profit = Sales – cost of sales
= R(140 000 – 96 000)
= R44 000

7.9.4 Revision exercise 4

Now use the data in exercise 3 above to record it in the following ledger accounts on 30 June 20.2 in the general ledger of Zetta Traders:

1. Inventory account
2. Purchases account
3. Sales account
4. Trading account

Solution: Revision exercise 4

ZETTA TRADERS

GENERAL LEDGER

Dr Inventory **1** **Cr**

20.1			**R**	**20.2**			**R**
Jul 1	Balance	b/d	6 000	Jun 30	Trading account		6 000
20.2							
Jul 1	Trading account		10 000				

Dr Purchases **2** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Balance	b/d	100 000	Jun 30	Trading account		100 000

Dr Sales **3** **Cr**

20.2			**R**	**20.2**			**R**
Jun 30	Trading account		140 000	Jun 30	Balance	b/d	140 000

Dr		Trading account				4	Cr
20.2			**R**	**20.2**			**R**
Jun 30	Inventory (opening)		6 000	Jun 30	Sales		140 000
	Purchases		100 000		Inventory (closing)		10 000
	Profit or loss (Gross profit)		44 000				
			150 000				150 000

7.9.5 Revision exercise 5

The following balances appeared in the ledger of P Ellis on 31 August 20.1

	R
Inventory – 1 August 20.1	2 000
Purchases	3 000
Sales	7 300
Carriage on purchases	250
Customs duties	800

After a stocktaking (counting of inventory) on 31 August 20.1 the inventory on hand was valued at R1 500.

Required:

(1) Open the above accounts in the ledger with the given balances or totals.

(2) Record the closing transfers in the general journal and post to the ledger.

(3) Show the gross profit in the trading account.

Solution: Revision exercise 5

P ELLIS

(1) GENERAL LEDGER

Dr		Inventory: Trading				1	Cr
20.1			**R**	**20.1**			**R**
Aug 1	Balance	b/d	2 000	Aug 31	Trading account	J1	2 000
20.1							
Sept 1	Trading account	J1	1 500				

Dr		Purchases				2	Cr
20.1			**R**	**20.1**			**R**
Aug 31	Balance	b/d	3 000	Aug 31	Trading account	J1	3 000

Dr		Sales				3	Cr
20.1			**R**	**20.1**			**R**
Aug 31	Trading account	J1	7 300	Aug 31	Balance	b/d	7 300

Dr		Carriage on purchases				4	Cr
20.1			**R**	**20.1**			**R**
Aug 31	Balance	b/d	250	Aug 31	Trading account	J1	250

Dr		Customs duties				5	Cr
20.1			**R**	**20.1**			**R**
Aug 31	Balance	b/d	800	Aug 31	Trading account	J1	800

(2) CLOSING JOURNAL TRANSFER *J1*

20.1			**R**	**R**
Aug 31	Sales	GL3	7 300	
	Inventory (closing)	GL1	1 500	
	Inventory (opening)	GL1		2 000
	Purchases	GL2		3 000
	Carriage on purchases	GL4		250
	Customs duties	GL5		800
	Trading account	GL6		2 750*
	Closing transfer to trading account			

* Balancing figure

(3)

Dr		Trading account				6	Cr
20.1			**R**	**20.1**			**R**
Aug 31	Inventory (opening)		2 000	Aug 31	Sales		7 300
	Purchases		3 000		Inventory (closing)		1 500
	Carriage on purchases		250				
	Custom duties		800				
	Profit or loss (gross profit)		2 750				
			8 800				8 800

COMMENTS

- *Instead of separate journal entries for closing transfers a combined journal entry is made, but remember that each item is recorded separately in the trading account.*
- *All expenditure which influences the cost price of products, such as carriage on purchases and customs duties in the present example, is added to the purchases (ie the purchase price).*

7.9.6 Revision exercise 6

The following balances appear, among others, in the ledger of G Grabe, a general dealer, on 28 February 20.1, the end of his financial year.

	R
Capital (1/3/20.0)	159 600
Drawings (total for the year)	5 000
Commission income	1 450
Rental expenses	12 850
Salaries and wages	28 460
Credit losses	260
Stationery	150
Municipal taxes	850

Required:

(1) Open the above accounts in the ledger, with the totals or balances as given.

(2) Suppose the gross profit for the year is R46 990. Prepare journal entries for the closing transfers.

(3) Complete the profit or loss account in the ledger, and also the posting of the closing transfers to the ledger accounts, which must be properly closed.

(4) What was the equity at the beginning of the financial year?

(5) What is the equity at the end of the financial year?

(6) What is the difference in the equity at the beginning and the end of the financial year?

Solution: Revision exercise 6

G. GRABE

(1) GENERAL LEDGER

Dr Capital **1** **Cr**

20.1			**R**	**20.0**			**R**
Feb 28	Drawings	J2	5 000	Mar 1	Balance	b/d	159 600
	Balance	c/d	160 470	**20.1**			
				Feb 28	Profit or loss	J2	5 870
			165 470				165 470
				20.1			
				Mar 1	Balance	b/d	160 470

Dr Drawings **2** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	5 000	Feb 28	Capital	J2	5 000

Dr		Commission income				3	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Profit or loss	J1	1 450	Feb 28	Balance	b/d	1 450

Dr		Rental expenses				4	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	12 850	Feb 28	Profit or loss	J1	12 850

Dr		Salaries and wages				5	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	28 460	Feb 28	Profit or loss	J1	28 460

Dr		Credit losses (Bad debts)				6	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	260	Feb 28	Profit or loss	J1	260

Dr		Stationery				7	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	150	Feb 28	Profit or loss	J1	150

Dr		Municipal taxes				8	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Balance	b/d	850	Feb 28	Profit or loss	J1	850

(2) **CLOSING TRANSFERS** *J1*

20.1			**R**	**R**
Feb 28	Trading account		46 990	
	Profit or loss	GL10		46 990
	Transfer of gross profit from trading account			
	Commission income	GL3	1 450	
	Profit or loss	GL9	41 120*	
	Rental expenses	GL4		12 850
	Salaries and wages	GL5		28 460
	Credit losses	GL6		260
	Stationery	GL7		150
	Municipal taxes	GL8		850
	Closing transfer to profit or loss account			

* Balancing figure

(3) **GENERAL LEDGER**

Dr Profit or loss **10** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Rental expenses	J1	12 850	Feb 28	Trading account (Gross profit)	J1	46 990
	Salaries & wages	J1	28 460		Commission income	J1	1 450
	Credit losses	J1	260				
	Stationery	J1	150				
	Municipal taxes	J1	850				
	Capital (Total comprehensive income for the year)	J2	5 870				
			48 440				48 440

CLOSING TRANSFERS *J2*

20.1			**R**	**R**
Feb 28	Profit or loss	GL10	5 870	
	Capital	GL1		5 870
	Transfer of profit to capital			
	Capital	GL1	5 000	
	Drawings	GL2		5 000
	To close drawings account			

(4) R159 600
(5) R160 470 (=R159 600 + R5 870 − R5 000)
(6) R870 (=R5 870 − R5 000) as well as (R160 470 − R159 600)

7.9.7 Revision exercise 7

On 28 February 20.2 the profit or loss account of H Hilton shows a profit of R23 192. The accounts below with balances appear in the ledger on this day:

	R
Capital	88 000
Sundry creditors	5 080
Sundry debtors	3 748
Inventory	12 060
Bank (Dr)	5 316
Petty cash	200
Drawings	4 430
Loan from XY Bank	1 550
Furniture at cost	10 400
Land and buildings at cost	81 668

Required:

(1) Prepare the statement of changes in equity of H Hilton for the period ended 28 February 20.2.

(2) Give a summary of the financial position of H Hilton's entity entity on 28 February 20.2 as indicated in the statement of financial position.

NB: No notes are required.

Solution: Revision exercise 7

H HILTON

(1) STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.2

	R Capital
Balance at 1 March 20.1	88 000
Total comprehensive income for the year	23 192
Drawings	(4 430)
Balance at 28 February 20.2	106 762

H HILTON

(2) STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.2

ASSETS	**R**
Non-current assets	92 068
Property, plant and equiment R(81 668 + 10 400)	92 068
Current assets	21 324
Inventories	12 060
Trade and other receivables	3 748
Cash and cash equivalents R(5 316 + 200)*	5 516
Total assets	113 392
EQUITY AND LIABILITIES	
Total equity	106 762
Capital	106 762
Non-current liabilities	1 550
Long-term borrowing	1 550
Current liabilities	5 080
Trade and other payables	5 080
Total equity and liabilities	113 392

* Bank R5 316 + Petty cash R200.

7.9.8 Revision exercise 8

Use the information in Ntini's Store's trial balance to prepare the following:

(1) Statement of profit or loss and other comprehensive income
(2) Statement of changes in equity
(3) Statement of financial position
(4) Notes to the financial statements

TRIAL BALANCE AS AT 31 DECEMBER 20.4

	Debit	**Credit**
	R	**R**
Land and buildings at cost	40 000	
Vehicles at cost	30 800	
Equipment at cost	20 000	
Drawings	3 600	
Trade receivables control	78 000	
Trade payables control		77 000
Inventory 1/1/20.4	22 080	
Cash on hand	1 440	
Cash sales		46 840
Rental income		280
Settlement discount received		440
Settlement discount granted	1 152	
Purchases	58 368	
Carriage on sales	1 932	
Advertisements	1 176	
Capital		95 284
Credit sales		67 200
Bank	6 840	
Salaries	15 020	
Carriage on purchases	4 356	
Sales returns	600	
Purchases returns		1 120
Import duty	2 800	
	288 164	288 164

Closing inventory on 31 December 20.4 amounts to R15 484.

Solution: Revision exercise 8

NTINI'S STORE

(1) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.4

	Notes	R	
Revenue R(46 840 + 67 200 – 600 – 1 152)	2		112 288
Cost of sales			(70 560)
Inventory (1 January 20.4)		22 080	
Net purchases R(58 368 – 1120 – 440)		56 808	
Carriage on purchases		4 356	
Import duties		2 800	
		86 044	
Inventory (31 December 20.4)		(15 484)	
Gross profit			41 728
Other income:			
Rental income			280
			42 008
Distribution, administrative and other expenses			(18 128)
Carriage on sales		1 932	
Advertisements		1 176	
Salaries		15 020	
Profit for the year			23 880
Other comprehensive income for the year			—
Total comprehensive income for the year			23 880

NTINI'S STORE

(2) STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.4

	Capital R
Balance at 1 January 20.4	95 284
Total comprehensive income for the year	23 880
Drawings	(3 600)
Balance at 31 December 20.4	115 564

NTINI'S STORE

(3) STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.4

ASSETS	Note	R
Non-current assets		90 800
Property, plant and equipment	3	90 800
Current assets		101 764
Inventories		15 484
Trade and other receivables		78 000
Cash and cash equivalents R(6 840 + 1 440)		8 280
Total assets		192 564
EQUITY AND LIABILITIES		
Total equity		115 564
Capital		115 564
Current liabilities		77 000
Trade and other payables		77 000
Total equity and liabilities		192 564

NTINI'S STORE

(4) NOTES FOR THE YEAR ENDED 3 DECEMBER 20.4:

1 Accounting policy:

The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

2 Income represents net sales to customers.

3

Property, plant and equipment	Land and buildings	Equipment	Vehicles	Total
	R	R	R	R
Carrying amount:				
Beginning of year	40 000	20 000	30 800	90 800
Cost	40 000	20 000	30 800	90 800
Accumulated depreciation	(—)	(—)	(—)	(—)
Depreciation	(—)	(—)	(—)	(—)
Carrying amount:				
End of year	40 000	20 000	30 800	90 800
Cost	40 000	20 000	30 800	90 800
Accumulated depreciation	(—)	(—)	(—)	(—)

No depreciation was written off during the financial year.

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- calculate the gross profit?
- calculate the net profit?
- record transactions according to the perpetual inventory system?
- record transactions according to the periodic inventory system?
- post closing journal entries to the trading account and profit or loss account?
- prepare the statement of profit or loss and other comprehensive income?
- prepare the statement of changes in equity?
- prepare the statement of financial position?
- prepare the notes to the financial statements?
- calculate appropriate percentages for evaluation purposes?

TOPIC C

ACCOUNTABILITY FOR CURRENT AND NON-CURRENT ASSETS

Learning outcome

The learner should be able to exercise control, record transactions, and to record the necessary calculations for valuation (where applicable) and adjustments related to current and non-current assets.

CONTENTS

STUDY UNIT

8

Cash and cash equivalents

Learning outcome

Students should be able to know how to treat all transactions related to cash and cash equivalents apart from cash receipts and payments.

Contents

KEY CONCEPTS

- Outstanding cheques
- Deposits
- Bank charges
- Interest on overdraft
- Direct deposits
- Dishonoured cheque
- Stale cheque
- Stopped/cancelled cheque
- Bank reconciliation statement
- Balance per bank account
- Balance per bank statement
- Petty cash float
- Imprest system
- Petty cash journal

8.1 The nature of cash and cash equivalents

Cash, in the accountancy environment, includes not only coins and notes but also postal orders, cheques and credit card transactions. As money is the primary legal tender, every transaction eventually leads to either an outflow or an inflow of money for an entity. Cash equivalents include savings accounts or any investment that can be converted into cash in a period shorter than 12 months. This qualifies cash and cash equivalents as current assets.

Study paragraphs 8.1 and 8.2 of the prescribed book.

GOLDEN RULE

Cash must be handled carefully since a lack of cash may lead to the ‘‘downfall’’ of an entity, accompanied by loss of job opportunities and all sorts of other troubles.

8.2 Internal control over cash

Study paragraph 8.3 of the prescribed book.

As money is necessary for survival, the internal controls applicable to cash are very important for a business. The following are measures that can be used by a business for control purposes:

- Employees’ duties should be divided in such a way that an error by one employee will be detected by another employee in the normal performance of his duties. It should take at least two employees to embezzle cash.
- Cash receipts should be recorded in such a way that the actual cash received can be checked against an independent daily record.
- Cash received should be banked daily.
- All payments except petty cash payments (see paragraph 8.4) should be made by cheque.
- The bank statement should be compared with the cash receipts and cash payments journals.
- The bank statement balance should be reconciled with the bank account balance.

8.3 Reconciliation of the bank statement balance with the bank account balance

8.3.1 Introduction

Study paragraph 8.4 of the prescribed book.

For purposes of safekeeping and cash control, all monies received are deposited at a bank. Although a bank is a financial institution it is managed like a business. Every entity that entrusts its money to a bank is a **creditor of the bank**. People or entities can also borrow money from a bank and will then be debtors of the bank.

The bank will issue, as often as requested or at least once a month, a statement to the entity showing their record of transactions with the entity.

The following will be reflected on the **bank statement**:

- the opening balance (beginning of the month)
- deposits credited during the month
- cheques paid (debited) during the month
- bank charges for the month
- interest charged (debit) on overdraft or paid on a favourable (credit) bank balance
- debit and stop orders for the month
- dishonoured cheques for the month (cheques deposited, but not paid by the drawers' bank)
- correction of errors made by the bank in the previous month

8.3.2 Why a bank reconciliation is necessary

If the bank and the entity keep record of the same transactions the balance of the bank statement and the bank account in the books of the business must be the same.

Study paragraph 8.5.1 of the prescribed book.

In order to ascertain that the bank account in the books of the entity corresponds to the bank statement, a **bank reconciliation statement** is prepared. This means the balance of the bank account in the books of the entity is reconciled with the balance on its bank statement.

The reconciliation process has two steps: first the entity's records are updated to account for actual transactions reflected by the bank statement, and secondly record those transactions to which the bank must still attend to in the **bank reconciliation statement.**

The bank reconciliation could be seen as an extension of the bank statement. An outstanding item that will be credited on the bank statement, must be credited on the bank reconciliation statement and vice versa.

REMEMBER

- A favourable bank **account** balance is on the **debit** side of the bank account as well as on the bank reconciliation statement.
- An unfavourable or overdrawn bank **account** balance is on the **credit** side of the bank account as well as on the bank reconciliation statement.
- A favourable bank **statement** balance is on the **credit** side of the bank statement as well as on the bank reconciliation statement.

- An unfavourable or overdrawn bank **statement** balance (indicated by DT, DR or OD) is on the **debit** side of the bank statement as well as on the bank reconciliation statement.

8.3.3 Procedure to follow in the reconciliation process

- Where a bank reconciliation statement was completed for the previous month the bank statement must first be compared with that bank reconciliation statement to ascertain whether the outstanding items and corrections have been done by the bank. Remember to compare the items on the debit side of the bank reconciliation statement with entries on the debit side of the bank statement and credit entries on the reconciliation with credit entries on the statement.
- Compare the amounts in the cash receipts journal for the current month with the entries on the credit side of the bank statement.
- Compare the amounts in the cash payments journal for the current month with entries on the debit side of the bank statement.

The differences between the bank statement, the previous month's reconciliation statement and the cash journals will then be corrected as explained in the prescribed book.

Study paragraph 8.5.2 in the prescribed book.

GOLDEN RULE

Transactions or corrections which the **entity** must react on, must be recorded in the two cash journals of the **entity,** e.g. bank charges, interest, debit/stop orders, errors in the books of the entity, stale cheques, etc.

GOLDEN RULE

Transactions or corrections which the **bank** must (or will) react on, must be recorded in the **bank reconciliation**, e.g. deposits not yet credited, unpaid cheques and errors made by the bank to be corrected.

Exercise 8.1

The bank reconciliation statement for June 20.0 and the CRJ, CPJ, bank account and bank statement of Benson Traders for July 20.0 reflect the following:

NB: The ticks (✓) indicate that those entries which appear in the books of the entity (i.e. the bank reconciliation at 30 June 20.0 and the two cash journals for July 20.0) also appear on the bank statement for July 20.0). They do not require any further attention. You should also check these by yourself.

BENSON TRADERS

BANK RECONCILIATION STATEMENT AS AT 30 JUNE 20.0

	Debit	Credit
	R	**R**
Favourable balance per bank statement		11 350
Deposit not yet credited (deposited 1/7/20.0)		✓ 2 000
Cheques not yet presented for payment		
No 11 — dated 23/6/20.0 (Donation)	*200	
No 13 — dated 30/6/20.0 (ABC Stores)	✓ 350	
Favourable balance per bank account	12 800	
	13 350	13 350

* *Cheque no 11 was not presented for payment during July and must, again, be shown as outstanding on the July 20.0 bank reconciliation statement.*

BENSON TRADERS

CASH RECEIPTS JOURNAL – JULY 20.0 (bank column only) *CRJ 7*

Doc no	Date	Details	Bank
	15	Cash sales	6 700 ✓
	25	Cash sales	3 300 ✓
	30	Cash sales	1 800
		Rental income	*850*
		Interest income	*80*
			12 730
			B 15

Amounts in italics are amounts entered as a result of the amounts reflected on the bank statement, but not yet in the CRJ. This updates the CRJ.

BENSON TRADERS

CASH PAYMENTS JOURNAL – JULY 20.0 (bank column only) *CPJ 7*

Doc no	Date	Details	Bank
14	5	Municipality	900 ✓
15	7	John's Wholesalers	2 500 ✓
16	9	ABC Stores	1 200 ✓
—	14	S Swan (R/D cheque)*	200 ✓
17	15	Cash (wages)	450 ✓
18	30	Telkom	180
19		Cash (wages)	450 ✓
		*P Saxo (R/D cheque)**	*300*
		Insurance	*500*
		Bank charges	*43*
			6 723
			B 15

Amounts in italics are amounts entered as a result of the amounts reflected on the bank statement, but not yet in the CPJ. This updates the CPJ.

* The accounts of S Swan and P Saxo in the trade receivables ledger, must be debited with the amounts of R200 and R300 respectively. If any discount was involved on receipt of the cheques the discount must be cancelled via the general journal. The accounts of S Swan and P Saxo would be debited and the discount allowed would be credited.

REAL BANK LIMITED

Real Bank Limited
Registered Bank
Reg no 93/2571
VAT-Reg No: 2600101432

Tel: (012) 555–5555
Fax: (012) 555–5556

BENSON TRADERS
PO Box 12345
PRETORIA
0001

Account no 01/200/998/9

Statement no 3
July 20.0

Details	Cheque no	Fee	Date	Debit	Credit	Balance
		R		R	R	R
Balance b/f			01:07			11 350
Deposit			01:07		2 000 ✓	13 350
Cheque	13	1,20	02.07	350 ✓		13 000
Unpaid cheque:						
S Swan		1,00	07:07	200 ✓		12 800
Cheque	15	3,50	09:07	2 500 ✓		10 300
Deposit		7,00	15:07		6 700 ✓	17 000
Cheque	14	1,50	15:07	900 ✓		16 100
Cheque	17	1,20	15:07	450 ✓		15 650
Cheque	16	1,20	20:07	1 200 ✓		14 450
Deposit		3,10	25:07		3 300 ✓	17 750
Unpaid cheque:						
P Saxo		1,60	30:07	300		17 450
Interest			30:07		80	17 530
Deposit: R Charles			30:07		850	18 380
Cheque	19	1,20	30:07	450 ✓		17 930
XYZ Insurance Co		0.50	30:07	500		17 430
Deposit book				20		17 410
Service fees: July				23		17 387

The unticked debit entries were entered in the cash payments journal before the journal was closed off for July 20.0.

The unticked credit entries were entered in the cash receipts journal before the journal was closed off for July 20.0.

ADDITIONAL INFORMATION

(a) S Swan and P Saxo are debtors of the business.
(b) The deposit on 30/07/20.0 is in respect of rent received.

Solution Exercise 8.1

GENERAL LEDGER

Dr Bank **B15** **Cr**

20.0			**R**	**20.0**			**R**
Jul 1	Balance	b/d	12 800	Jul 31	Payments	CPJ 7	6 723
31	Receipts	CRJ 7	12 730		Balance	c/d	18 807
			25 530				25 530
Aug 1	Balance	b/d	18 807				

BANK RECONCILIATION STATEMENT AS AT 31 JULY 20.0

	Debit	**Credit**
	R	**R**
Favourable balance per bank statement		17 387
Deposit not yet credited (deposited 1/8/20.0)		1 800
Cheques not yet presented for payment:		
No 11 — dated 23/6/20.0 (Donation)	200	
No 18 — dated 30/7/20.0 (Telkom)	180	
Favourable balance per bank account	18 807	
	19 187	19 187

Exercise 8.2

The following information relates to Cool Cat Carter Traders:

(a) BANK RECONCILIATION STATEMENT AS AT 31 MAY 20.9

	Dr	**Cr**
	R	**R**
Debit balance as per bank statement	460	
Cheques not yet presented for payment:		
No 404 – dated 20/12/20.8 (L Lombard)	50	
No 447 – dated 25/5/20.9 (M Mitsi)	25	
Deposit not yet credited		115 ✓
Incorrect entry by the bank		20 ✓
Credit balance as per bank account		400
	535	535

(b)

Dr Bank **Cr**

			R	**20.9**			**R**
				Jun 1	Balance	b/d	400

(c) CASH RECEIPTS JOURNAL (bank column only) FOR JUNE 20.9 *CRJ 6*

Date	Details	Fol	Amount
			R
2	Sales		300 ✓
5	Sales		150 ✓
10	L Long		150 ✓
19	J Dlamini		200 ✓
25	Sales		240 ✓
28	Sales		70
			1 110

(d) CASH PAYMENTS JOURNAL (bank column only) FOR JUNE 20.9 *CPJ 6*

Cheque Number	Date	Details	Fol	Amount
				R
450	3	B Nkura		40 ✓
451	8	R Swart		160 ✓
452	17	GEM Builders		300
453	18	K Kum & Co		170
454	27	S Soul		200 ✓
				870

(e) BANK STATEMENT FOR JUNE 20.9

Date	Details	Cheques etc	Deposits	Balance
		R	R	R
1	Balance			460 Dr
4	Deposit		300 ✓	160 Dr
6	Deposit		150 ✓	10 Dr
10	Deposit		150 ✓	140 Cr
12	Cheque 451	160 ✓		20 Dr
15	Deposit — K Nkome		90	70 Cr
20	Cheque 453	116		46 Dr
	Cheque “R/D” (L Long)	150		196 Dr
26	Deposit		240 ✓	44 Cr
28	Cheque 454	200 ✓		156 Dr
	Stop order — insurance	50		206 Dr
	Deposit — T Nkwe		40	166 Dr
	Deposit		115 ✓	51 Dr
	Error corrected		20 ✓	31 Dr
29	Bank interest	20		51 Dr
	Service fees	10		61 Dr
	Cheque 450	40 ✓		101 Dr
30	Deposit		200 ✓	99 Cr

(f) ADDITIONAL INFORMATION:

- According to the entries on cheque number 453, R170 was paid to K Kum & Co.

Required:

(1) Complete only the Bank column of the cash receipts and cash payments journals of Cool Cat Carter Traders for June 20.9.

(2) Show the bank account in the general ledger of Cool Cat Carter Traders properly balanced at 30 June 20.9.

(3) Prepare the bank reconciliation statement of Cool Cat Carter Traders as at 30 June 20.9. Commence with the balance as per bank statement.

Solution Exercise 8.2

COOL CAT CARTER TRADERS

(1) CASH RECEIPTS JOURNAL (bank column only) – JUNE 20.9 *CRJ 6*

Date	Details	Fol	Bank
			R
2	Sales		300 ✓
5	Sales		150 ✓
10	L Long		150 ✓
19	J Dlamini		200 ✓
25	Sales		240 ✓
28	Sales		70
30	*L Lombard/Trade payables control*		*50*
	K Nkome		90
	T Nkwe		*40*
			1 290

CASH PAYMENTS JOURNAL (bank column only) – JUNE 20.9 *CPJ 6*

Cheque No	Date	Details	Fol	Bank
				R
450	3	B Nkuna		40 ✓
451	8	R Swart		160 ✓
452	17	GEM Builders		300
453	18	K Kum & Co		170
454	27	S Soul		200 ✓
	30	*L Long/Trade receivables control*		*150*
		Insurance		*50*
		Interest expenses		*20*
		Bank charges		*10*
				1 100

(2) GENERAL LEDGER

Dr			Bank				Cr
20.9			**R**	**20.9**			**R**
Jun 30	Receipts	CRJ6	1 290	Jun 1	Balance	b/d	400
	Balance	c/d	210	30	Payments	CPJ6	1 100
			1 500				1 500
				20.9			
				Jul 1	Balance	b/d	210

(3) BANK RECONCILIATION STATEMENT AS AT 30 JUNE 20.9

	Dr	Cr
	R	**R**
Credit balance as per bank statement		99
Deposit not yet credited by the bank		70
Cheques not yet presented for payment:		
No 447 – dated 25/5/20.9 (M Mitsi)	25	
No 452 – dated 17/6/20.9 (GEM Builders)	300	
Bank error — cheque No 453 (R170–R116)	54	
Credit balance as per bank account		210
	379	379

COMMENTS

- *L Lombard's cheque (R50) has been outstanding for more than 6 months.*
- *Cheque no 453 issued to K Kum and Co for R170 was entered correctly in the cash payments journal. The bank made the mistake of debiting the bank statement with only R116. A mistake made by the bank must be shown in the bank reconciliation statement. During July 20.9 the bank will correct the error in the bank statement. The (R170 – R116 = R54) correction will then be ticked off against the R54 in the bank reconciliation statement for June 20.9.*

8.4 The petty cash journal

For purposes of control, all payments in a business are made by cheque.

There are, however, smaller amounts to be paid daily, for example for postage, carriage, wages for day workers, etc., for which payment by cheque is too expensive.

Entities usually cash a cheque to provide for a **petty cash float** to pay for these types of expenses.

Items purchased out of the petty cash float are recorded in the petty cash journal, which is part of the cash records but is separate from the cash payments journal. Recording is done from suitable petty cash vouchers authorised by responsible officials of the entity.

The so-called imprest system is preferable for controlling petty cash. The petty cashier is provided with a float of say R100. During the month payments are made and when necessary a cheque is issued to restore the float to R100.

Study paragraph 8.6 of the prescribed book.

Exercise 8.3

Books of Dickson Traders — June 20.9.

Cash cheque 727 for R300 for petty cash on 1 June.

PETTY CASH PAYMENTS — JUNE 20.9

Date	Details	Cash voucher	Amount
			R
4	Stationery	001	25,20
8	Stamps	002	18,10
12	Cleaner's wages	003	60,00
17	Pro-advertising poster	004	26,50
19	Cleaner's wages	005	60,00
21	Stamps	006	8,50
23	Paper	007	21,95
26	Cleaner's wages	008	60,00
27	Taxi fare for messenger	009	10,00

Cash cheque number 795 is issued on 30 June 20.9 to restore the petty cash float to R300.

Required:

(1) Prepare a petty cash journal for June 20.9 with the following payment analysis columns: total, wages, postage, stationery and sundries.

(2) Post to the petty cash control account in the general ledger and balance this account.

Solution Exercise 8.3

DICKSON TRADERS

(1) PETTY CASH JOURNAL — JUNE 20.9 *PCJ 1*

Receipts			Payments											
Date	Fol	Total	Date	Details	Petty cash voucher	Fol	Total	Wages	Postage	Stationery	Sundries Amount	Sundries Fol	Sundries Details
20.9		R	**20.9**				R	R	R	R	R		
Jun 1	CPJ8	300,00	4	Stationery	001		25,20			25,20			
30	CPJ8	290,25	8	Stamps	002		18,10		18,10				
			12	Wages	003		60,00	60,00					
			17	Pro-ad	004		26,50				26,50		Advertising
			19	Wages	005		60,00	60,00					
			21	Stamps	006		8,50		8,50				
			23	Paper	007		21,95			21,95			
			26	Wages	008		60,00	60,00					
			27	Messenger	009		10,00				10,00		Travelling expenses
							290,25	180,00	26,60	47,15	36,50		
			30	Balance	c/d		300,00				300,00		
		590,25					590,25	180,00	26,60	47,15	336,50		
20.9 Jul 1	Balance b/d	300,00											

(2) GENERAL LEDGER

Dr Petty cash control **Cr**

Date	Details	Fol	Amount	Date	Details	Fol	Amount
20.9			**R**	**20.9**			**R**
Jun 1	Bank	CPJ8	300,00	Jun 30	Petty cash payments	PCJ1	290,25
30	Bank	CPJ8	290,25		Balance	c/d	300,00
			590,25				590,25
20.9 Jul 1	Balance	b/d	300,00				

8.5 Revision exercises and solutions

8.5.1 Revision exercise 1

The following information for January 20.9 relates to Monday Trading:

(a) BANK RECONCILIATION STATEMENT AS AT 31 DECEMBER 20.8

	Dr	Cr
	R	R
Debit balance as per bank statement	2 300	
Deposit not yet credited		2 100
Cheques not yet presented for payment:		
No 846 – dated 18/12/20.8 (B Small)	400	
No 849 – dated 21/12/20.8 (L Langa)	300	
Credit balance as per bank account		900
	3 000	3 000

(b) CASH RECEIPTS JOURNAL — JANUARY 20.9 (extract) *CRJ 8*

Date	Details	Analysis of receipts	Bank
		R	R
1	Sales	1 250	
	S Singh	300	1 550
5	Sales	1 500	
	Rental income	500	2 000
18	B Small (cheque 846 cancelled — cheque 856 re-issued)		400
19	Sales	2 000	
	M Nkosi	400	2 400
25	Sales	3 000	3 000
30	R Amer	400	
	Sales	1 200	1 600
			10 950

(c) CASH PAYMENTS JOURNAL — JANUARY 20.9 (extract) *CPJ 8*

Cheque number	Date	Details	Amount	Bank
			R	R
851	3	Purchases		1 500
852		S Sono		100
853	6	Municipality		150
		Water and electricity	100	
		Assessment rates	50	
854	10	Purchases		1 300
855	15	Salaries		2 000
856	18	B Small		400
857	20	H Ebrahim		50
858		Purchases		4 000
859	25	Furniture		2 000
860	30	Petty cash		100
861		R Seema		600
				12 200

(d) BANK STATEMENT — JANUARY 20.9

Date	Details	Cheque number	Cheque etc	Deposits	Balance
			R	R	R
1	Balance				2 300 Dr
				2 100	200 Dr
2				1 550	1 350 Cr
		851	1 500		150 Dr
6				2 000	1 850 Cr
7		853	150		1 700 Cr
11		854	1 300		400 Cr
15		855	2 000		1 600 Dr
20				2 400	800 Cr
21		858	4 000		3 200 Dr
26				3 000	200 Dr
		857	50		250 Dr
				5 000	4 750 Cr
		859	2 000		2 750 Cr
28	Interest		15		2 735 Cr
		856	400		2 335 Cr
30		860	100		2 235 Cr
	Bank charges		35		2 200 Cr
	Stop order		500		1 700 Cr

(e) ADDITIONAL INFORMATION:

- The stop order of R500 represents the annual inventory insurance premium with the Pay Insurance Co.
- The deposit of R5 000 (26 January 20.9) was made by the tenant of an office, in respect of the rental for January and February 20.9.

Required:

(1) Prepare the cash receipts and cash payments journals of Monday Trading for January 20.9.

(2) Show the bank account in the general ledger of Monday Trading, properly balanced at 31 January 20.9.

(3) Prepare the bank reconciliation statement of Monday Trading as at 31 January 20.9. Begin with the balance as per bank statement.

Solution: Revision exercise 1

MONDAY TRADING

(1) CASH RECEIPTS JOURNAL – JANUARY 20.9 (extract)

Date	Details	Bank
31	Subtotal	10 950
	Rental income	5 000
		15 950

CASH PAYMENTS JOURNAL – JANUARY 20.9 (extract)

Date	Details	Bank
31	Subtotal	12 200
	Interest expenses	15
	Bank charges	35
	Insurance	500
		12 750

(2) GENERAL LEDGER

Dr Bank **Cr**

20.9			**R**	**20.9**			**R**
Jan 31	Receipts	CRJ	15 950	Jan 1	Balance	b/d	900
				31	Payments	CPJ	12 750
					Balance	c/d	2 300
			15 950				15 950
20.9							
Feb 1	Balance	b/d	2 300				

(3) BANK RECONCILIATION STATEMENT AS AT 31 JANUARY 20.9

	Dr	Cr
	R	**R**
Credit balance as per bank statement		1 700
Deposit not yet credited		1 600
Cheques not yet presented for payment:		
No 849 – dated 27/12/20.8 (L Langa)	300	
No 852 – dated 3/1/20.9 (S Sono)	100	
No 861 – dated 30/1/20.9 (R Seema)	600	
Debit balance as per bank account	2 300	
	3 300	3 300

8.5.2 Revision exercise 2

The following information relates to Ontario Traders:

(a) Pencil totals of the bank column of the cash journals at 31 December 20.8: **R**

- Cash receipts journal 25 718
- Cash payments journal 27 115

(b) Item that appeared on the bank reconciliation statement at 30 November 20.8 but not on the bank statement:

- Cheque No 632, issued to L Marino on 15 June 20.8 231

(c) Items that appeared in the cash receipts and cash payments journals, but not on the bank statement:

- A deposit entered in the cash receipts journal on 31 December 20.8, banked on 3 January 20.9 792

- Cheque No 985, issued on 29 December 20.8 to the municipality to pay the water and electricity account — 2 211

(d) Items that appeared on the bank statement but not in the cash journals:

• Bank charges	62
• Interest on bank overdraft	70
• A stop order for an annual donation to a primary school	220
• A "R/D" cheque originally received from debtor, S Scholly	308
• A deposit, paid directly into the bank account of Ontario Traders, by a tenant F Flee	1 100

(e) Balance of the bank account in the general ledger at 30 November 20.8 (debit)	297
(f) Balance as per bank statement at 31 December 20.8 (favourable)	990

Required:

(1) Complete the cash receipts and cash payments journal of Ontario Traders for December 20.8.

(2) Show the bank account in the general ledger of Ontario Traders properly balanced at 31 December 20.8.

(3) Prepare the bank reconciliation statement of Ontario Traders as at 31 December 20.8. Begin with the balance as per bank statement.

Solution: Revision exercise 2

ONTARIO TRADERS

(1) CASH RECEIPTS JOURNAL – DECEMBER 20.8 (extract)

Date	Details	Bank
31	Subtotal	25 718
	Rental income	1 100
	L Marino/Trade payables control	231
		27 049

CASH PAYMENTS JOURNAL – JANUARY 20.8 (extract)

Date	Details	Bank
31	Subtotal	27 115
	Bank charges	62
	Interest on bank overdraft	70
	Donations	220
	R Scholly/Trade receivables control	308
		27 775

(2) GENERAL LEDGER

Dr Bank **Cr**

20.8			R	**20.8**			R
Dec 1	Balance	b/d	297	Dec 31	Payments	CPJ	27 775
31	Receipts	CRJ	27 049				
	Balance	c/d	429				
			27 775				27 775
				20.9			
				Jan 1	Balance	b/d	429

(3) BANK RECONCILIATION STATEMENT AS AT 31 DECEMBER 20.8

	Debit	Credit
	R	R
Credit balance per bank statement		990
Deposit not yet credited by the bank		792
Cheque not yet presented for payment:		
No 985 – dated 29/12/20.8 (water and electricity)	2 211	
Credit balance per bank account		429
	2 211	2 211

8.5.3 Revision exercise 3

The following information for September 20.7 relates to Mic Shops:

(a) Pencil totals of the bank columns in the cash journals at 30 September 20.7:	R
• Cash receipts journal	8 658
• Cash payments journal	7 932
(b) Credit balance per bank account in the general ledger at 31 August 20.7	800
(c) Unfavourable balance per bank statement at 30 September 20.7	104
(d) Items appearing in the cash journals but not on the bank statement:	
• A deposit on 30 September 20.7	808
• Cheque No 2894 issued on 30 September 20.7 to pay the telephone account	450
(e) Items appearing on the bank statement but not in the cash journals:	
• Bank charges	35
• Interest on bank overdraft	85
• A direct deposit made by P Parsons, a debtor	300
• A cheque issued by D Dickensen returned by the bank marked "R/D" (insufficient funds)	90
• A deposit meant for another client of the bank	175

(f) Cheque No 2867 for R118 issued to Pros Limited, a creditor, during the month was recorded as R181 in the cash payments journal. This mistake was discovered when the CPJ was compared with the bank statement.

Required:

(1) Complete the cash receipts and cash payments journals of Mic Shops for September 20.7.

(2) Show the bank account in the general ledger of Mic Shops, properly balanced at 30 September 20.7.

(3) Prepare the bank reconciliation statement of Mic Shops as at 30 September 20.7. Begin with the balance as per bank statement.

Solution: Revision exercise 3

MIC SHOPS

(1) CASH RECEIPTS JOURNAL – SEPTEMBER 20.7 (extract)

Date	Details	Bank
30	Subtotal	8 658
	P Parsons/Trade receivables control	300
	Pros Limited/Trade payable control (correction of cheque 2867)	63
		9 021

CASH PAYMENTS JOURNAL – SEPTEMBER 20.7 (extract)

Date	Details	Bank
30	Subtotal	7 932
	Bank charges	35
	Interest on bank overdraft	85
	D Dickensen/Trade receivables control	90
		8 142

(2) GENERAL LEDGER

Dr Bank **Cr**

20.7			**R**	**20.7**			**R**
Sep 30	Receipts	CRJ	9 021	Sep 1	Balance	b/d	800
				30	Payments	CPJ	8 142
					Balance	c/d	79
			9 021				9 021
20.7							
Oct 1	Balance	b/d	79				

(3) BANK RECONCILIATION STATEMENT AS AT 30 SEPTEMBER 20.7

	Debit	Credit
	R	R
Debit balance per bank statement	104	
Deposit not yet credited by the bank		808
Cheques not yet presented for payment:		
No 2894 – dated 30/9/20.7 (telephone)	450	
Debit erroneous deposit	175	
Debit balance per bank account	79	
	808	808

8.5.4 Revision exercise 4

BOOKS OF BUWANG TRADERS

(a) BANK RECONCILIATION STATEMENT AS AT 30 APRIL 20.8

	Dr	Cr
	R	R
Credit balance per bank statement		840,60
Credit outstanding deposit		370,00
Debit cheques not yet presented:		
No 420 – dated 20/11/20.7 (Donations)	2 000,00	
No 691 – dated 17/1/20.8 (LL Traders)	416,40	
No 715 – dated 28/2/20.8 (R Rex)	638,80	
Credit error on bank statement		120,00
Credit balance per bank account		1 724,60
	3 055,20	3 055,20

(b) The bank statement for May 20.8 reflected the following items which did not appear in the cash journals:

- Correction of error — R120
- Deposit credited — R370
- Cheque No 691 for R416,40
- Dishonoured cheque from D Baloyi — R150
- Cheque No 004 for R90 issued by another client of the bank
- Chequebook — R28,50, service fee — R36,40, interest on overdraft — R19,80
- Stop order for insurance premium — R290
- Direct deposit of R200 by J Matla for rental

(c) The cash journals reflected the following differences from the bank statement:

- Deposits not yet entered by the bank — R1 450,00
- Cheques not yet presented:

  No 802 – dated 3/5/20.8 (DR Limited) — R1 964,62
  No 803 – dated 4/5/20.8 (AA Suppliers) — R2 134,20

(d) Cheque No 420 was issued on 20 November 20.7 in favour of Botmelo Day Care as a donation. The day care centre has since closed down.

(e) Balances and pencil totals at the end of May 20.8:

- Cash receipts journal — R11 258,29
- Cash payments journal — R13 428,72
- Bank statement — R977,89 (favourable)

Required:

(1) Complete the cash receipts and cash payments journals of Buwang Traders for May 20.8.

(2) Show the bank account properly balanced.

(3) Prepare the bank reconciliation statement as at 31 May 20.8.

Solution: Revision exercise 4

BUWANG TRADERS

(1) CASH RECEIPTS JOURNAL – MAY 20.8 (extract)

Date	Details	Bank
31	Subtotal	11 258,29
	Rental income	200,00
	Donations (Cheque 420 cancelled)	2 000,00
		13 458,29

CASH PAYMENTS JOURNAL – MAY 20.8 (extract)

Date	Details	Bank
31	Subtotal	13 428,72
	D Baloye/Trade receivables control	150,00
	Bank charges	64,90
	Interest on overdraft	19,80
	Insurance	290,00
		13 953,42

(2) GENERAL LEDGER

Dr Bank **Cr**

20.8			**R**	**20.8**			**R**
May 31	Receipts	CRJ	13 458,29	May 1	Balance	b/d	1 724,60
	Balance	c/d	2 219,73	31	Payments	CPJ	13 953,42
			15 678,02				15 678,02
				20.8			
				Jun 1	Balance	b/d	2 219,73

(3) BANK RECONCILIATION STATEMENT AS AT 31 MAY 20.8

	Debit	Credit
	R	**R**
Credit balance per bank statement		977,89
Deposit not yet credited by the bank		1 450,00
Cheques not yet presented for payment:		
No 715 – dated 28/2/20.8 (R Rex)	638,80	
No 802 – dated 3/5/20.8 (DR Limited)	1 964,62	
No 803 – dated 4/5/20.8 (AA Suppliers)	2 134,20	
Credit incorrect cheque on bank statement		90,00
Credit balance per bank account		2 219,73
	4 737,62	4 737,62

COMMENTS

- *The opening balance of the bank account of R1 724,60 is taken from the given (April's) bank reconciliation statement.*
- *Cheque 715 had still not been presented at the end of May and was recorded on the bank reconciliation statement at 31 May 20.8.*
- *Cheque 420 had not been presented after six months. It was debited to the bank account as it is a **stale cheque.***
- *Interest on the overdraft was entered **separately** and was not included in the bank charges.*

8.5.5 Revision exercise 5

Books of Pitsi Dealers for August 20.4.
Petty cash balance 1 August 20.4 — R200
Petty cash payments — August 20.4:

Date	Details	Cash voucher	Amount
			R
4	Cleaner's wages	072	60
7	Stamps	073	15
11	Cleaner's wages	074	60
14	Stationery	075	35
18	Cleaner's wages	076	60
19	Tea, coffee & milk	077	40
25	Cleaner's wages	078	60
27	Owner took R30 for taxi fare	079	30

On 15 August 20.4 and on 31 August 20.4 cash cheques were issued to restore the float to R200.

Required:

(1) Prepare a petty cash journal for August 20.4 with the following payment columns: total, wages, postage, stationery and sundries.

(2) Post to the petty cash control account in the general ledger and balance this account.

Solution: Revision exercise 5

PITSI DEALERS

(1) PETTY CASH JOURNAL — AUGUST 20.4 *PCJ6*

Receipts			Payments											
Date	Fol	Total	Date	Details	Petty cash voucher	Fol	Total	Wages	Postage	Stationery	Sundries Amount	Sundries Fol	Sundries Details
20.4		R	20.4				R	R	R	R	R		
Aug 1	b/d	200,00	Aug 4	Cleaner's wages	072		60,00	60,00					
15	CPJ6	170,00	7	Stamps	073		15,00		15,00				
15	CPJ6	190,00	11	Cleaner's wages	074		60,00	60,00					
			14	Stationery	075		35,00			35,00			
			18	Cleaner's wages	076		60,00	60,00					
			19	Tea, coffee & milk	077		40,00				40,00		Refreshments
			25	Cleaner's wages	078		60,00	60,00					
			27	Taxi fare – owner	079		30,00				30,00		Drawings
							360,00	240,00	15,00	35,00	70,00		
			30	Balance	c/d		200,00				200,00		
		560,00					560,00	240,00	15,00	35,00	270,00		
20.4 Sep 1	b/d	200,00											

(2) GENERAL LEDGER

Dr Petty cash control **Cr**

20.4			**R**	**20.4**			**R**
Aug 1	Balance	b/d	200	Aug 31	Petty cash payments	PCJ6	360
15	Bank	CPJ6	170		Balance	c/d	200
31	Bank	CPJ6	190				
			560				560
20.4							
Sep 1	Balance	b/d	200				

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- describe the nature and importance of cash?
- describe how control over cash is exercised?
- reconcile the bank statement balance with the bank account balance?
- prepare a petty cash journal?

STUDY UNIT

9

Trade and other receivables

Learning outcome

Students should be able to know how all aspects of debtors are to be treated in the books of an entity.

Contents

KEY CONCEPTS

- Credit transaction
- Trade debtors
- Credit term
- Settlement discount granted
- Credit losses (Bad debts)
- Current assets
- Allowance for credit losses
- Debtors control

9.1 Introduction

A sale made without the buyer paying at the time of the sale is known as a credit transaction. The person or business owing money to an entity which originates from a credit sale is known as a trade debtor. A debtor accepts responsibility for paying the debt within a specific period. The period is known as a credit term and is predetermined in accordance with the credit policy of the entity making the sale. Because some debtors do not pay their accounts, many firms create an allowance for credit losses.

In this study unit we will concentrate on how debtors are encouraged to pay their accounts on time. We will also look at the writing off of bad debts/credit losses, the creation and adjustment of the allowance for credit losses.

Study paragraphs 9.1 and 9.2 of the prescribed book.

9.2 Settlement discount granted

Discount is often offered to debtors in order to encourage a quick settlement of their debts within the stated credit term. The credit term will be shown on the credit invoice, for example, 30 days from the date of sale.

Study paragraph 9.3 of the prescribed book.

Exercise 9.1

A client purchased R2 850 worth of goods on credit on 1 March 20.0.

The client has one month (the credit term) in which to settle the debt. If the client pays before 31 March 20.0, a discount of 2% will be granted. If the client settles the account before 31 March 20.0 it means that the amount payable is R2 793, calculated as follows:

$R2\ 850 - R(2\ 850 \times \frac{2}{100})$

$= R(2\ 850 - 57)$

$= R2\ 793$

If VAT at 14% is included in the R2 850, the VAT collected on behalf of the SA Revenue Service (SARS) (recorded at the date of sale) will amount to R350 and will be recorded in the VAT output account.

The selling price recorded in the sales account in the general ledger is R2 500. The fact that discount has been granted does not affect the original selling price recorded in the general ledger.

The discount will, however, have an influence on VAT. Although the debtor purchased the goods for R2 850 the actual income for the business is R2 500. If 2% discount is allowed on the R2 500 the income for the business is R2 450. VAT (calculated at 14%) on R2 450 is R343. The original VAT of R350 is therefore overstated and must be reduced by R7, in other words 2% $\times$ R350. Such adjustments are made in the ***VAT input account*** and ***NOT*** in the VAT output account. The reason for this is that the net sales (sales less sales returns) multiplied by the VAT percentage, should result in the amount of VAT output.

The discount of R57 thus includes VAT of R7, which may be calculated as follows:

$\frac{57}{1} \text{ X } \frac{14}{114} = \text{R7}$

Solution Exercise 9.1

The accounting entries for the exercise are as follows:

Dr Trade receivables control **Cr**

20.0			**R**	**20.0**			**R**
Mar 1	Sales		2 850	Mar 31	Bank		2 793
					Settlement discount granted		50
					VAT input		7
			2 850				2 850

Dr Sales **Cr**

			R	**20.0**			**R**
				Mar 1	Trade receivables control		2 500

Dr VAT input **Cr**

20.0			**R**	**20.0**			**R**
Mar 31	Trade receivables control		7				

Dr		VAT output					Cr
			R	**20.0**			**R**
				Mar 1	Trade receivables control		350

Dr		Settlement discount granted					Cr
20.0			**R**				**R**
Mar 31	Trade receivables control		50				

Dr		Bank					Cr
20.0			**R**				**R**
Mar 31	Trade receivables control		2 793				

Settlement discount granted will be written off at the end of the financial period and subtracted from sales in the statement of profit or loss and other comprehensive income. The influence of discount on VAT was also discussed in paragraph 5.9.

9.3 Allowance for settlement discount granted

An entity with a settlement discount granted policy applicable to debtors who fully pay their accounts in the settlement period must, at the end of the financial year create an allowance for settlement discount granted for these sales that took place in the current financial year but for who the settlement period falls in the next financial year. The allowance for settlement discount granted will reduce the sales amount that will be recorded. When an allowance for settlement discount granted is created, there are certain accounting procedures that have to be followed. These procedures will be explained by way of the following example:

Exercise 9.2

On 30 June 20.0, the end of the financial year of Brio Traders, outstanding trade receivables control account amounted to R30 000 and the sales amounted to R70 000.

The entity's credit policy allows a settlement discount grated of 5% if the account is settled within 30 days after the sale took place. Over the years the entity established that 90% of their customers take up the settlement discount granted.

90% x R30 000 = R27 000 (debtors that might take up the settlement discount granted offer)

Allowance for settlement discount granted: R27 000 x 5% = R1 350.

Solution Exercise 92

The following accounting entries are necessary to create an allowance for settlement discount granted:

BRIO TRADERS

GENERAL JOURNAL

			Debit	Credit
20.0			**R**	**R**
Jun 30	Sales		1 350	
	Allowance for settlement discount granted			1 350
	Allowance for settlement discount granted created at year-end			

GENERAL LEDGER

Dr Sales **Cr**

20.0			**R**	**20.0**			**R**
Jun	Allowance for settlement discount granted		1 350	Jun 30	Balance		70 000

Dr Allowance for settlement discount granted **Cr**

				20.0			**R**
				Jun 30	Sales		1 350

COMMENTS

- *The sales for the year is, an income of R68 650 and is disclosed as "Revenue" in the statement of profit or loss and other comprehensive income for the year ended 30 June 20.0.*
- *Remember that the trade receivable control account is an asset account and allowance for settlement discount granted is a contra asset account. The allowance for settlement discount granted must be deducted from the trade receivables control account (R30 000) to determine the amount at which trade receivables must be taken into account under trade and other receivables in the statement of financial position.*

Disclosure on the statement of financial position

NAME OF ENTITY

STATEMENT OF PROFIT OR LOSS AND OTHE COMPREHENSIVE INCOME FOR THE YEAR ENDED

	R
Revenue/Income/Sales	xxx xxx
Less: Settlement discount granted	xx xxx
Less: Allowance for settlement discount granted	xx xxx

Debtors are current assets. Current assets are assets which the entity can reasonably expect to realize within the normal business cycle of one year.

According to IFRS, current assets must be disclosed as follows on the statement of financial position:

NAME OF ENTITY

STATEMENT OF FINANCIAL POSITION AS AT

	R
ASSETS	
Current assets	xxx xxx
Inventories	xx xxx
Trade receivables	xx xxx
Less: Allowance for credit losses	x xxx
Less: Allowance for settlement discount granted	x xxx
Cash and cash equivalents	x xxx
Total assets	xxx xxx
EQUITY AND LIABILITIES	

9.4 Interest charged

Many entities charge interest on the outstanding debt if an account is not paid within the credit term. Suppose the entity which sold the goods in the above example has a policy of charging 18% interest per annum on accounts that are not paid within the stated credit terms. If the client does not pay the account of R550 before 31 March 20.0, but only pays it at the end of April, he will be charged 18% per annum interest (for 1 month) on R550 and will have to pay R558,25, calculated as follows:

$R550 + R(550 \times \frac{18}{100} \text{ x } \frac{1}{12})$

$= R(550 + 8{,}25)$

$= R558{,}25$

The interest increases the outstanding balance on the individual debtor's account as well as the balance in the trade receivables control account. This transaction is recorded by means of a general journal entry.

9.5 Credit losses (bad debts)

When a credit transaction occurs there is always a possibility that the debt might not be paid. These debts which are never paid are known as credit losses or irrecoverable debts. Because there is always the possibility that some debts will not be paid, most entities have a policy of creating an allowance for credit losses.

9.5.1 Writing off of credit losses (bad debts)

When management decides that a specific debt will not be recovered, the amount must be written off as a credit loss. When credit losses are written off the debtor's personal account and the trade receivables control account are affected. The amount of the credit loss will be debited to the credit losses account (a nominal account) and credited to the debtor's personal account and the trade receivables control account (a statement of financial position account).

Study paragraphs 9.4 to 9.6 of the prescribed book.

Exercise 9.3

On 15 May 20.0 AM Traders was informed that A Langa, a debtor who owed the entity R660, was declared insolvent. The amount must be written off as irrecoverable. The balance on the trade receivables control account at 30 April was R18 000.

Solution Example 9.3

The accounting entries are as follows:

AM TRADERS

GENERAL JOURNAL

		Fol	Debit	Credit
20.0			**R**	**R**
May 15	Credit losses		660	
	A Langa/Trade receivables control			660
	Write A Langa's account off as irrecoverable			

GENERAL LEDGER

Dr Trade receivables control **Cr**

20.0			**R**	**20.0**			**R**
May 1	Balance	b/d	18 000	May 15	Credit losses		660

Dr Credit losses **Cr**

20.0			**R**				**R**
May 15	Trade receivables control		660				

TRADE RECEIVABLES LEDGER

A Langa

			Debit	Credit	Balance
20.0			**R**	**R**	**R**
May 1	Account rendered				660
	Credit losses			660	—

9.5.2 Allowance for credit losses

It is customary for entities selling goods on credit to create an allowance for credit losses. This allowance is based on the estimated credit losses (bad debts). The prospect of not realising all debts is typical of this type of uncertainty. When an allowance for credit losses is created, there are certain accounting procedures that have to be followed. These procedures will be explained with the aid of the following example:

Exercise 9.4

On 30 June 20.0, the end of the financial year of Trio Traders, outstanding trade debtors amounted to R20 000.

The financial manager determined that the allowance for credit losses account should amount to R800 at 30 June 20.0.

Solution Exercise 9.4

The following accounting entries are necessary to create a new allowance for credit losses:

TRIO TRADERS

GENERAL JOURNAL

			Debit	Credit
20.0			**R**	**R**
Jun 30	Credit losses		800	
	Allowance for credit losses			800
	Allowance for credit losses created at year end			

GENERAL LEDGER

Dr Trade receivables control **Cr**

20.0			**R**				
Jun 30	Balance	b/d	20 000				

Dr Allowance for credit losses **Cr**

				20.0			**R**
				Jun 30	Credit losses		800

Dr Credit losses **Cr**

20.0			**R**				
Jun 30	Allowance for credit losses		800				

CLOSING JOURNAL ENTRY

			Debit	Credit
20.0			**R**	**R**
Jun 30	Profit or loss		800	
	Credit losses			800
	Closing credit losses off to the profit or loss account			

GENERAL LEDGER

Dr Credit losses **Cr**

20.0			**R**	**20.0**			**R**
Jun 30	Allowance for credit losses		800	Jun 30	Profit or loss		800

Dr Profit or loss (extract) **Cr**

20.0			**R**				
Jun 30	Credit losses		800				

COMMENTS

- *When an allowance is created the only accounts which are affected are the credit losses account (a nominal account) and the allowance for credit losses (a contra asset account). In the general ledger the balance on the trade receivables control account remains R20 000. The trade receivables' control account will only be credited when **actual** credit losses are verified.*
- *The allowance for credit losses (R800) is deducted from trade receivables (R20 000). The R19 200 is shown in the statement of financial position as current assets under trade and other receivables.*
- *The R800 credit losses is closed off to the profit and loss account.*

9.5.3 Increasing the allowance for credit losses (bad debts)

Exercise 9.5

On 30 June 20.1 the outstanding trade debtors of Trio Traders (follows on Exercise 10.3) amounted to R30 000. (Credit losses already written off during the year amounted to R730.)

The financial manager determined that the allowance for credit losses account should amount to R1 200 at 30 June 20.1.

The following accounting entries are necessary to adjust the allowance for credit losses:

TRIO TRADERS

GENERAL JOURNAL

			Debit	Credit
20.1			**R**	**R**
Jun 30	Credit losses		400	
	Allowance for credit losses			400
	Allowance for credit losses adjusted: **R**			
	New allowance *1 200*			
	Existing allowance *800*			
	Amount needed for adjustement *400*			

GENERAL LEDGER

Dr Trade receivables control **Cr**

20.1			**R**				
Jun 30	Balance	b/d	30 000				

Dr Allowance for credit losses **Cr**

				20.0			**R**
				Jul 1	Balance	b/d	800
				20.1			
				Jun 30	Credit losses		400
							1 200

Dr Credit losses **Cr**

20.1			**R**	**20.1**			**R**
Jun 30	Balance	b/d	730	Jun 30	Profit or loss		1 130
	Allowance for credit losses		400				
			1 130				1 130

COMMENTS

- *The credit losses written off during the year were debited to the credit losses account (the current balance of R730) and were credited to the trade receivable control account* ***before*** *the balance of R30 000 was calculated on the control account.*

- *The trade receivables control account is not affected by a change in the allowance for credit losses.*
- *The allowance for 20.0 (R800) is deducted from the allowance calculated for 20.1 (R1 200). Only the difference is debited to credit losses and credited to the allowance for credit losses.*
- *Remember that the trade receivables control account is an asset account and allowance for credit losses is a contra asset account. The allowance for credit losses (R1 200) must be deducted from the trade receivables control account (R30 000) to determine the amount at which debtors must be taken into account under trade and other receivables in the statement of financial position.*
- *The credit losses for the year (R730) and the difference in the allowance (R400) are written off as an expense in the profit and loss account (R1 130).*

9.5.4 Decreasing the allowance for credit losses

Exercise 9.6

On 30 June 20.2 the outstanding trade debtors of Trio Traders (follows on Exercise 9.5) amounted to R25 000. (Credit losses already written off during the year amounted to R960.)

The financial manager determined that the allowance for credit losses account should amount to R1 000 at 30 June 20.2.

Solution Exercise 9.6

The following accounting entries are necessary to adjust the allowance for credit losses:

TRIO TRADERS

GENERAL JOURNAL

				Debit	Credit
20.2				**R**	**R**
Jun 30	Allowance for credit losses			200	
	Credit losses				200
	Allowance for credit losses adjusted:	**R**			
	Existing allowance	*1 200*			
	New allowance	*1 000*			
	Amount needed for adjustment	*200*			

GENERAL LEDGER

Dr		Trade receivables control					Cr
20.2			**R**				
Jun 30	Balance	b/d	25 000				

Dr		Allowance for credit losses					Cr
20.2			**R**	**20.1**			**R**
Jun 30	Credit losses		200	Jul 1	Balance	b/d	1 200
	Balance	c/d	1 000				
			1 200				1 200
				20.2			
				Jul 1	Balance	b/d	1 000

Dr		Credit losses					Cr
20.2			**R**	**20.2**			**R**
Jun 30	Balance	b/d	960	Jun 30	Allowance for credit losses		200
					Profit or loss		760
			960				960

COMMENTS

- *The trade receivables control account is not affected by changes in the allowance for credit losses.*
- *The credit balance that has increased from the original R800 to R1 200 must now be reduced to R1 000. This has to be done by making a debit entry in the account. However, the balance carried forward on the allowance for credit losses account will **always** be a **credit balance**.*
- *The fact that in the years 20.0 and 20.1 the entries in the credit losses account have been debited does not mean that all the entries posted to the account will be debits. It is self-evident that if the allowance is decreased, the difference between the existing and the new allowance has to be added back. The only way this can be done is to debit the allowance for credit losses account and credit the credit losses account.*

9.5.5 Writing off credit losses (bad debts) when an allowance for credit losses exists

If credit losses are written off where an allowance for credit losses exists, one of two methods can be followed:

METHOD 1:

As credit losses occur, the credit losses can be written off against the allowance account: debit the allowance account and credit the debtor's personal account and the trade receivables control account.

Exercise 9.7

On 30 November 20.0 Trio Traders (follows on Exercise 9.3) was informed that B Down, a debtor who owed R730, was declared insolvent.

During the financial year that ended on 30 June 20.1 credit sales amounted to R40 000 and R29 270 was received from debtors in payment of their accounts. The financial manager determined that the allowance for credit losses account should amount to R1 200 at 30 June 20.1.

Solution Exercise 9.7

The accounting entries are as follows:

TRIO TRADERS

GENERAL JOURNAL

			Debit	Credit
20.1			**R**	**R**
Nov 30	Allowance for credit losses		730	
	B Down/Trade receivables control			730
	Write B Down's account off as irrecoverable			

GENERAL LEDGER

Dr Trade receivables control **Cr**

20.0			**R**	**20.0**			**R**
Jul 1	Balance	b/d	20 000	Nov 30	Allowance for credit losses		730
20.1				**20.1**			
Jun 30	Sales		40 000	Jun 30	Bank		29 270
					Balance	c/d	30 000
			60 000				60 000
20.1							
Jul 1	Balance	b/d	30 000				

Dr Allowance for credit losses **Cr**

20.0			**R**	**20.0**			**R**
Nov 30	Trade receivables control		730	Jul 1	Balance	b/d	800
20.1				**20.1**			
Jun 30	Balance	c/d	1 200	Jun 30	Credit losses*		1 130
			1 930				1 930
				20.1			
				Jul 1	Balance	b/d	1 200

*Balancing figure

Dr		Credit losses					Cr
20.1			**R**	**20.1**			**R**
Jun 30	Allowance for credit losses		1 130	Jun 30	Profit or loss		1 130

TRADE RECEIVABLES LEDGER

B Down

		Debit	Credit	Balance
20.0		**R**	**R**	**R**
Jul 1	Account rendered			730
Nov 30	Allowance for credit losses		730	—

Method 2:

The allowance for credit losses account remains unchanged during the year. Credit losses that occur during the year are written off against the credit losses account.

Exercise 9.8

On 30 November 20.0 Trio Traders (follows on Exercise 9.3) was informed that B Down, a debtor who owed R730, was declared insolvent.

During the financial year that ended on 30 June 20.1 credit sales amounted to R40 000 and R29 270 was received from debtors in payment of their accounts. The financial manager determined that the allowance for credit losses account should amount to R1 200 at 30 June 20.1.

Solution Exercise 9.8

The accounting entries are as follows:

TRIO TRADERS

GENERAL JOURNAL

			Debit	Credit
20.0			**R**	**R**
Nov 30	Credit losses		730	
	B Down/Trade receivables control			730
	Write B Down's account off as irrecoverable			

GENERAL LEDGER

Dr		Trade receivables control					Cr
20.0			**R**	**20.0**			**R**
Jul 1	Balance	b/d	20 000	Nov 30	Credit losses		730
20.1				**20.1**			
Jun 30	Sales		40 000	Jun 30	Bank		29 270
					Balance	c/d	30 000
			60 000				60 000
20.1							
Jul 1	Balance	b/d	30 000				

Dr Allowance for credit losses Cr

				20.0			**R**
				Jul 1	Balance	b/d	800
				20.1			
				Jun 30	Credit losses		400
							1 200

Dr Credit losses Cr

20.0			**R**	**20.1**			**R**
Nov 30	Trade receivables control		730	Jun 30	Profit or loss		1 130
20.1							
Jun 30	Allowance for credit losses		400				
			1 130				1 130

TRADE RECEIVABLES LEDGER

B Down

		Debit	Credit	Balance
20.0		**R**	**R**	**R**
Jul 1	Account rendered			730
Nov 30	Credit losses		730	—

COMMENT

- *The amount written off as credit losses in the profit or loss account remains unchanged. (Refer to previous exercise.)*

9.5.6 Recovery of credit losses (bad debts) written off

When money is recovered that was previously written off as irrecoverable (a credit loss), it must be recorded and disclosed separately. An account, **credit losses recovered,** will be opened for this purpose. The money recovered will be debited against the bank account and the credit losses recovered account will be credited. Credit losses recovered are seen as an income and are added to other operating income in the statement of profit or loss and other comprehensive income. This is to cancel the expense written off previously.

Study paragraph 9.7 of the prescribed book.

9.5.7 VAT, credit losses and credit losses recovered

The amount owed by a debtor always includes VAT. The VAT collected on credit sales is paid over every second month to the SA Revenue Service. If a debt is not paid and has to be written off, the seller is entitled to claim the VAT portion that was included in the credit losses back from the SA Revenue Service.

Similarly, when a debt/credit loss which was previously written off is recovered, the seller is responsible for paying over to the SA Revenue Service the VAT component of that sale.

Study paragraphs 9.8 to 9.11 of the prescribed book.

9.6 Presentation on the statement of financial position

Debtors are current assets. Current assets are assets which the entity can reasonably expect to realise within the normal business cycle of one year.

According to IFRS, current assets must be disclosed as follows on the statement of financial position:

NAME OF ENTITY

STATEMENT OF FINANCIAL POSITION AS AT ....

ASSETS	**R**
Non-current assets	
Current assets	xxx xxx
Inventories	xx xxx
Trade and other receivables	xx xxx
Cash and cash equivalents	x xxx
Total assets	xxx xxx
EQUITY AND LIABILITIES	

9.7 Trade receivables control account

Many entities sell their goods on credit. If only one or two credit transactions were involved an account for the debtor can be opened in the general ledger and the specific debtor will be debited and the sales account credited with the amount of the transaction. But, as we explained in study unit 5, if an entity mainly, or to a great extent, sells on credit, a sales journal can be used for all the credit sales transactions. A separate ledger is then kept in which an account for every debtor is listed. Posting from the journals to the trade receivables ledger takes place on a daily basis.

To obtain a complete record of all the transactions, a control account is kept in the general ledger. The trade receivables control account contains a **summary** of all the entries made in the individual debtors' accounts. Posting to the trade receivables' control account takes place once a month when the totals of all the subsidiary journals are finalised.

Study paragraphs 9.12 to 9.14 of the prescribed book.

The procedure can be summarised as follows:

Individual entries in the sales journal	Posted to	Personal accounts of debtors (debit side) in the trade receivables ledger on the day the transaction took place.
Total of the debtors control column in the sales journal	Posted to	Trade receivables control account (debit side) on the last day of the month.
Individual entries in the sales returns journal	Posted to	Personal accounts of debtors (credit side) in the trade receivables ledger on the day the transaction took place.
Total of the debtors control column in the sales returns journal	Posted to	Trade receivables control account (credit side) on the last day of the month.
Individual entries in the cash receipts journal	Posted to	Personal accounts of debtors (credit side) in the trade receivables ledger on the day the transaction took place.
Total of the debtors control column in the cash receipts journal	Posted to	Trade receivables control account (credit side) on the last day of the month.

Exercise 9.9

The opening balances on the individual debtors are: debtor A: R450,00, debtor B: R680,00 and debtor C: R220,00.

JOURNALS

SALES JOURNAL — MAY 20.2 *SJ1*

Date	Debtor	Fol	Sales	VAT output	Trade receivables
			R	R	R
2	A	DL1	200,00	20,00	220,00
	B	DL2	400,00	40,00	440,00
	C	DL3	100,00	10,00	110,00
			700,00	70,00	770,00
					GL 5

SALES RETURNS JOURNAL — MAY 20.2 *SRJ1*

Date	Debtor	Fol	Sales returns	VAT output	Trade receivables
			R	R	R
8	B	DL2	40,00	4,00	44,00
	C	DL3	20,00	2,00	22,00
			60,00	6,00	66,00
					GL 5

CASH RECEIPTS JOURNAL — MAY 20.2 *CRJ1*

Date	Details	Fol	Bank	Trade receivables	Discount allowed	VAT input
			R	R	R	R
15	A	DL1	600,00	670,00	64,00	*6,00
	B	DL2	400,00	400,00		
	C	DL3	500,00	522,00	20,00	2,00
			1 500,00	1 592,00	84,00	8,00
				GL5		

* Approximation

GENERAL JOURNAL — MAY 20.2 *J1*

Date	Details	Fol	Total Debit	Total Credit
			R	R
15	C/trade receivables	DL3	803,00	
	Furniture			730,00
	VAT output			73,00
	Sold furniture on credit to C			
18	Furniture		230,00	
	VAT input	DL3	23,00	
	C/trade receivables			253,00
	Received			
	furniture back from C			
			1 056,00	1 056,00

Required:

(1) Prepare the trade receivables control account in the general ledger.

(2) Prepare the ledger accounts of the three debtors in the trade receivables ledger.

* List of opening balances of debtors

	R
A	450,00
B	680,00
C	220,00
	1 350,00

Solution Exercise 9.9

GENERAL LEDGER

Dr Trade receivables control **GL5** **Cr**

20.2			**R**	**20.2**			**R**
May 1	Balance*	b/d	1 350,00	May 31	Sales returns	SRJ1	66,00
31	Sales	SJ1	770,00		Bank and discount	CRJ1	1 592,00
	Furniture	J1	730,00		Furniture	J1	230,00
	VAT output	J1	73,00		VAT input	J1	23,00
					Balance	c/d	1 012,00
			2 923,00				2 923,00
20.2							
Jun 1	Balance**	b/d	1 012,00				

GOLDEN RULE

The trade receivables control account is a summary of ALL transactions related to all the individual debtor accounts in the trade receivables ledger.

GOLDEN RULE

What was done (Dr or Cr) to the individual debtor accounts, must be done IN TOTAL to the trade receivables control account.

TRADE RECEIVABLES LEDGER (General ledger format)

Dr A **DL1** **Cr**

20.2			**R**	**20.2**			**R**
May 1	Balance*	b/d	450,00	May 15	Bank and discount	CRJ1	670,00
2	Sales	SJ1	220,00				
			670,00				670,00

Dr B **DL2** **Cr**

20.2			**R**	**20.2**			**R**
May 1	Balance*	b/d	680,00	May 8	Sales returns	SRJ1	44,00
2	Sales	SJ1	440,00	15	Bank	CRJ1	400,00
				31	Balance	c/d	676,00
			1 120,00				1 120,00
20.2							
Jun 1	Balance**	b/d	676,00				

Dr			C			DL3	Cr
20.2			**R**	**20.2**			**R**
May 1	Balance*	b/d	220,00	May 8	Sales returns	SRJ1	22,00
2	Sales	SJ1	110,00	15	Bank and		
15	Furniture	J1	803,00		discount	CRJ1	522,00
				18	Furniture	J1	253,00
				31	Balance	c/d	336,00
			1 133,00				1 133,00
20.2							
Jun 1	Balance**	b/d	336,00				

** List of closing balances of debtors

	R
A	—
B	676,00
C	336,00
	1 012,00

GOLDEN RULE

The total of all the balances of the individual debtor accounts in the trade receivables ledger must equal the balance of the trade receivables control account in the general ledger.

COMMENTS

- *The totals from the journals are posted to the control account.*
- *The opening and closing **balances on the control account** are the same as the **totals of the lists** of balances of the individual debtors.*
- *When debtors settle their accounts and they receive discount, VAT is also affected. The actual amount received from the debtor is shown in the bank column, the discount in the settlement discount allowed column and the VAT that must be cancelled in the VAT input column. These three amounts must add up to the amount shown in the debtors column. The total of the debtors column that is posted to the trade receivables control account at the end of the month already includes discount and is posted as bank and discount. The totals of the settlement discount granted column and the VAT input column are consequently not credited separately to the trade receivables control account.*

Exercise 9.10

The following information in respect of June 20.1 was obtained from the financial records of N Nelson:

	R
Balance on the trade receivables control account – 31 May 20.1	19 190
Totals for the month:	
Cash receipts journal:	
Trade receivables column	16 860
Settlement discount granted column	1 470
Sales journal (Trade receivables column)	19 500
Sales returns journal (Trade receivables column)	4 615
General journal:	
Credit losses written off	751
Certain accounts with debit balances transferred from the creditors ledger to the trade receivables ledger	46
Interest charged on overdue accounts	160
List of individual debtors per trade receivables ledger	16 230

In the process of reconciling the balance on the trade receivables control account with the list of balances per trade receivables ledger, the following errors were discovered:

(1) Sales invoice No 1001 for R2 270 which had been entered correctly in the sales journal, was entered in A Abel's account as R2 770.
(2) Credit note No 52 for R30 was entered correctly in the sales returns journal but erroneously posted as a debit to the account of B Brown.
(3) A cheque for R75 received from P Pet in full settlement of his account was incorrectly analysed as sales in the cash receipts journal.
(4) The sales journal was overcast by R1 000. (''Overcast'' means that the amounts have been added up incorrectly and that the total amount is R1 000 more than it should be.)

Required:

(1) Prepare the trade receivables control account at 30 June 20.1 properly balanced. Each entry must indicate the correct contra ledger account.

(2) Reconcile the balance on the trade receivables control account as determined in 1 above with the total of the debtors list.

N NELSON

(1) GENERAL LEDGER

Dr Trade receivables control **Cr**

20.1			**R**	**20.1**			**R**
Jun 1	Balance	b/d	19 190	Jun 30	Bank (3)	CRJ	16 860
30	Sales R(19 500 – 1 000) (1)	SJ	18 500		Sales returns	SRJ	4 615
					Credit losses	GJ	751
	Trade payables control (2)	GJ	46		Sales	GJ	75
	Interest received	GJ	160		Balance	c/d	15 595
			37 896				37 896
20.1							
Jul 1	Balance	b/d	15 595				

(2) RECONCILIATION

		R	R
Total of the list of debtors' balances			16 230
Less: Error on A Abel's account R(2 770 – 2 270)	(5)	(500)	
Incorrect posting of credit note, B Brown (R30 × 2)	(4) and (5)	(60)	
Correction of error — P Pet		(75)	(635)
Balance as per Trade receivables control account			15 595

Remarks

(1) When an error is made in totalling a journal the mistake only affects the control account; it cannot affect the debtors list.

(2) It is possible for a creditor of a business to be a debtor of that business as well. It can also happen that a debtor may have a credit balance on his account. If either of these situations occurs it is advisable to transfer the debit or credit amount to the trade receivables or trade payables control accounts respectively.

(3) The amount in the debtors column is R16 860. This amount is the total amount received from debtors including any settlement discount granted.

(4) When an entry was made on the wrong side of an account, the effect of the correction is double the amount of the error. First, the wrong entry must be cancelled and then the amount must be correctly entered.

(5) In cases of both A Abel and B Brown, the entries in the control account are correct. The errors have to be corrected in the accounts of the debtors and then on the list.

When answering a question on the reconciliation of a trade receivables control account with the list of debtors, it is very important that you read the question very carefully. As you are reading, decide what type of error is involved. Also ensure that when you do the control account, you use the correct contra ledger account.

9.8 Revision exercises and solutions

9.8.1 Revision exercise 1

Client A buys R750 of goods from B Enterprises. Client A has 60 days in which to settle the account. If the account is settled within 30 days a discount of 5% is granted. If the account is paid after 30 days but on or before 60 days, no discount is granted. If the account is not paid within 60 days, interest of 20% per annum is charged.

Which of the following statements is *incorrect?*

(a) The amount payable at the end of 30 days is R712,50.
(b) The amount of interest due after 60 days is R24,66.
(c) The credit term is 30 days.
(d) The credit term is 60 days.

Solution: Revision exercise 1

Statement (c) is incorrect.

The credit term is 60 days. If the client pays the debt within 30 days it means that he can take advantage of the discount granted by the entity.

9.8.2 Revision exercise 2

The following information relates to Source Boutique:

(1) Balances at 28 February 20.3:	**R**
Trade receivables control	42 000
Credit losses recovered	2 600

(2) Additional information:

(a) An amount of R800, previously written off as a credit loss, was recovered on 1 July 20.2 and credited to the debtor's account.
(b) Debtors accounts to the amount of R1 500, outstanding since 1 March 20.2, must be written off.
(c) It was determined that the allowance for credit losses account should amount to R1 652 at 28 February 20.3.

Which of the following amounts will be shown as credit losses in the statement of profit or loss and other comprehensive income of Source Boutique for the year ending 28 February 20.3?

(a) R3 152 {R1 652+R1 500}
(b) R3 088 {R1 588+R1 500}
(c) R1 500
(d) R2 352 {R(1 500 – 800) + R1 652}

Solution: Revision exercise 2

The correct statement is (a), R3 152.

Calculation:	**R**
Credit losses	1 500
Allowance for credit losses	1 652
	3 152

* To post a credit loss recovered to the trade receivables control account is incorrect. The journal entry to correct the entry is as follows:

JOURNAL ENTRY *J1*

20.3			**R**	**R**
Feb 28	Trade receivables control		800	
	Credit losses recovered			800
	Reversal of entry made 1/7/20.2			

The trade receivables control account balance will be *increased* by this entry and *decreased* by the credit loss written off.

JOURNAL ENTRY *J2*

20.3			**R**	**R**
Feb 28	Credit losses		1 500	
	Trade receivables control			1 500
	Credit losses written off			

Dr Trade receivables control **Cr**

20.3			**R**	**20.3**			**R**
Feb 28	Balance	b/d	42 000	Feb 28	Credit losses	J2	1 500
	Credit losses				Balance	c/d	41 300
	recovered	J1	800				
			42 800				42 800
20.3							
Mar 1	Balance	b/d	41 300				

Dr Credit losses **Cr**

20.3			**R**	**20.3**			**R**
Feb 28	Trade receiv-						
	ables control	J2	1 500	Feb 28	Profit or		
	Allowance for				loss*	J4	3 152
	credit losses*	J3	1 652				
	(creation of						
	new allowance)						
			3 152				3 152

* The journal entries (J3 and J4) indicated in the credit losses account are obvious and are therefore not shown.

9.8.3 Revision exercise 3

The following information relates to Dumpies Traders at 28 February 20.1:

(1) Balances:

	R
Trade receivables control account 28/2/20.0	55 000
Allowance for credit losses 28/2/20.0	3 240
Credit losses recovered	2 500
Credit sales	305 000
Settlement discount granted	4 200

(2) Additional information:

During the year R270 000 was collected (received) from debtors in respect of credit sales. Debtor J Solomon was declared insolvent and his account of R500 has to be written off. It was determined that the allowance for credit losses account should amount to R4 265 at 28 February 20.1.

Solution: Revision exercise 3

Calculation:

Dr Trade receivables control **Cr**

20.0			**R**	**20.1**			**R**
Mar 1	Balance	b/d	55 000	Feb 28	Bank (2)		270 000
20.1					Settlement discount granted (2)		4 200
Feb 28	Sales		305 000		Allowance for credit losses		500
					Balance (1)	c/d	85 300
			360 000				360 000
20.1							
Mar 1	Balance	b/d	85 300	(1)			

Remarks

(1) The balance on the trade receivables control account is always carried forward to the next financial period.

(2) The amount of *cash received* from debtors does not include settlement discount granted to debtors. The total amount in the *debtors column* of the cash receipts journal will be R274 200, which then includes the Settlement discount granted.

The journal entries and general ledger accounts in respect of the allowance are as follows: (Method 1 was followed – refer to paragraph 9.4.5.)

GENERAL JOURNAL

20.1		**R**	**R**
Feb 28	Allowance for credit losses	500	
	J Solomon/Trade receivables control		500
	Writing off of amount owed by J Solomon		
	Credit losses	1 525	
	Allowance for credit losses		1 525
	Adjustment of allowance — **R**		
	Allowance — 4 265		
	* *Add:* Credit loss written off — 500		
	4 765		
	Less: Existing allowance — 3 240		
	Amount needed — 1 525		

GENERAL LEDGER

Dr			Allowance for credit losses				Cr
20.1			**R**	**20.0**			**R**
Feb 28	Trade receiv-ables control		500	Mar 1	Balance	b/d	3 240
	Balance	c/d	4 265	**20.1** Feb 28	Credit losses		1 525
			4 765				4 765
				20.1 Mar 1	Balance	b/d	4 265

Dr			Credit losses				Cr
20.1			**R**	**20.1**			**R**
Feb 28	Allowance for credit losses		1 525	Feb 28	Profit or loss		1 525

COMMENT

- *Irrespective of which method is followed (refer to paragraph 9.5) the balance on the allowance for credit losses account will be R4 265, and R1 525 will be debited to the profit or loss account as credit losses.*

9.8.4 Revision exercise 4

(1) The following information was obtained from the financial records of Fine Traders on 28 February 20.8:

	R
Balance of allowance for credit losses account 28/2/20.7	510
Balance of trade receivables control account 28/2/20.7	10 200
List of individual debtors as per trade receivables ledger	11 520
Totals for the month:	
Cash receipts journal:	
Trade receivables column	69 140
Settlement discount granted column	3 000
Sales column	101 100
Trade payables column	1 400
Cash payments journal:	
Trade payables column	80 000
Trade receivables column (cheques dishonoured)	3 200
Purchases column	60 000
Sales journal	69 020
Purchases journal	53 800
Sales returns journal (all on credit sales)	1 000
Purchases returns journal	2 150

(2) ADDITIONAL INFORMATION:

(a) The debtors column in the cash receipts journal was overcast by R1 000.
(b) The creditors column in the purchases journal was overcast by R2 000.
(c) A sales invoice for the amount of R600 was entered twice in the sales journal and posted twice to the personal account of B Broad.
(d) Credit note No 31, for R500, was credited to the account of T Thin, but no other entry was made in the books.
(e) An invoice for the amount of R50 was correctly entered in the purchases journal, but posted as R150 to the account of N Narrow.
(f) An invoice for the amount of R400 was correctly entered in the sales journal, but posted as R40 to the account of D Dandy.
(g) A cheque for R900 received from debtor G Great was returned by the bank marked "R/D". The necessary entry was made in the cash payments journal, but no posting was made to the account of G Great.
(h) The balance of P Pauper's account for R1 420 has still to be written off as irrecoverable.
(i) It was determined that the allowance for credit losses account should amount to R538 at 28 February 20.8.

Required:

(1) Prepare a properly balanced trade receivables control account for the month ending 28 February 20.8.
(2) Reconcile the total of the list of debtors with the balance on the trade receivables control account as calculated in (1).
(3) Prepare the journal entry for the adjustment of the new allowance for credit losses at 28 February 20.8 and show all the transactions relating to credit losses and allowance for credit losses in the general ledger.

Solution: Revision exercise 4

(1)

Dr Trade receivables control **Cr**

20.7			**R**	**20.8**			**R**
Mar 1	Balance	b/d	10 200	Feb 28	Bank and discount R(69 140 – 1 000)		68 140
20.8							
Feb 28	Sales R(69 020 – 600)		68 420		Sales returns R(1 000 + 500)		1 500
	Bank (R/D cheques)		3 200		Allowance for credit losses		1 420
					Balance	c/d	10 760
			81 820				81 820
20.8							
Mar 1	Balance	b/d	10 760				

(2) Reconciliation of debtors list

	R	R
Total of debtors list		11 520
Add: R/D cheque adjustment (G Great)	900	
Sales invoice adjustment		
R(400 – 40) (D Dandy)	360	1 260
		12 780
Less: Duplicate sales invoice (B Broad)	(600)	
Credit loss	(1 420)	(2 020)
Balance as per trade receivables control		10 760

(3) Journalising the allowance for credit losses and the general ledger

GENERAL JOURNAL *J2*

		R	R
20.8			
Feb 28	Credit losses	1 448	
	Allowance for credit losses		1 448
	Adjustment of allowance		

	R	R
New allowance		538
Add: Credit loss written off (P Pauper)	1 420	
Less: Opening balance of allowance:	510	910
Amount needed		1 448

GENERAL LEDGER

Dr Allowance for credit losses **Cr**

			R				R
20.8				**20.7**			
Feb 28	Trade receivables	J1*	1 420	Mar 1	Balance	b/d	510
	Balance	c/d	538	**20.8**			
				Feb 28	Credit losses**	J2	1 448
			1 958				1 958
				20.8			
				Mar 1	Balance	b/d	538

Dr Credit losses **Cr**

			R				R
20.8				**20.8**			
Feb 28	Allowance for credit losses		1 448	Feb 28	Profit or loss	J3*	1 448

* Journal entries J1 and J3 are obvious and are not shown.

** Balancing figure

COMMENTS

- *Always read the question carefully. Much of the information given in this question has nothing to do with the trade receivables control account. Make sure that you know what items have to be entered in a trade receivables control account.*
- *The actual amount written off (R1 420) is more than the opening balance of the allowance. An additional amount (more than the new allowance) must therefore be credited to the allowance (and debited to the credit losses account).*
- *If the other method of writing off credit losses were followed (paragraph 9.4) the net result would be the same. The balance of the allowance for credit losses would be R538 and the amount written off as credit losses in the profit or loss account would be R1 448.*

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- calculate the amount of discount on early payment of debts, calculate its effect on VAT, and will you be able to record it?
- calculate the amount of allowance for credit losses and how to record it in the books?
- record the entries involving credit losses (Bad debts) written off?
- show how debtors are disclosed in the statement of financial position?
- prepare a trade receivables control account?

STUDY UNIT

10

Inventory

Learning outcome

Students should be able to know and understand the importance of inventory and how entries related to inventory is recorded in the books of an entity.

Contents

KEY CONCEPTS

- Valuation of inventory
- Historical cost
- Consistency
- Gross profit percentage
- Disclosure in the financial statements

10.1 Introduction

Inventory is one of the more important assets for many entities. Inventory can be classified as all or any one of the following:

- goods which are kept to be sold in the normal course of business (merchandise)
- goods which are in the process of being manufactured for sale
- goods which are used during the manufacture of inventory for sale (eg manufacturing material)
- goods which are consumed in the normal business activities (eg stationery)

It is important to keep strict control over inventory and this is often done by means of an inventory count, which usually takes place at the end of the financial year. Even if an inventory count occurs on a continuous basis throughout the year it is still customary to count the inventory annually.

If you have forgotten what the difference is between a perpetual and a periodic inventory system, refer to study unit 7, section 7.4.

Study paragraphs 10.1 and 10.2 of the prescribed book.

10.2 The importance of correct inventory valuation

It is very important that inventory is valued correctly. A mistake in the inventory figure will affect the calculation of cost of sales, the gross profit and subsequently profit in the statement of profit or loss and other comprehensive income. On the statement of financial position the total of the current assets as well as the equity will be incorrect. This mistake will also affect the figures for the following year, because the closing inventory for one year is the opening inventory for the next year.

Study paragraph 10.5 of the prescribed book.

The following exercise illustrates what can happen when incorrect figures are used.

Exercise 10.1

The following information pertaining to three financial years ended 31 December was obtained from the records of Woud Traders:

From the statement of financial position:

	20.2	**20.1**	**20.0**
Total equity	**R**	**R**	**R**
Capital	332 230	224 230	120 000

From the statement of profit or loss and other comprehensive income:

	20.2	20.1
	R	R
Revenue	420 000	396 000
Cost of sales	(252 000)	(237 770)
Opening inventory	151 824	144 000
Purchases	256 176	245 594
	408 000	389 594
Closing inventory	(156 000)	(151 824)
Gross profit	168 000	158 230
Distribution, administrative and other expenses	(60 000)	(54 000)
Profit for the year	108 000	104 230
Other comprehensive income for the year	—	—
Total comprehensive income for the year	108 000	104 230

ADDITIONAL INFORMATION

(a) Merchandise amounting to R4 104, received on 31 December 20.1, is included in inventory but the invoice was only received and recorded in the purchases journal on 10 January 20.2.

(b) An invoice for merchandise with a cost price of R1 740 and a selling price of R2 106, dispatched Free On Board on 31 December 20.1, was completed and recorded in the sales journal on 3 January 20.2. These goods were included in the inventory at 31 December 20.1.

(c) The business uses the periodic inventory system.

Required:

Prepare the adjusted statement of profit or loss and other comprehensive income and calculate the equity of the owner that must be shown in the statement of financial position for 20.1 and 20.2. Calculations must be clearly shown.

Solution Exercise 10.1

Calculation of correct amounts:

		R
(a)	Inventory 31/12/20.1	151 824
	Less: Merchandise already dispatched	1 740
	Correct inventory 31/12/20.1	150 084
(b)	Purchases for 20.1	245 594
	Add: Correction of goods already received	4 104
	Correct amount of purchases for 20.1	249 698
(c)	Purchases for 20.2	256 176
	Less: Correction of goods already received	4 104
		252 072
(d)	Sales for 20.1	396 000
	Add: Selling price of goods dispatched	2 106
	Correct amount of sales for 20.1	398 106

		R
(e)	Sales for 20.2	420 000
	Less: Selling price of goods dispatched	2 106
	Correct amount of sales for 20.2	417 894

ADJUSTED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	20.2	20.1
	R	R
Revenue	417 894	398 106
Cost of sales	(246 156)	(243 614)
Opening inventory	150 084	144 000
Purchases	252 072	249 698
	402 156	393 698
Closing inventory	(156 000)	(150 084)
Gross profit	171 738	154 492
Distribution, administrative and other expenses	(60 000)	(54 000)
Profit for the year	111 738	100 492
Other comprehensive income for the year	—	—
Total comprehensive income for the year	111 738	100 492

ADJUSTED EQUITY OF THE OWNER

	R
Equity (capital) – 20.1 (given)	224 230
Less: Incorrect profit given for 20.1	104 230
Equity – 20.0	120 000
Add: Revised profit for 20.1	100 492
Equity – 20.1	220 492
Add: Revised profit for 20.2	111 738
Equity – 20.2	332 230

10.3 Valuation of inventory at historical cost

Study paragraph 10.3 of the prescribed book.

In this course inventory is valued at historical cost. Inventory can also be measured according to other methods, for example first-in-first-out method and weighted average method. It is not necessary for you to know how these methods are applied.

When determining the **historical cost** of inventory, more costs are involved than simply the cost of purchasing the goods that are to be sold. Other costs that must be included are:

- costs of transporting the goods from the point of purchase to the premises of the business
- import duty — if goods are purchased from outside South Africa
- railage on goods purchased or carriage inwards
- insurance on goods purchased

The above-mentioned costs form part of the cost price of inventory and will be used in determining the gross profit of an entity.

There are disadvantages to using historical cost as a basis for valuation. For instance, if the value of the inventory falls below historical cost then the value stated is not realistic. Inventory must then be valued at net realisable value (NRV) as an alternative to historical cost. Net realisable value is the price at which inventory can be sold. If it is necessary to incur any costs to sell the products at the realisable value, these costs must be deducted from the selling price to determine the net realisable value.

10.4 Methods of estimating the value of inventory

Study paragraph 10.6 and 10.7 of the prescribed book.

There is more than one method of estimating inventory. The only method that we will be discussing is the **gross profit method.** It is sometimes necessary to use this method, for example, if inventory has been damaged or destroyed.

Gross profit is the difference between sales and cost of sales. If the amount of sales and the cost of sales are known, then

Sales	–	Cost of sales	=	Gross profit
R300 000	–	R200 000	=	R100 000

If only the cost of sales and gross profit are known, then

Cost of sales	+	Gross profit	=	Sales
R200 000	+	R100 000	=	R300 000

The actual gross profit is sometimes given as a percentage of either the cost of sales or sales.

If the gross profit is expressed as a percentage of the cost of sales, then we use the following formula:

$$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1} = \text{Gross profit percentage on cost of sales}$$

If the gross profit is expressed as a percentage of sales then the following formula is used:

$$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1} = \text{Gross profit percentage on sales}$$

Applying the above figures to these formula, we get the following gross profit percentages:

$$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1} = \frac{R100\,000}{R200\,000} \times \frac{100}{1} = 50\%$$

$$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1} = \frac{R100\,000}{R300\,000} \times \frac{100}{1} = 33\tfrac{1}{3}\%$$

10.5 Consistency in the application of procedures

It is very important that any valuation of inventory should be applied consistently throughout the year. Any change in the basis of inventory valuation from one year to the next or during the same year has to be disclosed. Disclosure takes place by means of a note to the financial statements, explaining the nature and effect of the change.

10.6 Disclosure of inventory in the financial statements

Inventory is a current asset. In this course inventory consists mainly of finished products. In addition, there may be other inventory items such as packaging material, stationery and cleaning materials. All the different inventories are subclassified under inventories in the statement of financial position. The accounting policy applied for the valuation of inventory must be disclosed in a note to the statement of financial position.

Example

Presentation on the statement of financial position:

Current assets	**R**
Inventories R(60 000 + 6 000)	66 000

(For a more detailed exposition refer to paragraph 9.6.)

The cost of merchandise is part of the cost of sales, that is, it is used in calculating the gross profit. Stationery is used in the sales function and any expenses for stationery used are written off under selling, administrative and general expenses in the statement of profit or loss and other comprehensive income when calculating profit.

Study paragraph 10.4 of the prescribed book.

10.7 Revision exercises and solutions

10.7.1 Revision exercise 1

(1) Which combination of the following statements is correct?

(a) Office furniture bought by Furnishop Traders for the new secretary is classified under property, plant and equipment in the statement of financial position.
(b) The cost of stationery used is included in the calculation of gross profit.
(c) When using the periodic inventory system the cost of sales is calculated after a physical inventory count has been done.
(d) Closing inventory includes all goods on the premises. This includes goods that have already been paid for by a purchaser.

1. (a) (b) (c) (d)
2. (a) (b)
3. (a) (c)
4. (a) (c) (d)

(2) What is the difference between cost of goods purchased and cost of sales?

Solution: Revision exercise 1

(1) Option 3, (a) and (c) is correct.

COMMENTS

- *Statement (a) The goods were not bought for resale.*
- *Statement (b) Stationery has nothing to do with the cost of purchasing goods for resale. Stationery used is a selling expense shown under distribution, administrative and other expenses in the statement of profit or loss and other comprehensive income.*
- *Statement (c) When the periodic inventory system is used the only way of knowing how much inventory is on hand is to do an inventory count.*
- *Statement (d) If the ownership of goods has passed to the purchaser, that is the purchaser has paid or undertaken to pay for the goods, then these goods are not included in the closing inventory figure.*

(2) Cost of goods purchased does not include opening and closing inventory, whereas cost of sales does.

10.7.2 Revision exercise 2

The following information relates to Bombay Traders:

	R
Balances at 28 February 20.4:	
Inventory: Trading — 28 February 20.3	20 000
Purchases	106 000
Purchases returns	6 000
Import duty	10 000
Sales	175 000
Sales returns	5 000
Carriage on sales	4 800
Packaging material used	7 200

ADDITIONAL INFORMATION

Inventory: Trading — 28 February 20.4	25 000
Inventory: Packaging material — 28 February 20.4	600

Which of the following represents the correct amount of cost of goods purchased and cost of sales respectively?

Cost of goods purchased	Cost of sales
1. R116 000	R111 000
2. R110 000	R110 400
3. R116 000	R110 400
4. R110 000	R105 000

Solution: Revision exercise 2

Option 4 is correct.

Cost of goods purchased, R110 000; cost of sales, R105 000.

Calculation:

	R
Purchases	106 000
Purchases returns	(6 000)
	100 000
Import duty	10 000
Cost of goods purchased	110 000

	R
Cost of sales:	
Sales	175 000
Sales returns	(5 000)
Revenue	170 000
Cost of sales	(105 000)
Opening inventory – 28 Feb. 20.3	20 000
Purchases	110 000
	130 000
Closing inventory – 28 Feb. 20.4	(25 000)
Gross profit	65 000

COMMENTS

- *Closing inventory is only goods for sale (merchandise) and does not include packaging material. Packaging material is a consumable inventory. Packaging material used is an expense and packaging material on hand is shown under inventory as a current asset in the statement of financial position.*
- *Revenue is equal to gross sales minus sales returns. All other expenses related to sales are deducted from gross profit.*

10.7.3 Revision exercise 3

From the following information, calculate the gross profit percentage on cost of sales and sales.

	20.3 R	20.2 R	20.1 R
Revenue	600 000	375 000	300 000
Cost of sales	(402 000)	(255 000)	(210 000)
Gross profit	198 000	120 000	90 000

Solution: Revision exercise 3

	20.3	20.2	20.1
$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$	$\frac{R198\,000}{R402\,000} \times \frac{100}{1}$ $= 49{,}3\%$	$\frac{R120\,000}{R255\,000} \times \frac{100}{1}$ $= 47{,}1\%$	$\frac{R90\,000}{R210\,000} \times \frac{100}{1}$ $= 42{,}9\%$
$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	$\frac{R198\,000}{R600\,000} \times \frac{100}{1}$ $= 33\%$	$\frac{R120\,000}{R375\,000} \times \frac{100}{1}$ $= 32\%$	$\frac{R90\,000}{R300\,000} \times \frac{100}{1}$ $= 30\%$

10.7.4 Revision exercise 4

The following is an extract from the statement of profit or loss and other comprehensive income of M Dry, a general dealer, for the year ended 30 June 20.6:

M DRY

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.6 (extract)

		R
Revenue		114 000
Cost of sales		(76 000)
Inventory — 1/7/20.5	30 000	
Purchases	90 000	
	120 000	
Inventory — 30/6/20.6	(44 000)	
Gross profit		38 000

ADDITIONAL INFORMATION

(a) On 30 June 20.7 a fire occurred in the warehouse before the annual inventory count could be completed, and an estimated 25% of the total inventory was destroyed.
M Dry informs you that the same mark-up was applied in the last financial year as was used in 20.5/6.

(b) Purchases and sales for the 20.6/7 financial year amounted to R96 000 and R120 000 respectively.

Required:

(1) Prepare the section of the statement of profit or loss and other comprehensive income reflecting the estimated gross profit for the year ended 30 June 20.7.

(2) Calculate the value of the inventory destroyed by the fire.

Solution: Revision exercise 4

M DRY

(1) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.7 (estimated)

		R
Revenue		120 000
Cost of sales		(80 000)
Inventory — 30 June 20.6	44 000	
Purchases	96 000	
	140 000	
Inventory — 30 June 20.7	(60 000)	
Gross profit		40 000

COMMENT

- Calculation of the gross profit percentage on sales 20.5/6:

  $= \frac{R38\,000}{114\,000} \times \frac{100}{1} = 33\frac{1}{3}\,\%$

  To calculate the cost of sales:

  Gross profit percentage on sales $= \frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$

  Gross profit = Sales × gross profit percentage

  $= R120\,000 \times \frac{33^1/_3}{100}$

  = R40 000

  Therefore: Cost of sales = Sales – Gross profit

  = R120 000 – R40 000

  = R80 000

- Closing inventory for 20.6 is the opening inventory of 20.7.

  Calculation of closing inventory can also be done as follows:

  Closing inventory = Opening inventory + Purchases – Cost of sales

  = R44 000 + R96 000 – R80 000

  = R60 000

(2) VALUE OF INVENTORY DESTROYED:

R60 000 × 25% = R15 000

SELF-ASSESSMENT

Now that you have studied this study unit, can you

- explain why it is important to value and record inventory accurately?
- explain why an inventory valuation method has to be applied consistently and accurately?
- discuss what inventory consists of and how inventory is presented in the statement of financial position?

STUDY UNIT

11

Property, plant and equipment

Learning outcome

Students should be able to record transactions related to property, plant and equipment.

Contents

KEY CONCEPTS

- Historical cost price
- Tangible non-current assets
  - land and buildings
  - machinery
  - vehicles
  - furniture and equipment
- Depreciation
- Accumulated depreciation
- Sale (alienation) of property, plant and equipment
- Disposal of property, plant and equipment

11.1 Introduction

For an item to be classified as an asset, it is not necessary for the entity to be the legal owner of the item. Assets obtained on credit and lease agreements can be treated as assets by the entity provided the corresponding liability is recorded. For accounting purposes the economic reality and not the legal ownership of the item must be taken into account when determining whether an item can be classified as an asset, in other words substance over form. Refer to paragraph .35 of the Framework.

Non-current assets are, as you already know, acquired with the intention of carrying out, supporting or facilitating operations. Non-current assets have an operating lifespan of more than one year and can be used over and over again. They are used but not consumed (ie non-current assets are not used up in the short term).

Non-current assets may be tangible, intangible or financial assets.

Tangible non-current assets are assets such as buildings, machinery, vehicles and furniture. They are assets which you can see and touch. They are shown in the statement of financial position under the heading ''Property, plant and equipment''.

Because property, plant and equipment become obsolete after several years, they must be written off over their expected economic life. This is usually done by means of a provision referred to as depreciation. The annual amount written off is treated as an expense in the profit and loss account.

When an asset can no longer operate economically, it is replaced. The proceeds on the realisation (sale) of the asset are normally used to partly finance the new asset.

All the aspects in the accounting system relating to the above will be explained further on in this study unit.

Study paragraphs 11.1 to 11.3 of the prescribed book.

11.2 Determination of the cost price of property, plant and equipment

The cost price of property, plant and equipment consists of:

- the purchase price, including all expenses incurred in getting the asset to the premises
- all the installation costs including, for example, the wages of the business's own technical personnel
- any other expenses incurred in getting the asset operational

The cost price will remain constant throughout the life of the asset and is referred to as the historical cost price.

Financing costs on loans raised to acquire the asset are not included in the cost price of the asset. The same applies to maintenance costs.

Study paragraph 11.4 of the prescribed book.

11.3 Safeguarding and control of property, plant and equipment

An assets register is used in which the following important information regarding the asset is recorded:

- location
- serial number
- cost price
- date of acquisition
- expected lifespan
- carrying amount
- current year's depreciation
- accumulated depreciation

Study paragraph 11.10 of the prescribed book.

11.4 Recording the purchase of property, plant and equipment

The purchase of property, plant and equipment is recorded in the applicable asset accounts. For example, machinery is recorded in the machinery (at cost) account and vehicles in the vehicles (at cost) account.

Since the asset accounts in question do not contain any details, it is necessary to keep the assets register (see paragraph 11.3 and example 11.12 in the prescribed book) up to date.

The totals of the cost prices in the assets register with regard to a specific asset account must be equal to the balance of that asset account in the general ledger.

At the end of each period the asset account is balanced and reconciled with the amount in the assets register.

Study paragraphs 11.5 and 11.6 of the prescribed book.

11.5 The concept of depreciation

Assets are acquired to generate income. Because income is generated, the cost of owning the asset can be written off against income earned over the useful life of the asset.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Once the depreciable amount has been established the method of allocating the depreciable amount must be decided on (refer to paragraph 11.7 on the methods of calculating depreciation). The method decided on for allocating depreciation must represent a fair allocation of the cost of owning the asset each year.

Study paragraphs 11.7.1 – 11.7.3 of the prescribed book.

11.6 Recording depreciation

During the expected useful life of an asset, a reasonable amount must be written off from the cost price of the asset in each financial period and debited to a depreciation account.

Under the double-entry system, another account has to be credited with the same amount. In practice it is not the asset account but a contra asset account, the accumulated depreciation account, which is credited with the annual depreciation.

The difference between the debit balance on the asset account and the credit balance on the accumulated depreciation account is known as the net carrying amount of the asset.

Study paragraph 11.7.4 of the prescribed book.

11.7 Methods of calculating depreciation

There are various methods of determining the amount of annual depreciation to be written off. We will discuss only the straight line method, the diminishing balance method and the production unit method.

Study paragraph 11.7.5 of the prescribed book.

Exercise 11.1

Suppose Bilgredon bought a machine on 1 June 20.0 for R500 000 with a discount of R60 000, transport costs of R15 000 and installation costs of R5 000. The depreciable cost price of the machine is R(500 000 − 60 000+15 000+ 5 000) = R460 000. The estimated lifespan is 5 years. (Bilgredon's financial year ends on 31 May.) We now examine the three methods of using this information.

Required:

Use the given information and prepare

(1) depreciation schedules,

(2) general journal entries, and

(3) ledger accounts

to record the depreciation according to

(a) the straight line method,

(b) the diminishing balance method, and

(c) the production unit method (using the given additional information).

Solution Exercise 11.1

(a) Straight line method

The cost price is written of over the expected useful life (in years) of the asset.

(a) (1) ASSET AND DEPRECIATION SCHEDULE: STRAIGHT LINE METHOD

Date	Cost price (a)	Calculation of depreciation $\frac{\text{Cost price}}{\text{Lifespan in years}}$ or 20% × cost price	Annual depreciation	Accumulated depreciation (b)	Carrying amount (a) – (b)
May 31	**R**		**R**	**R**	**R**
20.1 (End of financial year 1)	460 000	$\frac{460\,000}{5}$	92 000	92 000	368 000
20.2 (End of financial year 2)	460 000	$\frac{460\,000}{5}$	92 000	184 000	276 000
20.3 (End of financial year 3)	460 000	$\frac{460\,000}{5}$	92 000	276 000	184 000
20.4 (End of financial year 4)	460 000	$\frac{460\,000}{5}$	92 000	368 000	92 000
20.5 (End of financial year 5)	460 000	$\frac{460\,000}{5}$	92 000	460 000	NIL
		Total depreciation	R460 000		

This method is also known as the **fixed installment** method.

(a) (2) JOURNAL ENTRIES FOR THE FIVE YEARS

GENERAL JOURNAL

20.1			**R**	**R**
May 31	Depreciation: machinery		92 000	
	Accumulated depreciation: machinery			92 000
	Provision for depreciation on the straight line method (year 1)			
	Profit or loss		92 000	
	Depreciation: machinery			92 000
	Closing entry			

The journal entries for the years 20.2, 20.3, 20.4, and 20.5 would be the same as above.

(a) (3) **GENERAL LEDGER**

Dr Machinery (at cost) **Cr**

20.1			**R**				
Jun 1	Bank		460 000				

Dr Accumulated depreciation: machinery **Cr**

20.1			**R**	**20.1**			**R**
May 31	Balance	c/d	92 000	May 31	Depreciation 20.1		92 000
				20.1			
				June 1	Balance	b/d	92 000
20.2				**20.2**			
May 31	Balance	c/d	184 000	May 31	Depreciation 20.2		92 000
			184 000				184 000
				20.2			
				June 1	Balance	b/d	184 000
20.3				**20.3**			
May 31	Balance	c/d	276 000	May 31	Depreciation 20.3		92 000
			276 000				276 000
				20.3			
				June 1	Balance	b/d	276 000
20.4				**20.4**			
May 31	Balance	c/d	368 000	May 31	Depreciation 20.4		92 000
			368 000				368 000
				20.4			
				June 1	Balance	b/d	368 000
20.5				**20.5**			
May 31	Balance	c/d	460 000	May 31	Depreciation 20.5		92 000
			460 000				460 000
				20.5			
				June 1	Balance	b/d	460 000

Dr Depreciation: machinery **Cr**

20.1			**R**	**20.1**			**R**
May 31	Accumulated depreciation		92 000	May 31	Profit or loss		92 000

The entries would be the same as the above for the years 20.2, 20.3, 20.4 and 20.5.

Dr Profit or loss (extract) **Cr**

20.1			**R**				
May 31	Depreciation: machinery		92 000				

The entries would be the same as the above for the years 20.2, 20.3, 20.4 and 20.5.

COMMENT

- *The depreciable amount is the cost of the asset less its residual value. The residual value is the expected value (eg scrap value, trade-in value) of the asset at the end of its useful life. In this example there was no residual value given.*

BILGREDON

STATEMENT OF FINANCIAL POSITION AS AT 31 MAY (extract)

	20.5	20.4	20.3	20.2	20.1
Non-current assets	R	R	R	R	R
Property, plant and equipment	NIL	92 000	184 000	276 000	368 000

COMMENTS

- *Only the carrying amount is shown on the face of the statement of financial position.*
- *A detailed reconciliation of movements in the carrying amount from the beginning to the end of the financial period is shown in a note.*

The following is an example of the note for the year ended 31 May 20.2:

BILGREDON

NOTES FOR THE YEAR ENDED 31 MAY 20.2

Property, plant and equipment	Machinery	Total
	R	R
Carrying amount:		
Beginning of year	368 000	368 000
Cost	460 000	460 000
Accumulated depreciation	(92 000)	(92 000)
Additions	—	—
Disposals	(—)	(—)
Depreciation	(92 000)	(92 000)
Carrying amount:		
End of year	276 000	276 000
Cost	460 000	460 000
Accumulated depreciation	(184 000)	(184 000)

COMMENT

- *Additions and disposals are shown in the exercise for illustrative purposes only. They need not be shown unless there were additions or disposals during the applicable financial period.*

(b) Diminishing balance method

In this case a fixed percentage of the **carrying amount** is written off annually. Assume that a percentage of 20% is given.

(b) (1) ASSET AND DEPRECIATION SCHEDULE: DIMINISHING BALANCE METHOD

Date	Cost price (a)	Calculation of depreciation $\frac{20}{100}$ x carrying amount	Annual depreciation	Accumulated depreciation (b)	Carrying amount (a) – (b)
May 31	**R**		**R**	**R**	**R**
20.1 (End of financial year 1)	460 000	$\frac{20}{100} \times \frac{460\,000}{1}$	92 000	92 000	368 000
20.2 (End of financial year 2)	460 000	$\frac{20}{100} \times \frac{368\,000}{1}$	73 600	165 600	294 400
20.3 (End of financial year 3)	460 000	$\frac{20}{100} \times \frac{294\,400}{1}$	58 880	224 480	235 520
20.4 (End of financial year 4)	460 000	$\frac{20}{100} \times \frac{235\,520}{1}$	47 104	271 584	188 416
20.5 (End of financial year 5)	460 000	$\frac{20}{100} \times \frac{188\,416}{1}$	37 683	309 267	150 733
		Total depreciation	R309 267		

The carrying amount at the end of the fifth year (R150 733) is deemed to be the disposal (scrap) value of the asset. According to this method the carrying amount will, mathematically, never become nil.

This method does not use the depreciable amount (cost less residual value) as the basis for calculation, but is based on the cost price less accumulated depreciation, or the carrying amount.

(b) (2) JOURNAL ENTRIES FOR THE FIVE YEARS

GENERAL JOURNAL

			R	R
20.1 May 31	Depreciation: machinery		92 000	
	Accumulated depreciation: machinery			92 000
	Provision for depreciation at 20% pa on the diminishing balance method (year 1)			
	Profit or loss		92 000	
	Depreciation: machinery			92 000
	Closing entry			
20.2 May 31	Depreciation: machinery		73 600	
	Accumulated depreciation: machinery			73 600
	Provision for depreciation at 20% pa on the diminishing balance method (year 2)			
	Profit or loss		73 600	
	Depreciation: machinery			73 600
	Closing entry			
20.3 May 31	Depreciation: machinery		58 880	
	Accumulated depreciation: machinery			58 880
	Provision for depreciation at 20% pa on the diminishing balance method (year 3)			
	Profit or loss		58 880	
	Depreciation: machinery			58 880
	Closing entry			
20.4 May 31	Depreciation: machinery		47 104	
	Accumulated depreciation: machinery			47 104
	Provision for depreciation at 20% pa on the diminishing balance method (year 4)			
	Profit or loss		47 104	
	Depreciation: machinery			47 104
	Closing entry			
20.5 May 31	Depreciation: machinery		37 683	
	Accumulated depreciation: machinery			37 683
	Provision for depreciation at 20% pa on the diminishing balance method (year 5)			
	Profit or loss		37 683	
	Depreciation: machinery			37 683
	Closing entry			

(b) (3) **GENERAL LEDGER**

Dr Machinery (at cost) **Cr**

20.1			R				
Jun 1	Bank		460 000				

Dr Accumulated depreciation: machinery **Cr**

20.1			R	**20.1**			R
May 31	Balance	c/d	92 000	May 31	Depreciation 20.1		92 000
20.2				**20.1**			
May 31	Balance	c/d	165 600	Jun 1	Balance	b/d	92 000
				20.2			
				May 31	Depreciation 20.2		73 600
			165 600				165 600
20.3				**20.2**			
May 31	Balance	c/d	224 480	Jun 1	Balance	b/d	165 600
				20.3			
				May 31	Depreciation 20.3		58 880
			224 480				224 480
20.4				**20.3**			
May 31	Balance	c/d	271 584	Jun 1	Balance	b/d	224 480
				20.4			
				May 31	Depreciation 20.4		47 104
			271 584				271 584
20.5				**20.4**			
May 31	Balance	c/d	309 267	Jun 1	Balance	b/d	271 584
				20.5			
				May 31	Depreciation 20.5		37 683
			309 267				309 267
				20.5			
				Jun 1	Balance	b/d	309 267

Dr Depreciation: machinery **Cr**

20.1			R	**20.1**			R
May 31	Accumulated depreciation		92 000	May 31	Profit or loss		92 000
20.2				**20.2**			
May 31	Accumulated depreciation		73 600	May 31	Profit or loss		73 600
20.3				**20.3**			
May 31	Accumulated depreciation		58 880	May 31	Profit or loss		58 880
20.4				**20.4**			
May 31	Accumulated depreciation		47 104	May 31	Profit or loss		47 104
20.5				**20.5**			
May 31	Accumulated depreciation		37 683	May 31	Profit or loss		37 683

Dr		Profit or loss (extract)					Cr
20.1			**R**				
May 31	Depreciation: machinery		92 000				
20.2							
May 31	Depreciation: machinery		73 600				
20.3							
May 31	Depreciation: machinery		58 880				
20.4							
May 31	Depreciation: machinery		47 104				
20.5							
May 31	Depreciation: machinery		37 683				

BILGREDON

STATEMENT OF FINANCIAL POSITION AS AT 31 MAY (extract)

	20.5	**20.4**	**20.3**	**20.2**	**20.1**
Non-current assets	**R**	**R**	**R**	**R**	**R**
Property, plant and equipment	150 733	188 416	235 520	294 400	368 000

BILGREDON

NOTES FOR THE YEAR ENDED 31 MAY 20.2

Property, plant and equipment	**Machinery**	**Total**
	R	**R**
Carrying amount:		
Beginning of year	368 000	368 000
Cost	460 000	460 000
Accumulated depreciation	(92 000)	(92 000)
Depreciation	(73 600)	(73 600)
Carrying amount:		
End of year	294 400	294 400
Cost	460 000	460 000
Accumulated depreciation	(165 600)	(165 600)

(c) Production unit method

In this case the units produced by the machine are written off annually as a percentage of the units the machine is expected to produce over its total life span. Production for year 1 = 500 units, year 2 = 550 units, year 3 = 300 units, year 4 = 200 units and year 5 = 450 units. The total number of units expected to be produced by the machine = 2 000 units.

(c) (1) ASSET AND DEPRECIATION SCHEDULE: PRODUCTION VOLUME METHOD

Date	Cost price (a)	Calculation of depreciation*	Anual depreciation	Accumulated depreciation (b)	Carrying amount (a) – (b)
May 31	**R**		**R**	**R**	**R**
20.1 (End of financial year 1)	460 000	$\frac{500}{2\,000} \times 460\,000$	115 000	115 000	345 000
20.2 (End of financial year 2)	460 000	$\frac{550}{2\,000} \times 460\,000$	126 500	241 500	218 500
20.3 (End of financial year 3)	460 000	$\frac{300}{2\,000} \times 460\,000$	69 000	310 500	149 500
20.4 (End of financial year 4)	460 000	$\frac{200}{2\,000} \times 460\,000$	46 000	356 500	103 500
20.5 (End of financial year 5)	460 000	$\frac{450}{2\,000} \times 460\,000$	103 500	460 000	NIL
		Total depreciation	R460 000		

* Formula for calculating depreciation

$$= \frac{\text{Units produced during the year}}{\text{expected number of units to be produced over life span}} \text{ x Cost price}$$

(c) (2) THE JOURNAL ENTRIES ARE SIMILAR TO THOSE IN (b) (2).

(c) (3) GENERAL LEDGER

Dr Machinery (at cost) **Cr**

20.1			R				
Jun 1	Bank		460 000				

Dr Accumulated depreciation: machinery **Cr**

20.1			R	**20.1**			R
May 31	Balance	c/d	115 000	May 31	Depreciation 20.1		115 000
20.2				**20.1**			
May 31	Balance	c/d	241 500	Jun 1	Balance	b/d	115 000
				20.2			
				May 31	Depreciation 20.2		126 500
			241 500				241 500
20.3				**20.2**			
May 31	Balance	c/d	310 500	Jun 1	Balance	b/d	241 500
				20.3			
				May 31	Depreciation 20.3		69 000
			310 500				310 500
20.4				**20.3**			
May 31	Balance	c/d	356 500	Jun 1	Balance	b/d	310 500
				20.4			
				May 31	Depreciation 20.4		46 000
			356 500				356 500

Dr Accumulated depreciation: machinery (continued) **Cr**

20.5			**R**	**20.4**			**R**
May 31	Balance	c/d	460 000	Jun 1	Balance	b/d	356 500
				20.5			
				May 31	Depreciation 20.5		103 500
			460 000				460 000
				20.5			
				Jun 1	Balance	b/d	460 000

Dr Depreciation: machinery **Cr**

20.1			**R**	**20.1**			**R**
May 31	Accumulated depreciation		115 000	May 31	Profit or loss		115 000
20.2				**20.2**			
May 31	Accumulated depreciation		126 500	May 31	Profit or loss		126 500
20.3				**20.3**			
May 31	Accumulated depreciation		69 000	May 31	Profit or loss		69 000
20.4				**20.4**			
May 31	Accumulated depreciation		46 000	May 31	Profit or loss		46 000
20.5				**20.5**			
May 31	Accumulated depreciation		103 500	May 31	Profit or loss		103 500

Dr Profit or loss (extract) **Cr**

20.1			**R**				
May 31	Depreciation: machinery		115 000				
20.2							
May 31	Depreciation: machinery		126 500				
20.3							
May 31	Depreciation: machinery		69 000				
20.4							
May 31	Depreciation: machinery		46 000				
20.5							
May 31	Depreciation: machinery		103 500				

BILGREDON

STATEMENT OF FINANCIAL POSITION AS AT 31 MAY (extract)

	20.5 R	20.4 R	20.3 R	20.2 R	20.1 R
Non-current assets					
Property, plant and equipment	NIL	103 500	149 500	218 500	345 000

BILGREDON

NOTES FOR THE YEAR ENDED 31 MAY 20.2

Property, plant and equipment	**Machinery**	**Total**
	R	**R**
Carrying amount:		
Beginning of year	345 000	345 000
Cost	460 000	460 000
Accumulated depreciation	(115 000)	(115 000)
Depreciation	(126 500)	(126 500)
Carrying amount:		
End of year	218 500	218 500
Cost	460 000	460 000
Accumulated depreciation	(241 500)	(241 500)

Study paragraphs 11.7.4 to 11.7.6 and 11.9 of the prescribed book.

11.8 Acquisition of property, plant and equipment during the financial year

Suppose a machine is purchased six months before the end of the year. The provision for depreciation for the first year must be determined for the portion of the year, which in this case is $\frac{6}{12}$ or 50% of the year.

If the cost price of the machine is R460 000 and the depreciation rate is 20% per year, the depreciation to be provided for the first year will be:

R460 000 $\times \frac{20}{100} \times \frac{6}{12}$

= R46 000.

Study paragraphs 11.7.7 to 11.7.8 of the prescribed book.

11.9 Disposal of property, plant and equipment

Study paragraph 11.8 of the prescribed book.

When an asset is no longer useful to an entity, and is disposed of, it must be removed from the books and the assets register.

There are different ways to dispose of an asset:

- scrapping the asset
- selling it outright
- trading it in as partial payment on the purchase of a new asset

If the asset is traded-in for another asset, or sold, the profit or loss made on the disposal of the asset must be treated as income or expenditure in the statement of profit or loss and other comprehensive income for the current financial period.

Exercise 11.2

Scrapping an asset that has been written off entirely. (This means there are no proceeds.) Suppose that Bilgredon used the straight-line method of depreciation and decided to scrap the machine at the end of its useful life.

Required:

Show the journal entry and ledger accounts to record the transaction.

Solution Exercise 11.2

GENERAL JOURNAL

20.5			**R**	**R**
May 31	Accumulated depreciation: machinery		460 000	
	Machinery (at cost)			460 000
	Scrapped machine written off			

GENERAL LEDGER

Dr Machinery (at cost) **Cr**

20.1			**R**	**20.5**			**R**
Jun 1	Bank		460 000	May 31	Accumulated depreciation		460 000

Dr Accumulated depreciation: machinery **Cr**

20.5			**R**	**20.1**			**R**
May 31	Machinery (at cost)		460 000	May 31	Depreciation		92 000
				20.2			
				May 31	Depreciation		92 000
				20.3			
				May 31	Depreciation		92 000
				20.4			
				May 31	Depreciation		92 000
				20.5			
				May 31	Depreciation		92 000
			460 000				460 000

Exercise 11.3

Scrapping an asset (at the end of the financial year) which has not been written off (depreciated) entirely.

Suppose that Bilgredon bought a machine costing R460 000 on 30 November 20.0. They decided to scrap the machine at the year ended 31 May 20.5 when the accumulated depreciation amounted to R402 500. (Note that in this exercise the purchase date has changed and the production volume method of depreciation is used.)

Required:

(a) Show the journal entries and ledger accounts to record the transactions.

(b) Show the note regarding property, plant and equipment.

Solution Exercise 11.3

(a) GENERAL JOURNAL

20.5			**R**	**R**
May 31	*Realisation of machinery		460 000	
	Machinery (at cost)			460 000
	Transfer machinery at cost to realisation account			
	Accumulated depreciation: machinery		402 500	
	Realisation of machinery			402 500
	Transfer depreciation to realisation account			
	Loss on disposal of machinery		57 500	
	Realisation of machinery			57 500
	Loss on scrapping of machine			

*NOTE: The account ''Realisation of machinery'' is used to capture the entries regarding the disposal of the machinery.

GENERAL LEDGER

Dr Machinery (at cost) **Cr**

20.0			**R**	**20.5**			**R**
Nov 30	Bank		460 000	May 31	Realisation of machinery		460 000

Dr Accumulated depreciation: machinery **Cr**

20.5			R	**20.1**			R
May 31	Realisation of machinery		402 500	May 31	Depreciation (part of year)		57 500
				20.2			
				May 31	Depreciation		126 500
				20.3			
				May 31	Depreciation		69 000
				20.4			
				May 31	Depreciation		46 000
				20.5			
				May 31	Depreciation		103 500
			402 500				402 500

Dr Realisation of machinery **Cr**

20.5			R	**20.5**			R
May 31	Machinery at cost		460 000	May 31	Accumulated depreciation		402 500
					Loss on disposal of machinery		57 500
			460 000				460 000

Dr Loss on disposal of machinery **Cr**

20.5			R				
May 31	Realisation of machinery		57 500				

BILGREDON

(b) NOTES FOR THE YEAR ENDED 31 MAY 20.5

Property, plant and equipment	**Machinery**	**Total**
	R	R
Carrying amount:		
Beginning of year	161 000	161 000
Cost	460 000	460 000
Accumulated depreciation*	(299 000)	(299 000)
Depreciation	(103 500)	(103 500)
Disposals	(57 500)	(57 500)
Cost	(460 000)	(460 000)
Accumulated depreciation	402 500	402 500
Carrying amount:		
End of year	—	—
Cost	—	—
Accumulated depreciation	—	—

* R57 500 + R126 500 + R69 000 + R46 000

Study paragraph 11.11 of the prescribed book.

Exercise 11.4

Suppose that Bilgredon had sold the machine in exercise 11.3 for R60 000 cash instead of scrapping it.

Required:

Prepare the journal entries and ledger accounts to record this transaction.

Solution Exercise 11.4

GENERAL JOURNAL

20.5			**R**	**R**
May 31	Realisation of machinery		460 000	
	Machinery (at cost)			460 000
	Transfer machine at cost to realisation account			
	Accumulated depreciation: machinery		402 500	
	Realisation of machinery			402 500
	Transfer depreciation to realisation account			
	Bank*		60 000	
	Realisation of machinery			60 000
	Cash received for machinery			
	Realisation of machinery		2 500	
	Profit on sale of machinery			2 500
	Sold machinery at a profit			

*This entry will normally be recorded in the cash receipts journal.

GENERAL LEDGER

Dr Machinery (at cost) **Cr**

20.0			**R**	**20.5**			**R**
Nov 30	Bank		460 000	May 31	Realisation of machinery		460 000

Dr Accumulated depreciation: machinery **Cr**

20.5			**R**	**20.1**			**R**
May 31	Realisation of machinery		402 500	May 31	Depreciation		57 500
				20.2			
				May 31	Depreciation		126 500
				20.3			
				May 31	Depreciation		69 000
				20.4			
				May 31	Depreciation		46 000
				20.5			
				May 31	Depreciation		103 500
			402 500				402 500

Dr Realisation of machinery **Cr**

20.5			**R**	**20.5**			**R**
May 31	Machinery at cost		460 000	May 31	Accumulated depreciation		402 500
	Profit on sale of machinery		2 500		Bank		60 000
			462 500				462 500

Dr Profit on sale of machinery **Cr**

				20.5			**R**
				May 31	Realisation of machinery		2 500

Dr Bank **Cr**

20.5			**R**				
May 31	Realisation of machinery		60 000				

Pro rata depreciation:

When an asset is sold before the end of its expected life span and during the financial year, the pro rata depreciation for the period from the beginning of the financial year up to the date of sale must be taken into account as part of the accumulated depreciation. For example, if you sell an asset on 30 September and the financial year end is 31 December, the asset has been in use for 9 months or $\frac{3}{4}$ of the year. If the percentage for a full year is 20%, the pro rata depreciation in this case would be $\frac{9}{12} \times 20\%$ for the last year.

Summary

The following six (6) steps should be followed when dealing with the disposal of an asset:

1. **Record the depreciation of the current period up until the date of disposal (general journal):**

   Debit: Depreciation
   Credit: Accumulated depreciation

   Now calculate the total accumulated depreciation of the disposed asset.

2. **Transfer the total accumulated depreciation of the disposed asset to the realisation account (general journal):**

   Debit: Accumulated depreciation
   Credit: Realisation account

3. **Transfer the cost price of the disposed asset to the realisation account (general journal):**

   Debit: Realisation account
   Credit: The particular asset account (Vehicles, Equipment, etc.)

4. **Record the amount earned on the realisation (note that the realisation account is credited in all three cases):**

   4.1 Sold for cash (CRJ):

   Debit: Bank
   Credit: Realisation account

   4.2 Sold on credit (general journal):

   Debit: Trade receivables (and Trade receivables control account)
   Credit: Realisation account

   4.3 Asset traded in (general journal):

   Debit: The asset account (as part of the cost price of the new asset)
   Credit: Realisation account

5. **Determine the profit or loss on the disposed asset:**

   5.1 If the total of the debit side of the realisation account is bigger than that of the credit side, the asset was disposed of at a loss.
   5.2 If the total of the credit side of the realisation account is bigger than that of the debit side, the asset was disposed of at a profit.

6. **Transfer the profit or loss to the profit or loss account on disposal of that type of asset (general journal):**

   6.1 Profit:

   Debit: Realisation account
   Credit: Profit on disposal of ... account

   6.2 Loss:

   Debit: Loss on disposal of ... account
   Credit: Realisation account

GOLDEN RULE

Profits and losses on disposal of assets must be disclosed separately in the statement of profit or loss and other comprehensive income.

11.10 Revision exercises and solutions

11.10.1 Revision exercise 1

The following information relates to Bacinis:

Balances as at 31 August 20.3:	R	R
Plant and machinery (at cost)	85 000	
Accumulated depreciation: plant and machinery		46 600

ADDITIONAL INFORMATION

(a) According to the assets register, plant and machinery consist of two Zobo machines of equal value. Both the machines were purchased and installed on the same date.
(b) Depreciation is written off at 20% per annum by the diminishing balance method.
(c) On 31 January 20.4, management decided to increase production capacity and purchased a Jojo machine on credit from Maxi Limited for R90 000. One of the Zobo machines was traded in, reducing the amount owing to Maxi Ltd to R70 500.
(d) On 1 February 20.4, installation charges on the new machine amounting to R6 000 were paid in cash.

Required:

(1) Prepare journal entries to record the above transactions, excluding cash, for the year ended 31 August 20.4.

(2) Show the following general ledger accounts for the year ended 31 August 20.4, properly balanced:

(a) Accumulated depreciation

(b) Machinery realisation

(3) Prepare the note regarding property, plant and equipment for the year ended 31 August 20.4

Solution: Revision exercise 1

(1) GENERAL JOURNAL

20.4			R	R
Jan 31	Plant and machinery (at cost)		90 000	
	Maxi Ltd			90 000
	Jojo machine purchased on credit			
	Depreciation	(1)	1 600	
	Accumulated depreciation			1 600
	Depreciation written off on machine traded in			
	Machinery realisation		42 500	
	Plant and machinery (at cost)			42 500
	Transfer cost price of machine traded in			

	Accumulated depreciation Machinery realisation *Transferring depreciation of machine traded in*	(1)	24 900	24 900
	Maxi Ltd Machinery realisation *Recording trade-in value of Zobo machine*	(2)	19 500	19 500
	Machinery realisation Profit on sale of machinery *Transferring profit on machine traded in*		1 900	1 900
Aug 31	Depreciation Accumulated depreciation *Depreciation on plant and machinery*	(3)	15 040	15 040

(2) GENERAL LEDGER

(a)

Dr Accumulated depreciation **Cr**

20.4			**R**	**20.3**			**R**
Jan 31	Machinery realisation		24 900	Aug 31	Balance	b/d	46 600
				20.4			
				Jan 31	Depreciation		1 600
20.4				Aug 31	Depreciation		15 040
Aug 31	Balance	c/d	38 340				
			63 240				63 240
				20.4			
				Sep 1	Balance	b/d	38 340

(b)

Dr Machinery realisation **Cr**

20.4			**R**	**20.4**			**R**
Jan 31	Plant and machinery		42 500	Jan 31	Accumulated depreciation		24 900
	Profit on sale of machinery		1 900		Maxi Ltd		19 500
			44 400				44 400

CALCULATIONS:

1 *Depreciation on machine traded in* **R**

To 31 August 20.3 (R46 600 $\times \frac{1}{2}$) 23 300

31 August 20.3 – 31 January 20.4

$\frac{20}{100} \times \frac{5}{12} \times$ R(42 500 $-$ 23 300) 1 600

24 900

2 *Trade-in value*

R90 000 − R70 500	19 500

3 *Depreciation on machinery still in use*

Zobo machine	
$R(42\ 500 - 23\ 300) \times \frac{20}{100}$	3 840
Jojo machine	
$R(90\ 000 + 6\ 000) \times \frac{20}{100} \times \frac{7}{12}$	11 200
	15 040

(3) BACINIS

NOTES FOR THE YEAR ENDED 31 AUGUST 20.4

Property, plant and equipment	Machinery	Total
	R	R
Carrying amount:		
Beginning of year	38 400	38 400
Cost	85 000	85 000
Accumulated depreciation	(46 600)	(46 600)
Additions (R90 000 + R6 000)	96 000	96 000
Depreciation (R1 600 + R15 040)	(16 640)	(16 640)
Disposals	(17 600)	(17 600)
Cost	(42 500)	(42 500)
Accumulated depreciation	24 900	24 900
Carrying amount:		
End of year	100 160	100 160
Cost (R85 000 + R96 000 – R42 500)	138 500	138 500
Accumulated depreciation (R46 600 + R16 640 – R24 900)	(38 340)	(38 340)

11.10.2 Revision exercise 2

On 1 January 20.1 B Book started an entity, BB Printers, and bought a printing machine, Zebra, for R40 000 cash.

On 1 October 20.2 he bought an additional printing machine, Jaguar, on credit from AB Machinery for R60 000 and paid a deposit of R10 000.

The Zebra machine became obsolete and BB Printers decided to purchase a Cheetah machine from ZYP Company for R100 000. The Zebra machine was accepted as a trade-in, valued at R15 000. The Cheetah machine was installed on 1 July 20.3 and BB Printers paid R5 000 installation costs.

ADDITIONAL INFORMATION

(a) Depreciation on the Zebra and Jaguar machines is provided for at 20% per annum on the straight line method.

(b) The estimated life span of the Cheetah machine is 8 years and the estimated trade-in value at the end of the term is R9 000.

Required:

Prepare the following ledger accounts, properly balanced and closed off, for the year ended 31 December 20.3:

(1) Machinery at cost

(2) Depreciation

(3) Accumulated depreciation

(4) Machinery realisation

Solution: Revision exercise 2

GENERAL LEDGER

(1)

Dr Machinery (at cost) **Cr**

20.3			**R**	**20.3**			**R**
Jan 1	Balance	b/d	100 000	Jul 1	Machinery realisation		40 000
Jul 1	ZYP Company		100 000	Dec 31	Balance	c/d	165 000
Jul 1	Bank		5 000				
			205 000				205 000
20.4							
Jan 1	Balance	b/d	165 000				

(2)

Dr Depreciation **Cr**

20.3			**R**	**20.3**			**R**
Jul 1	Accumulated depreciation		4 000	Dec 31	Profit or loss		22 000
Dec 31	Accumulated depreciation		18 000				
			22 000				22 000

(3)

Dr Accumulated depreciation **Cr**

20.3			**R**	**20.3**			**R**
Jul 1	Machinery realisation		20 000	Jan 1	Balance	b/d	19 000
Dec 31	Balance	c/d	21 000	Jul 1	Depreciation		4 000
				Dec 31	Depreciation		18 000
			41 000				41 000
				20.4			
				Jan 1	Balance	b/d	21 000

(4)

Dr			Machinery realisation				Cr
20.3			**R**	**20.3**			**R**
Jul 1	Machinery (at cost)		40 000	Jul 1	Accumulated depreciation		20 000
					ZYP Company		15 000
					Loss on disposal of machinery		5 000
			40 000				40 000

CALCULATIONS

1 *Balances on 31 December 20.2:* **R**

Machinery:	Zebra	40 000
	Jaguar	60 000
		100 000

Accumulated depreciation:

Zebra:	$20\% \times R40\ 000 \times 2$	16 000
Jaguar:	$20\% \times R60\ 000 \times \frac{3}{12}$	3 000
		19 000

2 *Depreciation:*

Zebra 1 January 20.3 – 1 July 20.3	
$20\% \times R40\ 000 \times \frac{6}{12}$	4 000
Zebra 1 January 20.1 – 1 July 20.3	
R(16 000 + 4 000)	20 000
Jaguar 31 December 20.3:	
$20\% \times R60\ 000 \times 1$	12 000
Cheetah 31 December 20.3:	
$R(105\ 000 - 9\ 000) \div 8 \times \frac{6}{12}$	6 000
	18 000

11.10.3 Revision exercise 3

B Box, the owner of Box Traders, bought a new machine for R60 000 on 1 July 20.0. He decided to write off depreciation at 25% per annum, using the straight-line (fixed instalment) method.

On 1 October 20.2 he purchased a second machine for R80 000 cash and decided on the same depreciation policy as before.

On 30 June 20.3 the machine bought during 20.0 was sold for R18 000 cash.

Required:

Prepare the following ledger accounts reflecting all applicable entries, in the books of Box Traders, properly balanced/closed off at 31 March of each financial year (show all calculations):

(1) Machinery at cost
(2) Depreciation
(3) Accumulated depreciation
(4) Machinery realisation

Solution: Revision exercise 3

GENERAL LEDGER

(1)

Dr Machinery (at cost) **Cr**

20.0			**R**	**20.3**			**R**
Jul 1	Bank		60 000	Mar 31	Balance	c/d	140 000
20.2							
Oct 1	Bank		80 000				
			140 000				140 000
20.3				**20.3**			
Apr 1	Balance	b/d	140 000	Jun 30	Machinery realisation		60 000
				20.4			
				Mar 31	Balance	c/d	80 000
			140 000				140 000
20.4							
Apr 1	Balance	b/d	80 000				

(2)

Dr Depreciation **Cr**

20.1			**R**	**20.1**			**R**
Mar 31	Accumulated depreciation	(1)	11 250	Mar 31	Profit or loss		11 250
20.2				**20.2**			
Mar 31	Accumulated depreciation	(2)	15 000	Mar 31	Profit or loss		15 000
20.3				**20.3**			
Mar 31	Accumulated depreciaton	(3)	25 000	Mar 31	Profit or loss		25 000
				20.4			
Jun 30	Accumulated depreciation	(4)	3 750	Mar 31	Profit or loss (loss)		23 750
20.4							
Mar 31	Accumulated depreciation	(5)	20 000				
			23 750				23 750

(3)

Dr Accumulated depreciation **Cr**

20.2			**R**	**20.1**			**R**
Mar 31	Balance	c/d	26 250	Mar 31	Depreciation	(1)	11 250
				20.2			
				Mar 31	Depreciation	(2)	15 000
			26 250				26 250
20.3				**20.2**			
Mar 31	Balance	c/d	51 250	Apr 1	Balance	b/d	26 250
				20.3			
				Mar 31	Depreciation	(3)	25 000
			51 250				51 250
20.3				**20.3**			
Jun 30	Machinery			Apr 1	Balance	b/d	51 250
	realisation	(6)	45 000	Jun 30	Depreciation	(4)	3 750
20.4				**20.4**			
Mar 31	Balance	c/d	30 000	Mar 31	Depreciation	(5)	20 000
			75 000				75 000
				20.4			
				Apr 1	Balance	b/d	30 000

(4)

Dr Machinery realisation **Cr**

20.3			**R**	**20.3**			**R**
Jun 30	Machinery at cost		60 000	Jun 30	Accumulated		
	Profit on sale of				depreciation		45 000
	machinery		3 000*		Bank		18 000
			63 000				63 000

* Balancing figure

CALCULATIONS

Depreciation:	R	R
(1) 1 July 20.0 to 31 March 20.1: R60 000 $\times \frac{25}{100} \times \frac{9}{12}$		11 250
(2) 1 April 20.1 to 31 March 20.2: R60 000 $\times \frac{25}{100}$		15 000
(3) First machine		
1 April 20.2 to 31 March 20.3: R60 000 $\times \frac{25}{100}$	15 000	
Second machine		
1 October 20.2 to 31 March 20.3: R80 000 $\times \frac{25}{100} \times \frac{6}{12}$	10 000	25 000
(4) First machine (sold)		
1 April 20.3 to 30 June 20.3: R60 000 $\times \frac{25}{100} \times \frac{3}{12}$		3 750
(5) Second machine (for year)		
1 April 20.3 to 31 March 20.4: R80 000 $\times \frac{25}{100}$		20 000
(6) Accumulated depreciation – First machine		
R(11 250 + 15 000 + 15 000 + 3 750)		45 000

11.10.4 Revision exercise 4

The following information regarding machines X and Y relates to Jingo:

	Machine X	Machine Y
Date of purchase	1 March 20.0	1 September 20.1
Purchase price (cash)	R40 000	R88 000
Installation cost	R4 000	R4 000
Estimated useful life	4 years	5 years
Scrap value	R4 000	R12 000

The entity uses the straight-line (fixed instalment) method to provide for depreciation. On 31 August 20.1 machine X was sold for R26 000 cash.

Required:

Prepare the following ledger accounts of Jingo for the year ended 28 February 20.2, properly balanced/closed off:

(1) Machinery at cost (machines X and Y)

(2) Machinery realisation

(3) Accumulated depreciation

(4) Depreciation

Solution: Revision exercise 4

GENERAL LEDGER

(1)

Dr Machinery (at cost) **Cr**

20.1			R	**20.1**			R
Mar 1	Balance	b/d	44 000	Aug 31	Machinery realisation		44 000
Sep 1	Bank		92 000	**20.2**			
				Feb 28	Balance	c/d	92 000
			136 000				136 000
20.2							
Mar 1	Balance	b/d	92 000				

(2)

Dr Machinery realisation **Cr**

20.1			R	**20.1**			R
Aug 31	Machinery		44 000	Aug 31	Accumulated depreciation		15 000
					Bank		26 000
					Loss on sale of machinery		3 000
			44 000				44 000

(3)

Dr Accumulated depreciation **Cr**

20.1			**R**	**20.1**			**R**
Aug 31	Machinery realisation	(1)	15 000	Mar 1	Balance	b/d	10 000
				Aug 31	Depreciation		5 000
20.2				**20.2**			
Feb 28	Balance	c/d	8 000	Feb 28	Depreciation	(2)	8 000
			23 000				23 000
				20.2			
				Mar 1	Balance	b/d	8 000

(4)

Dr Depreciation **Cr**

20.1			**R**	**20.2**			**R**
Aug 31	Accumulated depreciation		5 000	Feb 28	Profit or loss		13 000
20.2							
Feb 28	Accumulated depreciation		8 000				
			13 000				13 000

CALCULATIONS:

Depreciation to be written off		**R**
1	*Machine X*	
	$\frac{44\,000 - 4\,000}{4}$	10 000 pa
	1 March 20.0 – 28 Feb 20.1	10 000
	1 March 20.1 – 31 Aug 20.1 ($\frac{10\,000}{1} \times \frac{6}{12}$)	5 000
		15 000
2	*Machine Y*	
	$\frac{92\,000 - 12\,000}{5}$	16 000 pa
3	1 Sep 20.1–28 Feb 20.2 ($\frac{16\,000}{1} \times \frac{6}{12}$)	8 000

SELF-ASSESSMENT

Having studied this study unit, can you:

- define a non-current asset?
- explain how the cost price of a non-current asset is determined?
- record the entries for the purchase of property, plant and equipment?
- record the entries for the disposal of property, plant and equipment?
- calculate the depreciation according to the three methods explained and record the related entries?

STUDY UNIT

12

Other non-current assets

Learning outcome

Students should be able to record transactions related to other non-current assets such as investments.

Contents

KEY CONCEPTS

- Intangible assets
- Amortisation
- Other financial assets
- Cash investments
- Loans granted
- Investments in shares
- Ordinary shares
- Investment income

12.1 Introduction

Non-current assets are divided into tangible assets, intangible assets and other financial assets. Tangible assets (property, plant and equipment) were discussed in study unit 11. In this study unit other non-current assets (intangible assets and other financial assets) will be discussed.

Study paragraph 12.1 of the prescribed book.

12.2 Intangible assets

IAS 38 (AC 129 .2) defines intangible assets as ''... identifiable, non-monetary assets without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes, which are controlled by an entity as a result of past events, and from which future economic benefits are expected to flow to the entity.''

Study paragraph 12.2 of the prescribed book.

12.3 Financial instruments

Study paragraph 12.3 of the prescribed book.

12.4 Types of other financial assets and method of recording them

When a financial asset is acquired, the relevant financial asset account is debited and the bank account credited.

12.4.1 Cash investments

Every entity tries to invest its available cash in the most profitable way, that is the entity tries to:

- obtain the highest yield, or
- earn the best return on its investment

Although cash investments may not always be the most profitable type of investment, entities often have cash temporarily available which they want to invest for a relatively short period. The cash may be required on a specific future date.

These investments may be in the form of savings accounts, call deposits or fixed deposits. This kind of investment usually yields interest at a fixed rate or a rate that does not change often.

Study paragraph 12.4.1 of the prescribed book.

12.4.2 Investments in shares

A popular form of investment is the purchase of shares in a company. The investment return on shares is called ‘‘dividends’’.

Dividends earned on investments in shares differ from interest in that interest is usually earned at a fixed rate while dividends are received only if the company which issued the shares declares a dividend. The rate at which dividends are to be paid out is decided on annually. The accounting procedure is basically the same as for interest.

As regards the extent of dividends declared, you should note that dividends are shown either as a percentage of the nominal value of the shares or as cents per share.

Study paragraphs 12.4.2 and 12.5 of the prescribed book.

TOPIC D

ACCOUNTABILITY FOR CURRENT AND NON-CURRENT LIABILITIES

Learning outcome

The learner should be able to explain, valuate and record the transactions pertaining to current and non-current liabilities and to explain how they are controlled.

CONTENTS

STUDY UNIT

13

Current liabilities

Learning outcome

Students should be able to know the treatment of current liabilities in the books of an entity

Contents

KEY CONCEPTS

- Trade payables
- Sundry current liabilities
- Value-Added Tax payable
- Instalments payable on interest bearing borrowings
- Accrued expenses
- Provisions
- Dividends payable
- Profit share payable
- Settlement discount received

13.1 Introduction

A liability is a claim which a party other than the owner/s has on the assets of the entity. It usually originates from a transaction in the past but it can also be the result of legal action. It is expected that the payment of a liability will lead to an outflow of resources.

Liabilities can be classified as current liabilities, indicating that payment will or should take place within the next period of 12 months, or non-current liabilities for which payment should take place after the next period of 12 months.

The following items are usually classified as current liabilities:

- trade payables
- accrued expenses
- income received in advance
- instalments payable on long-term borrowings
- Value-Added Tax payable to the SA Revenue Services
- bank overdraft

Study paragraphs 13.1 to 13.3 of the prescribed book.

13.2 Trade payables

This type of creditor results from the purchase of goods and services on credit.

When creditors are paid within a specific period according to an agreement, the entity may get a discount on the outstanding account.

Settlement discount received is deducted in determining the cost of purchases. Suppose, for example, LM Traders purchased merchandise costing R500 on 2 January 20.1 from creditor BAD Suppliers. On 30 January 20.1, LM Traders issued a cheque for R495 in full settlement of BAD Suppliers' account.

The entries would be as follows:

Dr		Trade payables: BAD Suppliers					Cr
20.1			**R**	**20.1**			**R**
Jan 30	Bank		495	Jan 2	Purchases		500
	Settlement discount received		5				
			500				500

Dr		Settlement discount received					Cr
20.1			**R**	**20.1**			**R**
Dec 31	Purchases		5	Jan 30	Trade payables: BAD Suppliers		5

COMMENTS

- *Settlement discount received is deducted from purchases in determining the cost of purchases.*
- *In this specific example we showed two entries on the debit side of the creditors account. The total of the two amounts is normally recorded in the creditors column of the cash payments journal. Only one posting, representing both accounts is then necessary.*
- *Creditor BAD Suppliers will be one of many creditors. A trade payables control account in the general ledger will then be in use and will represent all individual creditors appearing in the trade payables ledger. A debit to a creditor's individual account will be included in the debits to the control account and vice versa.*
- *In study unit 6 we explained the influence of Settlement discount received on VAT. In this study unit we will be ignoring VAT.*

Study paragraphs 13.5 to 13.6 of the prescribed book.

13.3 Sundry current liabilities

There are several types of current liabilities. At the end of the financial year an entity must provide for accrued expenses or losses and VAT payable to the SA Revenue Service. Income received in advance is also classified as a current liability.

To refresh your memory with regard to accrued expenses and income received in advance, revise study unit 6, which deals with adjustments.

Study paragraph 13.7 of the prescribed book.

GOLDEN RULE

That portion of a long-term loan or obligation to be repaid within the next 12 months, must be disclosed as a current liability in the statement of financial position.

13.4 Disclosure in the statement of financial position

According to International Financial Reporting Standards in South Africa, the current liabilities are disclosed as follows in the statement of financial position:

NAME OF ENTERPRISE

STATEMENT OF FINANCIAL POSITION AS AT ....

	R
ASSETS	
EQUITY AND LIABILITIES	
Total equity	
Current liabilities	XXX XXX
Trade and other payables	XX XXX
Income received in advance	X XXX
Other financial liabilities	X XXX
Current portion of long-term borrowings	XX XXX
Current VAT payable	X XXX

Exercise 13.1

The following balances were taken from the post-adjustment trial balance of Picnic Traders as at 31 December 20.1:

	R
Trade payables	221 000
Accrued interest on loan	1 500
Bank overdraft	34 600
VAT control	4 500
Income received in advance	13 000

The layout in the statement of financial position with regard to the above will be as follows:

PICNIC TRADERS

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.1 (extract)

	R
ASSETS	
EQUITY AND LIABILITIES	
Total equity	
Current liabilities	274 600
Trade and other payables R(221 000 + 1 500)	222 500
Income received in advance	13 000
Other financial liabilities	34 600
Current VAT payable	4 500

Study paragraph 13.4 of the prescribed book.

13.5 Trade payables control account

The trade payables control account in the general ledger represents all the individual creditors in the creditors (subsidiary) ledger.

The trade payables control account reflects a summary of the individual creditors' transactions and the balance of the trade payables control account must be equal to the total of the individual creditors' account balances.

Posting to the personal accounts of the creditors takes place on a daily basis. Once a month, when the totals of all the creditors control columns in all the subsidiary journals have been determined, the amounts are posted to the trade payables control account.

The procedure can be summarised as follows:

Individual entries in the purchases journal	Posted to	Personal accounts of creditors (credit side) in the trade payables ledger on the day the transaction took place
Total of the creditors control column in the purchases journal	Posted to	Trade payables control account (credit side) on the last day of the month
Individual entries in the purchases returns journal	Posted to	Personal accounts of creditors (debit side) in the creditors ledger on the day the transaction took place
Total of the creditors control column in the purchases returns journal	Posted to	Trade payables control account (debit side) on the last day of the month
Individual entries in the cash payments journal	Posted to	Personal accounts of creditors (debit side) in the trade payables ledger on the day the transaction took place
Total of the creditors control column in the cash payments journal	Posted to	Trade payables control account (debit side) on the last day of the month

Provision can be made in the general journal for analysis columns for the trade receivables and trade payables control accounts. The entries made in the general journal that affect creditors must also be posted on a daily basis to the personal accounts of the creditors and the totals of the columns at the end of the month to the control accounts.

At the end of the month all the accounts in the general ledger and subsidiary ledgers must be balanced and a list with all the outstanding creditors' balances compiled. The balance on the trade payables control account must be equal to the total of the creditors list. If not, an error was made either when posting to an individual creditor's account in the trade payables ledger or when posting the totals of the journals to the trade payables control account. The accountant must then determine the reason/s for the difference/s and make the necessary corrections.

The following errors will result in a difference between the balance of the creditors control account and the list of individual creditors balances in the trade payables ledger:

- Error/s in posting to either the control account and/or to the trade payables ledger, eg a posting to the debit side of an account instead of to the credit side, or transposition of figures (R123 instead of R231)
- Incorrect balancing of accounts
- Incorrect totalling of one or more columns in the journals
- Incorrect listing of a balance
- Omission of a posting, where an entry in a journal (or the total column) was not posted to the ledger account/s

A reconciliation of the trade payables control account balance with the total of individual creditors balances is explained in the following exercise:

Exercise 13.2

The following information relates to Tip-Top Traders:

(1) *List of creditors' balances as at 30 September 20.2 as per trade payables ledger:*

	R
L Brand	6 424
S Ismail	10 285
C Roux	19 426
J Zulu	4 048
	40 183

(2) *Balance of the trade payables control account in the* general ledger as at 31 August 20.2:

	R
	47 072

(3) *Totals of subsidiary journals as at 30 September 20.2:*

	R
Purchases journal	96 282
Sales journal	138 195
Purchases returns journal	2 899
Sales returns journal	6 403
Cash receipts journal:	
Bank column	210 818
Sales column	98 000
Trade receivables column	118 624
Settlement discount granted column	5 806
Cash payments journal:	
Bank column	187 520
Purchases column	87 000
Trade payables column	105 358
Settlement discount received column	4 838

ADDITIONAL INFORMATION

(a) A credit note of R353 received from S Ismail in respect of goods returned was correctly entered in the purchases returns journal, but posted to the wrong side of S Ismail's account.
(b) An invoice of R286 in respect of goods purchased from L Brand was erroneously omitted from the purchases journal.
(c) According to the monthly statement received from J Zulu, interest of R45 has been charged on the overdue account. No entry has as yet been made.
(d) According to the trade payables ledger the correct balance on C Roux's account at 30 September 20.2 was R14 926.
(e) Wages paid, R880, was analysed to the creditors column in the cash payments journal. No correction has as yet been made.
(f) The purchases journal was overcast by R1 000. (''Overcast'' means that the total amount is more than it should be. ''Undercast'' means that the total is less than it should be.)

Required:

(1) Prepare the trade payables control account in the general ledger for September 20.2.
(2) Prepare the corrected accounts of the creditors in the trade payables ledger.
(3) Prepare a list of the adjusted creditors' balances as at 30 September 20.2.

Solution Exercise 13.2

TIP-TOP TRADERS

(1) GENERAL LEDGER

Dr Trade payables control **Cr**

20.2			**R**	**20.2**			**R**
Sep 30	Purchases returns	PRJ	2 899	Sep 1	Balance	b/d	47 072
	Bank	CPJ	105 358	30	Purchases R(96 282		
	Balance	c/d	35 308		– 1 000 + 286)	PJ	95 568
					Interest expenses	J	45
					Wages	J	880
			143 565				143 565
				20.2			
				Oct 1	Balance	b/d	35 308

GOLDEN RULE

- The trade payables control account is a summary of ALL transactions related to all the individual creditor accounts in the trade payables ledger.

GOLDEN RULE

- What was done (Dr or Cr) to the individual creditor accounts, must be done IN TOTAL to the trade payables control account.

(2) TRADE PAYABLES LEDGER

L Brand

			Dr	**Cr**	**Balance**
20.2			**R**	**R**	**R**
Sep 30	Account rendered	b/d			6 424 Cr
	Purchases	PJ		286	6 710 Cr

S Ismail

			Dr	**Cr**	**Balance**
20.2			**R**	**R**	**R**
Sep 30	Account rendered	b/d			10 285 Cr
	Purchases returns ($2 \times$ R353)	J	706		9 579 Cr

C Roux

			Dr	Cr	Balance
20.2			**R**	**R**	**R**
Sep 30	Account rendered	b/d			14 926 Cr

J Zulu

			Dr	Cr	Balance
20.2			**R**	**R**	**R**
Sep 30	Account rendered	b/d			4 048 Cr
	Interest expenses	J		45	4 093 Cr

(3) LIST OF ADJUSTED BALANCES PER TRADE PAYABLES LEDGER AS AT 30 SEPTEMBER 20.2:

	R	
L Brand	6 710	
S Ismail	9 579	
C Roux	14 926	
J Zulu	4 093	
	35 308	Balance as per trade payables control account.

GOLDEN RULE

The total of all the balances of the individual creditor accounts in the trade payables ledger, must equal the balance of the trade payables control account in the general ledger.

COMMENTS

- *If information was omitted or was transferred incorrectly from the source document to the purchases journal both the trade payables control account and the individual creditor's account will be affected by the mistake.*
- *If the information was entered correctly in the journal but a posting error was made to the trade payables ledger, the individual creditor's account must be corrected and the creditors list must be adjusted to correct the error.*
- *If an adding mistake was made in one or more columns in the journals, the correction must only be made in the trade payables control account.*
- *In this exercise the mistakes or omissions on the creditors' personal accounts were corrected on their accounts and a new list (adjusted list) that equalled the balance of the trade payables control account was compiled at 30 September 20.2.*

Study paragraphs 13.8 to 13.10 of the prescribed book.

13.6 Revision exercises and solutions

13.6.1 Revision exercise 1

MY Company commenced trading on 1 December 20.1 and they are registered for VAT purposes. Sales in December (all on credit) amounted to R570 000 (inclusive of VAT calculated at 14%).

Required:

Show the related accounts and entries in the general ledger, in order to indicate the amount of VAT payable to SARS.

Solution: Revision exercise 1

MY COMPANY

GENERAL LEDGER

Dr Sales **Cr**

20.1			**R**	**20.1**			**R**
Dec 31	Trading account		500 000	Dec 31	Trade receivables control		500 000

Dr Trade receivables control **Cr**

20.1			**R**				
Dec 31	Sales and VAT		570 000				

Dr VAT output **Cr**

				20.1			**R**
				Dec 31	Trade receivables control		70 000

13.6.2 Revision exercise 2

MY Company, whose financial year ends on 31 December 20.0, has a loan of R600 000 secured by a first mortgage over land and buildings redeemable in three equal annual instalments of R200 000. The first instalment is payable on 30 June 20.1.

Required:

Show how the amount will be reflected on the statement of financial position as at 31 December 20.0.

Solution: Revision exercise 2

MY COMPANY

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.0 (extract)

	R
ASSETS	
EQUITY AND LIABILITIES	
Total liabilities	600 000
Non-current liabilities	400 000
Long-term borrowings	400 000
Long-term loan secured by a first mortgage over land and buildings	400 000
Current liabilities	200 000
Current portion of long-term borrowings	200 000

COMMENT

We will explain more about non-current liabilities in study unit 14.

13.6.3 Revision exercise 3

The following information in respect of June 20.1 was obtained from the records of N Nelson:

	R
Balance of trade payables control account — 31 May 20.1	16 571
Totals for the month	
Cash payments journal:	
Trade payables column	14 326
Settlement discount received column	1 673
Purchases journal	17 350
Purchases returns journal	3 750
General journal:	
Certain accounts with debit balances transferred to trade receivables ledger from trade payables ledger	46
List of individual creditors per trade payables ledger:	
Credit balances	16 812
Debit balances	110

In the process of reconciling the balances on the trade payables control account with the list of individual balances per creditors ledger, the following errors were discovered:

(a) An invoice for R1 787, which had been entered correctly in the purchases journal was entered against the account of Tims Ltd as R1 878.
(b) Credit note No 63 for R60 was entered correctly in the purchases returns journal, but erroneously posted as a credit to the account of Ewing Ltd.
(c) A cheque for R90 paid to M Sorry was entered on the debit side of S Sorry's account.

(d) The total of the list of creditors balances was overcast by R500.
(e) The total of the purchases journal was undercast by R100.

Required:

(1) Prepare the trade payables control account as at 30 June 20.1, properly balanced. The first word(s) of each entry must indicate the contra ledger account.

(2) Reconcile the total of the list of creditors balances with the balance of the trade payables control account as determined in (1) above.

Solution: Revision exercise 3

N NELSON

(1) GENERAL LEDGER

Dr Trade payables control **Cr**

20.1			**R**	**20.1**			**R**
Jun 30	Bank	CPJ	14 326	Jun 1	Balance	b/d	16 571
	Purchases returns	PRJ	3 750		Purchases	PJ	17 450
	Balance	c/d	15 991		R(17 350+100)		
					Trade receivables control	J	46
			34 067				34 067
				20.1			
				Jul 1	Balance	b/d	15 991

(2) RECONCILIATION

	R	R
Total of the list of creditors balances (credit balances less debit balances) (R16 812 – R110)		16 702
Less: Tims Ltd R(1 878 – 1 787)	91	
Ewing Ltd R(60 × 2)	120	
Overcasting	500	711
Balance of trade payables control account		15 991

SELF-ASSESSMENT

Now that you have studied this study unit, can you:

- explain what a trade payables is?
- explain what settlement discount received is?
- calculate the discount involved and record the appropriate entries?
- explain the different types of sundry current liabilities?
- show how current liabilities are disclosed in the statement of financial performance?
- reconcile the balance of the trade payables control account in the general ledger with the total of the list of individual creditors balances in the trade payables ledger?

STUDY UNIT

14

Non-current liabilities

Learning outcome

Students should be able to describe the non-current liabilities, record the necessary entries in the books and disclose it in the statement of financial position.

Contents

KEY CONCEPTS

- Non-current liabilities
- Long term
- Mortgage
- Debenture
- Registrar of Deeds
- Insured by
- Disclosure
- Long-term borrowings

14.1 Introduction

A non-current liability is a liability which is payable at the end of the financial period, after a period of more than one year. The entity usually provides security for this type of loan.

Study paragraphs 14.1 and 14.2 of the prescribed book.

14.2 Recording of a non-current liability in the books and its disclosure in the financial statements

Long-term borrowings must be disclosed under non-current liabilities on the statement of financial position. In this course we will concentrate on long-term borrowings, namely long-term loans, mortgages and debentures.

14.2.1 Long-term loans and mortgages (Long-term borrowings)

Study paragraph 14.3 of the prescribed book.

Exercise 14.1

Eco buys a property on 1 January 20.1 for R114 000 by means of a first mortgage in favour of ABC Bank. The interest rate payable is 17% per annum and payment will take place in four equal installments every fifth year. The first payment will be on 1 January 20.6. The entity's financial year end is 31 December.

Required:

Show the entries in the ledger accounts and the liability portion of the statement of financial position of Eco.

Solution Exercise 14.1

ECO

LEDGER ACCOUNTS

Dr Land **Cr**

20.1			**R**				
Jan 1	Mortgage: ABC Bank	J	114 000				

Dr Mortgage: ABC Bank **Cr**

				20.1			**R**
				Jan 1	Land		114 000

ECO

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.1 (EXTRACT)

ASSETS	**R**
EQUITY AND LIABILITIES	
Non-current liabilities	114 000
Long-term borrowings	114 000
Long-term loan from ABC Bank	114 000

COMMENTS

- *When an instalment on a loan is payable during the next financial year, the instalment must be disclosed as a current liability in the statement of financial position of the current year.*
- *In the statement of financial position as at 31 December 20.5 the amount indicated as a long-term loan will be R85 500 and under current liabilities an amount of R28 500 will be shown as the current portion of long-term borrowings.*
- *In the statement of profit or loss and other comprehensive income an expense of R19 380 (17% x R114 000) in respect of interest expense will be shown annually for the first five years.*

14.2.2 Debentures

Study paragraphs 14.4 and 14.5 of the prescribed book.

Exercise 14.2

A Company wishes to borrow R2 000 000 by means of debentures of R1 000 each at 15% interest. The public are invited in an advertisement to buy the debentures. The debentures will be redeemed on 31 December 20.9. Applications for 2 500 debentures are received and 2 000 debentures are allocated on 1 January 20.1.

Required:

Show the entries in the ledger accounts and statement of financial position of A Company

A COMPANY

LEDGER ACCOUNTS

Dr Bank Cr

20.1			R	20.1			R
Jan 1	Applications for debentures		2 500 000	Jan 1	Applications for debentures		500 000

Dr Applications for debentures Cr

20.1			R	20.1			R
Jan 1	15% Debentures		2 000 000	Jan 1	Bank		2 500 000
	Bank		500 000				
			2 500 000				2 500 000

Dr 15% Debentures Cr

				20.1			R
				Jan 1	Applications for debentures		2 000 000

A COMPANY

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.1 (extract)

	R
ASSETS	
EQUITY AND LIABILITIES	
Non-current liabilities	2 000 000
Long-term borrowings	2 000 000
2 000, 15% R1 000 debentures redeemable on 31 December 20.9	2 000 000

COMMENTS

- *The amount received as a result of excess applications is repaid to the unsuccessful applicants.*
- *Debentures may also be secured by a mortgage.*
- *The annual interest expense on the debentures will be shown in the statement of profit or loss and other comprehensive income.*
- *On the statement of financial position as at 31 December 20.8 the debentures will be shown as a current liability since they will be redeemed within the next 12 months.*

14.3 Revision exercises and solutions

14.3.1 Revision exercise 1

(1) What criterion is used to determine whether a liability is a non-current or a current liability?
(2) How do debentures differ from an ordinary long-term loan?
(3) What do the words "secured by a first bond over land and buildings" mean?

Solution: Revision exercise 1

(1) The criterion for determining whether an item is non-current or current is 12 months. A liability which is payable within 12 months is a current liability, and one which is payable after 12 months is a non-current liability.
(2) The only difference between debentures and a long-term loan is that with debentures there are a number of creditors, whereas with a long-term loan there is usually only one creditor which is usually a financial institution.
(3) "Secured by a first bond over land and buildings" means that the person or institution providing the loan has a first claim on the land and buildings in question. If the borrower is not able to repay the loan, the claimant can seize the land and buildings, sell them and retain as much of the amount as the mortgagor owes the claimant. The remaining portion of the amount goes to the second mortgagee, who in turn claims as much as is owed to him. Any remaining portion goes to the owner. Such a mortgage bond is registered against the property by the Registrar of Deeds. The Registrar of Deeds is a government office which controls such matters. If the borrowers were to try to sell the land and buildings, the property cannot be transferred to the buyer's name before all mortgagees had been paid the amounts owed to them.

14.3.2 Revision exercise 2

On 30 June 20.1 B Bomb Enterprises bought a stand, erf number 213, situated on the corner of Short and Long Streets in Pandorp for R100 000. B Bomb paid a deposit of R20 000 and took out a mortgage for the balance with Goodfin.

The applicable interest rate is 17% per annum payable annually on 30 June. The loan is to be redeemed by means of annual instalments of R10 000. The first capital redemption will take place on 30 June 20.2.

The financial year-end of B Bomb Enterprises is 30 September.

Required:

Show the following for the year ended 30 September 20.1:

(1) The appropriate ledger accounts with the relevant information only
(2) The relevant information in the statement of profit or loss and other comprehensive income for the year ended 30 September 20.1
(3) The relevant items as they would appear in the statement of financial position as at 30 September 20.1

Solution: Revision exercise 2

B BOMB ENTERPRISES

(1) LEDGER ACCOUNTS

Dr Land **Cr**

20.1			**R**				
Jun 30	Bank		20 000				
	17% Mortgage: Goodfin		80 000				
			100 000				

Dr 17% Mortgage: Goodfin **Cr**

				20.1			**R**
				Jun 30	Land		80 000

Dr Bank **Cr**

				20.1			**R**
				Jun 30	Land		20 000

Dr Interest expenses **Cr**

20.1			**R**	**20.1**			**R**
Sep 30	Accrued expenses		3 400	Sep 30	Profit or loss		3 400

Dr Accrued expenses **Cr**

				20.1			**R**
				Sep 30	Interest expenses		3 400

B BOMB ENTERPRISES

(2) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 20.1 (extract)

	R
Profit from operations	xx xxx
Finance costs:	(x xxx)
Interest expenses	3 400

B BOMB ENTERPRISES

(3) STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20.1 (extract)

ASSETS	**R**
Non-current assets	100 000
Property, plant and equipment	100 000
EQUITY AND LIABILITIES	
Total liabilities	83 400
Non-current liabilities	70 000
Long-term borrowings	70 000
17% Long-term loan secured by a first mortgage over land. Repayable in annual instalments of R10 000. The first instalment is payable on 30 June 20.2	70 000
Current liabilities	13 400
Trade and other payables	3 400
Current portion of long-term borrowings	10 000

COMMENTS

- *On 30 September 20.1 interest had not yet been paid on the loan because it is payable annually on 30 June. The first amount of interest will therefore be paid only on 30 June 20.2.*
  The interest is calculated as follows:
  For the year the amount is
  $$R80\ 000 \times \frac{17}{100} = R13\ 600$$
  Because only three months' interest has accrued, the amount that has to be provided for is:
  $$R13\ 600 \times \frac{3}{12} = R3\ 400$$
- *The interest is shown as an expense in the statement of profit or loss and other comprehensive income because the loan has already been utilised for three months of the financial year, irrespective of whether the interest has been paid.*
- *The statement of financial position has to show all the details of the loan — only that part that will be outstanding for more than 12 months on 30 September 20.1 will be shown as a non-current liability. The instalment which is payable within 12 months is shown as a current liability.*
- *The land is a non-current asset on which no depreciation is written off.*
- *The interest which has not yet been paid is also a current liability. See also paragraph 6.2.2.*

SELF-ASSESSMENT

Now that you have studied this study unit, can you describe the following, record the necessary entries and calculations in the books and show how they will appear in the statement of financial position:

- long-term loan?
- mortgage?
- debenture?
- interest on loans?

TOPIC E

ACCOUNTING REPORTING

Learning outcome

The learner should be able to prepare the financial statements (i.e. the statement of profit or loss and other comprehensive income, statement of changes in equity and the statement of financial position) and the notes to the financial statements of a sole proprietor, a nonprofit organisation and to prepare proper books from incomplete records.

CONTENTS

STUDY UNIT

15

Financial statements of a sole proprietorship

Learning outcome

Students should be able to record all transactions related to a sole proprietor and prepare the financial statements of a sole proprietor.

Contents

KEY CONCEPTS

- Sole proprietor/sole trader
- Equity
- Capital
- Profit/loss for the period/year
- Drawings
- Additional investment

15.1 Introduction

A sole proprietorship (also known as a sole trader) is the simplest form of business ownership and is often managed by the owner himself. There is no legislation prescribing how a sole proprietorship should be established.

Cash and/or any other type of asset, for example a motor vehicle, is necessary to start the business entity.

The equity simply consists of the capital invested in the business entity plus the profit made (or less a loss suffered) and less any money and/or goods withdrawn by the owner for personal use.

Study paragraphs 15.1 to 15.3 of the prescribed book.

15.2 Establishment of a sole proprietorship

A sole proprietor usually contributes capital in the form of cash, and/or non-current assets in the form of property, plant and equipment towards the starting of the business. The following example illustrates the accounting entries that are made when a sole proprietorship is established.

Exercise 15.1

On 1 March 20.1 J Brewis invests R25 000 to start JB Television Services, a service entity. His investment consists of R3 000 cash, equipment valued at R8 000 and a motor vehicle valued at R14 000.

Required:

Show the journal entry that will be made to record the relevant information of JB Television Services on the date of the investment.

Solution Exercise 15.1

JB TELEVISION SERVICES

GENERAL JOURNAL

20.1			**R**	**R**
Mar 1	Bank		3 000	
	Equipment		8 000	
	Motor vehicles		14 000	
	Capital			25 000
	Deposit of cash in the bank account of the entity and recording of other assets brought into the entity at valuation			

COMMENTS

- *On 1 March 20.1 "Capital" indicates the interest of J Brewis (the owner) in his business. Different meanings are attached to the word "capital" in the financial and accounting worlds. You will have to learn to differentiate between the various meanings by noting the context in which the word is used.*
- *The cash portion of the capital is usually recorded in the cash receipts journal.*

On 1 March 20.1 the statement of financial position of the entity is as follows:

JB TELEVISION SERVICES

STATEMENT OF FINANCIAL POSITION AS AT 1 MARCH 20.1

ASSETS	**Note**	**R**
Non-current assets		22 000
Property, plant and equipment	2	22 000
Current assets		3 000
Cash and cash equivalents		3 000
Total assets		25 000
EQUITY AND LIABILITIES		
Total equity		25 000
Capital		25 000
Total equity and liabilities		25 000

JB TELEVISION SERVICES

NOTES FOR THE PERIOD ENDED 1 MARCH 20.1

1 Accounting policy:

1.1 The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

1.2 Property, plant and equipment are shown at valuation.

2

Property, plant and equipment	Vehicles	Equipment	Total
Carrying amount:			
Beginning of year	14 000	8 000	22 000
Cost	14 000	8 000	22 000
Accumulated depreciation	(—)	(—)	(—)

We must again emphasise that an entity in which the owner has an interest (as J Brewis has in JB Television Services) is an *accounting entity* which is separate from the owner. If a statement of financial position were compiled for J Brewis personally, it would contain an item "Investment in JB Television Services."

15.3 Further capital contributions and profit

After the entity has been in operation for some time, the owner may decide to extend his business (eg by buying and selling television sets in addition to maintaining them). Brewis could then find his present capital insufficient. Suppose he decides to invest a further R15 000 cash in the entity on 1 August 20.1. The capital account in the books of the entity (and also the capital section of the statement of financial position, if we were to prepare one at this stage) would reflect the increase.

JB TELEVISION SERVICES

GENERAL LEDGER

Dr Capital: J Brewis **Cr**

				20.1			**R**
				Mar 1	Bank		3 000
					Equipment		8 000
					Motor vehicle		14 000
				Aug 1	Bank*		15 000
							40 000

The total value of the owner's initial investment is R25 000 (R[3 000 + 8 000 + 14 000])
* The owner's additional investment

You will remember that the profit for a financial period is transferred to the capital account at the end of the period. Suppose that the profit of the entity in the first financial year amounts to R9 000. The profit is added to the capital:

GENERAL JOURNAL

		R	**R**
Profit or loss		9 000	
Capital: J Brewis			9 000
Transfer of profit for the year			

Brewis's capital will now amount to R49 000:

	R
Initial investment	25 000
+ Additional investment	15 000
+ Profit for the year	9 000
	49 000

15.4 Drawings

Unless Brewis has an adequate income from another source, he will probably have to use the profit from his business for personal use. Generally, the "drawings" will take the form of cash withdrawals, but he could also withdraw other assets. Consider, for example, a retailer who takes groceries (ie from the trading inventory of the business) for his own use. This would also be classified as "drawings".

Assume the owner, J Brewis, withdrew R8 000 in cash during the year. The entries would be as follows:

J B TELEVISION SERVICES

GENERAL LEDGER

Dr Capital: J Brewis **Cr**

20.2			**R**	**20.2**			**R**
Feb 28	Drawings		8 000	Feb 1	Balance	b/d	40 000
	Balance	c/d	41 000	28	Profit or loss (profit)		9 000
			49 000				49 000
				20.2			
				Mar 1	Balance	b/d	41 000

Dr Drawings **Cr**

20.2			**R**	**20.2**			**R**
Feb 28	Bank		8 000	Feb 28	Capital: J Brewis		8 000
			8 000				8 000

COMMENT

- *The original investment of the owner and any further contributions specified as capital contributions are referred to as capital. When profit is added and drawings subtracted from the capital investment this is known as equity. The equity shows the interest of the owner in the entity. In other words the balance of R41 000 represents equity and not capital. Equity is the claim that the owner has against the assets of the entity. In a sole proprietorship the capital account is used to show the changes in equity. The changes in equity are disclosed in a statement called the "Statement of changes in equity".*

15.5 The presentation of equity in the statement of changes in equity and statement of financial position

Study paragraphs 15.4 to 15.6 of the prescribed book.

It is required that full details of equity must be shown in a statement of changes in equity. Any changes in the course of the financial year, must be shown in the statement as follows:

JB TELEVISION SERVICES

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.2

		Capital R
Balance at 1 March 20.1		25 000
Additional investment		15 000
Total comprehensive income for the year		9 000
Drawings		(8 000)
Balance at 28 February 20.2		41 000

Only the balance at the end of the year will be shown in the statement of financial position as follows:

JB TELEVISION SERVICES

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.2 (extract)

	Note	R
EQUITY AND LIABILITIES		
Total equity		41 000
Capital		$\boxed{41\ 000}$

The following exercise illustrates a simple statement of profit or loss and other comprehensive income, statement of changes in equity and statement of financial position of a sole proprietorship. Take careful note of how the owner's equity is treated.

Exercise 15.2

The following information relates to Jeff's Maintenance Services:

POST-ADJUSTMENT TRIAL BALANCE AS AT 31 DECEMBER 20.1.

		Dr R	Cr R
Bank		580	
Trade receivables control		5 515	
Inventory: cleaning materials		640	
Equipment at cost		13 000	
Vehicles at cost		17 000	
Accumulated depreciation on equipment			2 600
Accumulated depreciation on vehicles			6 800
Insurance		720	
Trade payables control			165
Fees earned			65 895
Capital: J Jefferson — 1 January 20.1			20 200
Drawings		12 000	
Wages		18 650	
Administrative expenses		12 410	
Advertisements		335	
Fuel and maintenance		1 110	
Depreciation (equipment R1 300, vehicles R3 400)		4 700	
Rental expenses		9 000	
		95 660	95 660

Required:

(1) Prepare the statement of profit or loss and other comprehensive income of Jeff's Maintenance Services for the year ended 31 December 20.1.

(2) Prepare the statement of changes in equity of Jeff's Maintenance Services for the year ended 31 December 20.1.

(3) Prepare the statement of financial position of Jeff's Maintenance Services as at 31 December 20.1.

(4) Show the notes for the year ended 31 December 20.1.

JEFF'S MAINTENANCE SERVICES

(1) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.1

	Note	R
Revenue	2	65 895
Distribution, administrative and other expenses		(46 925)
Insurance		720
Wages		18 650
Administrative expenses		12 410
Advertisements		335
Fuel and maintenance		1 110
Rental expenses		9 000
Depreciation R(1 300 + 3400)		4 700
Profit for the year		18 970
Other comprehensive income for the year		—
Total comprehensive income for the year		18 970

JEFF'S MAINTENANCE SERVICES

(2) STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.1

	Capital R
Balance at 1 January 20.1	20 200
Total comprehensive income for the year	18 970
Drawings	(12 000)
Balance at 31 December 20.1	27 170

JEFF'S MAINTENANCE SERVICES

(3) STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.1

ASSETS	**Note**	**R**
Non-current assets		20 600
Property, plant and equipment	3	20 600
Current assets		6 735
Inventories		640
Trade and other receivables		5 515
Cash and cash equivalents		580
Total assets		27 335
EQUITY AND LIABILITIES		
Total equity		27 170
Capital		27 170
Current liabilities		165
Trade and other payables		165
Total equity and liabilities		27 335

JEFF'S MAINTENANCE SERVICES

(4) NOTES FOR THE YEAR ENDED 31 DECEMBER 20.1

1 Accounting policy:

The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

2 Revenue represents fees earned from clients for services rendered.

3

Property, plant and equipment	Vehicles	Equipment	Total
	R	R	R
Carrying amount:			
Beginning of year	13 600	11 700	25 300
Cost	17 000	13 000	30 000
Accumulated depreciation	(3 400)	(1 300)	(4 700)
Depreciation for the period	(3 400)	(1 300)	(4 700)
Carrying amount:			
End of year	10 200	10 400	20 600
Cost	17 000	13 000	30 000
Accumulated depreciation	(6 800)	(2 600)	(9 400)

15.6 Revision exercises and solutions

15.6.1 Revision exercise 1

(1) What is the meaning of the accounting term "capital"?
(2) How is the profit of a sole proprietorship treated in the accounting records of the entity at the end of a financial year?
(3) What is meant by the term "drawings"?
(4) How are drawings treated in the accounting records of a sole proprietorship at the end of a financial year?
(5) What does equity of a sole trader consist of?

Solution: Revision exercise 1

(1) The "capital" of the owner in a sole proprietorship indicates the owner's initial investment plus any additional capital investments.
(2) The profit of a sole proprietor for a financial period is transferred to the capital account of the owner and becomes part of equity at the end of each financial period.
(3) Drawings are cash amounts or merchandise withdrawn from the business entity by the owner for personal use. Drawings result in a decrease in the equity of the sole proprietorship because assets of the entity are taken by the owner.
(4) Drawings by the owner are debited to a drawings account during the financial year. At the end of the financial year the drawings account is closed off to the capital account.
(5) The equity consists of the initial capital invested in the business entity plus all additional investments, plus the profit for the year (or less the loss) and less the drawings.

15.6.2 Revision exercise 2

The following information relates to Peter Pumpkin, a service entity:

(1) TRIAL BALANCE OF PETER PUMPKIN AS AT 28 FEBRUARY 20.1

		Dr R	Cr R
Land and buildings (at cost)		100 000	
Furniture and fittings (at cost)		42 000	
Accumulated depreciation — 28 February 20.0:			
Furniture and fittings			5 000
15% Mortgage secured by land and buildings			30 000
Capital: P Pumpkin — 28 February 20.0			80 000
Trade receivables control		8 100	
Trade payables control			3 000
Bank overdraft			800
Drawings		7 300	
Petty cash		640	
Stationery		1 150	
Salaries		21 100	
Electricity		12 000	
Telephone expenses		1 860	
Fees earned			59 000
Rental income			16 500
Bank charges		150	
		194 300	194 300

(2) ADDITIONAL INFORMATION:

(a) Stationery on hand at 28 February 20.1, R150.

(b) It was determined that the allowance for credit losses account should amount to R405 at 28 February 20.1.

(c) Rental income amounts to R1 500 per month and the rental has been charged for the full financial year.

(d) Provide for interest still outstanding on mortgage.

(e) Provide for depreciation on furniture and fittings at 15% per annum on cost price.

Required:

(1) Prepare the statement of profit or loss and other comprehensive income of Peter Pumpkin for the year ended 28 February 20.1.

(2) Prepare the statement of changes in equity of Peter Pumpkin for the year ended 28 February 20.1.

(3) Prepare the statement of financial position of Peter Pumpkin as at 28 February 20.1.

(4) Show the notes for the year ended 28 February 20.1.

Solution: Revision exercise 2

PETER PUMPKIN

(1) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 20.1

	Note	R	
Revenue	2		59 000
Rental income (R1 500 × 12)			18 000
			77 000
Distribution, administrative and other expenses			(42 815)
Stationery R(1 150 – 150)		1 000	
Salaries		21 100	
Electricity		12 000	
Telephone expenses		1 860	
Bank charges		150	
Credit losses		405	
Depreciation: Furniture and fittings R(42 000 x 15%)		6 300	
			34 185
Finance costs: Interest on mortgage R(30 000 x 15%)			(4 500)
Profit for the year			29 685
Other comprehensive income for the year			—
Total comprehensive income for the year			29 685

PETER PUMPKIN

(2) STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.1

	Capital R
Balance at 1 March 20.0	80 000
Total comprehensive income for the year	29 685
Drawings	(7 300)
Balance at 28 February 20.1	102 385

PETER PUMPKIN

(3) STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1

ASSETS	Note	R
Non-current assets		130 700
Property, plant and equipment	3	130 700
Current assets		9 985
Inventories		150
Trade and other receivables R(8 100-405+1500)		9 195
Cash and cash equivalents		640
Total assets		140 685
EQUITY AND LIABILITIES		
Total equity		102 385
Capital		102 385
Total liabilities		38 300
Non-current liabilities		30 000
Long-term borrowings:		30 000
15% mortgage secured by land and buildings		30 000
Current liabilities		8 300
Trade and other payables R(3 000 + 4 500)		7 500
Other current liabilities		800
Total equity and liabilities		140 685

PETER PUMPKIN

(4) NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.1

1 Accounting policy:

1.1 The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

1.2 Property, plant and equipment

Land and buildings are classified as investment properties and are not depreciated.

Depreciation has been provided for at 15% per annum on the cost price of furniture and fittings.

2 Revenue represents fees earned from clients for services rendered.

3

Property, plant and equipment	Land and buildings	Furniture and fittings	Total
	R	R	R
Carrying amount:			
Beginning of year	100 000	37 000	137 000
Cost	100 000	42 000	142 000
Accumulated depreciation	(—)	(5 000)	(5 000)
Depreciation for the period	(—)	(6 300)	(6 300)
Carrying amount:			
End of year	100 000	30 700	130 700
Cost	100 000	42 000	142 000
Accumulated depreciation	(—)	(11 300)	(11 300)

15.6.3 Revision exercise 3

This exercise has been compiled to give you some practice in the whole process of recording and reporting from the point of entries in subsidiary journals up to the preparation of the financial statements.

Mr K Kuman, who is registered as a VAT vendor, has a general dealer's business. On 31 January 20.1, the following balances appeared in the ledger of the entity, Kumanbuy General Dealer: (The VAT period of the entity ends on unequal months.)

(1) LIST OF BALANCES	**R**	**R**
Furniture and equipment (at cost)		40 000
Vehicles (at cost)		50 000
Inventory — 1 March 20.0		56 080
Cash in bank		34 091
Accumulated depreciation — 28 February 20.0:		
— Furniture and equipment		4 000
— Vehicles		5 000
Debtors:		2 932
— A Abrahams	368	
— B Barnard	924	
— C Chetty	463	
— D Dlamini	1 177	
Creditors:		3 651
— K Khoza	2 137	
— L Lawson	1 110	
— M Mnisi	261	
— N Nagel	143	
VAT control (credit balance)		2 700
Sales		227 000
Purchases		166 000
Repairs		4 150
Petrol		2 974
Stationery		214
Water and electricity		6 138
Rental expenses		22 000
Wages and salaries		25 300
Telephone expenses		2 102
Capital: K Kuman — 28 February 20.0		169 630

Mr Kuman's policy is to bank all cash receipts daily.

(2) TRANSACTIONS, 10% VAT INCLUSIVE, DURING FEBRUARY 20.1:

20.1				**R**
Feb	1	Cash sales		2 200
	2	Received from C Chetty in full settlement of his account		452
	3	Paid L Lawson and received R55 discount		1 055
	4	Sold goods on credit to E Erasmus	990	
	6	Received from D Dlamini on his account		507
		Received from A Abrahams in full settlement of his account	346	
	9	Paid K Khoza		2 137
		Paid N Nagel in full settlement		132
		Paid M Mnisi		261
	11	Purchased goods on credit from:		
		K Khoza		7 040
		L Lawson		6 600
	12	Returned goods to K Khoza		165
	13	Cash sales		5 500
		Sold goods on credit to D Dlamini	880	
	15	Sold goods on credit to C Chetty	2 200	
	16	C Chetty returned goods		110
	17	Cash sales		1 100
	18	Paid BB Garage for repairs to vehicles		550
		Paid Pump Services for petrol		330
	19	Purchased stationery from CSA for cash		165
	20	K Kuman withdrew cash from the business		10 000
		Cash purchases from P Prins		3 146
	25	Paid:		
		K Khoza on account		3 000
		L Lawson on account		2 020
		South African Revenue Service for VAT outstanding on 31 January 20.1		2 700
	27	Paid the following:		
		City Council for water and electricity		671
		Rentguy for rental		2 200
		Wages and salaries		2 300
	28	Cash sales		2 750
		Purchased a new counter from Counterman for cash		1 100

(3) ADDITIONAL INFORMATION

(a) B Barnard was declared insolvent and could pay nothing in settlement of his account.

(b) Provision is made annually for depreciation on 28 February at 10% pa on the cost of vehicles as well as furniture and equipment. No vehicles or furniture and equipment were purchased or sold during the eleven months ended 31 January 20.1.

(c) Inventory on hand at 28 February 20.1 amounted to R60 000.

(d) The telephone account of R264 for February 20.1 was only received on 1 March 20.1.

(e) The bank statement received during March 20.1 indicated a favourable balance of R15 005 on 28 February 20.1. A comparison with the cash journals reflected the following:

(i) Cheques for water and electricity, R671 and rental, R2 200 issued on 27 February 20.1 had not yet been presented at the bank for payment.

(ii) A withdrawal of R3 000 from the personal bank account of Mr Kuman was erroneously debited to the entity's account.

(iii) Bank charges to the amount of R45 have not yet been recorded in the cash payments journal.

The above represented the only differences between the ledger balances and the bank statement on 28 February 20.1.

Required:

NB: It is in your own interests to do this exercise without referring to the suggested solution. Then you can compare your answer with the solution.

Although they are not given, you should use your own invoice numbers, receipt numbers, cheque numbers, et cetera to ensure that the solution is as complete and realistic as possible.

(1) Record the transactions for February 20.1 in the relevant subsidiary journals and close off the journals on 28 February 20.1.

(2) Prepare journal entries for the adjustments.

(3) Open the general ledger accounts at 31 January 20.1 and post the subsidiary journals to the ledger.

(4) Reconcile the balance of the bank account with that shown on the bank statement.

(5) Open the individual debtors and creditors accounts in the relevant ledgers, balance them and reconcile the list of balances with the balances of the control accounts in the general ledger.

(6) Prepare a post-adjustment trial balance.

(7) Prepare the closing journal entries and post to the ledger.

(8) Prepare the annual financial statements for the year ended 28 February 20.1.

Solution: Revision exercise 3

KUMANBUY GENERAL DEALER

(1) RECORDING OF TRANSACTIONS IN THE SUBSIDIARY JOURNALS

CASH RECEIPTS JOURNAL FOR FEBRUARY 20.1 *CRJ12*

Doc	Date	Details	Fol	Bank	Sales	VAT output	VAT input Dr	Trade receivables	Settlement discount granted Dr	Sundry accounts		
										Amount	Fol	Details
				R	R	R	R	R	R	R		
CI 51–60	1	Cash sales		2 200	2 000	200						
R1	2	C Chetty	DL3	452			(1)	463	(10)			
R2	6	D Dlamini	DL4	507				507				
R3		A Abrahams	DL1	346			(2)	368	(20)			
CI 61–73	13	Cash sales		5 500	5 000	500						
CI 74–78	17	Cash sales		1 100	1 000	100						
CI 79–87	28	Cash sales		2 750	2 500	250						
				12 855	10 500	1 050	(3)	1 338	(30)	—		
				L4	L14	L13	L12	L7	L25			

CASH PAYMENTS JOURNAL FOR FEBRUARY 20.1 *CPJ12*

Doc	Date	Details	Fol	Bank	Purchases	VAT input	VAT output	Trade payables	Settlement discount received	Sundry accounts		
							Cr			Amount	Fol	Details
				R	R	R	R	R	R	R		
C123	3	L Lawson	CL2	1 055			(5)	1 110	(50)			
C124	9	K Khoza	CL3	2 137				2 137				
C125		N Nagel	CL4	132			(1)	143	(10)			
C126		M Mnisi	CL1	261				261				
C127	18	BB Garage		550		50				500	L18	Repairs
C128		Pump Services		330						330	L19	Petrol
C129	19	CSA		165		15				150	L20	Stationery
C130	20	K Kuman		10 000						10 000	L11	Drawings
C131		P Prins		3 146	2 860	286						
C132	25	K Khoza	CL3	3 000				3 000				
C133		L Lawson	CL2	2 020				2 020				
C134		South African revenue service		2 700						2 700	L9	VAT control
C135	27	City council		671		61				610	L21	Water & electricity
C136		Rentguy		2 200		200				2 000	L22	Rental expenses
C137		Cash		2 300						2 300	L23	Wages & salaries
		Counterman		1 100		100				1 000	L 1	Furniture & equipment
	28	Bank		45						45	L30	Bank charges
				31 812	2 860	712	(6)	8 671	(60)	19 635		
				L4	L16	L12	L12	L8	L26			

PURCHASES JOURNAL FOR FEBRUARY 20.1 *PJ12*

Date	Details	Invoice	Fol	Purchases	VAT input	Trade payables
				R	R	R
11	K Khoza	501	CL3	6 400	640	7 040
	L Lawson	502	CL2	6 000	600	6 600
				12 400	1 240	13 640
				L16	L12	L8

SALES JOURNAL FOR FEBRUARY 20.1 *SJ12*

Date	Details	Invoice	Fol	Sales	VAT output	Trade receivables
				R	R	R
4	E Erasmus	901	DL5	900	90	990
13	D Dlamini	902	DL4	800	80	880
15	C Chetty	903	DL3	2 000	200	2 200
				3 700	370	4 070
				L14	L13	L7

PURCHASES RETURNS JOURNAL FOR FEBRUARY 20.1 *PRJ12*

Date	Details	Debit note	Fol	Purchases returns	VAT input	Trade payables
				R	R	R
12	K Khoza	301	CL3	150	15	165
				150	15	165
				L17	L12	L8

SALES RETURNS JOURNAL FOR FEBRUARY 20.1 *SRJ12*

Date	Details	Credit note	Fol	Sales returns	VAT output	Trade receivables
				R	R	R
16	C Chetty	201	DL3	100	10	110
				100	10	110
				L15	L13	L7

(2) GENERAL JOURNAL — FEBRUARY 20.1 *J12*

Date	Details	Fol	Debit	Credit
			R	R
28	Credit losses	L27	840	
	VAT input	L12	84	
	B Barnard/Trade receivables	DL2		
	control	L7		924
	B Barnard's account written off			
	Depreciation	L28	9 000	
	Accumulated depreciation: Vehicles	L6		5 000
	Furniture and equipment	L5		4 000
	Depreciation provided at 10% pa on cost			
	Telephone expenses	L24	240	
	VAT input	L12	24	
	Accrued expenses	L29		264
	Telephone account for February outstanding			
	*VAT control	L9	2 048	
	VAT input	L12		2 048
	Transfer of VAT input			
	*VAT output	L13	1 416	
	VAT control	L9		1 416
	Transfer of VAT output			

* If the VAT period does not coincide with the end of the financial year the VAT input and VAT output must be closed off to the VAT control account to determine the amount of VAT owed by or to the SARS that must be disclosed in the statement of financial position.

(3) GENERAL LEDGER

Dr Furniture and equipment (at cost) **L1** **Cr**

Date	Details	Fol	R	Date	Details	Fol	R
20.1				**20.1**			
Feb 1	Balance	b/d	40 000	Feb 28	Balance	c/d	41 000
28	Bank	CPJ12	1 000				
			41 000				41 000
20.1							
Mar 1	Balance	b/d	41 000				

Dr Vehicles (at cost) **L2** **Cr**

20.1			**R**				
Feb 1	Balance	b/d	50 000				

Dr Inventory **L3** **Cr**

20.0			**R**	**20.1**			**R**
Mar 1	Balance	b/d	56 080	Feb 28	Trading account	J13	56 080
20.1					Balance	c/d	60 000
Feb 28	Trading account	J13	60 000				
			116 080				116 080
20.1							
Mar 1	Balance	b/d	60 000				

Dr Bank **L4** **Cr**

20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	34 091	Feb 28	Payments	CPJ12	31 812
28	Receipts	CRJ12	12 855		Balance	c/d	15 134
			46 946				46 946
20.1							
Mar 1	Balance	b/d	15 134				

Dr Accumulated depreciation: Furniture and equipment **L5** **Cr**

20.1			**R**	**20.0**			**R**
Feb 28	Balance	c/d	8 000	Feb 28	Balance	b/d	4 000
				20.1			
				Feb 28	Depreciation	J12	4 000
			8 000				8 000
				20.1			
				Mar 1	Balance	b/d	8 000

Dr Accumulated depreciation: Vehicles **L6** **Cr**

20.1			**R**	**20.0**			**R**
Feb 28	Balance	c/d	10 000	Feb 28	Balance	b/d	5 000
				20.1			
				Feb 28	Depreciation	J12	5 000
			10 000				10 000
				20.1			
				Mar 1	Balance	b/d	10 000

Dr Trade receivables control **L7** **Cr**

20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	2 932	Feb 28	Bank and		
28	Sales	SJ12	4 070		discount	CRJ12	1 338
					Sales returns	SRJ12	110
					Credit losses	J12	924
					Balance	c/d	4 630
			7 002				7 002
20.1							
Mar 1	Balance	b/d	4 630				

Dr Trade payables control **L8** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Bank and			Feb 1	Balance	b/d	3 651
	discount	CPJ12	8 671	28	Purchases	PJ12	13 640
	Returns	PRJ12	165				
	Balance	c/d	8 455				
			17 291				17 291
				20.1			
				Mar 1	Balance b/d		8 455

Dr VAT control **L9** **Cr**

20.1			**R**	**20.1**			**R**
Feb 25	Bank	CPJ12	2 700	Feb 1	Balance	b/d	2 700
28	VAT input	J12	2 048	28	VAT output	J12	1 416
					Balance	c/d	632
			4 748				4 748
20.1							
Mar 1	Balance	b/d	632				

Dr Capital **L10** **Cr**

20.1			**R**	**20.0**			**R**
Feb 28	Drawings	J13	10 000	Mar 1	Balance	b/d	169 630
	Profit or						
	loss	J13	14 953				
	Balance	c/d	144 677				
			169 630				169 630
				20.1			
				Mar 1	Balance	b/d	146 677

Dr Drawings **L11** **Cr**

20.1			**R**	**20.1**			**R**
Feb 20	Bank	CPJ12	10 000	Feb 28	Capital	J13	10 000

Dr VAT input **L12** **Cr**

20.1			**R**	**20.1**			**R**
	Trade receivables	CRJ12	3	Feb 28	Trade payables	PRJ12	15
Feb 28	Bank	CPJ12	712		VAT control	J12	2 048
	Trade payables	PJ12	1 240				
	Trade receivables	J12	84				
	Accrued expenses	J12	24				
			2 063				2 063

Dr VAT output **L13** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Trade receivables	SRJ12	10	Feb 28	Bank	CRJ12	1 050
	VAT control	J12	1 416		Trade receivables	SJ12	370
					Trade payables	CPJ12	6
			1 426				1 426

Dr Sales **L14** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Settlement discount granted	J13	30	Feb 1	Balance	b/d	227 000
	Sales returns		100	28	Bank	CRJ12	10 500
	Trading account	J13	241 070		Trade receivables	SJ12	3 700
			241 200				241 200

Dr Sales returns **L15** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Trade receivables	SRJ12	100	Feb 28	Sales	J13	100

Dr Purchases **L16** **Cr**

20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	166 000	Feb 28	Settlement discount received	J13	60
28	Bank	CPJ12	2 860		Purchases returns		150
	Trade payables	PJ12	12 400	28	Trading account	J13	181 050
			181 260				181 260

Dr Purchases returns **L17** **Cr**

20.1			**R**	**20.1**			**R**
Feb 28	Purchases	J13	150	Feb 28	Trade payables	PRJ12	150

Dr Repairs **L18** **Cr**

20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	4 150	Feb 28	Profit or loss	J13	4 650
18	Bank	CPJ12	500				
			4 650				4 650

Dr Petrol **L19** **Cr**

20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	2 974	Feb 28	Profit or loss	J13	3 304
18	Bank	CPJ12	330				
			3 304				3 304

Dr			Stationery			L20	Cr
20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	214	Feb 28	Profit or loss	J13	364
19	Bank	CPJ12	150				
			364				364

Dr			Water and electricity			L21	Cr
20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	6 138	Feb 28	Profit or loss	J13	6 748
27	Bank	CPJ12	610				
			6 748				6 748

Dr			Rental expenses			L22	Cr
20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	22 000	Feb 28	Profit or loss	J13	24 000
27	Bank	CPJ12	2 000				
			24 000				24 000

Dr			Wages and salaries			L23	Cr
20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	25 300	Feb 28	Profit or loss	J13	27 600
27	Bank	CPJ12	2 300				
			27 600				27 600

Dr			Telephone expenses			L24	Cr
20.1			**R**	**20.1**			**R**
Feb 1	Balance	b/d	2 102	Feb 28	Profit or loss	J13	2 342
28	Accrued expenses	J12	240				
			2 342				2 342

Dr			Settlement discount granted			L25	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Trade receivables control	CPJ12	30	Feb 28	Sales	J13	30

Dr			Settlement discount received			L26	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Purchases	J13	60	Feb 28	Trade payables control	CPJ12	60

Dr			Credit losses			L27	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Trade receivables	J12	840	Feb 28	Profit or loss	J13	840

Dr		Depreciation				L28	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Accumulated depreciation:			Feb 28	Profit or loss	J13	9 000
	Furniture	J12	4 000				
	Vehicles	J12	5 000				
			9 000				9 000

Dr		Accrued expenses				L29	Cr
				20.1			**R**
				Feb 28	Telephone expenses	J12	240
					VAT input	J12	24
							264

Dr		Bank charges				L30	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Bank	CPJ12	45	Feb 28	Profit or loss	J13	45

Dr		Trading account				L31	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Inventory	J13	56 080	Feb 28	Inventory	J13	60 000
	Purchases	J13	181 050		Sales	J13	241 070
	Profit or loss (gross profit)	J13	63 940				
			301 070				301 070

Dr		Profit or loss				L32	Cr
20.1			**R**	**20.1**			**R**
Feb 28	Repairs	J13	4 650	Feb 28	Trading account	J13	63 940
	Petrol	J13	3 304		Capital (Total comprehensive income for the year)	J13	14 953
	Stationery	J13	364				
	Water and electricity	J13	6 748				
	Rental expenses	J13	24 000				
	Wages and salaries	J13	27 600				
	Telephone expenses	J13	2 342				
	Credit losses	J13	840				
	Depreciation	J13	9 000				
	Bank charges	J13	45				
			78 893				78 893

(4) BANK RECONCILIATION STATEMENT AS AT 28 FEBRUARY 20.1

		Debit	Credit
		R	R
Credit balance as per bank statement			15 005
Outstanding cheques: No 134		671	
135		2 200	
Correction of error			3 000
Debit balance as per bank account		15 134	
		18 005	18 005

(5) TRADE RECEIVABELS LEDGER, TRADE PAYABLES LEDGER AND APPLICABLE RECONCILIATIONS

TRADE RECEIVABELS LEDGER

Dr A Abrahams **DL1** **Cr**

20.1			R	**20.1**			R
Feb 1	Balance	b/d	368	Feb 6	Bank and discount	CRJ12	368

Dr B Barnard **DL2** **Cr**

20.1			R	**20.1**			R
Feb 1	Balance	b/d	924	Feb 28	Credit losses	J12	840
					VAT output	J12	84
			924				924

Dr C Chetty **DL3** **Cr**

20.1			R	**20.1**			R
Feb 1	Balance	b/d	463	Feb 2	Bank and discount	CRJ12	463
15	Sales	SJ12	2 200	16	Returns	SRJ12	110
				28	Balance	c/d	2 090
			2 663				2 663
20.1							
Mar 1	Balance	b/d	2 090				

Dr D Dlamini **DL4** **Cr**

20.1			R	**20.1**			R
Feb 1	Balance	b/d	1 177	Feb 6	Bank	CRJ12	507
13	Sales	SJ12	880	28	Balance	c/d	1 550
			2 057				2 057
20.1							
Mar 1	Balance	b/d	1 550				

Dr		E Erasmus				DL5	Cr
20.1			**R**				**R**
Feb 4	Sales	SJ1	990				

TRADE PAYABLES LEDGER

Dr		M Mnisi				CL1	Cr
20.1			**R**	**20.1**			**R**
Feb 9	Bank	CPJ12	261	Feb 1	Balance	b/d	261

Dr		L Lawson				CL2	Cr
20.1			**R**	**20.1**			**R**
Feb 3	Bank and			Feb 1	Balance	b/d	1 110
	discount	CPJ12	1 110	11	Purchases	PJ12	6 600
25	Bank	CPJ12	2 020	11	Purchases	PJ12	6 600
28	Balance	c/d	4 580				
			7 710				7 710
				20.1			
				Mar 1	Balance	b/d	4 580

Dr		K Khoza				CL3	Cr
20.1			**R**	**20.1**			**R**
Feb 9	Bank	CPJ12	2 137	Feb 1	Balance	b/d	2 137
12	Returns	PRJ12	165	11	Purchases	PJ12	7 040
25	Bank	CPJ12	3 000				
28	Balance	c/d	3 875				
			9 177				9 177
				20.1			
				Mar 1	Balance	b/d	3 875

Dr		N Nagel				CL4	Cr
20.1			**R**	**20.1**			**R**
Feb 9	Bank and						
	discount	CPJ12	143	Feb 1	Balance	b/d	143

RECONCILIATIONS

	R		R
Debtors — C Chetty	2 090	**Creditors** — L Lawson	4 580
D Dlamini	1 550	K Khoza	3 875
E Erasmus	990		
Balance of control account	4 630	Balance of control account	8 455

KUMANBUY GENERAL DEALER

(6) POST-ADJUSTMENT TRIAL BALANCE AS AT 28 FEBRUARY 20.1

		Debit	Credit
		R	R
Furniture and equipment (at cost)		41 000	
Vehicles (at cost)		50 000	
Inventory		56 080	
Bank		15 134	
Accumulated depreciation:			
Furniture and equipment			8 000
Vehicles			10 000
Capital			169 630
Drawings		10 000	
Trade receivables control		4 630	
Trade payables control			8 455
VAT control		632	
Sales			241 200
Sales returns		100	
Purchases		181 260	
Purchases returns			150
Repairs		4 650	
Petrol		3 304	
Stationery		364	
Water and electricity		6 748	
Rental expenses		24 000	
Wages and salaries		27 600	
Telephone expenses		2 342	
Settlement discount granted		30	
Settlement discount received			60
Credit losses		840	
Depreciation		9 000	
Accrued expenses			264
Bank charges		45	
		437 759	437 759

(7) CLOSING JOURNAL ENTRIES

J13

Date	Details	Fol	Debit	Credit
20.1			R	R
Feb 28	Settlement discount received	L26	60	
	Purchases	L16		60
	Closing transfer			
	Sales	L14	30	
	Settlement discount granted	L25		30
	Closing transfer			
Feb 28	Sales	L14	100	
	Sales returns	L15		100
	Closing transfer of sales returns			
	Purchases returns	L17	150	
	Purchases	L16		150
	Closing transfer of purchases returns			
	Trading account	L31	237 130	
	Inventory	L3		56 080
	Purchases	L16		181 050
	Closing transfer			
	Inventory	L3	60 000	
	Sales	L14	241 070	
	Trading account	L31		301 070
	Closing transfer			

Date	Details	Fol	Debit	Credit
20.1			**R**	**R**
	Trading account	L31	63 940	
	Profit or loss	L32		63 940
	Transfer of gross profit			
Feb 28	Profit or loss	L32	78 893	
	Repairs	L18		4 650
	Petrol	L19		3 304
	Stationery	L20		364
	Water and electricity	L21		6 748
	Rental expenses	L22		24 000
	Wages and salaries	L23		27 600
	Telephone expenses	L24		2 342
	Credit losses	L27		840
	Depreciation	L28		9 000
	Bank charges	L30		45
	Transfer of income and expenses to profit or loss account			
	Capital	L10	14 993	
	Profit or loss	L32		14 953
	Transfer of loss for the period			
	Capital	L10	10 000	
	Drawings	L11		10 000
	Transfer of drawings			

KUMANBUY GENERAL DEALER

(8) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 20.1

	Note	R	
Revenue	2		241 070
Cost of sales			(177 130)
Inventory: 1 March 20.0		56 080	
Purchases		181 050	
		237 130	
Inventory: 28 February 20.1		(60 000)	
Gross profit			63 940
Distribution, administrative and other expenses			(78 893)
Repairs		4 650	
Petrol		3 304	
Stationery		364	
Water and electricity		6 748	
Rental expenses		24 000	
Wages and salaries		27 600	
Telephone expenses		2 342	
Credit losses		840	
Depreciation		9 000	
Bank charges		45	
Loss for the year			(14 953)
Other comprehensive income for the year			—
Total comprehensive loss for the year			(14 953)

KUMANBUY GENERAL DEALER

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.1

	Capital R
Balance at 1 March 20.0	169 630
Total comprehensive loss for the year	(14 953)
Drawings	(10 000)
Balance at 28 February 20.1	144 677

KUMANBUY GENERAL DEALER

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.1

ASSETS	**Note**	**R**
Non-current assets		73 000
Property, plant and equipment	3	73 000
Current assets		80 396
Inventories		60 000
Trade and other receivables		4 630
Current VAT receivable		632
Cash and cash equivalents		15 134
Total assets		153 396
EQUITY AND LIABILITIES		
Total equity		144 677
Capital		144 677
Current liabilities		8 719
Trade and other payables R(8 455+264)		8 719
Total equity and liabilities		153 396

KUMANBUY GENERAL DEALER

NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.1

1 Accounting policy:

1.1 The annual financial statements have been prepared on the historical cost basis and comply with International Financial Reporting Standards.

1.2 Property, plant and equipment:

Depreciation is provided for at 10% on the cost price of vehicles and furniture and equipment.

2 Revenue is recognised as net sales to customers.

3 Property, plant and equipment	Vehicles	Furniture and equipment	Total
	R	R	R
Carrying amount:			
Beginning of year	45 000	36 000	81 000
Cost	50 000	40 000	90 000
Accumulated depreciation	(5 000)	(4 000)	(9 000)
Additions	—	1 000	1 000
Depreciation	(5 000)	(4 000)	(9 000)
Carrying amount:			
End of year	40 000	33 000	73 000
Cost	50 000	41 000	91 000
Accumulated depreciation	(10 000)	(8 000)	(18 000)

SELF-ASSESSMENT

Now that you have studied this study unit, can you

- describe equity in a sole proprietorship?
- record the transactions relating to the establishment of a sole proprietorship?
- calculate the amount of equity?
- show how the equity is disclosed in the statement of changes in equity and in the statement of financial position?

STUDY UNIT

16

Nonprofit entities

Learning outcome

Students should be able to record all transactions related to organisations and societies not for gain.

Contents

KEY CONCEPTS

- Receipts and payments statement
- Income and expenditure statement
- Trading statement
- Statement of financial position
- Special funds
- Nonexpendable special funds
- Expendable special funds
- Accumulated fund
- Entrance fees
- Membership fees

16.1 Introduction

A nonprofit organisation can be defined as an economic entity which has the legitimate goal of furthering certain interests of the community. Its objective is not to distribute profits to the members but to use the profits in order to achieve the stated goal. Such an entity is oriented to render a *service* to its members, and not to pursue financial gain.

These entities/societies can range from informal social clubs, (for example an activity club for the elderly) to formal societies (for example schools and churches). Revenue may be acquired from a variety of sources, such as membership fees, donations, fund raising projects, bequests and even government subsidies. Membership, and not ownership, is acquired through the payment of membership fees. Members of a nonprofit organisation can therefore not claim the same rights in the entity as, for example, shareholders in a company excluding section 21-companies.

Study paragraphs 16.1 to 16.3.4 of the prescribed book.

16.2 Receipts and payments statement

Study paragraph 16.4.1 of the prescribed book.

A receipts and payments statement is an analysed and classified summary of the **cash transactions**. It is the most elementary version of a statement for a club or association. Smaller entities which have no other assets than cash will often only prepare a receipts and payments statement as the annual financial statement.

The statement can be prepared in a T-format where the **actual cash received** is entered on the debit side, and the **actual cash paid out** on the credit side. All the cash received and paid, whether it was operational revenue/expenses or revenue/expenses of a capital nature, is recorded in this statement. Prepayments, income received in advance and accrued amounts received or paid will also be entered because the accrual principle is not applied when this statement is prepared.

Since this statement is merely a summary of cash transactions, the opening balance of the statement represents the opening balance of cash on hand (in the bank), and the closing balance of the statement represents cash on hand (in the bank) at the end of the period.

It is obvious that no financial performance (surplus or shortage) or financial position (as reflected in the statement of financial position) can be determined from this statement.

Example

STEAR TENNIS CLUB

RECEIPTS AND PAYMENTS STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2

Receipts	**R**	**Payments**	**R**
Balance 30/6/20.1 b/d	4 700	Refreshments purchased	1 342
Entrance fees	500	Wages	4 220
Membership fees:	12 000	Tennis balls purchased	360
20.1	750	Tennis courts painted	750
20.2	10 000	Tennis courts built	7 000
20.3	1 250	Stationery and sundry expenditure	1 590
Interest income	2 332	Investment made at ABC Bank	5 000
Net proceeds from dance	620	Balance c/d	3 410
Donation	3 520		
	23 672		23 672
Balance b/d	3 410		

This statement can also be prepared in a vertical (narrative) format.

The financial information needs of a larger club or society will require more than the mere presentation of a receipts and payments statement. An income and expenditure statement (statement of profit or loss and other comprehensive income) as well as a statement of financial position, similar to those of an ordinary trading entity, are usually also required.

16.3 Income and expenditure statement

Study paragraphs 16.4.2 and 16.4.3 of the prescribed book.

For all practical purposes the income and expenditure statement is prepared according to the guidelines provided in IFRS.

It is very important to remember that outstanding and prepaid income and/or expenditure at the beginning and at the end of the period should be taken into account when preparing the income and expenditure statement. These prepaid or arrear items at the end of the period should also be shown on the statement of financial position in the usual way.

An income and expenditure statement is intended to determine the **surplus** or **deficit** for an accounting period.

This statement is very similar to a statement of profit or loss and other comprehensive income prepared by a trading concern. The *layout* may differ from that of a statement of profit or loss and other comprehensive income because all the relevant sources of income, including investment income, can be shown under the heading ''Income'' and all the expenses, including finance costs, can be shown under the heading ''Expenses''. The income and expenditure statement is also prepared according to the accrual principle. The difference between the revenue (credits) and expenses (debits) represents the surplus/deficit for the accounting period.

The following is a comparison between an income and expenditure statement and a receipts and payments statement:

Income and expenditure statement	Receipts and payments statement
1. Shows the total income and expenditure for the period, even if not yet received or paid (applying the accrual principle).	1. Shows only actual cash receipts and payments.
2. Indicates the result of the financial period's transactions by showing a surplus or a deficit.	2. Shows the amount of cash on hand at the beginning and at the end of a financial period, but does not indicate a surplus or deficit.
3. Receipts and payments of a capital nature are not brought into account.	3. Receipts and payments of a capital nature are included.

16.4 Trading statement

The majority of the bigger clubs do trade in order to generate revenue which they use to achieve their stated goals, for example, the provision of bar and refreshment facilities to their members. If the scale on which trading takes place justifies it, a separate trading statement can be prepared for each operational activity. Therefore it is possible to prepare more than one trading statement for a specific entity/society. The layout of such a trading statement is similar to the trading section of a statement of profit or loss and other comprehensive income of an ordinary trading concern. It closes off with the determination of the gross profit. Since trading takes place, the term "gross profit" instead of "surplus" is used. The gross profit is carried forward to the income and expenditure statement. The sales, administrative and general expenses in respect of each operational activity are deducted from the applicable gross profits in the income and expenditure statement. (Refer to the income and expenditure statement of Green Golf Club, paragraph 16.10, revision exercise 1, which is given further on in this study unit.)

16.5 Accumulated fund

Any *initial* donations made to begin the organisation, entrance fees, the surplus/deficit for each period and special funds donated for general expenses will form part of the accumulated fund.

When money is donated for a special purpose, separate investment accounts must be opened for special funds. This makes it possible to issue meaningful reports on the acquisiton and utilisation of funds.

16.6 Special funds

Study paragraph 16.3.5 of the prescribed book.

A nonprofit entity often sets money aside for a specific purpose so that not all the cash is spent on expenses of a general nature. Special funds are established for these purposes and they are usually accounted for separately from the accumulated funds. Donations can then be made to these funds or a special fund can be established for a conditional donation or legacy.

A separate investment account is usually opened for each special fund in which the capital is deposited. Such donations and income earned from the investments thereof do not form part of the general operating income of the organisation and should, as a general rule, not be included in the income and expenditure statement. Likewise, the applicable expenses should also be reflected through the fund account and not through the income and expenditure account.

Special funds can be divided into two main sections:

- *Firstly,* special funds can be established to save or set aside money for a **specific purpose**; eg, to purchase specific equipment. When sufficient funds have been accumulated or received, the equipment can be purchased with the capital amount as well as the income earned from the capital, if any.
- *Secondly,* special funds can be established where **only the income** earned from the investment of the capital amount may be applied. It is also possible that such income may only be spent on stipulated items.

  This implies that the capital amount of such funds must be invested in a sound security. This capital amount must remain untouched and will appear under the heading ''Special funds: Nonexpendable funds'' in the balance sheet. The investments relating to these funds must be shown as separate items on the asset section of the statement of financial position. Cross-references must be given on the statement of financial position.

  The funds account must be credited with the investment income. Should the income from the investment be greater than the expenses involved, the balance will be shown in the statement of financial position under the heading: ''Special funds: Expendable funds''. Obviously, a fund may not incur more expenses than the balance of the expendable portion thereof. Should the income from a fund be insufficient to pay for all the relevant expenses/costs, the organisation will have to find alternative means to finance the outstanding amounts.

The application of the revenue from or/and capital of a special fund may result in an increase in the assets of the non-profit entity. Although the purchase of such assets is financed by means of a fund, the increase in the value of the assets concerned must be shown as such on the asset side of the statement of financial position. Acknowledgement of the fact that an increase in an asset resulted from a fund can be shown in a note.

The following exercises illustrate fund accounts and their disclosure in the statement of financial position.

16.7 Exercises

Exercise 16.1

Special fund

Income from a fund which must be used for a specific expense

On 1 July 20.0 Stear Tennis Club received a donation to the amount of R8 000 from S Star on the express condition that the *income* received from the donation may only be used for the painting of the tennis courts. On the same date the amount was invested as a fixed deposit at ABC Bank at an interest rate of 10% per annum. The interest is received annually on 30 June. No tennis courts were painted during the year ended 30 June 20.1. It was decided, as a general policy, to invest all surplus interest amounts at ABC Bank as fixed deposits for a year. During the year ended 30 June 20.2, the tennis courts were painted at a cost of R750. The surplus interest was invested according to general policy at an interest rate of 10% per annum.

Required:

Show how these transactions will be recorded in the Star fund account of the club.

Solution Exercise 16.1

Dr Star fund **Cr**

		Expend-able (income)	Non-expend-able (capital)			Expend-able (income)	Non-expend-able (capital)
20.1		R	R	**20.0**		R	R
Jun 30	Balance c/d	800	8 000	Jul 1	Bank: Capital donation	—	8 000
				20.1 Jun 30	Bank: Interest on investment	800	
		800	8 000			800	8 000
20.2 Jun 30	Tennis courts painted	750	—	**20.1** Jul 1	Balance b/d	800	8 000
	Balance c/d	930	8 000	**20.2** Jun 30	Bank: Interest on investment (a)	880	—
		1 680	8 000			1 680	8 000
				20.2 Jul 1	Balance b/d	930	8 000

CALCULATION

(a) $(10\% \times R8\ 000) + (10\% \times R800) = R880$

COMMENTS

- *Because the interest earned and the expenses in respect of the tennis courts that were painted are accounted for in the fund account, these items will not be disclosed in the income and expenditure statement. The tennis courts were painted during the year. The recording of these expenses would have been as follows: Debit the painting of tennis courts account and credit the bank account. On 30 June 20.2, the date on which the interest was received, the fund account was debited with this expense and the painting of tennis courts account was credited. (This entry will balance the painting of tennis courts account.)*
- *The statement of financial position of the Stear Tennis Club will show the items in respect of the fund as follows:*

STEAR TENNIS CLUB

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.2 (extract)

	Note	R
ASSETS		
Non-current assets		
Financial assets: Star fund — Fixed deposit at 10% per annum at ABC Bank		8 930
FUNDS AND LIABILITIES		
Funds		
Special funds		8 930
Nonexpendable funds (capital)		
Star fund		8 000
Expendable funds		
Star fund		930

Exercise 16.2

SPECIAL FUND

Income from a fund which must be used to purchase property, plant and equipment.

On 1 July 20.0 the Stear Tennis Club received a donation to the amount of R100 000 from S Superstar on the express condition that the *revenue* from the fund may only be used for the building of tennis courts. On the same date the amount was invested as a fixed deposit at ABC Bank at an interest rate of 10% per annum. The interest is received annually on 30 June. No tennis courts were built during the year ended 30 June 20.1. It was decided, as a general policy, to invest all surplus interest amounts at ABC Bank as fixed deposits for a year. During the year ended 30 June 20.2, the tennis courts were built at a cost of R70 000.

Required:

Show how these transactions are recorded in the Superstar Fund account of the club.

Solution Exercise 16.2

Dr — Superstar fund — Cr

			Expendable (income)	Non-expendable (capital)				Expendable (income)	Non-expendable (capital)
			R	R				R	R
20.1 Jun 30	Balance	c/d	10 000	100 000	**20.0** Jul 1	Bank: Capital donation		—	100 000
					20.1 Jun 30	Bank: Interest on investment		10 000	
			10 000	100 000				10 000	100 000
20.2 Jun 30	Accumulated fund		21 000	—	**20.1** Jul 1	Balance	b/d	10 000	100 000
	Balance	c/d	—	100 000	**20.2** Jun 30	Bank: Interest on investment (a)		11 000	—
			21 000	100 000				21 000	100 000
					20.2 Jul 1	Balance	b/d	—	100 000

CALCULATION

(a) (10% × R100 000) + (10% × R10 000) = R11 000

COMMENTS

- *Because a non-current asset was obtained from the income of the fund, the amount contributed by the fund must be credited to the* ***accumulated fund*** *account. Bear in mind that the asset account was debited during the year at the date of the purchase.*
- *The statement of financial position of Stear Tennis Club will show the items in respect of the fund as follows:*

STEAR TENNIS CLUB

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.2 (extract)

	Note	R
ASSETS		
Non-current assets		170 000
Property, plant and equipment	1	70 000
Financial assets: Superstar fund — Fixed deposit at 10% per annum at ABC Bank		100 000
FUNDS AND LIABILITIES		
Funds		XX XXX
Accumulated fund		X XXX
Balance: 1 July 20.2		XXX
Add: Tennis court built		21 000
Special funds		
Nonexpendable funds (capital)		
Superstar fund		100 000

STEAR TENNIS CLUB

NOTES FOR THE PERIOD ENDED 20 JUNE 20.2 (extract)

Note 1 (extract)

Property, plant and equipment	**Land and buildings**
	R
Additions (tennis courts):	70 000
From own funds	49 000
From income:	
Superstar fund	21 000

Remark

The accumulated fund account will be credited with the amount which the ***fund*** *contributed to the building of the tennis courts. In other words, the amount of R21 000 will be added to the balance of the accumulated fund account.*

Exercise 16.3

PART OF ACCUMULATED FUND

Income from a fund which must be used to pay general (operational) expenses

On 1 July 20.1 Mr T Trueman donated R3 520 to the club on the express condition that the capital should be invested. The income from the investment can be used to pay general (operational) expenses. On the same date the amount was invested as a fixed deposit at ABC Bank at 10% interest per annum. The income was spent accordingly.

Solution Exercise 16.3

Because the income from the fund has to be used to pay general expenses, an income account can be opened in the general ledger of the entity. The balance of this account will be disclosed as follows in the income and expenditure statement:

STEAR TENNIS CLUB

INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2 (extract)

	R
Revenue	10 972
Membership fees	10 000
Interest income (donation from T Trueman)	352
Net proceeds from dance	620

The accounting for the capital amount and the related investment is as follows:

Debit bank and *credit* the *accumulated fund account* with the capital amount of R3 520. *Credit bank* and *debit* the *general investments account* of the club which is financed from the accumulated fund. The investment will still be disclosed separately, but will form part of these general investments.

The Trueman fund and the related investment will be disclosed as follows in the statement of financial position:

STEAR TENNIS CLUB

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.2 (extract)

ASSETS	**Note**	**R**
Non-current assets		10 520
Property, plant and equipment	1	7 000
Financial assets: General fund — Fixed deposit at 10% per annum at ABC Bank		
Trueman fund		3 520
FUNDS AND LIABILITIES		
Funds		
Accumulated fund (includes donation by T Trueman)		10 520

COMMENT

- *Assume that there were no conditions and that the donation of R3 520 could be spent on general expenses. The amount would be debited to the bank account and credited to the donation received account on the date on which the donation was received. The donation received will be disclosed in the general income and expenditure statement as follows:*

STEAR TENNIS CLUB

INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2 (extract)

	R
Revenue	14 140
Membership fees	10 000
Donation received (T Trueman)	3 520
Net proceeds from dance	620

16.8 Entrance fees

Refer to paragraph 16.3.1 of the prescribed book.

Entrance fees are payable by prospective members when they apply for membership of a club. The entrance fees are entered on the debit side of the bank account, and are credited to the entrance fees account.

These fees, being nonrecurrent, must be credited **directly** to the **accumulated fund** account (capitalised) and are **not** shown in the income and expenditure statement as revenue.

Study paragraphs 16.5 and 16.6 of the prescribed book.

16.9 Comprehensive example

The following information relates to Pretoria Modellers' Club, an association of people who build model boats as a hobby:

ITEMS ON THE PRE-ADJUSTMENT TRIAL BALANCE AT 28 FEBRUARY 20.2	**R**
Land and buildings (at cost)	50 000
Furniture and equipment:	
At cost	10 000
Accumulated depreciation (28 February 20.1)	2 710
Membership fees (received)	15 000
Membership fees in arrears (28 February 20.1)	900
Membership fees received in advance (28 February 20.1)	1 100
Telephone expenses	450
Wages	5 000
Water and electricity	4 600
Maintenance of buildings	1 500
Jekyll fund (28 February 20.1)	20 000
Current account — Zeeland Bank (favourable balance)	1 400
Admission fees received (to hobbies fair)	6 300
Hobbies fair expenses	8 200
10% Long-term loan (SAL Bank) — 28 February 20.1	30 000
(Loan secured by first mortgage over land and buildings)	
Accumulated fund (28 February 20.1)	25 940
Investment (SAL Bank)	20 000
Interest income — SAL Bank at 8% pa	1 600
Interest expense	3 000
Refreshments:	
Inventory (28 February 20.1)	200
Purchases	3 600
Sales	6 200

ADDITIONAL INFORMATION

(a) The income from the Jekyll fund may only be used for the maintenance of the buildings of the club.

(b) Membership fees:

In arrear at 28 February 20.2	R 800
Received in advance at 28 February 20.2	R1 300

(c) Depreciation on furniture and equipment is calculated at 10% per annum on the diminished balance. The depreciation for the year ended 28 February 20.2 must still be brought into account.

(d) Six new members joined the club during the year. The entrance fee of R200 per person is included in the figure for membership fees received, but should be included in the accumulated fund.

(e) Inventory of refreshments at 28 February 20.2 amounted to R300.

(f) The interest income (SAL Bank) was received in respect of the Jekyll fund.

(g) The current account — Zeeland Bank, had an unfavourable balance of R1 350 at 28 February 20.1.

Required:

Prepare:

1. The Jekyll fund account in the general ledger of the club for the year ended 28 February 20.2
2. The following statements of the club for the year ended 28 February 20.2:
   (a) Refreshments: trading statement
   (b) Receipts and payments statement
   (c) Income and expenditure statement
3. The statement of financial position of the club as at 28 February 20.2.
4. The property, plant and equipment note.

Solution: Comprehensive example

PRETORIA MODELLER'S CLUB

1 GENERAL LEDGER

Dr Jekyll fund **Cr**

			Expend-able (income)	Non-expend-able (capital)				Expend-able (income)	Non-expend-able (capital)
20.2			**R**	**R**	**20.1**			**R**	**R**
Feb 28	Maintenance: buildings		1 500	—	Mar 1	Balance	b/d	—	20 000
	Balance	c/d	100	20 000	**20.2** Feb 28	Bank: Interest on investment		1 600	
			1 600	20 000				1 600	20 000
					20.2 Mar 1	Balance	b/d	100	20 000

PRETORIA MODELLERS' CLUB

2(a) REFRESHMENTS: TRADING STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.2

		R
Revenue		6 200
Cost of sales		(3 500)
Inventory (28 February 20.1)	200	
Purchases	3 600	
	3 800	
Inventory (28 February 20.2)	(300)	
Gross profit		2 700

PRETORIA MODELLERS' CLUB

2(b) RECEIPTS AND PAYMENTS STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.2

		R
Bank balance at 28 February 20.1		(1 350)
Receipts		29 100
Membership fees	15 000	
Hobbies fair admissions	6 300	
Interest income	1 600	
Refreshments sold	6 200	
Payments		(26 350)
Telephone expenses	450	
Wages	5 000	
Water and electricity	4 600	
Maintenance of buildings	1 500	
Hobbies fair expenses	8 200	
Refreshments purchased	3 600	
Interest expenses	3 000	
Bank balance at 28 February 20.2 (favourable)		1 400

PRETORIA MODELLERS' CLUB

2(c) INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.2

		R
Income		22 500
Membership fees R(15 000 − 900 + 1 100 + 800 − 1 300 − 1 200) (a)	13 500	
Admission fees (hobbies fair)	6 300	
Gross profit on sale of refreshments	2 700	
Expenditure		(21 979)
Hobbies fair expenses	8 200	
Depreciation on furniture and equipment	729	
Interest (SAL Bank bond)	3 000	
Telephone expenses	450	
Wages	5 000	
Water and electricity	4 600	
Surplus for the year		521

PRETORIA MODELLERS' CLUB

(3) STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.2

ASSETS	**Note**	**R**
Non-current assets		76 561
Property, plant and equipment	3	56 561
Financial assets — SAL Bank at 8% pa		20 000
Jekyll fund		20 000
Current assets		2 500
Inventory (refreshments)		300
Trade and other receivables		800
Cash and cash equivalents		1 400
Total assets		79 061
FUNDS AND LIABILITIES		
Funds		47 761
Accumulated fund (b)		27 661
Special funds		20 100
Nonexpendable funds		20 000
Jekyll maintenance fund		20 000
Expendable funds		100
Jekyll maintenance fund		100
Total liabilities		31 300
Non-current liabilities		30 000
Long-term borrowing — SAL Bank (secured by first mortgage over land and buildings)		30 000
Current liabilities		1 300
Income received in advance		1 300
Total funds and liabilities		79 061

PRETORIA MODELLERS' CLUB

(4) NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.2

Note 3 (extract)

Property, plant and equipment	Land and buildings	Furniture and equipment	Total
	R	R	R
Carrying amount: Beginning of year	50 000	7 290	57 290
Cost price	50 000	10 000	60 000
Accumulated depreciation	—	(2 710)	(2 710)
Depreciation for the year	—	(729)	(729)
Carrying amount: End of year	50 000	6 561	56 561
Cost price	50 000	10 000	60 000
Accumulated depreciation	—	(3 439)	(3 439)

CALCULATIONS

(a)

Dt Membership fees **Cr**

20.1			R	**20.1**			R
Mar 1	Balance	b/d	900	Mar 1	Balance	b/d	1 100
20.2				**20.2**			
Feb 28	Entrance fees	J	1 200	Feb 28	Bank	CRJ	15 000
	Income and expenditure	J	*13 500		Balance	c/d	800
	Balance	c/d	1 300				
			16 900				16 900
20.2				**20.2**			
Mar 1	Balance	b/d	800	Mar 1	Balance	b/d	1 300

* Balancing figure

Both balances must be disclosed in the statement of financial position: The debit balance of R800 as a current asset and the R1 300 as a current liability.

The above membership fees account can be replaced by the following three accounts.

Dt			Membership fees				Cr
20.1			**R**	**20.1**			**R**
Mar 1	Accrued income	J	900	Mar 1	Income received in advance	J	1 100
20.2				**20.2**			
Feb 28	Entrance fees	J	1 200	Feb 28	Bank	CRJ	15 000
	Income received in advance	J	1 300		Accrued income	J	800
	Income and expenditure	J	13 500*				
			16 900				16 900

* Balancing figure

Dt			Accued income (Membership fees in arrears)				Cr
20.1			**R**	**20.1**			**R**
Mar 1	Balance	b/d	900	Mar 1	Membership fees	J	900
20.2				**20.2**			
Feb 28	Membership fees	J	800	Feb 28	Balance	c/d	800
			1 700				1 700
20.2							
Mar 1	Balance	b/d	800				

The closing balance of this account is shown as a current asset in the statement of financial position.

Dr			Income received in advance (Membership fees received in advance)				Cr
20.1			**R**	**20.1**			**R**
Mar 1	Membership fees	J	1 100	Mar 1	Balance	c/d	1 100
20.2				**20.2**			
Feb 28	Balance	c/d	1 300	Feb 28	Membership fees	J	1 300
			2 400				2 400
				20.2			
				Mar 1	Balance	b/d	1 300

The closing balance of this account is shown as a current liability in the statement of financial position.

(b) Accumulated fund = R(25 940 + 521 + 1 200) = R27 661

COMMENTS

- *The above example is an illustration of the treatment of funds. Note the following:*
  - *The income from the Jekyll fund is used to finance an expense* item.
  - *The nonexpendable capital amounts of funds are treated separately from the unspent portions of the interest which are still available for future applications (expendable funds).*

- *Should the income from a fund be insufficient to cover an expense, the shortage can be debited to the income and expenditure account of the club.*

- *In the above example the income and expenditure in respect of the hobbies fair is merely shown as a calculation in the income and expenditure statement. Had there been a number of different items pertaining to the fair, it would have been necessary to prepare a separate trading statement in respect of the hobbies fair.*
- ***Entrance fees are capitalised**, that is, credited directly to the accumulated fund account.*
- *In the question the opening balance of the accumulated fund is given. If it is not given, it can be calculated as the difference between the total debit balances and the total credit balances supplied in any list of balances from which the final statements are to be compiled.*

16.10 Revision exercises and solutions

16.10.1 Revision exercise 1

The following information relates to the Green Golf Club:

BALANCES AS AT 31 DECEMBER 20.4	**R**
Green fees and caddy fees received	16 000
Bank (debit balance)	5 500
Crockery and linen at cost — 31 December 20.3	7 000
Sundry debtors	2 100
Sundry creditors	16 000
Telephone expenses	6 600
Dining room:	
Purchases	14 500
Wages	10 000
Sales	30 000
Inventory — 31 December 20.3	1 000
Buildings (at cost)	160 000
Land and improvements (at cost)	520 000
Implements and tools:	
At cost	21 000
Accumulated depreciation — 31 December 20.3	11 000
Maintenance expenses	10 900
Entrance fees received	10 500
Bar:	
Purchases	50 000
Wages	12 000
Sales	100 000
Inventory — 31 December 20.3	3 000
Membership fees	84 000
Furniture:	
At cost	25 000
Accumulated depreciation — 31 December 20.3	6 000
Accumulated fund — 31 December 20.3	150 000
Interest expenses (Paid on mortgage to 30 June 20.4)	37 500
Salaries and wages	35 000
Stationery consumed	2 000
15% Mortgage	500 000
Insurance prepaid — 31 December 20.3	400

ADDITIONAL INFORMATION

(a) Bar inventory at 31 December 20.4 amounted to R2 500.
(b) At 31 December 20.4, dining room inventory was not counted, but it can be assumed that the usual gross profit margin of 50% on turnover was realised.
(c) At 31 December 20.4, crockery and linen were valued at R5 000.
(d) Implements and tools must be depreciated at 20% per annum, using the diminishing balance method.
(e) Furniture must be depreciated by R1 000.
(f) Insurance premiums paid during the year, amounting to R1 600, were debited to the telephone expense account. Half of this amount is to be regarded as insurance prepaid.
(g) The balance of the membership fees account was compiled from the following; an amount of R1 800 in respect of prepaid membership fees at 31 December 20.3 and cash received during the year, R82 200. The balance has still to be adjusted for the membership fees in arrears to the amount of R1 000 and prepaid membership fees to the amount of R2 100 at 31 December 20.4.
(h) A new member's register which is in use was designed and printed at a quoted price of R100. This transaction has still to be recorded in the books.
(i) The club secretary went on leave before Christmas and was paid his January 20.5 salary of R1 200 in advance. This amount forms part of the balance of the salaries and wages account (R35 000).
(j) On 29 December 20.4 a club member deposited an amount of R500 in the club's bank account as a donation. This donation was only discovered when the bank balance was compared with the balance of the bank statement and must still be taken into account.
(k) The mortgage is secured by a first mortgage over fixed property.

Required:

Prepare the following statements of Green Golf Club:

1. The income and expenditure statement for the year ended 31 December 20.4 (**NB:** Show the calculations of the gross profit for the bar and dining room separately.)
2. The statement of financial position as at 31 December 20.4.
3. The property, plant and equipment note.

Solution: Revision exercise 1

GREEN GOLF CLUB

(1) INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 31 DECEMBER 20.4

			R
Income			141 900
Membership fees R(1 800 + 82 200 – 2 100 + 1 000) (a)		82 900	
Green fees and caddy fees		16 000	
Income from bar sales		37 500	
Gross profit (b)	49 500		
Wages	(12 000)		
Income from dining room		5 000	
Gross profit (c)	15 000		
Wages	(10 000)		
Donation received		500	
Expenses			(133 000)
Salaries and wages R(35 000 – 1 200)		33 800	
Interest on mortgage (15% × R500 000)		75 000	
Maintenance		10 900	
Telephone expenses R(6 600 – 1 600)		5 000	
Stationery R(2 000 + 100)		2 100	
Insurance R(1 600 + 400 – 800)		1 200	
Depreciation		5 000	
Implements and tools (20% × R10 000)	2 000		
Furniture	1 000		
Crockery and linen R(7 000 — 5 000)	2 000		
Surplus for the year			8 900

GREEN GOLF CLUB

(2) STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.4

	Note	R
ASSETS		
Non-current assets		
Property, plant and equipment	3	711 000
Current assets		14 100
Inventory (refreshments)		3 000
Prepayments R(800 + 1 200)		2 000
Trade and other receivables R(2 100 + 1 000)		3 100
Cash and cash equivalents		6 000
Total assets		725 100
FUNDS AND LIABILITIES		
Funds		169 400
Accumulated fund (d)		169 400
Total liabilities		555 700
Non-current liabilities		500 000
Long-term borrowing — 15% mortgage		
(Secured by first mortgage over fixed property)		500 000
Current liabilities		55 700
Trade and other payables R[16 100 + 37 500 (e)]		53 600
Income received in advance		2 100
Total funds and liabilities		725 100

GREEN GOLF CLUB

(3) NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

Note 3 (extract)

Property, plant and equipment	**Land, building and improvements**	**Crockery and linen**	**Implements and tools**	**Furniture**	**Total**
	R	**R**	**R**	**R**	**R**
Carrying amount:					
Beginning of year	680 000	7 000	10 000	19 000	716 000
Cost	680 000	7 000	21 000	25 000	733 000
Accumulated depreciation	(—)	(—)	(11 000)	(6 000)	(17 000)
Depreciation for the period	(—)	(—)	(2 000)	(1 000)	(3 000)
Revaluation	(—)	(2 000)	(—)	(—)	(2 000)
Carrying amount:					
End of year	680 000	5 000	8 000	18 000	711 000
Cost	680 000	7 000	21 000	25 000	733 000
Accumulated depreciation	(—)	(2 000)	(13 000)	(7 000)	(22 000)

CALCULATIONS

(a)

Dr Membership fees **Cr**

	R		R
Income and expenditure	82 900	Income received in advance	1 800
Income received in advance	2 100	Bank	82 200
		Accrued income	1 000
	85 000		85 000

(b) *Bar gross profit*

	R	R
Sales		100 000
Less: Cost of sales		50 500
Opening inventory	3 000	
Purchases	50 000	
	53 000	
Less: Closing inventory	2 500	
Gross profit		49 500

(c) *Dining room gross profit*

Sales		30 000
Less: Cost of sales (R30 000 × 50%)		15 000
Opening inventory	1 000	
Purchases	14 500	
	15 500	
Less: Closing inventory (Balancing figure)	500	
Gross profit		15 000

(d) *Accumulated fund*

	R
Balance (28 February 20.1)	150 000
Add: Surplus for the year	8 900
Entrance fees	10 500
	169 400

(e) *Interest payable*

	R
15% of R500 000	75 000
Less: Paid	37 500
Due	37 500

COMMENTS

- *Entrance fees are not shown in the income and expenditure statement because*
  - *They represent nonrecurrent income.*
  - *They are of a capital nature.*

- *The current expenses of a club, society or organisation not for gain should be estimated in advance for the next financial year. The annual* ***membership fees*** *are then determined by dividing the total budgeted expenses by the number of members.*
- *Smaller* ***donations*** *received can be regarded as normal revenue, but should a donation be of a nonrecurrent nature and the amount is material (eg where a benefactor makes a special donation, or where a testamentary legacy is bequeathed), then it clearly becomes a receipt of a capital nature. Certain bodies, such as welfare organisations,* ***often*** *receive large amounts from the proceeds of a street collection, or from state grants-in-aid. These receipts are naturally not of a capital nature (unless specifically labelled and awarded as such) and should therefore be disclosed in the income and expenditure statement.*
- *Crockery, glassware, linen, et cetera are not current assets, but form part of the equipment that must be provided before income can be earned.*
- *Wages do not form part of* ***gross*** *profit and must be shown in the income and expenditure statement.*
- *Note that* ***in practice*** *calculations are* ***not*** *shown on final statements [eg insurance (R40 + $^1/_2$ of R160)]. For examination purposes, you may show calculations in this manner, on condition that they are clearly indicated as calculations.*

16.10.2 Revision exercise 2

The following information relates to the Spring Tennis Club:

(1) *Statement of financial position items as at 31 December 20.1*

	R	R
Equipment (at cost)	21 600	
Less: Accumulated depreciation	8 880	12 720
Fixed deposit at Trade Bank (at 12% per annum)		25 600
Inventory: Tennis balls		984
Accrued membership fees		192
Accrued interest on fixed deposit		1 024
Prepaid rental		480
Savings account (favourable)		2 880
Bank (favourable)		8 400
Accumulated fund		26 440
Special fund for championships		25 600
Prepaid membership fees		168
Accrued wages		72

(2) *Cash transactions for the year ended 31 December 20.2*

		R
Receipts:		
Visitors fees		4 860
Membership fees:	20.1	120
	20.2	19 920
	20.3	48
Entrance fees		864
Interest received:	Fixed deposit	3 584
	Savings account	156
Championship entry fees		3 240
Donations		4 680
Payments:		
Municipal taxes		3 504
Refreshments		1 800
Stationery		1 512
Tennis balls		5 280
Affiliation fees		120
Championship expenses		6 400
Honorarium		2 880
Wages		3 360
Maintenance		2 232
Rental: Tennis courts		4 800
Equipment (purchased on 30 September 20.2)		2 400
Transfer to savings account		1 080

ADDITIONAL INFORMATION

(a) Entrance fees must be capitalised.
(b) Inventory on hand at 31 December 20.2:
Tennis balls — R420
Refreshments — R72
(c) Rental of tennis courts amounted to R480 per month.
(d) Unpaid membership fees for 20.1 are irrecoverable.
(e) The club has 84 members and membership fees amount to R20 per month.
(f) Stationery amounting to R120 was purchased on credit and used during the year.
(g) Wages of R360 are still outstanding.
(h) Used equipment with a cost price of R1 200 and accumulated depreciation of R960 at 31 December 20.1 must be written off as from 1 January 20.2.
(i) Provision must be made for depreciation on equipment at 20% per annum on the diminished balance.
(j) The interest on the fixed deposit at Tradebank may only be used for championship expenses. The capital amount of the special fund is not expendable.

Required:

Prepare the following account and statements of Spring Tennis Club:

1. The membership fees account for the year
2. The income and expenditure statement for the year ended 31 December 20.2
3. The statement of financial position as at 31 December 20.2.
4. The property, plant and equipment note to the financial statements.

Solution: Revision exercise 2

SPRING TENNIS CLUB

(1) GENERAL LEDGER

Dt Membership fees **Cr**

20.2			**R**	**20.2**			**R**
Jan 1	Balance	b/d	192	Jan 1	Balance	b/d	168
Dec 31	Income and expenditure:			Dec 31	Bank — 20.1		120
					20.2		19 920
	R(20 × 84 × 12)		20 160		20.3		48
	Balance (prepaid)	c/d	48		Credit losses		72
					Balance (in arrears)	c/d	72
			20 400				20 400
20.3				**20.3**			
Jan 1	Balance	b/d	72	Jan 1	Balance	b/d	48

SPRING TENNIS CLUB

(2) INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 31 DECEMBER 20.2

	R
Income	29 856
Visitors' fees	4 860
Membership fees	20 160
Interest (savings account)	156
Donations	4 680
Expenses	(30 364)
Municipal taxes	3 504
Credit losses R(192 – 120)	72
Refreshments R(1 800 – 72)	1 728
Stationery R(1 512 + 120)	1 632
Tennis balls R(984 + 5 280 – 420)	5 844
Affiliation fees	120
Honorarium	2 880
Wages R(3 360 – 72 + 360)	3 648
Maintenance	2 232
Rental expenses R(480 × 12)	5 760
Depreciation (a)	2 616
Loss on the scrapping of equipment (a)	240
Championship: shortage (b)	88
Deficit for the year	(508)

SPRING TENNIS CLUB

(3) STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.2

ASSETS	Note	R
Non-current assets		37 864
Property, plant and equipment	3	12 264
Financial assets		25 600
Fixed deposit at Trade Bank (at 12% pa)		25 600
Current assets		15 540
Inventories R(420 + 72)		492
Trade and other receivables R[72 + 512 (c)]		584
Cash and cash equivalents R[3 960 + 10 504 (d and e)]		14 464
Total assets		53 404
FUNDS AND LIABILITIES		
Funds		52 396
Accumulated fund (f)		26 796
Special funds		25 600
Non-expendable funds		
Championships		25 600
Current liabilities		1 008
Trade and other payables R[120 + 360 + 480 (g)]		960
Income received in advance		48
Total funds and liabilities		53 404

SPRING TENNIS CLUB

(4) NOTES FOR THE YEAR ENDED 31 DECEMBER 20.2

Note 3

Property, plant and equipment	Equipment	Total
	R	R
Carrying amount: Beginning of year	12 720	12 720
Cost price	21 600	21 600
Accumulated depreciation	(8 880)	(8 880)
Additions (from own funds)	2 400	2 400
Disposals at carrying amount	(240)	(240)
Cost price	(1 200)	(1 200)
Accumulated depreciation	960	960
Depreciation for the year	(2 616)	(2 616)
Carrying amount: End of year	12 264	12 264
Cost price	22 800	22 800
Accumulated depreciation	(10 536)	(10 536)

CALCULATIONS

(a) *Loss on sale of equipment and depreciation*

	Cost price R	Accumulated depreciation R
Balance	21 600	8 880
Written off	(1 200)	(960)
	20 400	7 920
Purchased 30 Septermber 20.2	2 400	
	22 800	

Loss on scrapping of equipment R(1 200 – 960)
= R240

	R
Depreciation for the year	
R(20 400 – 7 920) $\times$ 20%	2 496
R2 400 $\times$ 20% $\times \frac{3}{12}$	120
	2 616

(b) *Championship shortage*

	R	
Expenses		6 400
Income: Entry fees	3 240	—
Interest (R25 600 $\times$ 12%)	3 072	6 312
Shortage		88

(c) *Interest accrued*

Interest receivable for the year (R25 600 $\times$ 12%)		3 072
Interest received	3 584	
Less: Accrued interest (31 Dec 20.1)	1 024	2 560
Accrued interest (31 Dec 20.2)		512

(d) *Savings account*

	R
Balance	2 880
Add: Deposit	1 080
	3 960

(e) *Bank*

Balance	8 400
Add: Receipts	37 472
	45 872
Less: Payments	35 368
Balance	10 504

(f) *Accumulated fund*

Balance (31 Dec 20.1)	26 440
Add: Entrance fees	864
Less: Shortage for the year	508
Balance (31 Dec 20.2)	26 796

(g) *Accrued rental expenses*

Payable per annum = R480 $\times$ 12	5 760
Less: Amount paid	4 800
Balance (31 Dec 20.2)	960
Less: Prepaid 31 December 20.1	480
	480

SELF-ASSESSMENT

Now that you have studied this study unit, can you

- prepare fund accounts?
- prepare receipts and payments statements?
- prepare trading statements?
- prepare income and expenditure statements?
- prepare the statement of financial position reflecting the financial position of the organisation, including information regarding special funds?
- record all calculations required, including those in respect of membership fees?

STUDY UNIT

17

Incomplete records

Learning outcome

Students should be able to convert to a double-entry system from incomplete records.

Contents

KEY CONCEPTS

- Incomplete records
- Statement of assets and liabilities
- Conversion to double entry system

17.1 Introduction

Sometimes small businesses, non-profit organisations etc, do not adhere to the double entry system of accounting. It is likely that the owners or management of these small organisations know very little about basic bookkeeping principles. Because of this, not all transactions are recorded and minimal accounting records are kept, for example, that of only debtors and creditors ie personal accounts. This is described as the single entry system of accounting which, for obvious reasons, leads to incomplete records.

Read paragraph 17.1 of the prescribed book.

17.2 Disadvantages of using imcomplete records

There are many disadvantages attached to the use of the single entry system. These may be summarised as follows:

17.2.1 Incompleteness

In the discussion on the double entry system the twofold aspect of each transaction was explained, namely that for each debit entry there must be a corresponding credit entry. This principle cannot apply where only personal accounts are kept and therefore the records kept under a single entry system will be incomplete. Apart from personal records, there are numerous transactions of an impersonal nature and no record of these transactions exist under the single entry system.

17.2.2 No record of non-current assets and non-current liabilities

Non-current assets and non-current liabilities are impersonal accounts and where only personal accounts are kept, there will be no reliable record of these assets and liabilities.

17.2.3 No details of profits and/or losses

Because nominal or profit or loss accounts are not kept it is impossible to determine the origin or existence of a profit or a loss from the accounting records. This lack of reliable information could adversely affect management, as it is difficult to frame a future policy if there are no records on which to base it. It is therefore impossible to compare the results of one year with those of a previous year, or to obtain any statistical information.

17.2.4 The final results are unreliable

Because only a single entry of personal transactions is recorded, a trial balance cannot be compiled. Furthermore, the balances on the debtors' and creditors' accounts may be incorrect because there are no control accounts with which to reconcile them. Assets and/or liabilities are also not recorded, and it is obvious, therefore, that any financial statements prepared from this information will be unreliable.

17.3 Calculation of profit/loss from incomplete records

For taxation and other purposes, the profits/losses of a business need to be calculated. When using the single entry system, the profit/loss for a certain period can only be determined by means of a comparison of the capital at the beginning of the period with the capital at the end of the period. An increase in capital may be regarded as a profit and a decrease as a loss. Provision should, however, be made for any additions to capital or withdrawals by the owner.

Study paragraph 17.2 of the prescribed book.

Exercise 17.1

D Donovan keeps his books on the single entry basis. On 30 April 20.1, his assets and liabilities are as follows:

	R
Furniture and fittings	16 500
Inventory	8 700
Sundry debtors	10 900
Bank (favourable)	2 200
Petty cash	300
Sundry creditors	9 400
Loan: DJ Bank	5 500

Firstly, a statement of assets and liabilities must be prepared at 30 April 20.1.

D DONOVAN

STATEMENT OF ASSETS AND LIABILITIES AS AT 30 APRIL 20.1

ASSETS	R
Non-current assets	16 500
Property, plant and equipment	16 500
Current assets	22 100
Inventory	8 700
Trade and other receivables	10 900
Cash and cash equivalents R(2 200 + 300)	2 500
Total assets	38 600
EQUITY AND LIABILITIES	
Total equity	23 700
Capital	*23 700
Total liabilities	14 900
Non-current liabilities	5 500
Long-term borrowing — DJ Bank	5 500
Current liabilities	9 400
Trade and other payables	9 400
Total equity and liabilities	38 600

* Balancing figure

On 30 April 20.2 the position appeared to be as follows:

	R
Furniture and fittings	16 500
Inventory	9 600
Sundry debtors	11 200
Bank	3 000
Petty cash	400
Sundry creditors	8 600
Loan: DJ Bank	5 000

It was also ascertained that D Donovan withdrew R2 500 from the entity during the year. Furniture and fittings must be depreciated by 10% per annum.

Required:

Calculate the profit or loss for the year and prepare a statement of assets and liabilities as at 30 April 20.2

Solution Exercise 17.1

The final capital on 30 April 20.2 must be determined first:

Assets	**R**
Furniture and fittings	16 500
Inventory	9 600
Sundry debtors	11 200
Bank	3 000
Petty cash	400
	40 700
Liabilities	(13 600)
Loan: DJ Bank	5 000
Sundry creditors	8 600
Capital	27 100

In order to determine the estimated profit for the year, the difference between the two capital amounts must be determined, and adjustments made for the drawings and depreciation:

	R
Capital at the end of the financial period (30 April 20.2)	27 100
Capital at the beginning of the period (30 April 20.1)	(23 700)
	3 400
Depreciation	(1 650)
Drawings	2 500
Estimated profit for the year	4 250

A statement of assets and liabilities as at 30 April 20.2 can now be prepared:

D DONOVAN

STATEMENT OF ASSETS AND LIABILITIES AS AT 30 APRIL 20.1

ASSETS	**R**
Non-current assets	14 850
Property, plant and equipment R(16 500–1 650)	14 850
Current assets	24 200
Inventory	9 600
Trade and other receivables	11 200
Cash and cash equivalents R(3 000 + 400)	3 400
Total assets	39 050
EQUITY AND LIABILITIES	
Total equity	25 450
Capital	*25 450
Total liabilities	13 600
Non-current liabilities	5 000
Long-term borrowing — DJ Bank	5 000
Current liabilities	8 600
Trade and other payables	8 600
Total equity and liabilities	39 050

	R
* Balance: 1 April 20.1	23 700
Estimated profit	4 250
Less drawings	(2 500)
	25 450

Take note of the systematic arrangement and grouping of the items which are essential to International Financial Reporting Standards.

Study paragraphs 17.3 to 17.6 of the prescribed book.

17.4 Conversion from a single entry into a double entry system

17.4.1 Where subsidiary journals are kept

Step 1

Prepare a statement of assets and liabilities at the beginning of the period (or use the closing statement of the previous period). The ''balances'' as shown in this statement are then journalised (general journal) and posted to the various general ledger accounts. This procedure opens the accounts in the general ledger in accordance with the double entry system.

Step 2

The next step is to prepare the various subsidiary journals as discussed in study unit 6. The cash receipts, cash payments, purchases, purchases returns, sales, sales returns and any other subsidiary journals, must be prepared.

The necessary entries for rental, salaries, wages, sundry expenses, purchase or sale of assets, cash purchases and sales, etc. should be made in the cash journals. It is also essential to regularly do a bank reconciliation as well as at the end of the period.

The individual debtors' and creditors' accounts should be checked carefully. Any mistakes should be corrected in the general journal.

Step 3

The entries in the subsidiary journals can now be posted to the various ledger accounts.

Step 4

Once satisfied that all the journals have been completed and that all postings have been made to the ledger accounts, the accounts must be balanced, and a trial balance prepared.

Step 5

Compile the financial statements as previously discussed in this study guide.

17.4.2 Where minimal records are kept

Because of the practical difficulties of constructing a proper set of books on the double-entry system from incomplete entries, it is sometimes better to start by preparing the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of financial position. In the following year proper systematic books and accounts can be kept. The procedure is as follows:

Step 1

Make a list of all assets and liabilities as at the beginning of the financial period.

Step 2

Calculate the capital as at the beginning of the period.

Step 3

Prepare a summary of the bank account for the year by using cheque counterfoils, deposit slips and bank statements as reference.

Step 4

Ascertain the balances of the assets and liabilities at the end of the period.

Step 5

The next step is to calculate the figures for ***purchases*** and ***sales.*** If no distinction can be made between cash and credit sales and purchases, the amounts can easily be calculated with the aid of the trade receivables and trade payables control accounts. All money received with regard to sales of inventory must then be credited to the trade receivables control account. (This procedure is unnecessary where cash sales and receipts from debtors can be determined accurately.) Similarly, all payments for purchases of inventory are debited to the trade payables control account.

Items such as settlement discounts received and granted, purchases or sales returns, interest received and paid, R/D cheques, credit losses, transfers from debtors to creditors and vice versa must be correctly debited/credited in the appropriate control accounts.

After provision has also been made in the control accounts for both opening and closing balances in respect of debtors, and of creditors, these accounts can be balanced. The balancing figure on the debit side of the trade receivables control account then represents ***sales***, and the balancing figure on the credit side of the trade payables control account will represent ***purchases.***

Step 6

Where accruals and prepayments exist for income and expenditure items, the amounts which must be disclosed in the statement of profit or loss and other comprehensive income need to be calculated.

Step 7

All the required information is now available and the financial statements can be prepared.

Exercise 17.2

C Caity runs a small business. She has never kept proper accounting records and asks you to be her accountant. After thorough investigation you ascertain the following particulars with regard to her business:

Balances as at 1 May 20.0:

	R
Vehicle	15 300
Furniture and fittings	12 600
Inventory: Trading	9 680
Trade receivables control	7 930
Trade payables control	5 645
Accrued wages	450

The analysis of the receipts and payments in her bank account for the year ended 30 April 20.1 was as follows (all receipts were banked and all payments were made by cheque):

Dr Bank **Cr**

		R			**R**
Balance	b/d	7 260	Payments to creditors		66 500
Received from debtors		124 538	Water and electricity		3 300
Cash sales		21 762	Wages		11 925
			Rental expenses		14 400
			Telephone expenses		3 420
			Advertising		2 100
			Insurance		3 250
			Sundry expenses		7 650
			Bank charges		190
			Drawings		35 500
			Balance	c/d	5 325
		153 560			153 560
Balance	b/d	5 325			

You establish that the following must also be taken into account:

(a) Depreciation is to be written off on the carrying amounts at 20% per annum on vehicles and at 10% per annum on furniture and fittings.
(b) Balances as at 30 April 20.1:

	R
Accrued wages	225
Prepaid insurance	250
Inventory: Merchandise	12 190
Trade receivables control	11 230
Trade payables control	7 145

Required:

Prepare the annual financial statements for C Caity for the year ended 30 April 20.1.

NB: Notes are not required.

Solution Exercise 17.2

The opening capital on 1 May 20.0 must be determined first:

Assets		**R**
Vehicles		15 300
Furniture and fittings		12 600
Inventory		9 680
Trade receivables control		7 930
Bank		7 260
		52 770
Liabilities		(6 095)
Trade payables control	5 645	
Accrued wages	450	
Capital		46 675

Determine the sales and purchases for the year to 30 April 20.1:

Dr Trade receivables control **Cr**

		R			R
Balance: Trade receivables	b/d	7 930	Bank: Trade receivables		124 538
Sales*		149 600	Cash sales		21 762
			Balance: Trade receivables	c/d	11 230
		157 530			157 530
Balance: Trade receivables	b/d	11 230			

Dr		Trade payables control			Cr
		R			R
Bank: Trade payables		66 500	Balance: Trade payables	b/d	5 645
Balance: Trade payables	c/d	7 145	Purchases*		68 000
		73 645			73 645
			Balance: Trade payables	b/d	7 145

* Balancing figures

Calculate the amounts to be taken into account in the statement of profit or loss and other comprehensive income for any prepayments or accruals.

Dr		Insurance			Cr
		R			R
Bank		3 250	Prepaid insurance		250
			Profit or loss		3 000
		3 250			3 250

Dr		Wages			Cr
		R			R
Bank		11 925	Accrued wages		450
Accrued wages		225	Profit or loss		11 700
		12 150			12 150

The financial statements can now be prepared.

C CAITY

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 APRIL 20.1

		R
Revenue		149 600
Cost of sales		(65 490)
Inventory: 1 May 20.0	9 680	
Purchases	68 000	
	77 680	
Inventory: 30 April 20.1	(12 190)	
Gross profit		84 110
Distribution, administrative and other expenses:		(50 080)
Water and electricity	3 300	
Wages	11 700	
Rental expenses	14 400	
Telephone expenses	3 420	
Advertising	2 100	
Insurance	3 000	
Other expenses	7 650	
Bank charges	190	
Depreciation R(3 060 + 1 260)*	4 320	
Profit for the year		34 030
Other comprehensive income for the year		—
Total comprehensive income for the year		34 030

* Vehicles (R15 300 × 20%) = R3 060 + Furniture and fittings (R12 600 × 10%) = R1 260.

C CAITY

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 APRIL 20.1

	Capital R
Balance at 1 May 20.0	46 675
Total comprehensive income for the year	34 030
Drawings	(35 500)
Balance at 30 April 20.1	45 205

C CAITY

STATEMENT OF FINANCIAL POSITION AS AT 30 APRIL 20.1

	Note	
ASSETS	**Note**	**R**
Non-current assets		23 580
Property, plant and equipment*		23 580
Current assets		28 995
Inventory		12 190
Trade and other receivables		11 230
Prepayments		250
Cash and cash equivalents		5 325
Total assets		52 575
EQUITY AND LIABILITIES		
Total equity		45 205
Capital		45 205
Current liabilities		7 370
Trade and other payables R(7 145 + 225)		7 370
Total equity and liabilities		52 575

* R(15 300 – 3 060) + R(12 600 – 1 260) = R23 580

17.5 Revision exercises and solutions

17.5.1 Revision exercise 1

K Kacey, the owner of Kacey Traders has not kept proper accounting records. She is, however, able to supply the following information:

Balances as at 31 July:

	20.1	20.2
	R	R
Vehicles (at cost)	24 500	24 500
Furniture and fittings (at cost)	18 800	18 800
Inventory: Trading	20 750	28 400
Trade receivables control	8 700	11 600
Bank (favourable)	1 300	2 700
Long-term borrowing	15 000	10 000
Trade payables control	9 500	11 800
Accrued expenses	2 400	1 200
Prepaid expenses	350	350

You also establish the following with regard to the year ended 31 July 20.2:

(a) K Kacey drew R18 500 during the year for own use.
(b) Depreciation of 15% per annum on the cost price of vehicles and 10% per annum on the cost price of furniture and fittings must still be provided for.
(c) An amount of R500 must be written off as irrecoverable.

Required:

(1) Calculate the estimated profit/loss of Kacey Traders for the year ended 31 July 20.2.

(2) Prepare the statement of financial position of Kacey Traders as at 31 July 20.2.

Solution: Revision exercise 1

(1) CALCULATION OF PROFIT/LOSS:

KACEY TRADERS

STATEMENT OF FINANCIAL POSITION AS AT 31 JULY 20.1

ASSETS	R
Non-current assets	43 300
Property, plant and equipment R(24 500+18 800)	43 300
Current assets	31 100
Inventory	20 750
Trade and other receivables	8 700
Prepayments	350
Cash and cash equivalents	1 300
Total assets	74 400
EQUITY AND LIABILITIES	
Total equity	47 500
Capital	*47 500
Total liabilities	26 900
Non-current liabilities	15 000
Long-term borrowings	15 000
Current liabilities	11 900
Trade and other payables R(9 500 + 2 400)	11 900
Total equity and liabilities	74 400

* Balancing figure

Determination of final capital:

Assets	**R**
Vehicles	24 500
Furniture and fittings	18 800
Inventory	28 400
Trade receivables control	11 600
Bank	2 700
Prepaid expenses	350
	86 350
Liabilities	(23 000)
Long-term borrowing	10 000
Trade payables control	11 800
Accrued expenses	1 200
Capital	63 350

Estimated profit

		R
Capital at the end of the financial period		63 350
Capital at the beginning of the period		(47 500)
		15 850
Drawings		18 500
Adjustments: Credit losses		(500)
Depreciation		(5 555)
Vehicles	(a)	3 675
Furniture and fittings	(b)	1 880
Estimated profit for the year		28 295

(a) R(24 500 $\times$ 15%) = R3 675
(b) R(18 800 $\times$ 10%) = R1 880

(2) KACEY TRADERS

STATEMENT OF FINANCIAL POSITION AS AT 31 JULY 20.2

ASSETS	**R**
Non-current assets	37 745
Property, plant and equipment R(24 500 + 18 800 – 5 555)	37 745
Current assets	42 550
Inventory	28 400
Trade and other receivables R(11 600 – 500 + 350)	11 450
Cash and cash equivalents	2 700
Total assets	80 295
EQUITY AND LIABILITIES	
Total equity	57 295
Capital	*57 295
Total liabilities	23 000
Non-current liabilities	10 000
Long-term borrowings: long-term loan	10 000
Current liabilities	13 000
Trade and other payables R(11 800 + 1 200)	13 000
Total equity and liabilities	80 295

	R
* Balance 1/8/20.1	47 500
Estimated profit	28 295
Less: Drawings	(18 500)
	57 295

17.5.2 Revision exercise 2

M Mandosa keeps his books on a single entry basis, but decides to change to the double entry system and asks for your assistance. You ascertain the following:

On 1 July 20.1 M Mandosa had the following assets:

	R
Land and buildings	36 000
Vehicle	12 000
Furniture and equipment	2 600
Inventory	13 000
Trade receivables control	2 200

His liabilities consisted of the following:

Loan: NKA Bank	8 400
Trade payables control	7 200
Bank (overdraft)	5 300

An analysis of his cash journals revealed the following:

Receipts	
Received from debtors and cash sales	139 600
Refunds from creditors in respect of overpayments on accounts	540
Mandosa paid into the business	7 600
Rent income	2 400
Payments	
Payments to creditors and suppliers of merchandise	77 400
Loan: NKA Bank paid in full	8 900
Debtor's cheques dishonoured (R/D)	840
Drawings	34 500
Wages paid	10 000
Telephone expenses	4 360

You also ascertain the following:

(a) On 30 June 20.2 M Mandosa had no cash on hand, except that in the bank.
(b) R200 interest was collected on overdue debtors' accounts.
(c) Settlement discount granted amounted to R720 and settlement discount received, R940, respectively.
(d) Depreciation must be provided for at 15% per annum on the cost price of vehicles and at 5% per annum on the cost price of furniture and equipment.
(e) Debtors' accounts, amounting to R500 were written off during the year as irrecoverable.
(f) On 30 June 20.2, Mandosa valued his merchandise inventory at R15 000. Debtors owed him R6 800 and he owed creditors R8 400.

Required:

Prepare a statement of profit or loss and other comprehensive income and a statement of changes in equity for the year ended 30 June 20.2, and a statement of financial position at that date. (Show your calculations of purchases and sales.) (**NB:** Notes are not required.)

Solution: Revision exercise 2

CALCULATIONS

(a) Capital at the beginning of the year:

	R
Assets	65 800
Land and buildings	36 000
Vehicles	12 000
Furniture and equipment	2 600
Inventory	13 000
Trade receivables control	2 200
	(20 900)
Liabilities	
Loan: NKA Bank	8 400
Trade payables control	7 200
Bank overdraft	5 300
Capital	44 900

(b) Bank balance at the end of the year:

	R
Opening balance	(5 300)
Receipts	150 140
Received from debtors and cash sales	139 600
Refunds from creditors	540
Mandosa paid into the business	7 600
Rental income	2 400
Payments	(136 000)
Payments to creditors and suppliers	77 400
Loan: NKA Bank paid in full	8 900
Debtor's cheques dishonoured	840
Drawings	34 500
Wages paid	10 000
Telephone expenses	4 360
Closing balance	8 840

(c)

Dr Trade receivables control **Cr**

		R			**R**
Balance	b/d	2 200	Bank		139 600
Bank: R/D cheques		840	Settlement discount		
Interest income		200	granted		720
Sales*		144 380	Credit losses		500
			Balance	c/d	6 800
		147 620			147 620
Balance	b/d	6 800			

(d)

Dr Trade payables control **Cr**

		R			**R**
Bank		77 400	Balance	b/d	7 200
Settlement discount			Bank		540
received		940	Purchases*		79 000
Balance	c/d	8 400			
		86 740			86 740
			Balance	b/d	8 400

* Balancing figure

M MANDOSA

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.2

		R
Revenue		143 660
Cost of sales		(76 060)
Inventory: 1 July 20.1	13 000	
Purchases	78 060	
	91 060	
Inventory: 30 June 20.2	(15 000)	
Gross profit		67 600
Other income		2 600
Rental income	2 400	
Interest received on debtors accounts	200	
		70 200
Distribution, administrative and other expenses:		(16 790)
Wages	10 000	
Sundry trade expenses	4 360	
Credit losses	500	
Depreciation R(1 800 + 130)*	1 930	
		53 410
Finance charges: Interest on loan (R8 900 – R8 400)		(500)
Profit for the year		52 910
Other comprehensive income for the year		—
Total comprehensive income for the year		52 910

* Vehicles (R12 000 x 15%) = R 1800 + furniture and equipment (R2 600 x 5%) = R130

M MANDOSA

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.2

	Capital
	R
Balance at 1 July 20.1	44 900
Contribution during the period	7 600
Total comprehensive income for the year	52 910
Drawings	(34 500)
Balance at 30 June 20.2	70 910

M MANDOSA

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.2

ASSETS	**R**
Non-current assets	48 670
Property, plant and equipment*	48 670
Current assets	30 640
Inventory	15 000
Trade and other receivables	6 800
Cash and cash equivalents	8 840
Total assets	79 310
EQUITY AND LIABILITIES	
Total equity	70 910
Capital	70 910
Current liabilities	8 400
Trade and other payables	8 400
Total equity and liabilities	79 310

* R36 000 + R(12 000 – 1 800) + R(2 600 – 130) = R48 670

SELF-ASSESSMENT

Now that you have studied this study unit, can you

- discuss the disadvantages of using incomplete records?
- define what is meant by incomplete records?
- prepare a statement of financial position?
- calculate a profit/loss from incomplete records?
- convert a single entry system into a double entry system?
- prepare financial statements from incomplete records?