education

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NATIONAL CURRICULUM STATEMENT

ACCOUNTING GUIDE GRADE 10

2008

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Purpose of Study Guide

The purpose of this Guide is to assist teachers and learners in both the GET and FET Band to manage accounting concepts and progression. The Guide provides basic accounting concepts, principles and practice as the first step towards introducing learners to accounting. The information contained in this document is intended to familiarise teachers and learners with accounting concepts and terms, accounting cycle, accounting tools, accounting equation, recording the difference between financial accounting and managerial accounting, basic cost concepts, basic budget concepts, inventory systems and internal control.

This document is not intended to serve as a complete manual, but as a guide to assist teachers in coping with and managing the curriculum knowledge gap of learners. It will form part of many other strategies and resources that will help beginners understand accounting.

How to use this Guide

This Guide should be used as a **resource** for teachers and learners and learners should continually be referred to the Guide for clarity-seeking issues in the subject/learning area. The Guide should be used in conjunction with other resources. The Guide is set out according to Learning Outcomes in the FET Band and teachers in the GET should continually refer to and use what is relevant for EMS.

Unit 1

This Unit is based on the following Learning Outcomes:

- EMS **Learning Outcome 3:** *The learner will be able to demonstrate knowledge and the ability to apply responsibly a range of managerial, consumer and financial skills;*

- Grade 10 – 12 **Learning Outcome 1:** *The learner will be able to demonstrate knowledge, understanding and the application of financial information according to generally accepted accounting practice and concepts.*

The Module includes

- accounting concepts and terms
- accounting cycle
- accounting tools
- recording
- accounting equation

Unit 2

This Unit is based on Accounting Learning Outcome 2: Managerial Accounting

The learner is able to demonstrate knowledge and understanding of managerial accounting as well as the application thereof.

The Unit includes

- difference between financial accounting and managerial accounting
- basic cost concepts
- basic budget concepts

Unit 3

This Unit is based on the Accounting Learning Outcome 3: Managing of Resources

The learner is able to demonstrate knowledge and understanding of the use of different financial and managerial control tools and strategies to manage resources in a responsible manner.

The Unit includes

- inventory systems
- code of ethics
- internal control

UNIT 1: FINANCIAL INFORMATION

INTRODUCTION

Establishing a business can be an exciting and surprising, but complicated and expensive endeavour. It looks so simple: you just make sure you sell goods for more than you make them, right? Wrong. Without proper record-keeping your prospering company may take a sudden and sharp dive toward bankruptcy.

Accounting is one of the most important tools for success in any business. It plays a role in every financial decision you make. From purchasing vehicles, equipment and supplies to increasing production, selecting inventory quantity and determining salaries accounting is a critical component of any successful business. But if you lack background knowledge of accounting, where do you begin?

DEFINITION AND EXPLANATION OF ACCOUNTING TERMS AND CONCEPTS

Accounting cycle: It is the accounting process that begins with the collection of financial data and ends with reports concerning financial statements, i.e. financial activity (income statement) and financial position (balance sheet).

Accounting equation: Assets = owner's equity + liabilities. The accounting equation is the basis for the financial statement called the balance sheet. Note that assets are on the left-hand side of the equation and liabilities and equities are on the right-hand side of the equation. Similarly, some balance sheets are presented so that assets are on the left and liabilities and owner's equity on the right.

Accounts payable/vendors: Also called A/P, accounts payable are the bills your business owes to suppliers; paying bills, writing cheques, paying vendors, making purchase orders and creating quotes and memos.

Accounts receivable/customers: Also called A/R, accounts receivable are the amounts owed to you by your customers, sale of products and goods or services rendered. This includes invoices and shipping for the sales.

Accrued interest: Interest accrued on a bond since the last interest payment was made.

Accrual method of accounting: With the accrual method, you record income when the sale occurs, not necessarily when you receive payment. You record an expense when you receive goods or services, even though you may not pay for them until later.

Adjusting entries: Special accounting entries that must be made when you close the books at the end of an accounting period. Adjustment entries are necessary to update your accounts for items that are not recorded in your daily transactions.

Allowance for bad debts: Also called provision for bad debts, it is an estimate of uncollectible customer accounts. It is known as a 'contra' account because it is listed with the assets, but it will have a credit balance instead of a debit balance. For balance sheet purposes, it is a reduction of accounts receivable.

Annual Report: A formal financial statement issued yearly by a corporation to its shareholders. The Annual Report shows assets, liabilities, earnings, profits or losses incurred, etc.

Assets: Include everything a corporation owns or everything that is due to it. Cash, investments, money due, material and inventories, etc. are called current assets while buildings, land, machinery, etc. are known as fixed assets. They are things of value held by the business. Assets are balance sheet accounts. Examples of assets are cash, accounts receivable, equipment, vehicles, furniture and fixtures.

Average cost method: Takes the average value of the product and uses that as a basis to figure out inventory.

Balance sheet: Also called a statement of financial position. It is a list of your assets and liabilities and the difference between the two which is your equity or net worth. The balance sheet is a real life example of the accounting equation because it shows that assets = liabilities + owner's equity. It is a condensed statement showing the nature and amount of a company's assets, liabilities and owner’s equity at a given date.

Book value/carrying cost: The value of a capitalised investment that has not been written off for tax purposes by depreciation, depletion or amortisation.

Capital: Money invested in the business by the owners. Also called equity.

Capital budgeting: A process that may include steps such as proposal generation, review and analysis, decision-making, implementation and follow-up. The aim is to select long-term investments that will maximise owner wealth.

Capital expenditure: Funds that are invested in projects of which the benefits may be realised over a period of time greater than one year.

Capital gain or capital loss: Profit or loss from the sale of a capital asset.

Cash: Cash at bank and on hand and cash equivalents such as money market instruments.

Cash costs (mining): Direct mining costs, direct processing costs, direct general and administration costs, consulting fees, management fees and bullion transportation and refining charges.

Cash flow: The reported net income of a corporation plus bookkeeping deductions that are not paid out in actual rands and cents (e.g. depreciation and depletion).

Cash method of accounting: If you use the cash method, you record income only when you receive cash from your customers. You record an expense only when you write the check to the vendor.

Closing: Closing the books refers to procedures that take place at the end of an accounting period. Adjusting entries are made and then the income and expense accounts are 'closed'. The net profit that results from the closing of the income and expense accounts is transferred to an equity account such as retained earnings.

Close Corporation: A legal entity formed by the issuance of a charter from the state. A corporation is owned by one or more stockholders.

Cost of goods sold/cost of sales: Cost of inventory items sold to your customers. It may consist of several cost components such as merchandise purchase costs, freight and manufacturing costs - all the costs incurred in getting the stock item to its saleable condition.

Company: It is formed in accordance with the Companies Amendment Act of 1973 and Act 20 of 2004 as amended. This company law allows for the establishment of a company with limited liability. The law governs the formation and operation of businesses that are established as separate entities, the owners are able to separate themselves from the business.

Credits: At least one component of every accounting transaction (journal entry) is a credit amount. Credits increase liabilities and equity and decrease assets. For this reason, you will sometimes see credits entered on the right-hand side (the liability and equity side of the accounting equation) of a two-column journal or ledger.

Current assets: Assets that are in the form of cash or will generally be converted to cash or used up within one year. Examples are accounts receivable and inventory. Items owned by the business which are cash or will be converted into cash in the near future (usually during a period of one year or less). Current assets includes stock, debtors and cash.

Current liabilities: Include money owed and payable by a company, usually within one year. Trade creditors are current liabilities. Liabilities payable within one year. Examples are accounts payable and payroll taxes payable.

Current ratio: Indicator of short-term debt-paying ability that is determined by dividing current assets by current liabilities.

Debits: At least one component of every accounting transaction (journal entry) is a debit amount. Debits increase assets and decrease liabilities and equity. For this reason, you will sometimes see debits entered on the left-hand side (the asset side of the accounting equation) of a two-column journal or ledger.

Depreciation: An annual write-off of a portion of the cost of fixed assets such as vehicles and equipment. Depreciation is listed among the expenses on the income statement.

Discounts: A reduction or a concession given on cash payment (cash discount) and on a large quantity of goods bought on credit (trade discount).

Double-entry accounting: In double entry accounting, every transaction has two journal entries: a debit and a credit. Debits must always equal credits. Double-entry accounting is the basis of a true accounting system. For every debit there must be a credit.

Drawing account: A general ledger account used by some sole proprietorships and partnerships to keep track of amounts and/or stock drawn out of the business by an owner.

Dividends: An amount paid to shareholders out of profits as a reward for investing in the business.

Equity: The net worth of your company. Also called owner's equity or capital. Equity comes from investment in the business by the owners, plus accumulated net profits of the business that have not been paid out to the owners. It essentially represents amounts owed to the owners. Equity accounts are balance sheet accounts.

Expense accounts: These are the accounts you use to keep track of the costs of doing business - where your money goes. Examples are advertising, payroll taxes and wages. Expenses are income statement accounts.

Financial accounting: It provides information to stockholders, creditors and other outsiders.

Financial institutions: They act as intermediaries between individuals and organisations that have a surplus of funds available and those that are experiencing a shortage of funds.

Financial management: Refers to the efficient management of all financial aspects within the broad framework of a company's strategy and planning.

Fixed Assets: Items owned by the business which have an enduring benefit to the business and form part of the infrastructure. They are assets that are generally not converted to cash within one year. Examples are equipment and vehicles.

Foot: To total the amounts in a column, such as a column in a journal or a ledger.

Generally Accepted Accounting Principles (GAAP): The common set of accounting principles, standards and procedures that companies use to compile their financial statements. The statements of GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted practice of recording and reporting accounting information.

General ledger: A general ledger is the collection of all balance sheet, income and expense accounts used to keep the accounting records of a business.

Gross profit: The difference between turnover and cost of sales.

Income: The number of units sold multiplied by unit price.

Income accounts: These are the accounts you use to keep track of your sources of income. Examples are merchandise sales, consulting revenue and interest income.

Income statement: Also called a profit and loss statement or a 'P&L'. It lists your income, expenses and net profit (or loss). The net profit (or loss) is equal to your income minus your expenses.

Interest: A rental amount charged by financial institutions for the use of money.

Inventory: Goods you hold for sale to customers. Inventory can be merchandise you buy for resale or merchandise you manufacture or process, selling the end product to the customer.

Journal: The chronological day-to-day transactions of a business are recorded in sales, cash receipts and cash disbursement journals. A general journal is used to enter period end adjusting and closing entries and other special transactions not entered in the other journals. In a traditional, manual accounting system, each of these journals is a collection of multi-column spreadsheets usually contained in a hardcover binder.

Leverage ratios: They indicate a firm's financial risk – debt to equity ratios.

Liabilities: What your business owes creditors. Liabilities are balance sheet accounts. Examples are accounts payable, payroll taxes payable and loans payable; all the claims against a corporation. Liabilities include current liabilities (accounts payable, wages, salaries, declared dividends) and fixed or long-term liabilities such as mortgage bonds, debentures and bank loans.

Liquidation: The process of converting securities or other property into cash. Upon dissolution of a company, the cash remaining after sale of assets and payment of creditors is distributed among the shareholders.

Liquidity ratios: Measure a firm's capacity to meet short-term financial obligations.

Long-term liabilities: Monies owing that will be paid after 12 months from the balance sheet date; liabilities that are not due within one year. An example would be a mortgage payable.

Loss: If expenses are more than income, the result is a loss or a deficit. This is determined by the difference between expenses and income.

Managerial accounting: Subject concerned with providing information to managers.

Net income: Also called profit or net profit, it is equal to income minus expenses. Net income is the bottom line of the income statement (also called the profit and loss statement).

Net worth: Net worth is the value of all your assets, minus the total of all your liabilities. Put another way, it is what you own minus what you owe. If you owe more than you own, you have a negative net worth. If you own more than you owe, you have a positive net worth.

Overheads: Cost or expense inherent in performing an engineering, construction or manufacturing operation that cannot be charged to or identified with a part of the work done or product manufactured. Such a cost or expense must therefore be allocated on some arbitrary basis or handled as a business expense independent of the volume of production.

Owner's equity: The amount of money the shareholders have invested in the business. It is made up of share capital; the original money provided by the shareholders and retained income.

Partnership: An unincorporated business with two or more owners.

Post: To summarise all journal entries and transfer them to the general ledger accounts. This is done at the end of an accounting period.

Prepaid expenses: Amounts paid in advance to a vendor or creditor for goods or services. A prepaid expense is actually an asset of your business because your vendor or supplier owes you the goods or services. An example would be the unexpired portion of an annual insurance premium.

Prepaid income: Also called income received in advance, it represents money you have received in advance of providing a service to your customer. Prepaid income is actually a liability of your business because you still owe the customer the service. An example would be an advance payment to you for some consulting services you will be performing in the future.

Profit: If income is more than expenses, the result is profit or gain. This is determined by the difference between the income and expenses.

Profit and loss statement: Also called an income statement or 'P&L'. It lists your income, expenses, and net profit (or loss). The net profit (or loss) is equal to your income minus your expenses.

Profitability ratios: Used to measure a firm's overall performance.

Provision for bad debts: Also called allowance for bad debts, it is an estimate of uncollectible customer accounts. It is known as a 'contra' account because it is listed with the assets, but it will have a credit balance instead of a debit balance. For balance sheet purposes, it is a reduction of accounts receivable.

Retained income: The profit remaining at the end of each year which belongs to the owners, but which has not been declared as dividends.

Return on investment (ROI):
Return on investment = [average annual profit/original investment] x 100 %
where average annual profit = [total gains - total outlay]/number of years.

Retained earnings: Profits of the business that have not been paid to the owners; profits that have been 'retained' in the business. Retained earnings is an 'equity' account presented on the balance sheet and on the statement of changes in owners' equity.

Selling and administration expenses: Expenses incurred in selling stock items and administrating the business.

Sole proprietorship/sole trader: An unincorporated business with only one owner.

Source documents: The original record of a transaction. They are used as evidence that a particular business transaction occurred, e.g. cash receipt, customer invoice, etc.

Specific cost method: Uses the cost of the item at the moment of purchase to figure out inventory.

Taxation: Amount paid to revenue authorities (e.g. SARS - South African Revenue Services) based on profits.

Trading inventory: Goods held for sale to customers.

Trial balance: A trial balance is prepared at the end of an accounting period by **adding up all the balances in your general ledger, debits together and credits together.** The debit balances should equal the credit balances.

Turnover: The total amount of **sales** made during the financial period for cash and on credit (stock items sold multiplied by its selling price).

Unearned revenue: Also called income **received in advance**, it represents money you have received in advance of providing a service to your customer. It is actually a liability of your business because you still owe the customer the service.

VAT: It is Value Added Tax levied on the supply of goods and services by vendors.

- **Zero-rated items**: Zero-rated items are goods or services which are taxed at a rate of 0%, e.g. milk, brown bread, maize, fruit, etc.
- **VAT-exempted items:** These items involve services that are not subject to VAT at either the standard rate or zero rate, e.g. childcare services, educational services, etc.
- **Standard rate:** In South Africa Standard-rated supplies are taxed at the rate of 14%.
- **VAT-able items:** These items are goods or services that are subject to VAT.

N.B. Once you master the above accounting terms and concepts, you are ready to learn about the following day-to-day accounting concepts.

INTRODUCTION TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

Accounting is limited in the way that performance and condition is reported by certain rules set out in the Generally Accepted Accounting Principles (GAAP). This framework has the primary objective of making the information relevant, reliable and comparable. Therefore, discussion of the principles will be limited to the following concepts:

Business entity: The financial affairs of the business are kept entirely separate from those of the owner and from all other entities with whom it has dealings.

Matching principle: In essence it requires that expenses and revenues are recognised in the same period. Expenses are offset against income generated by those expenses. Income and expense items are allocated to the correct time period.

Historical cost principle: The historical cost principle dictates that all assets and liabilities are recorded at their historical cost, i.e. original cost. Historical cost principle is used because of its reliability and freedom of bias when compared to fair market value principle. However, historical cost does not always provide relevant information.

Going-concern principle: Accounting must hold to the belief that the company will continue its existence for the foreseeable future in order for it to work. If it does not, it would make no sense for costs to be allocated over several years as in the case of depreciation accounting concepts – double taxation.

Principle of prudence: Financial results are reflected on a conservative basis, i.e. if in doubt, the pessimistic viewpoint is used.

Principle of materiality: Any information which is important to the reader must be highlighted or reflected separately. Conversely, irrelevant information should not be highlighted, as this could be confusing.

ACCOUNTING TOOLS

Learning to use journals (subsidiary books/books of prime entry/books of origin) is also necessary.

You must know how to use a general ledger; this is where all accounts are maintained. These are account ledgers where you initially record each of your account entries.

Use a trial balance to check the amounts of the balances of all accounts in the general ledger to assure accounts are in balance.

The profit/loss statement records your revenue, cost of goods and expenses. The balance sheet is a record of your assets, liabilities and equity. These statements allow you to track cash flow to avoid losing money faster than you are making it. Negative cash flow is one of the main reasons for business failure.

Understanding how to use each of these tools will aid you in maintaining and organising your accounts and will give you an immediate picture of your company's success.

ACCOUNTING CYCLE AND PROCESS

INTRODUCTION

A business begins with an investment of cash and/or other personal assets. Then additional assets such as land, building, equipment and supplies are acquired. Expenses such as salaries, advertising, and taxes are either paid or liabilities such as accounts payable, notes payable and taxes payable incurred. Finally, revenue is generated as cash or a promise of payment (accounts receivable).
Accounting is the process of tracking these financial activities and summarising them for interested parties (owners, managers, creditors, potential investors, etc.). The process (accounting cycle) begins with the collection of financial data and ends with reports concerning financial activity (income statement) and financial position (balance sheet).

1. Accounting cycle

The three steps below are performed throughout the accounting period as transactions occur.

The accounting process is a series of events that begins with source documents that are analysed into a transaction and ends with the closing of the books, i.e. opening of financial statements. Because this process is repeated each reporting period, it is referred to as accounting cycle and includes the following steps:

1.1 Collection of the source documents.

1.2 Recording the transactions by making entries in the appropriate journals, such as the cash receipt journal. See a list of journals in 2.2.

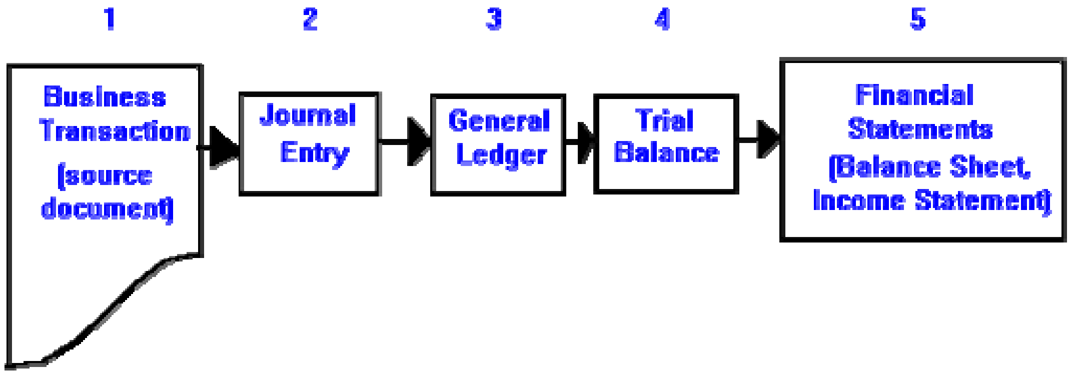
1.3 Post the general journal to the ledger accounts.

End of the accounting period

1.4 Prepare the trial balance to make sure that debits equal credits.

1.5 Prepare the financial statements.

2. Process/flow of information



Source documents

Source documents are the original record of a transaction. They provide the initial data about business transactions and are used as evidence that a particular business transaction occurred, e.g.:

- cash receipt
- credit card receipts
- cash register tapes
- credit invoice from customer and from suppliers
- deposit slips
- cheque counterfoil
- credit note, etc.

At a minimum, each source document should include the date, the amount and a description of the transaction. When practical, beyond these minimum requirements source documents should contain the name and address of the other party of the transaction.

Subsidiary journals/books of original/prime entries

Analyse the source documents to identify the transaction or other recognisable events. Analyse the transactions and classify according to the accounts that are affected and whether those accounts are debited or credited. The following are examples of a subsidiary journal:

- cash receipt journal (for cash/cheques received)
- cash payment journal
- debtors journal
- creditors journal
- debtors returns and allowances journal
- creditors returns and allowances journal
- petty cash journal
- salaries and wages journal
- general journal

The information from the source documents is used to create a chronological listing of all business transactions and detailed information about each transaction. Once a transaction has been journalised, the source document should be filed and made retrievable so that transactions can be verified should the need arise at a later date.

Posting to ledger

When posting to the ledger, you transfer to individual accounts to be able to summarise activity and obtain balance. When posting you can either post to general ledger or subsidiary ledger.

General ledger

The general ledger uses the summarised information transferred from the journal(s) to summarise the data into individual accounts.

Subsidiary ledger

The subsidiary ledger uses the detailed information transferred from the journal(s) to provide detailed information about special accounts called control accounts.

Trial balance (pre-adjustment trial balance)

The trial balance is a listing of all the ledger accounts, with debits in the left column and credits in the right column. At this point no adjusting entries have been made. The trial balance uses the information from the general ledger to summarise the data to use for preparing the financial statements.

Correct any discrepancies in the trial balance. If the columns are not in balance, look for the math. errors. While unbalancing columns indicate a recording error, note that balanced columns do not guarantee that there are no errors. For example, not recording a transaction or recording it in the wrong account would not cause an imbalance.

Prepare adjusting entries to record accrued, deferred and estimated amounts. Post adjusting entries to the ledger accounts and prepare the adjusted trial balance

Examples

Source documents

INVOICES

	INVOICE NO. 479
Klote's Merchandise Supplies	
354 Drive No.150	DATE: 10 May 2008
Silverton	ORDER NO: 150
	DELIVERED BY: Truck
TO: Roadrunner Delivery Service	TERMS: Payable in 30 days
155 Gateway Blvd	
Sunnyside	

QTY.	ITEM	UNIT PRICE	TOTAL
3	Merchandise	R300.00	R900.00

RECEIPTS

		RECEIPT 001
Klote's Office Supplies		
354 Drive No.150		
Silverton		
		13 May 2008
RECEIVED FROM: Roadrunner Delivery Service R900.00	900	00
AMOUNT OF: Nine hundred rands FOR: Merchandise Received by: John Doe (Signature)		
TOTAL	900	00

Transactions

The transactions for the two examples of source documents above are as follows:

10 May 2008 Sold merchandise on credit to Roadrunner Delivery Service at R900.00
13 May 2008 Received a cash payment of R900.00 from Roadrunner Delivery Service in settlement of this account

SUBSIDIARY JOURNALS

Cash receipt journal

Doc	Day	Detail	Analysis	Bank	Sales	Debtors control	Discount allowed	SUNDRIES	
								Amount	Detail
01	May 13	Roadrunner Delivery Service	900.00	900.00		900.00			

Cash payment journal

Doc	Day	Detail	Analysis	Bank	Sales	Creditors control	Discount received	SUNDRIES	
								Amount	Detail

Note

- *Cash receipt journal is for merchandise sold for cash, cash received for services rendered, deposits made directly into the bank and cash received for anything.*
- *Cash payment journal is for payment by cheque, bank charges, payment by stop order or debit order and debtors cheques dishonoured.*

Debtors journal

Inv.	Day	Debtors	Sales	Cost of sales
749	May 10	Roadrunner Delivery Service	900.00	
			900.00	

Debtors allowances journal

Inv.	Day	Debtors	Debtors allowance	Cost of sales

Creditors journal

Inv	Day	Creditor	Creditors control	Trading stock	Stationery	Furniture	Sundries	
							Amount	Detail

Creditors allowances journal

Inv	Day	Creditor	Creditors control	Trading stock	Stationery	Furniture	Sundries	
							Amount	Detail

Note

- *Debtors journal is the book of first entry in which merchandise sold on credit is recorded from the sales credit invoice to the customer.*
- *Debtors allowances journal is the book of first entry in which merchandise returns are recorded from the credit notes.*

- *Creditors journal is the book of first entry in which merchandise sold on credit is recorded from the supplier's credit invoice.*
- *Creditors allowances journal is the book of first entry in which merchandise returns are recorded from the credit notes.*

General journal

Day	Detail	Dr	Cr	Debtors		Creditors	
				Dr	Cr	Dr	Cr

Note:

- *In the general journal you enter any transaction which does not go in any of the above journals.*

GENERAL LEDGER

Dr DEBTORS CONTROL Cr

Dr CREDITORS CONTROL Cr

Dr SALES ACCOUNT Cr

							To Roadrunner Delivery Service		

Note

- *When posting to the ledger, you transfer to individual accounts to be able to summarise activity and obtain balance.*
- *One account is debited and one account is credited.*

TRIAL BALANCE ON 30 JUNE 2008

	DEBIT	CREDIT
Balance sheet account section		
Nominal account section		

Note

- *The trial balance is a listing of all the ledger accounts, with debits in the left column and credits in the right column.*
- *At this point no adjusting entries have been made. The trial balance uses the information from the general ledger to summarise the data to use for preparing the financial statements.*

Financial statements

The financial statements of a business use the summarised data contained in the trial balance to prepare the financial reports of the business. Financial statements include the following:

- Prepare income statement from the revenue, expenses, gains and losses.
- Balance sheet from assets, liabilities and owner's equity accounts.
- Statement of retained earnings from net income and dividend information.
- Cash flow from the other financial statements using direct and indirect method.

1. An income statement. The income statement presents a summary of an entity's income and expenses for a specific period of time, such as a year. The most important concept to be learned from an income statement is that it is dynamic. It represents the performance for the period of time that is described. It does not represent any particular point during the period. (Example: An income statement for 2008 would show all the revenue and expenses for the year and would on its last line - 'the bottom line' - show whether the business had a loss or a profit).

Do not make the mistake of assuming that because the last date in the heading is 31/12/2007 that the income statement is just for that date. It is for a period of 12 months, i.e. 01/01/2007 to 31/12/2007.

2. Balance sheet. Also called the statement of financial position. It is a static report of the condition of the company at a specific point in time. It reflects the assets, liabilities and owner's equity at that moment. The best way to describe it is: "A snapshot of the financial position of a company at a determined point in time".

3. Statement of cash flows. It reports the inflow and outflow of cash during a period. Just like the income statement, the statement of cash flow covers transactions during a period. Inflow and outflow of cash are categorised into operating, financing and investing in order to provide a high level of detail and useful information.

Note: Balance sheet and the accounting equation: A term often used in accounting is 'accounting equation'. In its simplest form, the accounting equation shows the relationship between assets (the resources) and the sum of liabilities and owner's equity (claims on the resources). It is expressed as:

ASSETS = OWNER'S EQUITY + LIABILITIES

The accounting equation

Two concepts must be explained before we proceed to the first step of the accounting process of recording transactions. **Firstly, it will be necessary to understand the relationship between assets, liabilities and owner's equity** as demonstrated by the accounting equation. **Secondly, the system of debits and credits**, designed to change the variables of the accounting equation, must be understood.

1.

ASSETS -	LIABILITIES =	OWNER'S EQUITY
ITEMS OF VALUE -	WHAT IS OWED =	NET WORTH

2. DEFINITIONS

ACCOUNT: Storage area for financial information
DEBIT: Left side of an account
CREDIT: Right side of an account
T ACCOUNT: Simplified account

3. BALANCE SHEET ACCOUNTS

ASSETS: Items of value
CAPITAL: Owner's equity account for sole proprietorships and partnerships
LIABILITIES: Amounts owed
OWNER'S EQUITY: Net worth of a business
RETAINED EARNINGS: The account used to store income earned but not distributed by a corporation

4. DEBITS AND CREDITS

Please relate the definitions in 2 and 3 above to the schematic below. Note the accounting equation has been rewritten to better explain debits and credits.

ASSETS		=	LIABILITIES		+	OWNER'S EQUITY	
DR	CR		DR	CR		DR	CR
	-		-	+		-	+

The DOUBLE ENTRY system of debits and credits facilitates the increasing and decreasing of the amounts stored in the balance sheet accounts. The above schematic summarises part of the system. After rewriting the accounting equation, it should be noted that assets are on the opposite side of the equation from liabilities and owner's equity and are therefore treated in an opposite manner by the system.

NOTE: The following example will show only the current transaction information in each T account.

5. ANALYSING TRANSACTIONS - SAMPLE PROBLEM

Assets = Liabilities + Owner's Equity

1. Darin Jones, a second year student at Wits University, started the Quick Clean Laundry Service with a R100 cash investment.

Cash/Bank	
100	

Capital: Darin Jones	
	100

2. On Sept. 1, paid R50 for 5 months of ads in the school newspaper.

Advertising	
50	

Cash/Bank	
	50

3. On Sept. 1, purchased laundry supplies for R25 cash.

Cleaning material/Laundry supplies	
25	

Cash/Bank	
	25

4. On Sept. 1, purchased R48 of laundry equipment paying down R8.

Laundry equipment	
48	

Creditors control	
	40

Cash/Bank	
	8

5. Darin made an additional investment of R50.

Cash/Bank	
50	

Capital: Darin Jones	
	50

6. Paid one-fourth of the amount owed on the laundry equipment.

Cash /Bank	
	10

Creditors control	
10	

6. TEMPORARY OWNER'S EQUITY STORAGE ACCOUNTS

WITHDRAWALS is a storage account used to record periodic decreases in owner's equity by sole proprietors and partners.

EXPENSES represent a decrease in owner's equity caused by a decrease in assets (usually cash) or an increase in liabilities (creditors and loan etc.) resulting from normal business activity. Examples include salaries, advertising and interest.

INCOME represents an increase in owner's equity caused by an increase in assets (usually cash or debtors control) resulting from normal business activity. Examples include sales, interest income and rent revenue.

7. DEBITS AND CREDITS

Please relate the definitions in number 6 to the expanded schematic below.

ASSETS		=	LIABILITIES		+	OWNER'S EQUITY	
DR	CR		DR	CR		DR	CR
+	-		-	+		-	+

WITHDRAWALS	
DR	CR
-	+

EXPENSES		INCOME	
DR	CR	DR	CR
-	+	-	+

Expense, revenue and withdrawals are temporary storage accounts used to track changes in owner's equity and their positive or normal balance is consistent with the eventual change to be made in owner's equity. That is, expenses and withdrawals are debits because they will eventually lower owner's equity and revenue is a credit because it will eventually increase owner's equity. Revenue, expense and withdrawals may also be thought of as changes in assets and/or liabilities which cause owner's equity to change.

8. ANALYSING TRANSACTIONS - SAMPLE PROBLEMS

Assets = Liabilities + Owner's Equity

7. Darin withdrew R20 for personal use

.

Cash/Bank	
	20

Withdrawal: Darin Jones	
20	

8. Cash collected for laundry services performed during the month amounted to R140. R10 was also due for services rendered.

Cash/Bank	
140	

Debtors control	
10	

Current income	
	150

9. Paid R75 for the use of washers and dryers for September.

Cash/Bank	
	75

Washer/dryer expense	
75	

10. Received R5 on account.

Cash/Bank	
5	

Debtors control	
5	

11. On Sept. 26, two students paid R10 for following week's laundry service.

Cash/Bank	
20	

Current income	
	20

12. Paid monthly phone bill of R10.

Cash/Bank	
	10

Telephone expense	
10	

Closing journal entries

Prepare closing journal entries that close temporary accounts such as revenues, expenses, gains and losses. These accounts are closed to a temporary income summary account, from which the balance is transferred to the retain earnings account (capital). Any dividend or withdrawal accounts are also closed to capital.

Post-adjustment trial balance

Post the closing entries to the ledger accounts and prepare the post closing trial balance to make sure debits equal credits. At this point only the permanent accounts appear since the temporary ones have been closed. Prepare reversing journal entries.

Beginning of the new period

Prepare reversing journal entries. These journal entries are often used when there has been an accrual or deferral that was recorded as an adjusting entry on the last day of the accounting period.

Summary of the accounting cycle

1. Every accounting entry is based on a business transaction which is usually evidenced by a business document (source document), such as a check or a sales invoice.
2. A journal is a place to record the transactions of a business. The typical journals used to record the chronological, day-to-day transactions are sales/debtors journal and cash receipt journal and a cash payment journal. A general journal is used to record special entries at the end of an accounting period.
3. While a journal records transactions as they happen, the ledger groups transactions according to their type, based on the accounts they affect. The general ledger is a collection of all balance sheet, income and expense accounts used to keep the accounting records of a business. At the end of an accounting period, all journal entries are summarised and transferred to the general ledger accounts. This procedure is called **'posting'.**
4. A trial balance is prepared at the end of an accounting period by adding up all the account balances in the general ledger. The sum of the debit balances should equal the sum of the credit balances. If total debits don't equal total credits, you must track down the errors.
5. Finally, financial statements are prepared from the information in your trial balance.

Basic accounting principles

A few basic accounting principles must be kept in mind when maintaining, updating and balancing your accounts.

- A credit in one account always equals a debit in another.
- Also remember that you must subtract the liabilities of your company from the asset value to determine the equity of you company.
- Revenue alone will not give you a clear picture of the worth of your company.

To ensure proper accounting in a business, you should follow a simple procedure:

- Keep or make source documents, e.g. a receipt of each transaction in your company.
- Analyse each transaction to determine the type of transaction, accounts involved and the resulting debit or credit to individual accounts.
- Record these transactions in the journals so that you can access the information in the future.
- **Transfer or post** the information to the appropriate accounts in the ledger and then balance the amounts by adding or subtracting from each specific category and summing to make sure that the credits are equal to the debits.
- Make any adjustments needed to the income and expense accounts at the end of the period and close the account by taking the balance to zero and preparing a financial statement (income statements, balance sheet).

> In bookkeeping texts, examples and ledgers you may see the words 'Debit' and 'Credit abbreviated. Dr. stands for Debit; Cr. stands for Credit.

Note

Double-entry accounting: In double-entry accounting, every transaction has two journal entries - a debit and a credit. Debits must always equal credits. Because debits equal credits, double-entry accounting prevents some common bookkeeping errors. Errors that do occur are easier to find. Double-entry accounting is the basis of a true accounting system.

In double-entry accounting, every transaction affects at least two accounts, since there is at least one debit and one credit for each transaction.

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS: RATIOS

Analysis and interpretation of financial statements and notes with reference to:

Gross profit margin

Gross profit margin indicates how well the company can generate a return at the gross profit level. It addresses three areas -- inventory control, pricing and production efficiency.

The formula is

$$\text{Gross profit on sales} = \frac{\text{Gross profit}}{\text{Total sales}} \times 100$$

$$\text{Gross profit on cost of sales} = \frac{\text{Gross profit}}{\text{Cost of sales}} \times 100$$

Net profit on sales

Net profit margin shows how much net profit is derived from every rand of total sales. It indicates how well the business has managed its operating expenses. It can also indicate whether the business is generating enough sales volume to cover minimum fixed costs and still leave an acceptable profit.

The formula is

$$\text{Net profit on sales} = \frac{\text{Net profit}}{\text{Total sales}} \times 100$$

Operating expenses on sales

Operating expenses are calculated in order to determine the operating efficiency of the concern. As this ratio indicates the percentage of operating expenses to the net sales, it is better for a concern to have this ratio in less percentage. The less percentage of cost means higher margin to earn profit.

The formula is

$$\text{Operating expenses on sale} = \frac{\text{Operating expenses}}{\text{Net sales}} \times 100$$

Operating profit on sales

Operating profit ratio indicates the earning capacity of the concern on the basis of its business operations and not from earnings from the other sources. It shows whether the business is able to stand in the market or not.

The formula is

$$\text{Operating profit on sale} = \frac{\text{Operating profit}}{\text{Net sales}} \times 100$$

Current ratio

Current ratio measures the company's ability to pay its short-term liabilities from short-term assets.

The formula is

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Acid test ratio

The acid test ratio is a measure of liquidity. It is a strict test of the corporation's liquidity.
The formula is

$$\text{Acid test ratio (quick test ratio)} = \frac{\text{Current assets/stock}}{\text{Current liabilities}}$$

Solvency ratio

Solvency ratios help investors assess a company's ability to meet its long-term obligations. They also tell investors how the company has been financed (debt or equity) and whether that is changing over time.

There are several formulas used to gauge a company's ability to meet its long-term obligations.

The formula is

$$\text{Solvency ratio} = \frac{\text{Total net worth}}{\text{Total assets}}$$

Other major solvency ratios are

Debt to assets

The basic debt to assets ratio is expressed simply as

$$\text{Debt to equity} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

Like debt to assets, there are also several variations chosen to measure various aspects.

Total liabilities/total equity

(Short-term debt + long-term debt)/total equity
(Short-term debt + long-term debt)/(short-term debt + long-term debt + total equity)
Interest coverage (times interest earned - TIE)

Return on equity

Return on equity is also called return on investment (ROI). It determines the rate of return on the invested capital. It is used to compare investment in the company against other investment opportunities such as stocks, real estate, savings, etc. There should be a direct relationship between ROI and risk (i.e. the greater the risk, the higher the return).

The formula is

$$\text{Return on equity} = \frac{\text{Net profit before taxes}}{\text{Net worth}}$$

NOTES: How to complete the transactions of a SOLE TRADER
Examples

- Record year-end adjustments and closing transfers in the correct subsidiary journals.
- Prepare final accounts and financial statements.
- Apply ratios to calculate ratios which are useful in decision-making.

Analyse and interpret ratios

YEAR-END ADJUSTMENTS

- Accrued income
- Accrued expenses
- Pre-paid expenses
- Income received in advance
- Consumable stores on hand
- Trading stock deficit
- Provision for bad debts
- Depreciation (refer to asset disposal)

STEPS IN DOING YEAR-END ADJUSTMENTS

- Prepare journal entries for the adjustments
- Journalise all closing transfers
- Post to the ledger
- Final accounts
- Financial statements

1.1 ACCRUED INCOME (INCOME RECEIVABLE)

This is income earned but not yet received at the end of the accounting period.

Accrued income has two elements:

- Asset element (balance sheet section)
- Income element (nominal section)

IMPORTANT INFORMATION
- Date of financial year-end
- Balance of income account in pre-adjusted trial balance

For example: Rent income and interest on investment

On 28 February 2001 the accumulated period footings in the general ledger of Prince Traders of the rent income account totalled R9 900 and those of the interest on investment account totalled R4 800.

Adjustments

- Rent has been received from T. Tenant for eleven months only.
- R40 000 has been invested for one year at 16% p.a.
  Provide for outstanding interest for the last quarter (amount received for 9 months amount to R4 800).

The three elements are

- an asset account (accrued income)
- an income account (rent income and interest on investment)
- effect on accounting equation (asset increases, owner's equity increases)

Analysis of information

Rent income

$\frac{R9\ 900}{11}$ = R900 per month

R900 rental for the last month of the year is still outstanding. This rental, which is in fact **rent receivable**, must be brought into account for the current financial year as **accrued income.**

Interest on investment

Calculation of interest: R40 000 x $\frac{16}{100}$	=	R6 400
Interest received for 9 months		(R4 800)
Accrued income		R1 600

OR

Calculation of interest for the last quarter of the year:

$\frac{R40\ 000}{1} \times \frac{16}{100} \times \frac{3}{12}$ = R1 600 (accrued income)

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Accrued income B16 Cr

2001 Feb	28	Interest on investment	GJ	1 600					
		Rent income	GJ	900					
				2 500					

Nominal accounts section

Dr Rent income N4 Cr

2001 Feb	28	Profit & loss	GJ	10 800	2001 Feb	28	Total	b/f	9 900
							Accrued income	GJ	900
				10 800					10 800

Dr Interest on investment N5 Cr

2001 Feb	28	Profit & loss	GJ	6 400	2001 Feb	28	Total	b/d	4 800
							Accrued income	FJ	1 600
				6 400					6 400

Final accounts section

Dr Profit and loss F2 Cr

					2001 Feb	28	Rent income	GJ	10 800
							Interest income	GJ	6 400
							Discount received	GJ	xxx

NOTES

2. Different types of accrued income are accumulated in the accrued income account in the balance sheet accounts section. Accrued income is a current asset of the business. The entries in this account will be **reversed** at the beginning of the next financial year.

3. Accrued income will be included in the note to the financial statements under trade and other receivables.

THE REVERSALS

On the first day of the next accounting period, the rent income and interest on investment must be reversed to the accounts in the nominal accounts section.

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Accrued income B16 Cr

2001 Mar	1	Balance	b/d	2 500	2001 Mar	1	Rent income	GJ	900
							Interest on investment	GJ	1 600
				2 500					2 500

Nominal accounts section

Dr Rent income N4 Cr

2001 Mar	1	Accrued income	GJ	900					

Dr Interest on investment N5 Cr

2001 Mar	1	Accrued income	GJ	1 600					

1.2 ACCRUED EXPENSES

These are the operating expenses incurred during the accounting period which have not been paid.

Accrued expense has two elements:

- Liability element (balance sheet section).
- Expense element (nominal section).

IMPORTANT INFORMATION

- Date of financial year-end.
- Balance of expense account in pre-adjusted trial balance.

For example: Telephone and interest on loan

On 28 February 2001 the accumulated period footings in the general ledger of Prince Traders of the telephone account totalled R9 870 and those on the interest on loan account totalled R8 250.

Adjustments

(a) The February telephone account of R950 has still not been paid.
(b) The last month's interest at 18% p.a. on the mortgage loan of R50 000 is still payable (amount of interest paid to date R8250).

The three elements are

- liability account (accrued expenses)
- expense account (telephone, interest on loan)
- effect on accounting equation (liability increases, owner's equity decreases)

Analysis of information

Telephone:

11 months	R 9 870
1 month (February)	R 950 (Accrued expense)
	R10 820

Interest on loan:

Calculation of interest $\frac{R50\ 000}{1} \times \frac{18}{100}$ = R9 000

Amount on interest paid to date (R8 250)
Accrued expense R 750

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Accrued expenses B15 Cr

					2002 Feb	28	Telephone	GJ	950
							Interest on loan	GJ	750
									1 700

Nominal accounts section

Dr Telephone N12 Cr

2002 Feb	28	Total	b/d	9 870	2002 Feb	28	Profit and loss	GJ	10 820
		Accrued expenses	GJ	950					
				10 820					10 820

Dr Interest on loan N18 Cr

2002 Feb	28	Total	b/d	8 250	2002 Feb	28	Profit and loss	GJ	9 000
		Accrued expenses	GJ	750					
				9 000					9 000

Final accounts section

Dr Profit and loss F2 Cr

2002 Feb	28	Telephone	GJ	10 820	2002 Mar	1	Balance	b/d	1 700
		Interest on loan	GJ	9 000					
		Advertising	GJ	xxx					
		Wages	GJ	xxx					
		Sundry expenses	GJ	xxx					

NOTES:
Accrued expenses are accumulated in one accrued expense account in the balance sheet accounts section of the general ledger. Accrued expenses are a current liability of the business.
The entries in this account will be reversed in the next financial year by means of journal entries. Accrued expenses will be included in the notes to the financial statement under trade and other payables.

THE REVERSALS

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Accrued expenses Cr

2002 Mar	1	Telephone	GJ	950	2002 Mar	1	Balance	b/d	1 700
		Interest on loan	GJ	750					
				1 700					1 700

Nominal accounts section

Dr Telephone Cr

					2002 Mar	1	Accrued expenses	GJ	950

Dr Interest on loan Cr

					2002 Mar	1	Accrued expenses	GJ	750

1.3 PREPAID EXPENSES

These are expenses paid for in the present accounting period, for the next accounting period.

Prepaid expenses has two elements:

- Asset element (balance sheet section).
- Expense element (nominal section).

IMPORTANT INFORMATION

- Date of financial year-end.
- Balance of expense account in pre-adjusted trial balance.

For example: Insurance

On 28 February 2002 the accumulated period footings in the general ledger of Prince Traders of the insurance account totalled R4 400.

This included an amount of R1 440 which was paid on 1 July 2001 for 1 year (1 July 2001 to 30 June 2002).

The three elements are

- asset account (prepaid expenses)
- expense account (insurance)
- effect on accounting equation (asset increases, owner's equity increases)

Analysis of information

R1 440 ÷ 12 = R120 per month

28 February 2002 to 30 June 2002 = 4 months

4 months x R120 = R480 (prepaid)

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Prepaid expenses B19 Cr

2002 Feb	28	Insurance	GJ10	480					

Nominal accounts section

Dr Insurance N12 Cr

2002 Feb	28	Total	b/f	4 400	2002 Feb	28	Prepaid expenses	GJ10	480
							Profit and loss	GJ10	3 920
				4 400					4 400

Final accounts section

Dr			Profit and loss					F2	Cr
2002 Feb	28	Insurance	GJ10	3 920					
		Water and electricity	GJ10	XXX					
		Accrued expense	GJ10	XXX					

NOTES

1. All kinds of prepaid expenses are accumulated in the prepaid expense account in the balance sheet accounts section. Prepaid expenses are a current asset of the business. The entries in this account will be reversed at the beginning of the next financial year. Prepaid expenses will be included in the notes to the financial statement under trade and other receivables.

THE REVERSALS

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr			Prepaid expenses					B19	Cr
2002 Feb	28	Balance	b/d	480	2002 Mar	1	Insurance	GJ11	480

Nominal accounts section

Dr			Insurance					N12	Cr
2002 Mar	1	Prepaid expenses	GJ11	480					

1.4 INCOME RECEIVED IN ADVANCE (DEFERRED INCOME)

This is income relating to the next accounting period already received in the current accounting year.

Income received in advance has two elements:

- Liability element (balance sheet section).
- Income element (nominal section).

IMPORTANT INFORMATION

- Date of financial year-end.
- Balance of income account in pre-adjustment trial balance.

For example: Rent income

On 28 February 2002 the accumulated period footings in the general ledger of Price Traders of the rent income account totalled R19 865.

Adjustment

Rent was received from the tenant for the period 1 March 2001 to 31 March 2002.
Take into account that the rent was increased by 10% on 1 September 2001.

The three elements are

- liability account (income received in advance)
- income account (rent income)
- effect on accounting equation (liability increases, owner's equity decreases)

Analysis of information

1 March 2001	-	28 February 2002 =	12 months
28 February 2002	-	31 March 2002=	1 month
			13 months

1 September 2001 rent increase by 10 %.

Old rent	=	1 March 2001	-	31 August 2001 = 6 months
New rent	=	1 September 2001	-	31 March 2002 = 7 months

Rent received R19 865.

Calculation of rent income

Let the rent be 100% per month from 1 March 2001 to 31 August 2001 and 110 % per month from 1 September 2001 to 31 March 2002.

$6 \times 100\,\% = 600\,\%$

AND

$7 \times 110\,\% = 770\,\%$

$600\,\% + 770\,\% = 1\,370\,\% = R19\,865$

$$\frac{1\,370\,\%}{1\,370} = \frac{R19\,865}{1\,370}$$

$$1\,\% = R14{,}50$$

$$110\,\% = R14{,}50 \times 110$$

$$= R1\,595 \text{ (Received in advance)}$$

Alternative method for calculating rent income: Let the monthly rent be x.

$$6x + 7(1{,}10x) = R19\,865$$

$$6x + 7{,}7x = R19\,865$$

$$13{,}7x = R19\,865$$

$$\underline{13{,}7x} = \underline{R19\,865}$$

13,7 13,7

x = R1 450

Add 10 % = R 145

R1 595 (Received in advance)

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Income received in advance B28 Cr

					2002 Feb	28	Rent income	GJ10	1 595

Nominal accounts section

Dr Rent income N10 Cr

2002 Feb	28	Income received in advance	GJ10	1 595	2002 Feb	28	Total	b/d	19 865
		Profit and loss	GJ10	18 270					
				19 865					19 865

Final accounts section

Dr Profit and loss F2 Cr

					2002 Feb	28	Rent income	GJ10	18 270
							Interest on investment	GJ10	XXX
							Discount received	GJ10	XXX

NOTE

Different types of income received in advance are accumulated in the income received in advance account in the balance sheet accounts section. Income received in advance is a current liability of the business. The entries in this account will be reversed at the beginning of the next financial year.

Income received in advance will be included in the notes to the financial statements under trade and other payables.

THE REVERSALS

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Income received in advance B18 Cr

2002 Mar	1	Rent income	GJ12	1 595	2002 Feb	1	Balance	b/d	1 595

Nominal accounts section

Dr Rent income N10 Cr

					2002 Mar	1	Income received in advance	GJ12	1 595

1.5 CONSUMABLE STORES ON HAND

A business purchases a number of consumable items used in conducting its operations, for example:

Stationery
Cleaning material
Fuel
Packing material

These items are expenses at the time of purchase. However, at the end of the financial year, there may be some items that are unused and which cannot be regarded as an expense, but as a temporary asset.

Consumable stores on hand has two elements:

- Asset account (balance sheet section).
- Expense account (nominal section).

For example: Packing material and printing and stationery

On 28 February 2001 the accounted period footings (totals) appeared in the general ledger of Prince Traders.

Packing material	R8 600
Printing and stationery	R8 900

Adjustment

On 28 February 2001 a physical count revealed that the following were on hand:

Packing material	R1 600
Printing and stationery	R 900

The three elements are

- asset account (consumable stores on hand)
- expense account (packing material, printing and stationery)
- effect on accounting equation (asset increases, owner's equity increases).

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Consumable stores on hand B15 Cr

2002 Feb	28	Packing material	GJ	1 600					
		Printing & stationery	GJ	900					
				2 500					

Nominal accounts section

Dr Packing material N7 Cr

2002 Feb	28	Total	b/d	8 600	2002 Feb	28	Consumable stores on hand	GJ	1 600
							Profit and loss	GJ	7 000
				8 600					8 600

Dr Printing and stationery N8 Cr

2002 Feb	28	Total	b/d	8 900	2002 Feb	28	Consumable stores on hand	GJ	900
							Profit and loss	GJ	8 000
				8 900					8 900

Final accounts section

Dr Profit and loss F2 Cr

2002 Feb	28	Advertising	GJ	XXX					
		Wages	GJ	XXX					
		Packing material	GJ	7 000					
		Printing & stationery	GJ	8 000					

NOTES
All kinds of consumable stores on hand are accumulated in the *Consumable stores on hand* account in the balance sheet accounts section. Consumable stores on hand are similar to trading stock in that, in the event of the business closing down, these stores may be sold along with trading stock in order to provide funds to settle liabilities. Consumable stores on hand are a current asset of the business and will be reversed at the beginning of the next financial year. Consumable stores on hand will be included in the notes to the financial statements under inventories.

THE REVERSAL

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Consumable stores on hand B15 Cr

2002 Mar	1	Balance	b/d	2 500	2002 Mar	1	Packing material	GJ	1 600
							Printing & stationery	GJ	900
				2 500					2 500

Nominal accounts section

Dr Packing material N7 Cr

2002 Mar	1	Consumable stores on hand	GJ	1 600					

Dr Printing and stationery N8 Cr

2002 Mar	1	Consumable stores on hand	GJ	900					

1.6 TRADING STOCK DEFICIT

(The continuous/perpetual inventory system)

There are two methods of accounting for trading stock:

(a) Perpetual inventory system
(b) Periodic inventory system

The trading stock account in the general ledger when using the perpetual inventory system indicates the amount of stock that should be available for sale.

How can we be sure that the amount reflected in the trading account is accurate?

By conducting a physical stock count.

A stock count may reveal that there is less stock than reflected in the trading stock account (deficit) or more than the disclosed figure (surplus).

A journal adjustment entry is necessary to ensure that the trading stock account reflects the correct value of stock on hand.

The three elements are

- expense account (trading stock deficit)
- asset account (trading stock)
- effect on accounting equation (owner's equity decreases, asset decreases)

For example: Trading stock deficit

On 28 February 2002 the trading stock account in the general ledger of Prince Traders reflected a balance of R32 200. The physical stock count revealed the value of goods on hand to be R31 000.

Prince Traders uses the perpetual inventory system.

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Trading stock B6 Cr

2002 Feb	28	Balance	b/d	32 200	2002 Feb	28	Trading stock deficit	GJ	1 200
							Balance	c/d	31 000
				32 200					32 200
2002 Mar	1	Balance	b/d	31 000					

Nominal accounts section

Dr — Trading stock deficit — N18 — Cr

2002 Feb	28	Trading stock	GJ	1 200	2002 Feb	28	Profit and loss	GJ	1 200

1.7 PROVISION FOR BAD DEBTS

The accountant of a business knows from experience that a certain percentage of (present) debtors (at the end of the financial year) may not be able to pay their accounts by the end of the year.

On the last day of the accounting period, this expected loss must be brought into account so that the financial statements do not reflect an inaccurate figure for 'Debtors'.

Past history could give an accurate indication of the percentage of debtors who are likely to be bad debts in the future.

An adjustment entry will be made to provide for the potential bad debts at the end of the financial year.

This is done by creating a provision for bad debts account.

Provision for bad debts is an asset account. However, since it is brought into the books as a credit balance it is regarded as a negative asset.

This account has the effect of reducing the balance on trade debtors amount in the note to the balance sheet.

1.7.1 Creation of provision for bad debts

The three elements are

- expense account (provision for bad debts adjustment account – owner's equity)
- asset account (provision for bad debts - asset)
- effect on accounting equation (owner's equity decreases, asset decreases)

Adjustment

On 28 February 2002 the debtors control account in the general ledger of Prince Traders has a balance of R48 000. It was decided to create a provision for bad debts equal to 5 % of total debtors.

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr — Provision for bad debts — B10 — Cr

					2002 Feb	28	Provision for bad debts adjustment	GJ	2 400

Nominal accounts section

Dr Provision for bad debts adjustment N18 Cr

2002 Feb	28	Provision for bad debts	GJ	2 400	2002 Feb	28	Profit and loss	GJ	2 400

Final accounts section

Dr Profit and loss F2 Cr

2002 Feb	28	Advertising	GJ	XXXX					
		Wages	GJ	XXXX					
		Packing material	GJ	XXXX					
		Printing & stationery	GJ	XXXX					
		Provision for bad debts adjustment	GJ	2 400					

Treatment in the financial statement

- The debtors control has a debit balance in the ledger, while the provision for bad debts account will have a credit balance. The provision for bad debts will be subtracted from the debtors control figure when the balance sheet is prepared.

- The provision for bad debts adjustment account has a debit total and will be shown in the income statement as an expense.

1.7.2 Increase in provision for bad debts

An increase in provision for bad debts is necessary if debtors balances increase, i.e. the balance on this year end is more than the balance of the previous year.

The three elements are

- expense account (provision for bad debts adjustment – owner's equity)
- asset account (provision for bad debts - asset)
- effect on accounting equation (owner's equity decreases, asset decreases)

Adjustment

At the end of the second accounting period, 28 February 2003, the debtors control account in the general ledger of PO Traders has a balance or R55 000.
The provision for bad debts account has a balance of R2 400 from the previous year.

The provision must be adjusted to 5 % of total debtors.

Calculation

			R	
Debtors control on 28 February 2003		=	55 000	
	R55 000 x 5 %	=	2 750	(Provision for this year)
			(2 400)	(Provision for last year)
			350	(Provision must increase by R350 this year)

GENERAL LEDGER OF PRINCE TRADERS
Balance sheet accounts section

Dr Provision for bad debts B9 Cr

					2002 Mar	1	Balance	b/d	2 400
					2003 Feb	28	Provision for bad debts adjustment	GJ	350
									2 750

Nominal accounts section

Dr Provision for bad debts adjustment N13 Cr

2003 Feb	28	Provision for bad debts	GJ	350	2003 Feb	28	Profit and loss	GJ	350

Final accounts section

Dr Profit and loss F2 Cr

2003 Feb	28	Advertising	GJ	XXXX					
		Wages	GJ	XXXX					
		Packing material	GJ	XXX					
		Printing and stationery	GJ	XXXX					
		Provision for bad debts adjustment	GJ	350					

Treatment in the financial statements

- The debtors control account has a debit balance in the ledger, R55 000 while provision for bad debts account will have a credit balance, R2 750.
  - The provision for bad debts will be deducted from the debtors control figure when the balance sheet is prepared.

- The provision for bad debts adjustment account has a debit total and will be shown in the income statement as an expense.

1.7.3 Decrease in provision for bad debts

A decrease in the amount owed by debtors at the end of the year will result in a decrease in provision for bad debts.

The three elements are

- income account (provision for bad debt adjustment – owner's equity)
- asset account (provision for bad debts - asset)
- effect on accounting equation (owner's equity increases, asset increases)

Adjustment

At the end of the third accounting period, 28 February 2004, the debtors control account in the general ledger of PO Traders has a balance of R50 000. The provision for bad debts account has a balance of R2 750 from the previous year.

The provision must be adjusted to 5 % of total debtors.

Calculation

		R	
Debtors control on 28 February 2004	=	50 000	
	R50 000 x 5 % =	2 500	(Provision for the year)
		(2 750)	(Provision for last year)
		250	(Provision must decrease by R250 this year)

GENERAL LEDGER OF PRINCE TRADERS

Balance sheet accounts section

Dr Provision for bad debts B9 Cr

2004 Feb	28	Provision for bad debts adjustment	GJ	250	2003 Mar	1	Balance	b/d	2 750
		Balance	c/d	2 500					
				2 750					2 750
					2004 Mar	1	Balance	b/d	2 500

Nominal accounts section

Dr Provision for bad debts adjustment N13 Cr

2004 Feb	28	Profit and loss	GJ	250	2004 Feb	28	Provision for bad debts	GJ	250

Final accounts section

Dr			Profit and loss					F2	Cr
					2004 Feb	28	Trading account	GJ	XXXX
							Rent income	GJ	XXXX
							Interest income	GJ	XXXX
							Provision for bad debts adjustment	GJ	250

Treatment in the financial statement

- The debtors control account has a debit balance in the ledger, R50 000, while provision for bad debts account will have a credit balance, R2 500.
- The provision for bad debts will be deducted from the trade debtors figure in the notes to the balance sheet.
- The provision for bad debts adjustment account has a credit total and will be shown in the income statement as an income.

PREPARATION OF FINANCIAL STATEMENTS

2.1 INCOME STATEMENT

The income statement will reflect the results of the trading or service activities of a business for a specific accounting period, usually a year. In other words, the net profit or net loss for the financial year.

Total income	R100 000		Total income	R50 000
Total expense	(70 000)	OR	Total expense	(70 000)
Net profit	30 000		Net loss	20 000

All income and expense items are contained in the nominal accounts section of the general ledger. Therefore the income statement may be prepared from

- the trading account and profit and loss account in the final account section in the ledger
- the nominal accounts section in the post-adjustment trial balance

2.2 BALANCE SHEET

The balance sheet will reflect the financial position as a result of the trading or service activities of a business on a **specific day** i.e. the financial year-end.

In other words the balance sheet will reflect the assets, liabilities and owners equity at the end of the financial year. All assets, liabilities and owner's equity accounts are contained in the balance sheet accounts section of the general ledger. Therefore the balance sheet may be prepared from

- the post-closing trial balance
- the balance sheet account section of the post-adjustment trial balance

Income statement and balance sheet format

INCOME STATEMENT FOR THE YEAR ENDED ....

	NOTE	R	R
Sales			xxx
Cost of sales			(xx)
Gross profit			xxx
Other operating income			xxx
(example) Rent income		Xxx	
Fee income		Xxx	
Trading stock surplus		Xxx	
Profit on sale of asset		Xxx	
Gross operating income			xxx
Operating expenses			(xx)
(example) Salaries and wages		Xxx	
Provision for bad debts adjustment		Xxx	
Depreciation		Xxx	
Packing material		Xxx	
Audit fees		Xxx	
Stationery		Xxx	
Sundry expenses		Xxx	
Operating profit			xxx
Interest income	(1)		xxx
Profit before financing cost			xxx
Interest expense	(2)		(xx)
Net profit for the year	(7)		xxx

BALANCE SHEET AND NOTES TO FINANCIAL STATEMENTS

BALANCE SHEET AT ....

	NOTE	R	R
ASSETS			
Non-current assets			xxx
Tangible assets	(3)	xxx	
Financial assets			
Fixed deposit: (maturation period more than 12 months)		xxx	
Current assets			xxx
Inventories	(4)	xxx	
Trade and other receivables	(5)	xxx	
Cash and cash equivalents	(6)	xxx	
Total assets			xxx
EQUITY AND LIABILITIES			
Owner's equity	(7)		xxx
Non-current liabilities			xxx
Mortgage bond (not payable within 12 months)		xxx	
Current liabilities			xxx
Trade and other payables	(8)	xxx	
Bank overdraft		xxx	
Short-term loan (payable within 12 months)		xxx	
Total equity and liabilities			xxx

PRINCE TRADERS

NOTES TO FINANCIAL STATEMENTS

1. Interest income	R
from investments (e.g. fixed deposit)	xxx
from overdue debtors	xxx
from current accounts	xxx

2. Interest expense	R
on mortgage bond	xxx
on bank overdraft	xxx
on overdue creditors	xxx

3. Tangible assets	Land & buildings R	Vehicles R	Equipment R	Total R
Cost price	xxx	xxx	xxx	xxx
Accumulated depreciation		(xx)	(xx)	(xx)
Carrying value (last day of previous year)	xxx	xxx	xxx	xxx
Movements				
Additions at cost	xxx		xxx	xxx
Disposals at carrying value		(xx)		(xx)
Depreciation for the year		(xx)	(xx)	(xx)
Carrying value (last day of current year)	xxx	xxx	xxx	xxx
Cost price	xxx	xxx	xxx	xxx
Accumulated depreciation		(xx)	(xx)	(xx)

4. Inventories	R
Trading stock	xxx
Consumable stores on hand	xxx

5. Trade and other receivables (debtors)	R
Trade debtors	xxx
Provision for bad debts	(xx)
Net trade debtors	xxx
Accrued income	xxx

Prepaid expenses	xxx
Deposit: water and electricity	xxx

6. Cash and cash equivalents	R
Fixed deposit (maturing within 12 months)	xxx
Savings account	xxx
Bank	xxx
Cash float	xxx
Petty cash	xxx

7. Owner's equity	R
Balance (last day of previous year)	xxx
Net profit (or loss) for the year	xxx
Additional capital contributed	xxx
Drawings	(xx)
Balance (last date of current year)	xxx

8. Trade and other payables (creditors)	R
Trade creditors	xxx
Accrued expenses	xxx
Income received in advance	xxx
SARS: P.A.Y.E	xxx
Creditors for salaries	xxx
Creditors for wages	xxx

UNIT 2: DIFFERENCE BETWEEN FINANCIAL AND MANAGERIAL ACCOUNTING

Financial accounting is used to prepare accounting information for people outside the organisation or not involved in the day to day running of the company, e.g. shareholders, government agencies and creditors. Financial accounting procedures must generally conform to external standards such as those developed by the Financial Accounting Standards Board (FASB), while management accounting methods are left almost completely to the discretion of the individual organisations.

Managerial accounting

Managerial accounting provides accounting information to help managers make decisions to manage the business. It is a set of practices and techniques aimed at providing managers with financial information to help them make decisions and maintain effective control over corporate resources. For example, managerial accounting answers such questions as:

- What is the company's average cost per unit of labour.
- How many rands in sales does each marketing rand bring in.
- What is the required rate of return to make a new investment worthwhile.
- Which activities require the greatest expenditure and which earn the greatest profit.

Managerial accounting procedures are intended primarily to supply knowledge to decision-makers within an organisation.

Basic cost concepts

Define costing

Product costing is the process of tracking and studying all the various expenses that are accrued in the production and sale of a product, from purchases of raw material to expenses associated with transporting the final product to retail establishments.

Direct cost

Costs that are traced to a specific cost objective like product/service.

Indirect cost

Costs that CANNOT be directly traceable to a particular cost objective and incurred for multiple cost objectives.

Direct material

Direct material is a material directly identifiable as a basic component in a manufacturing process, e.g. sugar in the production of sweets.

Indirect material

Indirect material is for some reason not directly identifiable as a basic component in a manufacturing process, e.g. electricity costs in a sweets factory.

Direct labour

Direct labour is that portion of payroll expense directly associated with the manufacture of a product, e.g. a machine operator.

Indirect labour

Indirect labour is that portion of payroll expense not directly traceable to the production process, e.g. a delivery assistant.

Overheads

Overheads are best described as the portion of manufacturing costs which is neither direct material nor direct labour, e.g. indirect material, indirect labour, factory rent, depreciation, heat, power, insurance, maintenance, supervision and machinery cost.

Variable cost

Variable costs are expenses that change in direct proportion to the activity of a business. They increase directly in proportion to the level of sales in rands or units sold. The total variable cost changes with increased production. Depending on the type of business, some examples would be cost of goods sold, sales commissions, wages of part-time or temporary employees, delivery charges, cost of direct material or supplies and sales or production bonuses.

Fixed cost

Fixed costs remain the same regardless of the level of sales. Fixed costs are those that do not change with the level of sales. If sales increase or decrease but nothing else changes, then fixed costs remain the same. Depending on the type of business, some typical examples would be rent, interest on debt, insurance, plant and equipment expenses, business licenses and salaries of permanent full-time workers.

Suggested examples of direct and indirect costs

Cost	Direct	Indirect
Wages for workers in the workshop	X	
Telephone		X
Secretary's salary		X
Electricity	X	X
Rent for factory building		X
Petrol for car		X
Raw material cost	X	
Cost of replacing a worn-out tool		X

Note: Categorising costs as direct and indirect is sometimes controversial. A direct cost in one enterprise may be considered an indirect cost in another, based on size or nature.

BASIC BUDGET CONCEPTS

Cash budget

Cash budget is a forecast of estimated cash receipts (income) and disbursement (expenditure) for a specified period of time. It forms an overview of how money will be moved to and from the business bank account. This cash budget will then form the proposed cash flow forecast for the budgeted period.

Zero base budgeting

Zero base budgeting means that instead of starting with last year's budget, each department of the organisation will begin each year's request for a budget at zero rand and attempt to justify each and every amount that they plan to spend.

It is a process that requires an agency, department or division to justify budget requests as if its programmes were starting from scratch or from a base of zero. In theory this assures a review of all programmes at budget time.

Capital budget

The capital budget is the budget associated with acquisition or construction of major capital items including land, buildings and structures and equipment. Funds for these projects are usually appropriated from surpluses, earmarked revenues or from bond sales.

UNIT 3: MANAGING RESOURCES

SETTING SELLING PRICES

To set prices, the operator needs the following information:

- Cost of product
- Competitors' prices
- How much customers are willing to pay

In general the price must be

- low enough to attract customers to buy
- high enough to make the business a profit

To make a profit, the price must be higher than the total cost of the product! Hence, knowing the total cost of a product is essential in determining the price.

There are two methods:

- The operator takes the total cost per unit and adds a percentage margin to get his selling price.
- The operator takes the prices of his competitors and makes sure that his prices are competitive with theirs. But he has to make sure that his prices cover his total cost!

However, only if the product is better than that of competitors and the operator is able to communicate the additional benefit to the customers can he charge more than his competitors.

SETTING COST OF SALES

Cost of goods sold = opening stock + net purchases + direct expenses – closing stock.

SETTING LABOUR COSTS

The labour cost is analysed from two perspectives:

- Labour cost by unit of work: ***Labour cost by worker and month.***
  - It measures the expense that a businessperson undertakes when employing an employee during one month.
- Labour cost by unit of time: ***Labour cost by effective hours of work.***
  - It measures the expense that a businessperson undertakes for one effective hour of work.

The cost must be measured in net terms for the employer, in other words deducting the various subsidies received. The labour cost comprises a wide range of entries and is covered in two main blocks: the cost of wages and other costs.

Wage Cost

Comprises all remunerations, both in cash and in kind, made to workers for the performance of their work services for others, whether it rewards effective work, whatever the method of remuneration, or the rest periods accounted for as work.

Wages include: *the base wages, wage complements, overtime and/or complementary payments, bonuses and wage in kind.*

Overtime and/or complementary wage payment corresponds to payments for overtime hours, both structural (by acts of God) as well as non-structural (voluntary) and to payments for complementary hours in the case of part-time workers.
*Bonuse*s are remuneration received in periods greater than one month: bonuses, payments for participating in profits, premiums, objectives and any other exceptional payments.
*Delayed Payment*s are payments made in the reference month but earned in previous periods.

Other costs

The other costs include non-wage amounts and the obligatory contributions to social security.

INCOME AND EXPENSES

Examples

Income	Expenses
Entry fees	Facility rental
Sponsorships	Insurance
Added money donation	Stock charges
Snacks sold	Entry preparation & mailing copy costs, labels, postage
Spectator fees	paid, officials/staff salaries, accommodation, meals
Programme sales	Portable toilets/cleaning services
Food service to spectators	Programmes (copy charges)
Affiliation fee	Hospitality for officials & volunteers
Raffles	Sanctioning fees (if any)
	Cash payouts
	Prizes (giving)

PERIODIC AND PERPETUAL INVENTORY SYSTEM

Perpetual inventory system (Note: advantages and disadvantages are contained in the text below).

- Perpetual inventory system updates inventory accounts after each purchase or sale. Inventory subsidiary ledger is updated after each transaction. Inventory quantities are updated continuously. No detailed records of the actual inventory on hand are maintained during the period. Under the perpetual inventory system records are kept of the quantity and usually of the cost of individual items as they are bought or sold.
- This system provides useful information for management purposes.
- The cost of each item is recorded in the merchandise inventory account when purchased.
- As merchandise is sold, its cost is transferred from the merchandise inventory account to the cost of goods sold account.
- The balance of the merchandise inventory account equals the cost of goods on hand.
- The balance of the cost of goods sold account equals the cost of the merchandise sold to customers.
- The purchases account is not used.

Due to the widespread use of computers, the distinction of which inventory system is most appropriate, is blurred.

Periodic inventory system

Periodic inventory system records inventory purchase or sale in 'purchases' account. 'Purchases' account is updated continuously. However, 'Inventory' account/trading stock account is updated on a periodic basis at the end of each accounting period (e.g., monthly, quarterly). Inventory subsidiary ledger is not updated after each purchase or sale of inventory. The inventory on hand is counted periodically, usually at the end of the accounting period.

Taking a physical inventory

A physical inventory means actually counting all merchandise on hand.

- It is done under both periodic and perpetual inventory systems.
- It is easy to omit or double count items.
- Merchandise inventory includes all goods intended for sale, regardless of where they are physically located.
- The count does not include merchandise sold but not delivered or goods that cannot be sold.
- The actual count is usually taken after close of business on the last day of the fiscal year.
- Counting procedures must be carefully planned and may include the use of bar coding.

Inventory losses

Most companies experience losses from spoilage, shoplifting and theft by employees.

- Periodic inventory system does not provide a means for identifying these losses.
- Theft losses become a part of cost of goods sold for the period.
- Perpetual inventory system makes it easier to identify such losses.

Examples of journal entries

Examples: On May 1 2006 purchased 1,000 units of goods at R30 per unit.			
Under perpetual inventory system			
5/1/2006		Debit	Credit
	Trading stock	30 000	
	Accounts payable		30 000
Under periodic inventory system			
5/1/2006		Debit	Credit
	Purchases	30 000	
	Accounts payable		30 000

- Under periodic inventory system, all purchases during the accounting period are recorded in the 'purchases' account.

On May 6 2006 sold 200 units of goods at R50 per unit on credit.

Under perpetual inventory system

5/1/2006		Debit	Credit
	Accounts receivable	10 000	
	Sales		10 000
5/1/2006		Debit	Credit
	Cost of goods sold	6 000	
	Trading stock		6 000

Under perpetual inventory system, changes in trading stock account are recorded after each transaction.

Under periodic inventory system

5/1/2006		Debit	Credit
	Accounts receivable	10 000	
	Sales		10 000

CODE OF ETHICS

The code of ethics presents a set of objectives toward which professionals must continually strive. They represent a way of living a professional life, not simply how you are to behave at work.

Living the ethical life of a professional is a never ending test that will present numerous challenges for which the code offers a guide to decision-making.
The code governs ethical professional practice standards and violations of the code may be brought before the disciplinary committee as an ethics issue.

Examples of ethical values

Honesty and integrity
Honesty and integrity should be the guiding principles in all the activities of the organisation. All reporting obligations must be complied with fully and honestly. All forms of dishonesty and any dishonest conduct, such as fraud or corruption, are rejected.

Professional excellence
If you conduct your work in an innovative, creative and professionally excellent manner, employees will conduct themselves diligently and strive to enhance their productivity and the quality of their work.

Respect

Employers and employees acknowledge each other's areas of skill, competence and fields of expertise. Be transparent in your dealings with one another, share information and resources and avoid harmful competition to promote the overall interest of the organisation.

Fairness that builds trust

Decision-making and conduct within the organisation are informed by ethical values and policies and a respect for the rights of individuals. Fair, consistent and transparent decision-making will promote trust between individuals.

Collaboration

Employers and employees will work collaboratively to promote the legitimate interests of the organisation.

Non-discrimination

Strives to eliminate discrimination and to promote equal opportunity and affirmative action in all aspects of its activities.

INTERNAL CONTROL

Definition

Internal control is a process put in place by the board of directors, senior management and all levels of personnel to provide reasonable assurance that an organisation's objectives will be achieved.
Internal control includes all measures and practices used to mitigate exposure to risks that could potentially prevent an organisation from achieving its objectives. Policies and appropriate culture is introduced to facilitate an effective internal control process.

The main objectives of the internal control process can be categorised as follows:

- Safeguarding of assets (security objectives);
- Efficiency and effectiveness of operations (operational objectives);
- Reliability and completeness of accounting/financial and management information (information objectives);
- Compliance with organisational policies and procedures as well as applicable laws and regulations (compliance objectives).

Components of internal control

Internal control consists of five components, all of which must be present and functioning effectively to conclude that internal control over operations is effective:

1. Control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring

1. The **control environment** reflects the commitment of the board of directors and management to internal control. It provides discipline and structure to the control system. Elements of the control environment include

organisational structure of the institution
management's philosophy and operating style
integrity, ethics and competence of personnel
external influences that affect the bank's operations and risk
management practices (e.g., independent audits)
attention and direction provided by the board of directors and its
committees, especially the audit or risk management committees
effectiveness of human resources policies and procedures

2. **Risk assessment** is the identification, measurement and analysis of risks, internal and external, controllable and uncontrollable, at individual business levels and for the organisation as a whole. Management must assess all risks facing the organisation because uncontrolled risk-taking can prevent the organisation from reaching its objectives or can jeopardise its operations. Effective risk assessment helps determine what the risks are, what controls are needed and how they should be managed.

3. **Control activities** are the policies, procedures and practices established to help ensure that the organisation's personnel carry out board and management directives at every business level. These activities help ensure that the board and management act to control risks that could prevent a bank from attaining its objectives.

These are the procedures designed to ensure that the business's goals are achieved.
Examples include:

- Authorization of transactions
- assigning responsibilities.
- segregation of duties;
- Recording: Transactions should be properly documented;
- Safeguarding: Assets should be physically secured.
- Reconciliation: The person performing the reconciliation (or verification procedures) should be independent from the individuals originally responsible for preparing the data;
- written procedures/policies, etc.

4. **Accounting, information and communication systems** capture and impart pertinent and timely information in a form that enables the board, management and employees to carry out their responsibilities. Accounting systems are the methods and records that identify, assemble, analyse, classify, record and report the transactions of an organisation. Information and communication systems enable all personnel to understand their roles in the control system, how their roles relate to others and their accountability.

5. **Monitoring** is the organisation's own oversight of the control system's performance. Ongoing monitoring should be part of the normal course of daily operations and activities. Internal and external audit functions, as part of the monitoring system, may provide independent assessments of the quality

and effectiveness of a control system's design and performance.

The effectiveness of internal control is a state or condition of the internal control process, as it provides assurance to management with respect to the achievement of stated objectives at a point in time. All five criteria above must be satisfied to conclude that internal controls are effective.

INTERNAL AUDIT

Internal auditing is a profession and an activity involved in advising organisations how to better achieve their objectives. It involves the utilisation of a systematic methodology for analysing business processes or organisational problems and recommending solutions.
Professionals called internal auditors are employed by organisations to perform the internal auditing activity. The scope of internal auditing within an organisation is broad and may involve internal control topics such as

- efficacy of operations
- reliability of financial reporting
- deterring and investigating fraud
- safeguarding assets
- compliance with laws and regulations

Internal auditors are not responsible for the execution of company activities; they advise management and the board of directors (or similar oversight body) on how to better execute their responsibilities. As a result of their broad scope of involvement, internal auditors may have a variety of higher educational and professional backgrounds.

ASSESSMENT TASKS AND SOLUTIONS

ACCOUNTING CONCEPTS

Task 1

ITEM	QUESTION	CONCEPT
1.	The same accounting concepts are applied in the same way in each accounting period.	
2.	Always relate revenue earned in a period with expenses incurred to generate this revenue.	
3.	The financial performance of a business is recorded and reported separately from the owner's personal financial statement.	
4.	Business is expected to remain in operations indefinitely.	
5.	Similar items should receive similar accounting treatment.	
6.	Use a common unit of measurement for reporting financial activity.	
7.	Profits should not be overstated and loss must not be understated.	
8.	Due to the high inflation rate, the replacement cost of the existing raw material has gone up by 30%. The company ignores this inflationary factor and records it at the value it has bought earlier.	
9.	A company has bought this property for R1 million in year 2003 but now the property has appreciated to R5 million. The company is recording the property at R1 million.	
10	Which principle/guideline requires the company's financial statements to have footnotes containing information that is important to users of the financial statements?	
11	Which principle/guideline directs a company to show all the expenses related to its revenue of a specified period even if the expenses were not paid in that period?	
12	A fixed asset with a cost of R50 000 is depreciated over its useful life of seven years rather than expensing the entire amount when it is purchased.	
13	A company borrowed R60 000 on December 1, 2005 and will make its only payment for interest when the note is paid off on June 1, 2006. The total interest for the six months will be R6 000. On the December 2005 income statement the accountant reported interest expense of R1 000.	
14	The success of the company is mainly attributed to the invaluable qualities of three employees, X, Y & Z. However, employees X, Y & Z are not recorded as an asset in the balance sheet of the company.	
15	The company has received goods valued at R200 000 and has already billed the customers for all these goods but so far it has only received suppliers' invoices for R50 000. The balance of R150 000 is taken up into the books of account. What concept is this?	
16	A large company purchases a R150 chair and expenses it immediately instead of recording it as an asset and depreciating it over its useful life. This practice may be acceptable because of which principle/guideline?	
17	For the December year-end close, the utilities bills have not been received for the month of November & December. However, based on previous average month trends, take up R20 000 X 2 = R40 000 as utilities expenses as estimates for November & December.	
18	The management has decided on a twelve-month financial reporting period. They have just started on the 1st January so they will complete the twelve months reporting period by 31st December.	
19	During the audit, auditors have discovered that a certain portion of the company sales is not true sales as they have evidence that the sales are financed by the company itself.	
20	In the notes to the financial statements, management disclosed that an earthquake has destroyed one of their factories in Thailand, hence stopping production and affecting the revenue of the company.	
21	Once a particular financial period is adopted by a business, it is not changed from one period to the next period.	
22	The cost of a dustbin in an office is treated as an expense rather than depreciating its cost over its useful life.	

23	Expenses are recognised in the same accounting period as the revenue which results from the incurrence of these expenses.	
24	Each transaction is described by a business document that proves the transaction did occur.	
25	The actual amount paid or received is the amount recorded in the books of accounts.	
26	Tax levied on the supply of goods and services by vendors.	
27	Goods or services which are taxed at a rate of 0%, e.g. milk, brown bread, maize, fruit, etc.	
28	These items involve services that are not subject to VAT at either the standard rate or zero rate, e.g. childcare services, educational services, etc.	
29	In South Africa items are taxed at the rate of 14%.	
30	Goods or services that are subject to VAT.	
31	VAT which your company would charge on items which it sells. Thus a company could wish to sell an item and added to the amount, a standard rate tax would be charged.	
32	VAT that you pay on all your business expenses and for which you have a tax invoice. It also relates to VAT paid on other goods and services bought or rented for the business.	

ACCOUNTING EQUATION

Task 2

Complete the following table. The first adjustment has been done for you.

Adjustment	General ledger		Affect			Reversal required
	Debit	Credit	A	E	L	
1. Bad debt written off	Bad debts	Debtors control	-	-	0	No
2. Depreciation on equipment						
3. Interest charged on debtors account						
4. The tenant owes rent for one month						
5. Provision for bad debts to be increased						
6. Telephone account has not been paid at year-end						
7. Interest on overdraft has been wrongly classified as bank charges						
8. Commission income received in advance at year-end						
9. Packing material on hand at the year-end per physical count						
10. Interest on loan owed at year-end						

11. Wages paid in advance at year-end						
12. A trading stock deficit is identified						

FINANCIAL STATEMENTS

Task 3

REQUIRED

Use the following information from Tip Top Traders to draw up:

- the income statement for the year ended February 28, 2002
- the balance sheet and notes to the balance sheet as at February 28, 2002

INFORMATION

TIP TOP TRADERS

TRIAL BALANCE ON FEBRUARY 28, 2002

Balance sheet accounts section	R	R
Capital		120 000
Drawings	500	
Land and buildings	121 800	
Vehicles	18 000	
Equipment	45 000	
20% fixed deposit: Zenn Bank	20 000	
15% mortgage bond: Africa Bank		50 000
Trading stock	12 970	
Accumulated depreciation on vehicles		3 420
Accumulated depreciation on equipment		3 750
Debtors control	15 950	
Creditors control		7 200
Provision for bad debts		800
Accrued expenses (telephone)		80
Income receivable (interest on fixed deposit)	2 000	

Prepaid expenses (insurance)	600	
Income received in advance (rent)		500
Bank		4 800
Cash float	300	
Petty cash	150	
Nominal accounts section		
Sales		156 280
Cost of sales	104 000	
Debtors allowances	280	
Interest on fixed deposit		4 000
Rent income		6 315
Water and electricity	5 270	
Telephone	1 600	
Insurance	5 400	
Interest on mortgage bond	1 875	
Sundry expenses	580	
Bad debts	320	
Stationery	350	
Donations	200	
	357 145	357 145

NOTE

The bookkeeper forgot to do the reversal journal entries on March 1, 2001 for telephone, interest on fixed deposit, insurance and rent.

ADJUSTMENTS

The physical stock count on February 28, 2002 shows the following:

Stationery	R75
Trading stock	R12 900

It was discovered that trading stock of R300 was erroneously counted twice.

A debtor, B. Els, who owed R150 in 2000 paid his debt on February 15, 2002. His debt was previously written off as irrecoverable. The cheque was erroneously posted to his account.

K. Uys, a debtor, disappeared. Write off his debt of R400 as irrecoverable.

Adjust the provision for bad debts to 5% of outstanding debtors.

The owner, Mr. Tip, instructed that a cheque for R300 should be donated to the local secondary school. This transaction was erroneously recorded as drawings.

One office was rented from September 1, 2000. The rental agreement stipulated that the rent was R500 per month and that it would be increased by 9% on September 1 each year. The tenant has to pay the rent in advance before the end of each month. The tenant honours the agreement.

The telephone account was received, but R350 must still be paid.

The mortgage bond from Africa Bank commenced on September 1, 2001. Interest is payable quarterly on the first day of March, June, September and December. The annual installment of R5 000 is payable on September 1.

The fixed deposit was invested on March 1, 2000 for three years. Interest is calculated half-yearly and is receivable on September 1 and March 1.

8. Included in insurance is an annual premium of R3 600 which was paid on January 1, 2002.

8. Depreciation must be calculated as follows:
Vehicles 10% per annum on the carrying value.
Equipment 15% per annum on cost price.

NOTE

Tip Top Traders bought new equipment for R20 000 on 1 September 2001.

ANSWER SHEET

TIP TOP TRADERS
INCOME STATEMENT FOR THE YEAR ENDED FEBRUARY 28, 2002

	NOTE	R	R
Sales			
Cost of sales			
Gross profit			
Other operating income			
Rent income			
Provision for bad debts adjustment			
Bad debts recovered			
Gross operating income			
Operating expenses			
Water and electricity			

Telephone			
Insurance			
Sundry expenses			
Bad debts			
Stationery			
Donations			
Trading stock deficit			
Depreciation			
Operating profit			
Interest income	(1)		
Profit before financing cost			
Interest expense	(2)		
Net profit for the year	(7)		

TIP TOP TRADERS
BALANCE SHEET AT FEBRUARY 28, 2002

	NOTE	R	R
ASSETS			
Non-current assets			
Tangible assets	(3)		
Financial assets			
Fixed deposit			
Current assets			
Inventories	(4)		
Trade and other receivables	(5)		
Cash and cash equivalents	(6)		
Total assets			
EQUITY AND LIABILITIES			

Owner's equity	(7)		
Non-current liabilities			
Mortgage bond			
Current liabilities			
Trade and other payables	(8)		
Bank overdraft			
Short-term loan			
Total equity and liabilities			

NOTES TO FINANCIAL STATEMENTS

1. Interest income	R
from investments (e.g. fixed deposit)	

2. Interest expense	R
on mortgage bond	

3. Tangible assets	Land & buildings R	Vehicles R	Equipment R	Total R
Cost price				
Accumulated depreciation				
Carrying value Feb. 28, 2001				
Movements				
Additions at cost				
Disposals at carrying value				
Depreciation for the year				
Carrying value Feb. 28, 2002				
Cost price				
Accumulated depreciation				

4. Inventories	R
Trading stock	
Consumable goods on hand	

5. Trade and other receivables (debtors)	R
Trade debtors	
Provision for bad debts	
Net trade debtors	
Accrued income	
Prepaid expenses	

6. Cash and cash equivalents	R
Cash float	
Petty cash	

7. Owner's equity	R
Balance February 28, 2001	
Net profit or loss for the year	
Drawings	
Balance February 28, 2002	

8. Trade and other payables (creditors)	R
Trade creditors	
Accrued expenses	
Income received in advance	

GENERAL LEDGER

Task 4

The financial year of Protea Traders ends on the last day of February. Protea Traders makes use of the periodic inventory system.

INSTRUCTION

Use the given information and prepare the following in the general ledger of Protea Traders:

Purchases account
Trading account
Profit and loss account
Post-closing trial balance on February 28, 2004

PROTEA TRADERS
PRE-ADJUSTMENT TRIAL BALANCE ON FEBRUARY 28, 2004

	R	R
	Debit	Credit
Balance sheet section		
Capital		170 270
Drawings	12 700	
Land and buildings	165 000	
Vehicles	120 000	
Equipment	67 970	
Accumulated depreciation on vehicles		24 500
Accumulated depreciation on equipment		15 490
Trading stock	63 800	
Debtors control	54 120	

Provision for bad debts		3 000
Bank overdraft		8 980
Creditors control		46 230
Fixed deposit	14 000	
Loan		24 000
Creditors for salaries	3 540	

Nominal accounts section		
Sales		506 270
Purchases	254 670	
Carriage on purchases	950	
Debtors allowances	4 620	
Creditors allowances		14 310
Salaries	33 625	
Trading license	4 000	
Stationery	1 740	
Interest on loan	3 240	
Insurance	5 500	
Bank charges	1 150	
Interest on overdraft	935	
Bad debts	2 370	
Discount		880
	813 930	813 930

Adjustments and additional information

The following goods were withdrawn from trading stock at cost price but not yet recorded:

(l) Stock withdrawn by the owner, R1 200.

(m) Stock donated to the local church, R720.

No entries have been made of the following transactions:

(n) An invoice received from Ntini Stores for merchandise purchased on credit, R1 020.

An invoice received from Pollock Transporters for the transport of goods purchased, R180.

A physical stocktaking on February 28, 2004 showed the following on hand:

(o) Trading stock, R66 900

(p) Stationery, R670

The employer contributes R1,30 to the medical aid for each R1,00 contributed by the employee.

Cheques for salaries were issued to the employees on February 25, 2004.

Payments to the medical aid fund and the South African Revenue Service are made on the third day of the following month.

It was discovered that the salary journal for February 2004 was not posted to the general ledger. The following information appeared in the salary journal for February 2004:

Gross salary		R4 600
(q)	Employees' deductions:	
	Medical aid	R360
	PAYE	R700

No entry has been made of the following information which appeared on the bank statement for February 2004:

Cash handling fee	R45
Service fee	R70
Interest on debit balance	R85

(r) Stop order for an annual trading license premium, R1 200, for period February 1, 2004 – January 1, 2005

Protea Traders had entered the following short-term insurance contracts:

	Only for the period	Premium
A	April 1, 2002 – March 31, 2003	R1 200 annually
B	April 1, 2003 – September 30, 2003	R600 monthly
C	November 1, 2003 – April 30, 2004	R1 800 bi-annually

H. Gibbs, a debtor whose debt had been written off during November 2003, honoured the amount of R320 on February 25, 2004. This amount was credited against debtors.

Write off the overdue account of A. Donald, a debtor, R440.

Adjust the provision for bad debts to 7 % of debtors.

On June 30, 2003 old equipment was sold for R37 000 cash. This transaction has not yet been recorded. The equipment had originally been purchased on January 1, 2002 for R48 000.

Depreciation is written off on equipment at 15 % p.a. according to the declining balance method.

Depreciation is written off on vehicles at 15 % p.a. on the cost price. Protea Traders bought a new vehicle, cost price R80 000, on April 30, 2003.

Interest on loan must be calculated at a rate of 18 % p.a. The loan account appears in the books as follows:

Dr			Loan					B6	Cr
2003 Aug	1	Bank	CPJ	12 000	2003 Mar	1	Balance	b/d	36 000

The amount on fixed deposit was invested on November 1, 2003 at 15 % p.a. interest. Interest is payable half-yearly.

The bookkeeper posted discount allowed and discount received to one account. Discount allowed to debtors amounted to R450 for the accounting period.

ANSWER SHEET

GENERAL LEDGER OF PROTEA TRADERS

Dr Purchases account N Cr

Feb	28	Balance	b/d		Feb	28	Drawings		
		Creditors control					Donations		
							Creditors allowances		
							Trading account		

Dr Trading account N Cr

Feb	28	Opening stock			Feb	28	Sales		
		Purchases					Closing stock		
		Carriage on purchases							
		Profit and loss							

Dr Profit and loss N Cr

Feb	28	Donations			Feb	28	Trading account		
		Stationery					Bad debts recovered		
		Bad debts					Interest on fixed deposit		
		Interest on overdraft					Discount received		

		Bank charges							
		Salaries							
		Medical aid contributions							
		Interest on loan							
		Insurance							
		Discount allowed							
		Depreciation							
		Provision for bad debts adjustment							
		Loss on sale of asset							
		Trading license							
		Capital							

Post-closing trial balance of Protea Traders on February 28, 2004

	R	R
	Debit	Credit
Balance sheet section		
Capital		
Land and buildings		
Vehicles		
Equipment		
Accumulated depreciation on vehicles		
Accumulated depreciation on equipment		
Trading stock		
Debtors control		
Provision for bad debts		
Bank		
Cash float		

Creditors control		
Fixed deposit		
Loan		
Consumable stores on hand		
Prepaid expenses		
Accrued expenses		
Accrued income		
South African Revenue Services (PAYE)		
Medical aid fund		

Analysis and interpretation of financial statements

The final result of a business over a specific accounting period is contained in the financial statements of the business.
The purpose in drafting the financial statements is not only to determine the financial position of the undertaking, but also to determine the

profitability
liquidity
soundness

of the undertaking at a specific date.
Therefore the proprietor must be able to analyse and interpret the information contained in the financial statements.
In analysing financial statements, we would like to arrive at answers to the following main questions:

(s) PROFITABILITY

- Gross profit on turnover/sales
- Gross profit on cost of sales
- Operating profit on turnover/sales
- Net profit on turnover/sales
- Operating expenses on turnover/sales

(t) RETURN

- Return on owner's equity
  (Average owner's equity = (year 1 + year 2))/ 2
- Net profit on opening owner's equity
- Return on total equities and liabilities

All above ratio's to be expressed as %.

(u) SOLVENCY

- Net assets (owner's equity)
- Total assets to total liabilities

(v) LIQUIDITY

- Net current assets (working capital)
- Current ratio (suggested norm 2:1)
- Acid test ratio/quick ratio (suggested norm 1:1)
- Rate of stock turnover

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS: RATIOS

Task 5

The following summary was extracted from the financial statements of Alice Supermarket

ALICE SUPERMARKET

FIGURES OBTAINED FROM THE INCOME STATEMENT FOR THE YEAR ENDED FEBRUARY 28, 2005

	R
Sales	680 000
Cost of sales	(450 000)
Gross profit	230 000
Other income (interest)	2 000
Total expenses	(157 000)
Net profit	75 000

FIGURES OBTAINED FROM THE BALANCE SHEET AS AT FEBRUARY 28, 2005

	R
Owner's equity (beginning of the year)	200 000
(end of the year)	300 000
Non-current liabilities	160 000
Tangible assets	220 000
Investments (financial assets)	20 000
Trading stock (beginning of the year)	120 000
(end of the year)	150 000
Trade and other receivables	122 000
Cash and cash equivalents	24 000
Trade and other payables	76 000

REQUIRED

Calculate the following ratios, percentages and amounts:

1. Gross profit on sales
2. Gross profit on cost of sales
3. Net profit on sales
4. Total expenses on sales
5. Return on owner's equity (use average equity)
6. Net assets at year-end
7. Solvency ratio
8. Net current assets (working capital) at year-end
9. Current ratio
10. Acid test ratio
11. Rate of stock turnover
12. Return on total equity and liabilities

ANSWER SHEET

1. Gross profit on sales

$$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$$

2. Gross profit on cost of sales

$$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$$

3. Net profit on sales

$$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$$

4. Total expenses on sales

$$\frac{\text{Total expenses}}{\text{Sales}} \times \frac{100}{1}$$

5. Return on owner's equity (use average equity)

$$\frac{\text{Net profit}}{\text{Average owner's equity}} \times \frac{100}{1}$$

6. Net assets at year-end

Tangible assets + Current assets

7. Solvency ratio

Total assets : Total liabilities

8. Net current assets (working capital) at year-end

Current assets - Current liabilities

9. Current ratio

Current assets : Current liabilities

10. Acid test ratio

Current assets - Trading stock : Current liabilities

11. Rate of stock turnover

$$\frac{\text{Cost of sales}}{\text{Average trading stock}}$$

12. Return on total equity and liabilities

$$\frac{\text{Net profit}}{\text{Owner's equity + liabilities}} \times \frac{100}{1}$$

SOLUTIONS

Task 1

ITEM	CONCEPT	ITEM	CONCEPT	ITEM	CONCEPT
1.	Consistency principle	13	Accrual principle	25	Historical cost principle
2.	Matching principle	14	Business entity principle	26	Value Added Tax
3.	Business entity concept	15	Accrual principle	27	Zero-rated items
4.	Going-concern concept	16	Materiality principle	28	VAT-exempted items
5.	Consistency principle	17	Accrual principle	29	Standard rate
6.	Money measurement/ monetary stability concept	18	Accounting period concept	30	VAT-able items
7.	Conservative or prudence principle	19	Substance over form principle	31	Output VAT
8.	Historical cost principle	20	Disclosure principle	32	Input VAT
9.	Historical cost principle	21	Consistency principle		
10	Disclosure principle	22	Materiality principle		
11	Accrual principle	23	Matching principle		
12	Matching principle	24	Objectivity principle		

YEAR-END ADJUSTMENTS

Task 2

No	Adjustment	General ledger		Effect			Reversal required
		Debit	Credit	A	O	L	
1	Bad debt written off	Bad debts	Debtors control	-	-	0	No
2	Depreciation on equipment	Depreciation	Accumulated depreciation on equipment	-	-	0	No
3	Interest charged on debtors account	Debtors control	Interest on overdue account	+	+	0	No
4	The tenant owes rent for one month	Accrued income	Rent income	+	+	0	Yes
5	Provision for bad debts to be increased	Provision for bad debts adjustment	Provision for bad debts	-	-	0	No
6	Telephone account has not been paid at year-end	Telephone	Accrued expense	0	-	+	Yes
7	Interest on overdraft has been wrongly classified as bank charges	Interest on bank overdraft	Bank charges	0	0	0	No

8	Commission income received in advance at year-end	Commission income	Income received in advance	0	-	+	Yes
9	Packing material on hand at the year-end per physical count	Consumable stores on hand	Packing material	+	+	0	Yes
10	Interest on loan owed at year-end	Interest on loan	Accrued expense	0	-	+	Yes
11	Wages paid in advance at year-end	Prepaid expenses	Wages	+	+	0	Yes
12	A trading stock deficit is identified	Trading stock deficit	Trading stock	-	-	0	No

Task 3

FINANCIAL STATEMENTS OF THE SOLE TRADER - TIP TOP TRADERS

INCOME STATEMENT FOR THE YEAR ENDED FEBRUARY 28, 2002

	NOTES	R	R
Sales (156 280 - 280)			156 000
Cost of sales			(104 000)
Gross profit			52 000
Other operating income			6 435
Rent income (500 + 6 315 - 545)		6 270	
Provision for bad debts adjustment		15	
Bad debts recovered		150	
Gross operating income			58 435
Operating expenses			(19 293)
Water and electricity		5 270	
Telephone (1 600 + 350 - 80)		1 870	
Insurance (600 + 5 400 - 3 000)		3 000	
Sundry expenses		580	
Bad debts (320 + 400)		720	
Stationery (350 - 75)		275	

Donations (200 + 300)		500	
Trading stock deficit (12 970 - 12 900 + 300)		370	
Depreciation		6 708	
Operating profit			39 142
Interest income (4 000 + 2 000 - 2 000)	(1)		4 000
Profit before financing cost			43 142
Interest expense (1 875 + 1 875)	(2)		(3 750)
Net profit for the year	(7)		39 392

TIP TOP TRADERS

BALANCE SHEET AT FEBRUARY 28, 2002

	NOTE	R	R
ASSETS			
Non-current assets			190 922
Tangible assets	(3)	170 922	
Financial assets			
Fixed deposit		20 000	
Current assets			33 040
Inventories	(4)	12 675	
Trade and other receivables	(5)	19 915	
Cash and cash equivalents	(6)	450	
Total assets			223 962
EQUITY AND LIABILITIES			
Owner's equity	(7)		159 192
Non-current liabilities			45 000
Mortgage bond		45 000	
Current liabilities			19 770
Trade and other payables	(8)	9 970	

Bank overdraft		4 800	
Short-term loan		5 000	
Total equity and liabilities			223 962

TIP TOP TRADERS

NOTES TO FINANCIAL STATEMENTS

1. Interest income	R
From investments (e.g. fixed deposit)	4 000

2. Interest expense	R
on mortgage bond (1 875 + 1 875)	3 750

3. Tangible assets	Land & buildings R	Equipment R	Vehicles R	Total R
Cost price	121 800	25 000	18 000	14 800
Accumulated depreciation	---	(3 750)	(3 420)	(7 170)
Carrying value (Feb. 28, 2001)	121 800	21 250	14 580	157 630
Movements				
Additions at cost	---	20 000	---	20 000
Disposals at carrying value	---	---	---	---
Depreciation for the year	---	(5 250)	(1 458)	(6 708)
Carrying value (Feb. 28, 2002)	121 800	36 000	13 122	170 922
Cost price	121 800	45 000	18 000	184 800
Accumulated depreciation	---	(9 000)	(4 878)	(13 878)

4. Inventories	R
Trading stock (12 970 - 300 - 70)	12 600
Consumable stores on hand	75
	12 675

5. Trade and other receivables (debtors)	R
Trade debtors (15 950 - 400 + 150)	15 700
Provision for bad debts (800 - 15)	(785)
Net trade debtors	14 915
Accrued income	2 000
Prepaid expenses	3 000
	19 915

6. Cash and cash equivalents	R
Cash float	300
Petty cash	150
	450

7. Owner's equity	R
Balance (Feb. 28, 2001)	120 000
Net profit or loss for the year	39 392
Drawings (500 – 300)	(200)
Balance (Feb. 28, 2002)	159 192

8. Trade and other payables	R
Trade creditors	7 200
Accrued expenses (350 + 1 875)	2 225
Income received in advance (500 + 9%)	545
	9 970

Calculations

Adjustment 1 + 2: Trading stock deficit

	R
Trial balance	12 970
Adjustment 1	(12 900)
	70
Adjustment 2	300
	370

Adjustment 3 + 4 + 5: Provision for bad debts.

	R
Trade debtors	15 950
Adjustment 3	150
Adjustment 4	(400)
	15 700 x 5%
	= R785

Provision for bad debts R800 - R785) = R15 decrease.

Adjustment 9: Interest on loan

:

	R
R50 000 x 15% x 6/12	3 750
Already paid	(1 875)
Outstanding	1 875
Trial balance	1 875
(Interest expense) adjustment	1 875
	3 750

Adjustment 10: Interest on fixed deposit

	R
R20 000 x 20%	4 000 p.a.
Reversal	(2 000)
Outstanding	2 000
Reversal	(2 000)
Trial balance	4 000
Adjustment	2 000
Interest income	4 000

Adjustment 11: Insurance

R3 600 / 12 = R300 pm

March to December: 10 months x R300 = R3 000 (prepaid)

Adjustment 12: Depreciation

	R
Vehicles R18 000 - R3 420 = R14 548 x 10%	1 458
Equipment R25 000 x 15%	3 750
R20 000 x 15% x 6/12	1 500
	6 708

Task 4

GENERAL LEDGER OF PROTEA TRADERS

Dr Purchases N2

Cr

Feb	28	Balance	b/d	254 670	Feb	28	Drawings	GJ	1 200
		Creditors control	GJ	1 020			Donations	GJ	720
							Creditors allowances	GJ	14 310
							Trading account	GJ	239 460
				255 690					255 690

Dr Trading account N14 Cr

Feb	28	Opening stock	GJ	63 800	Feb	28	Sales (506 270 - 4 620)	GJ	501 650
		Purchases	GJ	239 460			Closing stock	GJ	66 900
		Carriage on purchases (950 + 180)	GJ	1 130					
		Profit and loss	GJ	264 160					
				568 550					568 550

Dr		Profit and loss						N15	Cr
Feb	28	Donations	GJ	720	Feb	28	Trading account	GJ	264 160
		Stationery (1 740 - 670)	GJ	1 070			Bad debts recovered	GJ	320
		Bad debts (2 370 + 440)	GJ	2 810			Interest on fixed deposit	GJ	700
		Interest on overdraft (935 + 85)	GJ	1 020			Discount received (880 + 450)	GJ	1 330
		Bank charges (1 150 + 45 + 70)	GJ	1 265					
		Salaries (33 625 + 4 600)	GJ	38 225					
		Medical aid contributions	GJ	468					
		Interest on loan (3 240 + 2 160)	GJ	5 400					
		Insurance (5 500 - 600)	GJ	4 900					
		Discount allowed	GJ	450					
		Depreciation (1 989 + 1 905 + 16 000)	GJ	19 894					
		Provision for bad debts adjustment	GJ	780					
		Loss on sale of asset	GJ	791					
		Trading license (4 000 + 1 200 - 1 100)	GJ	4 100					
		Capital (net profit)	GJ	184 617					
				266 510					266 510

Post-closing trial balance of Protea Traders on February 28, 2004

	R	R
	Debit	Credit
Balance sheet section		
Capital (170 270 - (12 700 + 1 200) + 184 617)		340 987
Land and buildings	165 000	
Vehicles	120 000	
Equipment (67 970 - 48 000)	19 970	
Accumulated depreciation on vehicles (24 500 + 16 000)		40 500
Accumulated depreciation on equipment (15 490 + 1 989 + 1 905 - 10 209)		9 175
Trading stock	66 900	
Debtors control (54 120 + 320 - 440)	54 000	
Provision for bad debts (3 000 + 780)		3 780
Bank (37 000 asset disposal - 8 980 balance - 1 200 trading license - 115 bank charges)	26 620	
Creditors control (46 230 + 1 020 + 180)		47 430
Fixed deposit	14 000	
Loan		24 000
Consumable stores on hand	670	
Prepaid expenses (1 100 + 600)	1 700	
Accrued expenses		2 160
Accrued income	700	
South African Revenue Services (PAYE)		700
Medical aid fund (360 + 468)		828
	469 560	469 560

CALCULATIONS:

Adjustment 5 Trading license

Total	4 000	Prepaid expenses*	1 100
Bank	1 200	Profit and loss	4 100
	5 200		5 200

$* \text{ R1 200 } \times \frac{11}{12} = \text{ R1 100}$

Adjustment 6

	Payable on February 28, 2004	
A	R100	$(1\ 200 \times \frac{1}{12})$
B	R3 600	(600 x 6)
C	R1 200	$(1\ 800 \times \frac{4}{6})$

R100 + R3 600 + R1 200 = R4 900

Adjustment 9

Debtors control = R54 120 + R320 - R440
= R54 000 x 7 %
= R3 780

R3 780 - R3 000 = R780

Adjustment 10

Asset disposal

Equipment	48 000	Bank	37 000
		Accumulated depreciation on equipment	10 209
		Loss on sale of asset	791
	48 000		48 000

1 Jan. 2002 - 28 Feb. 2002

$R48\ 000 \times \frac{15}{100} \times \frac{2}{12} = R1\ 200$

1 Mar. 2002 - 28 Feb. 2003

$R48\ 000 - R1\ 200 = R46\ 800 \times \frac{15}{100} = R7\ 020$

1 Mar. 2003 - 30 Jun. 2003

$R48\ 000 - R8\ 220 = R39\ 780 \times \frac{15}{100} \times \frac{4}{12} = R1\ 989$

R1 200 + R7 020 + R1 989 = R10 209

Accumulated depreciation on equipment

Asset disposal	10 209	Balance	15 490
		Depreciation	1 989
Balance	9 175	Depreciation	1 905
	19 384		19 384
		Balance	9 175

$[(R67\ 970 - R48\ 000) - (R15\ 490 - R8\ 220^*)] \times \frac{15}{100}$

$= [R19\ 970 - R7\ 270] \times \frac{15}{100}$

$= R12\ 700 \times \frac{15}{100}$

$= R1\ 905$

* R1 200 + R7 020 = R8 220

Adjustment 11

$R40\ 000 \times \frac{15}{100} = R6\ 000$

$R80\ 000 \times \frac{15}{100} \times \frac{10}{12} = R10\ 000$

R6 000 + R10 000 = R16 000

Adjustment 12

$R36\ 000 \times \frac{18}{100} \times \frac{6}{12} = R3\ 240$

$R24\ 000 \times \frac{18}{100} \times \frac{6}{12} = R2\ 160$ (Accrued expense)

Adjustment 13

$R14\ 000 \times \frac{15}{100} \times \frac{4}{12} = R700$ (Accrued income)

Task 5

1. Gross profit on sales

$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$

$\frac{230\ 000}{680\ 000} \times \frac{100}{1}$

= 33,8%

2. Gross profit on cost of sales

$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$

$\frac{230\ 000}{450\ 000} \times \frac{100}{1}$

= 51,1%

3. Net profit on sales

$$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$$

$$\frac{75\ 000}{680\ 000} \times \frac{100}{1}$$

= 11,0%

4. Total expenses on sales

$$\frac{\text{Total expenses}}{\text{Sales}} \times \frac{100}{1}$$

$$\frac{157\ 000}{680\ 000} \times \frac{100}{1}$$

= 23,1%

5. Return on owner's equity (use average equity)

$$\frac{\text{Net profit}}{\text{Average owner's equity}} \times \frac{100}{1}$$

$$\frac{75\ 000}{½\ (200\ 000 + 300\ 000)} \times \frac{100}{1}$$

$$= \frac{75\ 000}{250\ 000} \times \frac{100}{1}$$

= 30%

6. Net assets at year-end

Assets - Liabilities = Owner's equity

Assets:	Tangible assets	R220 000
	Investments	20 000
	Inventory	150 000
	Trade receivables	122 000
	Cash	24 000
		R536 000
Liabilities:	Non-current liabilities	R160 000
	Trade payables	76 000
		R236 000

R536 000 - R236 000

= R300 000

7. Solvency ratio

Total assets : Total liabilities

536 000 : 236 000

2,27 : 1

8. Net current assets (working capital) at year-end

Current assets - Current liabilities

Current assets

Trading stock	R150 000
Receivables	122 000
Cash	24 000
	R296 000

Current liabilities

Trade payables R76 000

R296 000 - 76 000

= R220 000

9. Current ratio

Current assets : Current liabilities

296 000 : 76 000

3,89 : 1

10. Acid test ratio

Current assets - Trading stock : Current liabilities

(296 000 - 150 000) : 76 000

146 000 : 76 000

1,92 : 1

11. Rate of stock turnover

$$\frac{\text{Cost of sales}}{\text{Average inventory}}$$

$$\frac{450\ 000}{½\ (120\ 000 + 150\ 000)}$$

$$= \frac{450\ 000}{135\ 000}$$

= 3,33 times

12. Return on total equity and liabilities

$$\frac{\text{Net profit}}{\text{Owner's equity + liabilities}} \quad X \quad \frac{100}{1}$$

$$\frac{75\ 000}{(200\ 000 + 160\ 000 + 76\ 000)} \quad X \quad \frac{100}{1}$$

$$\frac{75\ 000}{436\ 000} \quad X \quad \frac{100}{1}$$

= 17,2%

(Owner's equity at beginning of year)

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