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Study Guide

Accounting

Grade 12

Via Afrika
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Our Teachers. Our Future.

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Appropriation of profit

Net profit: The positive surplus of income over expenses, calculated as gross profit plus income less operating expenses.

Income tax: Tax calculated on the net profit for the year is not an expense – it is an appropriation of income.

Provisional income tax: Tax paid during the financial year, six months after the beginning of the financial year.

Dividends: Distribution of a portion of the company's net profit to shareholders, as suggested by the board of directors and approved by shareholders. For example, 5c per share.

Retained income: Portion of net profit after income tax and dividends have been appropriated, and retained by the company as a distributable reserve. The distributable reserve is available for distribution to shareholders.

Appropriation account: A final account used only on the last day of the financial year to appropriate net profit and distributable reserves.

		APPROPRIATION							N
		Income tax (*Total amount due for the year*)	GJ	204 000			Retained income (*Transferred from retained income*)	GJ	40 000
		Ordinary share dividends (*Total dividend for the year*)	GJ	20 000			Profit and loss (*Net profit for the year*)*	GJ	680 000
		Retained income (*Transferred to retained income*)	GJ	496 000					
				720 000					720 000

Recording dividends in the General Ledger

GENERAL LEDGER OF FORMAT STORES LIMITED

BALANCE SHEET ACCOUNTS SECTION

		SHAREHOLDERS FOR DIVIDENDS							B10
20.9 Oct.	15	Bank (*Interim dividends paid*)	CPJ 1	12 000	20.9 Aug.	31	Ordinary share dividends (*Interim dividends declared*)	GJ1	12 000
					2.10 Feb.	28	Ordinary share dividends (*Final dividends declared*)	GJ1	8 000

NOMINAL ACCOUNTS SECTION

		ORDINARY SHARE DIVIDENDS							N19
20.9 Aug.	31	Shareholders for dividends (*Interim dividends declared*)	GJ1	12 000	2.10 Feb.	28	Appropriation account (*Closed off to appropriation*)	GJ1	20 000

2.10 Feb.	28	Shareholders for dividends (*Final dividends declared*)	GJ1	8 000					
				20 000					20 000

Recording income tax in the General Ledger

GENERAL LEDGER OF FORMAT STORES LIMITED

BALANCE SHEET ACCOUNTS SECTION

SARS: INCOME TAX									B9
20.9 Aug.	31	Bank (*Interim tax paid*)	CPJ 1	120 000	2.10 Feb.	28	Income tax (*Final day tax as calculated*)	GJ1	204 000
		Balance (*Owed on last day of current year*)	c/d	84 000					
				204 000					204 000
					Mar.	01	Balance (*Will be paid in next financial year*)	b/d	84 000

NOMINAL ACCOUNTS SECTION

INCOME TAX									N18
2.10 Feb.	28	SARS: Income tax (*Final day tax as calculated*)	GJ1	204 000	2.10 Feb.	28	Appropriation account (*Closed off to Appropriation*)	GJ1	204 000
				204 000					204 000

Recording retained income tax in the General Ledger

GENERAL LEDGER OF FORMAT STORES LIMITED

BALANCE SHEET ACCOUNTS SECTION

RETAINED INCOME									B3
2.10 Feb.	28	Appropriation account (*Transferred to Appropriation*)	GJ1	40 000	20.9 Mar.	01	Balance	b/d	40 000
					2.10 Feb.	28	Appropriation account (*Transferred from Appropriation*)	GJ1	496 000

Aspects pertaining to the financial statements

Only abridged (statutory) financial statements are published. These shortened financial statements are compiled to the minimum set of criteria as required by the Companies Act. Comparative figures are also indicated.

Income Statement (Statement of comprehensive income): A statement to measure the performance of the company in terms of income and expenses, as a profit or loss for the year.

Balance Sheet: A statement to show the financial position of a business at a specific time in terms of assets owned, liabilities owed and equity in terms of how much has been invested in the company and what the source of investment was.

Cash flow statement: A statement to provide information about the cash and cash equivalents on hand on the first day of the financial year, as well as the changes in cash and cash equivalents due to the inflow oroutflow of cash as a result of operating activities, investing activities and financing activities. This provides the cash and cash equivalents on the last day of the financial year.

Notes to the financial statements: These are explanatory notes to set out accounting procedures and policies.

Statement of changes in equity: These are explanatory notes to set out accounting procedures and policies.

Auditors' report: The auditor provides a written report based on the external audit of the financial statements, giving an 'audit opinion' about whether the financial statements give a 'true and fair' view of the state of affairs of the organisation and operations for the period.

- 'True' means that a transaction did take place and that an asset exists.
- 'Fair' means that a transaction is fairly valued and that assets and liabilities are fairly stated.

Directors' report: This contains information on the activities of the company during the past financial year, a perspective on the next financial year, as well as other important matters.

Users of financial statements

Different users need the information contained in financial statements in order to satisfy different requirements:

- Internal users are people directly involved with the management of the business.
- External users are people ororganisations that have a financial interest in the business, but are not directly involved with the management of the business.

Investors (owners)

Investors provide capital and are concerned with the risk inherent in, and return provided by, their investments. They use information to decide whether they should buy, hold or sell their interest in the business. Shareholders use information to assess the ability of the business to pay dividends.

Board of directors and management

The financial statements provide records of assets owned, liabilities owed and money invested. They help to manage the business and provide a way to measure the effectiveness of different sections and business as a whole. They monitor activities, performance and position and help with evaluation control processes.

Employees

Employees and labour unions are interested in information about the stability and profitability of their employers. They use information to measure the ability of the business to provide remuneration, retirement benefits and employment opportunities.

Banks, suppliers and other trade creditors

- Banks use information to determine whether loans and interest will be paid when due.
- Suppliers and other creditors use information to determine if amounts owed to them will be paid when due.

Government, SARS and other agencies

- SARS is interested in turnover (VAT is payable on sales), wages and salaries (income tax and PAYE are payable), import duties and profits (tax is payable on net profit).
- Governments and their agencies are interested in the allocation of resources and the activities of businesses. They also require information to regulate the activities of businesses, determine taxation policies and to form the basis for national income and similar statistics.

The public and customers

Businesses may make a significant contribution to the local economy in many ways, including the number of people they employ and their support of local suppliers. The financial statements may provide information about trends, changes and the range of activities.Customers have an interest in the continued success of a business especially when they have a long-term association with, or are dependent on, that business.

Basic principles of accounting and financial statements (GAAP & IFRS)

Historical cost

Transactions are recorded at historical cost price. Historical cost is the amount of resources given up to acquire the asset or consume the service or the amount of liability incurred. An increase in the value of assets in following financial years is not indicated as an increase in income. A building was purchased in 2005 for R600 000. The value of the building if it is sold today is R1 000 000. Land and buildings are shown as R600 000 on the Balance Sheet.

Prudence

The elements of the financial statements are conservative to make sure that assets and income are not overstated and that liabilities and expenses are not understated. The probability exists that not all trade debtors are going to pay the full amount owed to the business. So bad debts are possible. A contra account to Trade debtors, called Provision for bad debts, is opened. This brings the Trade debtors balance to the amount that is expected to be realised and prevents assets from being overstated. Stock is valued at the lower of cost or net realisable value to ensure that the value indicated in the Balance Sheet can be derived when selling stock.

Materiality

Information is material when it has the ability to influence the decisions of users of financial statements due to the amount involved or the importance of the event. The remuneration paid to the executives and the directors is material. The accounting policies are material because they help the users to understand the figures.

Business entity

The business and its owners are seen as two separately identifiable parties and the activities of a business are kept separate from its owners.

Going concern

The business is a 'going concern' and it is expected to remain in operation in the foreseeable future (the next financial year). It is not foreseen that the business will be liquidated in the near future. Notice the distinctions between:

- Fixed assets and current assets
- Short and long-term liabilities
- Capital and revenue expenditure.

If a company is in serious financial trouble and the Board of Directors has passed a resolution to liquidate the business, the company is not a going concern.

Matching (Accrual)

Incomes and expenses are recognised in the financial year when they occur and not when cash is received or paid. This ensures accurate net income figures. A business will realise the expense of the electricity bill during the current financial year when it is received and not during the next financial year when it is paid, because the service has already been used.

Substance over form

The financial impact of an event is measured instead of its legal form. Land and buildings are purchased at R2 000 000 during the last month of the current financial year. The registration process will only be finalised during the next financial year. The land and buildings are included in the current Balance Sheet.

Consistency and comparability

Best accounting practice involves applying IFRS principles consistently. This makes accounting information understandable, relevant, reliable and comparable. Accounting policies should only change for a valid reason. Comparable accounting information allows users to compare the current financial period with previous financial periods, as well as with other similar companies.

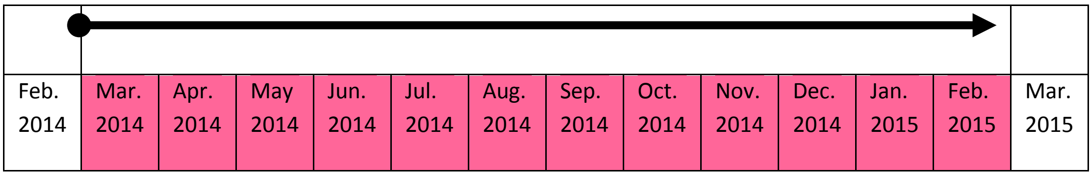
- The 2014 financial statements will include the corresponding 2013 figures.
- The 2014 financial statements of Alpha Traders Limited can be compared with the 2013 financial statements of Alpha Traders Limited to see whether the performance and position has improved or deteriorated.
- The 2014 financial statements of Alpha Traders Limited can be compared with the 2014 financial statements of Omega Traders Limited to see the difference in the performance and position of these two companies.

Monetary unit

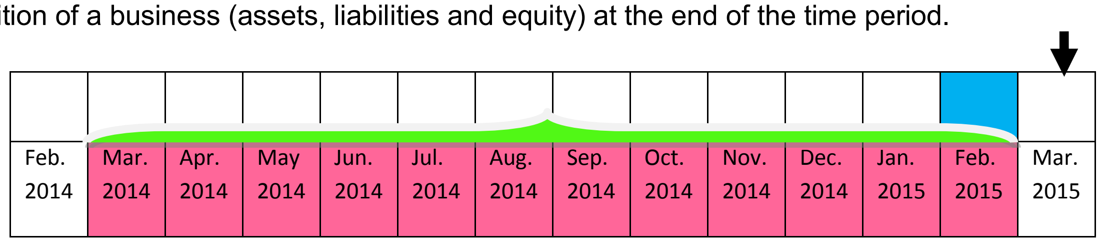
The currency of the country (R) is the monetary unit used as the basis of measurement. A business only accounts for those things that can be measured in terms of currency. If the business is the cause of a natural disaster (oil spill), they report the financial impact in the form of claims paid, damages paid, clean-up costs, etc.

Accounting period

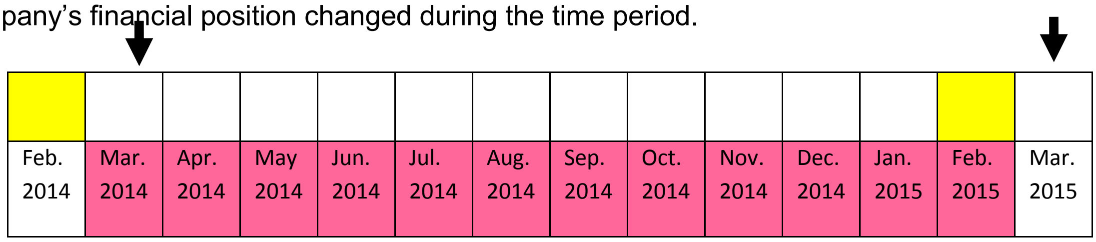
Financial statements are prepared for an accounting period and the results are reported on a periodic basis (such as every 12 months). The Income Statement provides insight into the performance of the company for a period of time.



The Balance Sheet (or statement of financial position) provides a snapshot of the financial position of a business (assets, liabilities and equity) at the end of the time period.



The cash flow statement and the statement of changes in equity provide details of how the company's financial position changed during the time period.



Published financial statements (public companies)

The board of directors

A company is managed by a board of directors. The directors are individuals elected as representatives of the stockholders in order to govern the company and look after shareholders' interests. The owners of the company (shareholders) appoint the board.

- The executive director is a full-time employee who has a specific decision-making role, for example, Chief Financial Officer or CFO.
- A non-executive director is a non-working director who does not take part in the day-to-day management of the company.

Duties of the directors

- Prepare the financial statements in accordance with applicable laws (company act, tax law) and regulations (IFRS & GAAP).
- Select and apply accounting policies.
- Present information, including accounting policies, in a manner that provides relevant,

reliable, comparable and understandable information.

- Provide additional disclosures, when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions and other events and conditions on the business's financial position and financial performance.
- Make an assessment of the company's ability to continue as a going concern.
- Take responsibility for keeping proper accounting records which disclose with reasonable accuracy the financial position of the company at any time.
- Safeguard assets.
- Take reasonable steps to prevent and detect fraud and other irregularities.
- See to the preparation of a directors' report and directors' remuneration report.
- Make decisions on company issues:
    - set company policy and objectives
    - employ the CEO and other executives
    - propose dividends
    - issue additional shares.

The annual general meeting (AGM)

Shareholders at the AGM vote according to the number of shares they own:

- Acceptance of the audited financial statements
- Approval of the recommended dividends
- Appointment of board members
- Appointment of auditors.

South African Institute of Chartered Accountants (SAICA)

SAICA is a professional body for chartered accountants and independent auditors:

- It issues guidelines and statements on generally accepted accounting practice (GAAP).
- It offers in-service training.
- It has a Code of Conduct which all members must follow. Failure to do this will result in their names being removed from SAICA and the members not being allowed to practise as accountants or independent auditors.

Internal control

Internal control is a management tool. Management sets in place policy measures, methods and procedures to ensure that they can achieve the company's objectives and goals. Examples of these are to ensure that there are no fatal accidents, that production hours are not lost, that they have procedures to curb mistakes, fraud and embezzlement.

Reasons for internal control measures

- Assets and income (cash) are protected from theft and fraud.
- Workers comply with accounting policies, safety procedures, laws and regulations in the workplace.

- Assets and resources are used effectively, efficiently and economically.
- All employees work towards achieving the objectives of the business.
  Tax regulations and laws governing business should be followed.

Fraud

Fraud is a false representation of facts with the intent to deceive (either by words or conduct) or misleading allegations or non-disclosure.

- **Occupational fraud**: Misuse/misappropriation of employer's assets or resources for personal gain.
- **Embezzlement:** Theft of money by means of false entries in the financial records.
- **Kick-backs:** These can be in the form of cash, receipts from suppliers for preferential treatment or information.

Types of control measures

- Preventative measures prevent undesired events, errors and costs. For example storing cash in a drop safe, putting up signs for wet floors, no smoking, no cell phones.
- Detective measures investigate errors and irregularitiesafter they have occurred. For example fire alarm, security videos.
- Corrective measures repair or correct errors and the effects of undesired events. For example, have a security guard on duty after being burgled.

Internal accounting control procedures

- Keep accounting records up to date, neat and in proper order.
- Do independent internal audits.
- Authorised staff must approve journal entries.
- Maintain and follow a current organisational chart.
- A properly qualified professional should head up the accounting department.
- More than one person should be responsible for the following duties (segregation of duties):
  - authorising transactions
  - recording transactions that follow on one another
  - controlling assets.
- Rotate employees from time to time.

Auditing

An audit involves collecting and evaluating information on financial transactions and financial statements. Set objectives and criteria are compared with the actual results achieved. This is done by measuring and evaluating the effectiveness of existing internal controls (that concern the accounting policy of the business), and how effectively they are applied.

Internal auditor

The internal auditor is an employee of the company whose job is to provide independent and objective evaluations to the audit committee and board of directors

Internal audit

Internal audits are the responsibility of management and are done by the internal auditor. The following aspects are audited:

- The implementation and/or effectiveness of financial activities, accounting procedures, operational efficiencies and corporate governance to ensure that these are in place and are actually followed.
- Identifying problem areas and taking corrective action.
- Ensuring effective control and management of resources and other assets.

External auditor

The external auditor is a suitably qualified person with a certified accounting designation who reports independently on the state of a company's business by providing an auditor's report.

External auditing

External audits are done by independent auditors to express an unbiased opinion of the company's financial statements. They need to assure shareholders that:

- the financial statements are reliable and free from material error
- the financial statements are a true and fair representation of the company's financial results and position for the past financial year
- the financial statements are prepared in accordance with IFRS and GAAP.

It is important to note that the primary function of an audit is not to detect fraud. External audits may be conducted as special-purpose audits. Forensic audits are done to detect fraud or embezzlement.

Gathering audit evidence

The auditor includes all information obtained by means of inspection, observation, inquiry and confirmation, recalculation, performing calculations and analytical procedures.

In a typical audit the auditor will identify staff involved in consecutive handling of accounting transactions, for example the person who receives cash, the person who deposits cash, the person who does the bank reconciliation, etc. The auditor will make sure of:

- the accuracy of the source document
- the authorisation of the transaction
- the accuracy of recording transaction in the accounting records
- the control measures in place to safeguard assets.

Documents the auditor needs

The auditor may request the following records and other documentation:

Accounting records	Petty Cash Book completely up to date to yearend File of invoices/vouchers for all items of expenditure File or book of receipts for money received Bank statements, deposit slips and cheque books

	Wages book and records General Ledger
Summaries and reconciliation statements	A Trial Balance or a summary of all receipts and payments Bank reconciliation statements Petty cash reconciliation statement Stock sheets
Schedules	Creditors list (money owed by the company) Debtors list (money owing to the company) Fixed assets register
Other information	A letter from bankers to confirm balances Minutes of Board meetings

Statistical sampling

The auditor will test the validity of a few transactions (samples) taken from all transactions (population). The sample is audited and if found correct it is assumed that the population will be correct. Samples can be collected by:

- selecting all transactions
- selecting specific items, such as all cash receipts above R200 000
- audit sample, such as selecting 20 cash receipts by means of random selection.

Audit report

- An audit results in a report giving an 'audit opinion' on the financial statements. Are they a 'true and fair' view of the state of affairs of the organisation and operations for the period?
- The audit report is addressed to the shareholders. It consists of:
  - an introduction stating what was audited
  - the directors' responsibility for the financial statements
  - the auditor's responsibility
  - the auditor's opinion.

Examples of auditors' opinions:

Auditor's opinion	**Comment**
Unqualified. The accounts give a true and fair view	The accounts, financial statements and accounting procedures are correct and complete
Qualified. Except for the effects of . . . , the accounts give a true and fair view	Specific misstatements/ issues are uncertain: incorrect accounting policy, debtors not recoverable, undisclosed fraud or insider loan, some documents not being available for review, an internal control flaw that could result in income not being recorded

Adverse. The accounts do not give a true and fair view	So many misstatements in the accounts that they are completely wrong
Disclaimer. We are not able to express an opinion	So many missing documents or explanations that we do not have enough information to form an opinion

Example of an audit report:

Independent auditors' report

Title of the report

To the Shareholders of Alpha Limited

Addressee

Introduction

We have audited the Group annual financial statements and annual financial statements of Alpha Limited, which comprise the statements of financial position at 30 June 2012, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes, and the directors' report, as set out on pages 25 to 84.

Directors' Responsibility for the Financial Statements

Explanation of directors' responsibility

The Company's directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Explanation of auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the business's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the business's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

Opinion of the auditor

In our opinion, these financial statements present fairly, in all material respects, the financial position of Alpha Limited at 30 June 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa.

Audits-R-Us
129 Tar Road
Somewhere Town
South Africa

Name and address of the auditors

AB Someone
Chartered Accountant (SA)
Registered Auditor
7 December 2012

Date

Exercise 1.1

The following information appeared in the records of Johnson Traders Limited for the financial year ended on 30 June 20.1.

Information

- Amount owed to SARS for Income tax on 30 June 20.0, R135 000.
- The outstanding amount was paid to SARS on 28 July 20.0.
- A first provisional income tax payment of R337 500 was made on 30 December 20.0.
- A second provisional income tax payment of R278 100 was made on 29 June 20.1.
- The net profit for the year ended 30 June 20.1 was calculated at R2 570 000.
- The income tax for the year was calculated at 28% on the net profit for the year.

Instructions

1 Draw up the SARS: Income tax account for the year ended 30 June 20.1.

GENERAL LEDGER OF JOHNSON TRADERS LIMITED

BALANCE SHEET ACCOUNTS SECTION

SARS: INCOME TAX **B12**

2 Which amounts will be used for income tax in the following financial statements?

Income statement/Statement of comprehensive income	
Balance sheet/Statement of financial position	
Specific section and description in Balance sheet / Statement of financial position	

3 For the purpose of the Cash Flow Statement calculate the income tax paid for the year.

Exercise 1.2

The information was provided by Pacco Limited for the year ended 28 February 20.2.

- R48 000 too much income tax was paid for the year ended 28 February 20.1.
- This amount will be taken into account with the first provisional tax payment.
- A provisional income tax payment was made on 31 August 20.1. The amount to be paid was calculated at R247 000. The extra R48 000 paid during the previous year was taken into account and the relevant amount was paid to SARS.
- A second provisional income tax payment was made on 28 February 20.2.
- The final income tax assessment for the year was R514 000.
- At the end of the financial year Pacco Limited still owed SARS R58 000.

Instructions

1 Draw up the SARS: Income tax account for the year ended 28 February 20.2.

GENERAL LEDGER OF PACCO LIMITED

BALANCE SHEET ACCOUNTS SECTION

SARS: INCOME TAX **B12**

2 In which section of the Balance Sheet/Statement of financial position did the balance of SARS: Income tax on 1 March 20.1 appear?

3 For the purpose of the Cash Flow Statement calculate the income tax paid during the year.

4 In which section of the Cash Flow Statement will the income tax paid appear?

Exercise 1.3

The information relates to Platinum Limited for the year ended 31 October 20.3:

- Amount owed to SARS for income tax for previous financial year paid on 16 November 20.2, R289 000
- Provisional tax of R960 000 was made in two equal payments during the year.
- Net profit after income tax of 28% on net profit for the year ended 31 October 2013, R2 570 400.

Instructions

Draw up the SARS: Income tax account for the year ended 31 October 20.3.

GENERAL LEDGER OF PLATINUM LIMITED

BALANCE SHEET ACCOUNTS SECTION

SARS: INCOME TAX **B12**

Exercise 1.4

From the financial records of Sharpco Limited on 28 February 20.4:

- The authorised share capital of the business is 900 000 shares.
- 740 000 shares were in issue on 28 February 20.3.
- All shares were sold at R20 each.
- A final dividend of 16c per share was declared on 28 February 20.3.
- The dividend was paid on 19 March 20.3.
- All the unissued shares were sold on 1 June 20.3 at R26 each.
- An interim dividend of 25c per share was declared and paid on 15 June 20.3.
- New shareholders were not entitled to the interim dividend.
- A final dividend of 18c was declared on 28 February 20.4.

Instructions

1 Draw up the Shareholders for dividends account as well as the Ordinary share dividends account on 28 February 20.4.

GENERAL LEDGER OF SHARPCO LIMITED

BALANCE SHEET ACCOUNTS SECTION

SHAREHOLDERS FOR DIVIDENDS **B13**

NOMINAL ACCOUNTS SECTION

ORDINARY SHARE DIVIDENDS **N15**

2 For the purpose of the Cash Flow Statement calculate the dividends paid during the year.

3 In which section of the Cash Flow Statement will the dividends paid appear?

Exercise 1.5

This information appeared in the financial records of Samoa Limited. The company has an authorised share capital of 1 000 000 ordinary shares.

Balances on 30 June 20.4

Ordinary share capital (240c each) R920 000
Retained income/Accumulated profitR220 000
SARS:Income tax (Cr.) R116 000
Shareholders for dividends R98 000

Some transactions during the year ended 30 June 20.5:

- The outstanding amounts was paid to SARS and the shareholders on 12 July 20.4.
- 50 000 shares were bought back at 240c from minor shareholders on 1 August 20.4.
- An interim dividend of 34c per share was declared and paid on 30 December 20.4.
- Provisional tax was paid on 31 December 20.4, R105 000.
- 150 000 shares were sold at 275c per share on 5 January 20.5.
- The net profit for the year ended 30 June 20.5 was calculated at R830 000.
- A final dividend of 42c per share was declared on 30 June 20.5
- A second provisional income tax payment was made on 30 June 20.5. The income tax for the year was calculated at R232 400.

Instructions

1 Calculate the balance of the Ordinary share capital account on 30 June 20.5.

2 Calculate the total ordinary share dividends for the year.

3 Draw up the Appropriation account for the year ended 30 June 20.5.

GENERAL LEDGER OF SAMOA LIMITED

NOMINAL ACCOUNTS SECTION

		APPROPRIATION ACCOUNT						**N18**	

4 Calculate the shareholders' equity on 30 June 20.5.

5 Calculate the following financial indicators:

5.1 Earnings per share (EPS)

5.2 Dividends per share (DPS)

5.3 Net asset value (NAV)

5.4 Comment on the financial indicators. Will the shareholders be satisfied?

EPS:
DPS:
NAV:
Conclusion:

6 Calculate the proceeds from shares issued for the purpose of the Cash Flow Statement:

Exercise 1.6

1 Complete the following table by calculating the missing amounts (?) in the Cash Flow Statements of three companies:

	Company A Limited	**Company B Limited**	**Company C Limited**
Cash effects of operating activities	760 000	435 000	?
Cash effects of investing activities	(2 340 000)	?	(367 000)
Cash effects of financing activities	?	210 000	(120 000)
Net change in cash and cash equivalents	?	143 000	251 000
Cash and cash equivalents at beginning of year	430 000	(27 000)	?
Cash and cash equivalents at end of year	(505 000)	?	127 000

2 Give a short description of possible cash flow activities of each company during the year.

Company A	
Company B	
Company C	

3 Which company's shareholders will be satisfied with the results for the year as shown in the Cash Flow Statements. Give a reason for your answer.

Company:
Motivation:

Term 2

Overview : Treatment of CAPS in Via Afrika's textbook

Term 2 Overview	**Topic 5**	
	Ethics	• Ethical behaviour in business • Professional bodies for accountants • Non-compliance with code of professional conduct • Plocies governing ethical conduct in the financial environment • Basic principles related to the governing of companies
	Topic 6	
	Fixed/tangible assets	• What you should know about fixed assets • Interpreting and reporting on the movements of fixed assets
	Topic 7	
	Financial accounting of close corporations (CCs)	• Accounting concepts unique to a CC • Difference between the financial statements of a company and a CC
	Topic 8	
	Internal control	• Applying internal control and internal audit processes in a business environment • Difference between the roles of internal and external auditors
	Topic 9	
	Inventory systems	• Validating inventories

		using the perpetual or periodic stock systems • Valuing inventories • GAAP principles, internal control and ethical issues relating to stock
	Topic 10	
	Reconciliation	• Analysis and interpretation of bank, debtors and creditors reconciliation • Reconciling creditors statements with their personal accounts • Reconciling debtors lists and creditors lists with control accounts • Analysing and interpreting debtors age analysis • Analysing and interpreting bank statements and bank reconciliation statements
	Topic 11	
	Value added tax (VAT)	• Calculating the amount payable to or receivable from SARS • Completing the VAT control account • Ethical issues related to VAT • Internal audit and control processes related to VAT

Fixed/tangible assets

Assets

Assets are resources the a business possesses and controls. They are expected to bring future economic benefits:

ASSETS		
Non-current assets		**Current assets**
Long-lasting resources (possessions of the business) like property, buildings, vehicles and equipment		Assets consisting of cash or which can be converted into cash in the short term (less than a year)
Fixed/Tangible assets	**Financial assets**	
Land and buildings Vehicle Equipment	Fixed assets Investments Shares in companies	Stock Trade and other receivables/Debtors Cash and cash equivalents

Fixed assets and concepts associated with fixed assets

A business uses fixed assets to generate income. Some fixed assets have a limited useful life. They can only be used for a certain number of years, after which they must be replaced. The cost of a fixed assets is distributed over its useful life by means of depreciation.

Cost price of an asset: The original price paid for the asset including any cost incurred in the acquisition of the asset (transport cost, registration cost, installation fee.

Depreciation: The allocation of the value of the asset over the useful life of the asset. It indicates how much of the value of the asset has been used to generate income in a specific period and which part of the cost of the asset can be used as a tax deductible expense. Depreciation is written off according to two methods:

- fixed percentage on cost price or straight line method (fixed amount method)
- diminished balance method or percentage on carrying value.

Accumulated depreciation: The total depreciation written off on a specific asset up to a specific date, i.e. the total value 'used'.

Carrying value: The remaining value of an asset or the part of the cost of an asset not yet written off as an expense. The minimum carrying value to be used in the records is R1.

Carrying value = Cost price – Accumulated depreciation

Asset register: An asset register lists all the details of each asset and assists the business to keep track of each fixed asset's correct value. It is important for the control over assets and decisions about the economic value of assets.

Example of depreciation

A vehicle was purchased on 1 March 20.1 for cash at R200 000 (financial year ending on 28 February).

Depreciation at 20% p.a. on cost price	Depreciation at 20% p.a. on diminished balance method
Depreciation on 28 February 20.2: 20% x 200 000 x 1 = 40 000	Depreciation on 28 February 20.2: 20% x 200 000 x 1 = 40 000
Depreciation on 28 February 20.3: 20% x 200 000 x 1 = 40 000	Depreciation on 28 February 20.3: 20% x (200 000 – 40 000) x 1 = 32 000

Depreciation on 28 February 20.4: 20% x 200 000 x 1 = 40 000		Depreciation on 28 February 20.4: 20% x (200 000 – 40 000 – 32 000) x 1 = 25 600	
Value of vehicles appears as follows in the Balance Sheet on 28 February 20.4:			
Cost price	200 000	Cost price	200 000
Accumulated depreciation	120 000	Accumulated depreciation	97 600
Carrying value	80 000	Carrying value	102 400

Disposal of a fixed asset

Any asset can be sold, withdrawn by the owner, traded in on another asset or donated. If an asset no longer offers economic benefit to the business, it is better to sell it to prevent any unnecessary cost. The following information about the specific asset is needed:

- the cost price of the asset (it must be removed from the records)
- the accumulated depreciation of an asset up to the date of sale (it must be removed from the records)
- the amount for which the asset was sold, traded in or withdrawn (it must be recorded)
- any profit or loss made with the transaction (it must be recorded).

Example

Transaction: A computer was purchased on 1 July 20.2 (financial year ending on 30 June).

Sold on 1 July 20.3 for R7 000		**Sold on 1 January 20.4 for R7 000**		**Sold on 30 June 20.4 for R7 000**	
Cost price	8 000	Cost price	8 000	Cost price	8 000
Accumulated depreciation (25% x 8 000)	2 000	Accumulated depreciation [2 000+(25% x 8 000 x $^{6}/_{12}$)]	3 000	Accumulated depreciation [2000 + (25% x 8000)]	4000
Carrying value (8 000 – 2 000)	6000	Carrying value (8 000 – 3 000)	5000	Carrying value (8 000 – 4 000)	4 000
Sold for	7 000	Sold for	7 000	Sold for	7 000
Profit on sale of asset (7 000 – 6 000)	1 000	Profit on sale of asset (7 000 – 5 000)	2 000	Profit on sale of asset (7 000 – 4 000)	3 000

Example

Trnascation: A computer was purchased on 1 June 20.3 (financial year ending on 30 June). Depreciation must be written off at 25% p.a. The computer is sold on 30 June 20.5 for R7 000. Show the effect of the transactions on the accounting equation.

Transaction	**Assets**	**Owner's equity**	**Liabilities**
Sold for cash	+ 7 000 – 4 000	+ 3 000	
Sold on credit	+ 7 000 – 4 000	+ 3 000	
Traded in	– 4 000	+ 3 000	– 7 000
Withdrawn by owner	– 4 000	+ 3 000 – 7 000	
Donated by the business	– 4 000	+ 3 000 – 7 000	

Example

Transaction: A computer was purchased on 1 July 20.5 (financial year ending on 30 June). Depreciation is written off at 25% p.a. on cost price. The computer is sold for R7 000 cash on 1 January 20.7. Show the effect on the accounting equation.

	Subsidiary book	**Account to debit**	**Account to credit**	**Amount**
Transfer of cost price	GJ	Asset disposal	Equipment	8 000
Pro rata depreciation written off	GJ	Depreciation		1 000 (25% x 8 000 x $^{6}/_{12}$)
Transfer of accumulated depreciation	GJ	Accumulated depreciation on equipment	Asset disposal	3 000 [(25% x 8 000) + (25% x 8 000 x $^{6}/_{12}$)]
Entry for sales*	CRJ	Bank	Asset disposal	7 000
Entry for profit or loss	GJ	Asset disposal	Profit on sale of asset	2 000 [7 000 – (8 000 – 3 000)]

**If the computer in the example is not sold for cash, the sales transaction will be recorded as follows (the other entries remain the same):*

	Subsidiary book	**Account to debit**	**Account to credit**
Entry for cash sales	CRJ	Bank	Asset disposal
Entry for credit sales	GJ	Debtors control	Asset disposal
Entry for trading in transaction	GJ	Creditors control	Asset disposal
Entry for drawings by owner	GJ	Drawings	Asset disposal
Entry for a donation	GJ	Donations	Asset disposal

Exercise 2.1

Use the information to complete the following accounts in the General Ledger of Shabangu Traders:

- Vehicles
- Accumulated depreciation on vehicles
- Accumulated depreciation on equipment
- Asset disposal
- Depreciation.

Information

1 The financial year of the business ends annually on 28 February.
2 Vehicles are depreciated at 15% p.a. on carrying value (diminished balance).
3 Equipment is depreciated at 20% p.a. on cost.
4 A new vehicle was purchased on 30 November 20.8 at R120 000. New equipment had been purchased during the year.
5 An old vehicle was sold for R22 000 on 1 February 20.9. The original cost of the vehicle was

R70 000 and the accumulated depreciation written off on 1 March 20.8 amounted to R46 000. No equipment was sold during the financial year.

NOTE TO FINANCIAL STATEMENTS ON 28 FEBRUARY 20.9			
3	**FIXED ASSETS**	**Vehicles**	**Equipment**
	Carrying value on 1 March 20.8	200 000	46 000
	Cost price on 1 March 20.8	350 000	90 000
	Accumulated depreciation	(150 000)	?
	Movements		
	Additions	120 000	?
	Disposals at carrying value	?	0
	Depreciation	?	(22 000)
	Carrying value on 28 February 20.9	?	?
	Cost price on 28 February 20.9	?	130 000
	Accumulated depreciation	(134 900)	?

GENERAL LEDGER OF SHABANGU TRADERS

BALANCE SHEET ACCOUNTS SECTION

VEHICLES **B**

ACCUMULATED DEPRECIATION ON VEHICLES **B**

Calculations:

ACCUMULATED DEPRECIATION ON EQUIPMENT **B**

ASSET DISPOSAL **B**

DEPRECIATION **B**

Exercise 2.2

The information was taken from the books of Thabo Co.

Instructions

1 Complete the fixed asset register. Show your workings.
2 Prepare the Asset disposal account.
3 Use the appropriate information to complete the note for fixed assets (Land & buildings/Property and Equipment).

Information

POST-ADJUSTMENT TRIAL BALANCE				
	28 February 20.8		**28 February 20.9**	
	Debit	**Credit**	**Debit**	**Credit**
Land and buildings	?		920 000	
Vehicles	?		620 000	
Equipment	280 000		?	
Accumulated depreciation on vehicles		147 000		?
Accumulated depreciation on equipment		136 640		?

ASSET REGISTER OF THABO CO

EQUIPMENT
Number : SIM078/RT
Date purchased : 1 March 20.5
Cost price : R80 000
Depreciation method : 20% p.a. on carrying value

Date	**Depreciation for year**	**Accumulated depreciation**	**Carrying value**
28 February 20.6	16 000	16 000	64 000
28 February 20.7	12 800	28 800	51 200
28 February 20.8	?	?	?
1 December 20.8	?	?	?
NOTE :	Traded in at R33 000 to Africa Enterprises Profit/Loss: ………………….		

Additional information

1 Alterations and improvements to the store during the year came to R440 000.
2 A new vehicle was bought on 1 November 20.8 on credit from Orapi Motors, R360 000.
3 Depreciation on vehicles is provided for at 25% p.a. on cost price.
4 Equipment was traded in at Africa Enterprises on 1 December 20.8 for new equipment with a cost price of R70 000. (See asset register.)
5 New equipment was bought on credit from Mudau Equipt for R86 000 on 1 February 20.9.
6 An account for R4 000 for the installation of the new equipment was received from Mbedzi & Son on the same day and paid.
7 Depreciation on equipment is provided for at 20% p.a. on carrying value.

Answer sheets

ASSET REGISTER OF THABO CO			
EQUIPMENT Number : SIM078/RT Date purchased : 1 March 20.5 Cost price : R80 000 Depreciation method : 20% p.a. on carrying value			
Date	**Depreciation for year**	**Accumulated depreciation**	**Carrying value**
28 February 20.6	16 000	16 000	64 000
28 February 20.7	12 800	28 800	51 200
28 February 20.8			
1 December 20.8			
NOTE:	Traded in at R33 000 to Africa Enterprises Profit/Loss: ………………….		

GENERAL LEDGER OF THABO CO

BALANCE SHEET ACCOUNTS SECTION

ASSET DISPOSAL **B**

3	**FIXED ASSETS**	**Land & buildings**	**Vehicles**	**Equipment**	**Total**
	Carrying value at beginning of year				
	Cost				
	Accumulated depreciation				
	Movements				

Exercise 2.3

Part A

Dumisani Vani is the owner of Xan Taxi Services. He started the business on 1 March 20.7. On that day he transferred Land & buildings valued at R300 000 as capital to the business and he bought three similar taxis for R330 000 (i.e. R110 000 each.) Xan Taxi Services did not buy or sell any vehicles during the first three financial years.

Information

2.10	May 31	Xan Taxi Services sold one taxi for R45 000 cash. This vehicle was purchased on 1 March 20.7 for R110 000. The vehicle is depreciated annually at the rate of 20% p.a. on cost price.
	Aug. 31	A new taxi was purchased on credit from Marema Motors for R200 000.
	Oct. 31	A new garage was built at a cost of R160 000 and repairs were done to the roof of the office for R12 000.
2.11	Feb. 28	The policy for depreciation has not changed since Xan Taxi Services started business operations. Depreciation is calculated at 20% p.a. on cost price.

Instructions

1 Prepare the Asset disposal account in the General Ledger. Omit folio numbers.

GENERAL LEDGER OF THABO CO									
BALANCE SHEET ACCOUNTS SECTION									
ASSET DISPOSAL									
Date		*Details*		*Amount*	*Date*		*Details*		*Amount*

2 Prepare the Accumlated appreciation on vehicles account in the General Ledger for the year ended 28 February 2.11.

ACCUMULATED DEPRECIATION ON VEHICLES									
Date		*Details*		*Amount*	*Date*		*Details*		*Amount*

3 Prepare the Note for Fixed assets to the Balance Sheet on 28 February 2.11.

NOTE TO FINANCIAL STATEMENTS ON 28 FEBRUARY 2.11			
3	**FIXED ASSETS**	**Land & buildings**	**Vehicles**
	Carrying value at beginning of year		
	Cost price		
	Accumulated depreciation		
	Movements		
	Additions		
	Disposals at carrying value		
	Depreciation		
	Carrying value at end of year		
	Cost price		
	Accumulated depreciation		

Part B

Lulama Hono runs a taxi business called Mama's Taxi Services. She is concerned that their revenue from taxi fares has not met the budget of R1 500 000 and that their fuel and repair costs have exceeded the budget of R710 000. Hono has taken the following information from the General Ledger, the Fixed Assets Register and other records on 28 February 2.11, the last day of the financial year.

Information

	Taxi 1	**Taxi 2**	**Taxi 3**
Name of driver	Michael	Matthew	Shariefah
Date purchased	1 March 20.0	1 March 20.8	1 March 20.10
Cost price of vehicle	R45 000	R180 000	R300 000
Accumulated depreciation	R44 999	R36 000	R60 000
Amount of revenue (income) earned	R618 300	R222 800	R279 900
Kilometres covered for the past year	68 700 km	69 200 km	31 100 km
Fuel and repair costs for the year	R439 680	R290 640	R136 840
Fuel and repair costs per kilometre	R6,40	R4,38	R4,40

Questions

1 What is a budget?

2 Calculate the total revenue from taxi fares for the year.

3 Calculate the total fuel and repair costs for the year.

4 Should Ms Hono be concerned about the differences between the actual and budgeted amounts? Give a reason for your answer.

5 Consider the given information. Explain whether or not Ms Hono should be concerned about any problem or aspect relating to each vehicle. Make suggestions.

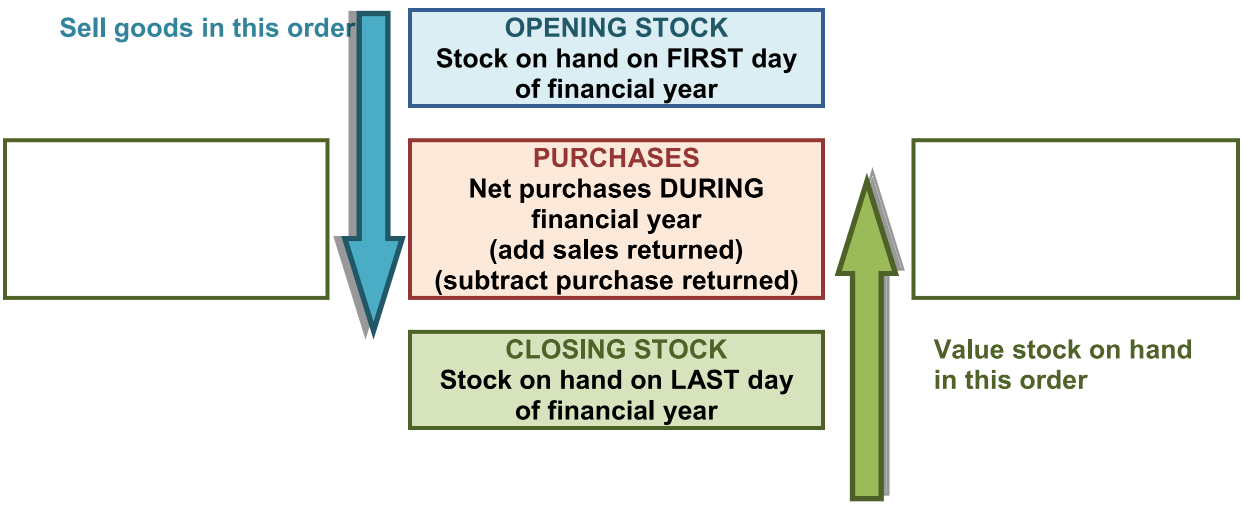
Taxi 1:
Taxi 2:
Taxi 3:

Stock valuation methods

Two methods are used to calculate the cost of sales for the financial period and the value of stock on hand on the last day of the financial period.

First-in-first-out (FIFO) method

The assumption is that goods bought first are sold first:



Example

PERPETUAL INVENTORY SYSTEM	FIRST IN FIRST OUT	PERIODIC INVENTORY SYSTEM
Sales: 120 @ R50 = **R6 000** + 150 @ R50 = **R7 500** + 180 @ R50 = **R9 000** = 450 @ R50 = **R22 500**	**Opening stock 100 units @ R10 = R1 000** **Jan. Purchases 150 units @ R12 = R1 800** **Sales 120 units @ R50** **Feb. Purchases 160 units @ R14 = R2 240** **Sales 150 units @ R50** **Mar. Purchases 200 units @ R18 = R3 600** **Sales 180 units @ R50**	Sales: 120 @ R50 = **R6 000** + 150 @ R50 = **R7 500** + 180 @ R50 = **R9 000** = 450 @ R50 = **R22 500**
Cost of sales: 100 @ R10 = **R1 000** + 20 @ R12 = **R240** + 130 @ R12 = **R1 560** +20 @ R14 = **R280** + 140 @ R14 = **R1 960** + R40 @ R18 = **R720** = R5 760		Units available: 100 + 150 + 160 + 200 = 610 units Units sold: 120 + 150 + 180 = 450 units Value of purchases: 1 000 + 1 800 + 2 240 + 3 600 = R8 640 Cost of sales = Total available for sale – value of stock on hand
Value of closing stock: 160 @ R18 = R2 880		Units on hand at year end: 610 – 450 = 160 units Value of closing stock: 160 @ R18 = R2 880

Weighted average method

Calculate the average cost per item purchased, weighted with regards to the number of units produced.

PERPETUAL INVENTORY

OPENING STOCK
Stock on hand on FIRST day of financial year
Q x AP = TC

PERIODIC INVENTORY

If perpetual inventory system is used, calculate AP after NEW sales has taken place

Add NET PURCHASES for the period
Q x AP = TC
Q x AP = TC
Q x AP = TC

If periodic inventory system is used, calculate AP at the end of the financial period

CLOSING STOCK
Stock on hand on LAST day of financial year
Q x AP = TC

Example

PERPETUAL INVENTORY SYSTEM	WEIGHTED AVERAGE	PERIODIC INVENTORY SYSTEM
Sales: 120 @ R50 = R600 + 150 @ R50 = R750 + 180 @ R50 = R900 + 450 @ R50 = R2 250	Opening stock 100 units @ R10 Jan. Purchases 150 units @ R12 Sales 120 units @ R50 Feb. Purchases 160 units @ R14 Sales 150 units @ R50 Mar. Purchases 200 units @ R18 Sales 180 units @ R50	Sales: 120 @ R50 = R600 + 150 @ R50 = R750 + 180 @ R50 = R900 + 450 @ R50 = R2 250
Find weighted average after each new purchase. Add the purchase to stock on hand: 100 @ R10,00 = R1 000 150 @ R12,00 = R1 800 250 @ R11,20 = R2 800 **(120 @ R11,20 = R1 344)** 130 @ R11,20 = R1 456 160 @ R14,00 = R2 240 290 @ R12,74 = R3 696 **(150 @ R12,74 = R1 912)** 140 @ R12,74 = R1 784 200 @ R18,00 = R3 600 340 @ R15,84 = R5384 **(180@R15,84 = R2 851)** 160 @ R15,84 = R2 533 Value of closing stock		Find weighted average by adding total purchases for the year to opening stock: 100 @ R10,00 = R1 000 150 @ R12,00 = R1 800 160 @ R14,00 = R2 240 200 @ R18,00 = R3 600 610 @ R14.16 = R8 640 160 @ R14,16 = R2 266 Value of closing stock **Cost of sales = (120 + 150 + 180) @ R14,16 = R6 372**
Cost of sales: **1 344 + 1 912 + 2 851 = R6 107**		Value of closing stock: 160 @ R18 = R2 880

Reasons for using FIFO method

- FIFO is simple and easy to use.
- Closing stock is valued at realistic (current) prices.
- Cost price is not estimated. Actual (real) prices are recorded.
- Movement of inventory is logical: stock bought first is sold first.
- If stock has a limited shelf life, old stock must be put at the front of the shelf and newer stock at the back.
- FIFO is suitable for all types of businesses that sell goods of a simliar kind (homogenous goods).

Reasons for using weighted average method

- With weighted average sporadic price increases are flattened (levelled).
- The closing stock is valued at realistic (current) prices.
- This is the best method to use when buying a lot of goods in small quantities.
- The influence of a single purchase is reduced. Price changes do not dramatically affect average costs.

Exercise 2.4

The owner of Boots for All buys leather boots from Namibia that they then sell to many retail outlets in South Africa. They use the FIFO method for all stock valuations and the periodic inventory system for the recording of inventory.

Information

Stock on hand (1 May 20.6)

May 1 Stock on hand: 200 pairs of boots at R1 500 each

Purchases (May 20.6)

May 3 Purchases of boots: 100 pairs of boots at R1 500 each

May 6 Return of boots: 20 pairs of boots bought on 3 May

May 13 Purchases of boots: 90 pairs of boots at R1 600 each (plus R300 courier cost for overnight delivery)

May 19 Purchases of boots: 50 pairs of boots at R1 800 each

May 26 140 pairs of boots ordered at R1 650 each. The boots will be invoiced and delivered on 1 June 20.6.

Sales (May 20.6)

May 7 90 pairs of boots at R2 040

May 14 120 pairs of boots at R2 040

May 21 110 pairs of boots at R2 040

May 28 60 pairs of boots at R2 040

May 31 Number of boots sold for the month: 380

Total sales amount: R775 200

Instructions

1 Calculate the cost of sales for the month of May 20.6 using the FIFO method.

2 Calculate the gross profit for the month of May 20.6.

3 Calculate the value of trading stock on hand on 31 May 20.6.

4 Calculate the cost of sales using the FIFO method for stock valuation and the perpetual inventory system for recording stock.

You need to calculate the price per pair of boots according to the weighted average method every time new stock was purchased due to the use of perpetual recording system:

5 The owner of Boots for All is unhappy that they decided to use the FIFO method of stock valuation for the business. He wonders if they should rather have used the weighted average method. The necessary calculations using the weighted average method are:

Cost of sales R591 986,80

Gross profit R183 213,20

Value of stock on hand R62 314,40

The owner has come to you for advice. Comment on:

- The difference the two methods will have on the financial statements.
- The reason for the figures being different.
- Give advice as to whether they should change the stock valuation method or not.

	Weighted average	**FIFO + Periodic**	**FIFO + Perpetual**
Cost of sales			
Gross profit			
Stock on hand			
Comment:			

Exercise 2.5

The information relates to Rodrigues Clothing, for the financial year ended 30 June 2.12. The business sells locally manufactured T- shirts. The business uses the Proudly South African logo in all its advertisements.

Information

1 The business applies the perpetual inventory system and weighted average method of stock valuation.

2 Information for the year:

	Units	**Unit price**	**Total value**
T-shirts on hand on 1 July 2.11	200	R120	R24 000
Purchases during the year	1 500		R176 750
Purchased on 31 August 2.11	350	R140	R49 000
Purchased on 30 November 2.11	600	R80	R48 000
Purchased on 31 January 2.12	550	R145	R79 750
T- shirts on hand on 30 June 2.12	?		
T-shirts sold during the year (before returns were taken into account)	1 430		

3 Local manufacturers increased their prices on 15 November to R160 per unit for the Christmas season. The owner decided to buy T-shirts from street vendors at a much lower price on 30 November 2.11. He was not sure of where the vendors get their merchandise.
4 The business sold their T-shirts at R200 per T-shirt throughout the year.
5 During December 130 customers returned the T-shirts as they were of very poor quality. The street vendors did not want to take the T-shirts back. So the business donated these T-shirts to a shelter for the homeless. The business decided to sell the last 110 T-shirts of the batch, purchased on 30 November, at a price of R100.

Instructions

1 Calculate the value of the stock on hand on 30 June 2.12.

2 Calculate the cost of sales for the year and comment on the situation.

3 Calculate the total sales for the year.

4 Calculate the gross profit for the year according to both stock systems.

5 If Rodrigues Clothing purchased the T-shirts at R160 during November, theunit price according to the weighted average method would have been R146,32. All the T-shirts could have been sold at R200 each. The gross profit would be R76 762, 40. Give your view on the decision to purchase T-shirts from street vendors and the effect it had on the business.

Bank reconciliation

Records of cash transactions are kept in the Cash Payments Journals (CPJ) and the Cash

Receipts Journal (CRJ) and then posted (transferred) to the Bank account in the General Ledger.

- The balance of the Bank account in the General Ledger is checked against the balance of the Bank account as per bank statement.
- A bank statement is a copy of the bank account as it appears in the bank's financial records.
- Bank statements are sent to clients to check and update their own records.

Bank reconciliation statement

The business draws up a bank reconciliation as an extension of the bank statement to reconcile the balance of the Bank account in the General Ledger with the balance as indicated on the bank statement, i.e. to explain the differences. The diagram shows the relationship between the Bank account and the bank statement:

GENERAL LEDGER OF OUR SHOP			**GENERAL LEDGER OF THEIR BANK**	
BANK ACCOUNT			**OUR ACCOUNT**	
Positive balance Receipts	Negative balance Payments	*Opening balance* *Transactions during the month*	Negative balance Payments	Positive alance Receipts
Positive balance	Negative balance	*Closing balance* *If these two balances are not the same, do bank reconciliation*	Negative balance	Positive balance

Why balance of Bank account and balance of bank statement differ

- The information is not complete. For example, bank charges are not known to the business until they get the bank statement.
- There is a time difference: the Bank account covers a full month (from 01/01 to 31/01) while bank statement may be from 26/01 to 25/02.
- There may be errors either by the bank on the bank statement or by the business in the journals and/or Bank account in the General Ledger.

Why we do bank reconciliation

- Control measure – CPJ, CRJ and bank account are updated
- Confirms accuracy of entries in CPJ, CRJ and bank account
- Check that bank has not made unauthorised payments or errors
- Keep track of interest, outstanding deposits, cheques issued, RD cheques, bank charges and/0r electronic payments and deposits.

Format of the bank reconciliation statement

NAME OF COMPANY: Format Limited **Bank reconciliation statment on 31 January 2.12**		
	Debit	**Credit**
Debit/Credit balance as per bank statement		xx xxx

Start with the balance on

			bank statement
Credit deposits not yet credited		xxx	*Deposits entered in CPJ but not yet on bank statement*
Credit items incorrectly debited		xxx	*Incorrect debit entries are corrected*
Debit items incorrectly credited	xxx		*Incorrect credit entries are corrected*
Debit outstanding cheques:			*Cheques issued but not yet presented for payment*
No. 111	xxx		
No. 133	xxx		
No. 134	xxx		
Debit/Credit balance as per bank account	x xxx		
	xx xxx	xx xxx	

Procedure for doing bank reconciliation

Step 1 Write down the format of bank reconciliation statement (BRS).

Step 2 Enter the balance of the bank statement.

Step 3 Check the entries on the bank statement (BS) with the Bank columns in the Cash Payments Journal (CPJ) and Cash Receipts JOurnal (CRJ) as well as with the previous month's BRS.

Step 4 Transaction on BS but not on CPJ or CRJ:

- Enter outstanding transactions on debit side of BS in CPJ.
- Enter outstanding transactions on credit side of BS in CRJ.
- Balance bank account in the General Ledger and put balance in on BRS as last entry.

Step 5 Transaction in CPJ or CRJ but not on BS:

- Enter outstanding deposits and incorrect debit entries on credit side of BRS.
- Enter cheques not presented for payment and wrong credit entries on debit side of BRS.

Step 6 Balance BRS.

Examples of entries

	Bank account in General Ledger		**Bank reconciliation statement**	
	Debit	**Credit**	**Debit**	**Credit**
Bank statement has debit balance			✓	
Bank statement has credit balance				✓
Deposit in CRJ/Bank account not show n on bank statement				✓
Incorrect debit entry on bank statement				✓
Incorrect credit entry on bank statement			✓	
Debit cheques issued but not yet presented for payment (i.e. cheques entered in CPJ but not showing on bank statement)			✓	
All payments on bank statement (debit entries) not entered in CPJ		✓		

All receipts on bank statement (credit entries) not entered in CPJ	✓			
Error in CPJ: value understated		✓		
Error in CPJ: value overstated	✓			
Error in CRJ: value understated	✓			
Error in CRJ: value overstated		✓		
Cancel cheque issued	✓			
Issue new cheque in place of cancelled cheque		✓	✓	
Bank account in General Ledger has debit balance			✓	
Bank account in General Ledger has credit balance				✓

Debtors reconciliation and debtors age analysis

All transactions with debtors are recorded in the relevant journals and posted to the Debtors control account in the General Ledger, as well as to the individual debtor's account in the Debtors Ledger:

- Debtors Journal (DJ) for credit sales.
- Debtors Allowances Journal (DAJ for sales returns.
- Cash Receipts Journal (CRJ) for cash/cheques received as payment from debtors and discount allowed.
- Cash Payments Journal (CPJ) for returned cheques received from debtors (RD cheques).
- General Journal (GJ). Debit column shows interest charged on overdue accounts as well as other increases in debtors.
- General Journal (GJ). Credit column shows transactions that reduce amount owed by debtors, including errors and omissions.

The balance of the Debtors control account in the General Ledger is checked against the Debtors List (which shows the balances of the debtors' individual accounts in the Debtors Ledger).

Control account: This is a summary account in the General Ledger. The details that support the balance in the summary account are in the Debtors Control Ledger (a subsidiary ledger)

Debtors control account: This is an account in the Balance Sheet accounts section of the General Ledger. It is a current asset as the money will be received within the twelve-month period. It is a summary of all the transactions with the individual debtors.

Example

GENERAL LEDGER OF FORMAT LIMITED

BALANCE SHEET ACCOUNTS SECTION

		DEBTORS CONTROL						**B**	
		Balance	b/d				Bank and discount allowed	CRJ	
		Sales	DJ				Debtors allowances	DAJ	

		Bank (R/D cheques)	CRJ					Journal credits	GJ	
		Journal debits	GJ					Balance	c/d	
		Balance	b/d							

Debtors Ledger: This is a subsidiary ledger containing individual accounts for each debtor. All transactions entered in the journals are posted to the individual account of the debtor. A balance is shown after each entry.

Debtors List: The business draws up a list (normally at the end of the month or at year end) showing the money owed by debtors on that date.

If you are reconciling the . . .	you check the . . .	with the . . .
Debtors control account	Debtors control account in the General Ledger	Debtors list containing balances of debtors' individual accounts as in the Debtors Ledger
Debtors' individual accounts	Debtors' individual accounts in the Debtors Ledger	Statement issued to debtors or with documentation supplied by debtor

Why debtors' accounts and statements differ

- Information is not complete (omissions). For example, debtors do not know of interest charges until the business issues a statement, invoices, payments or discounts omitted.
- There may be a time difference. The business has not yet recorded EFT payments by the debtor.
- Errors by either the business in the debtor's individual account or errors on the statement issued to the debtor (such as credit sales, amounts paid or discount allowed entered incorrectly).

Why we do debtors reconciliation

- A debtor claims that there are errors or omissions on the account.
- As a control measure, the Debtors control account is updated.
- It confirms accuracy of entries in DJ, DAJ, GJ, CPJ and CRJ as well as the debtor's individual account.
- It keeps track of credit sales, sales returned, payments received, discount allowed or interest charged on money owed by debtors.

Relationship between the Debtors List and the Debtors control account

GENERAL LEDGER OF OUR BUSINESS			DEBTORS LIST OF OUR BUSINESS	
DEBTORS CONTROL ACCOUNT			OUR ACCOUNT	
Opening balance b/d Sales	Bank & Discount allowed Debtors allowances	*Opening balance* *Transactions during the*	Debtor A Debtor B Debtor C	Rxx xxx Rxx xxx Rxx xxx

Bank (RD cheques)	Sundry entries	*month*	Debtor D	Rxx xxx
Sundry entries	Balance c/d	*Closing balance*		Rxxx xxx
Balance b/d		*If these two balances are not the same, look for reasons why they differ*		

Procedure for reconciling Debtors control account and Debtors List

Step 1 Open the Debtors control account and the Debtors List with the given balances.

Step 2 Correct the errors or omissions in the Creditors control account and/or in the creditor's individual account.

Step 3 Balance the Creditors control account and total the Creditors List. These two balances should be the same.

Procedure for reconciling debtor's individual account and statement issued

Step 1 Compare the debtor's individual account with the statement issued.

- The debit side of the statement is checked against the debit side of the account.
- The credit side of the statement is checked against the credit side of the account.

Step 2 Correct errors or omissions in the debtor's individual account in the Debtors Ledger by journalising and posting entries.

Step 3 Open the debtors reconciliation with the balance as per statement issued.

Step 4 Correct errors or omissions in the statement issued by adding omissions and corrrecting errors.

Step 5 You should end with the same balance as in the debtor's account.

The golden rule for reconciling debtors

- Subtract returns from the last invoice.
- Subtract cash received (receipts) and discount allowed from the oldest amount owed.

Debtors age analysis

This is an analysis of the amounts owed by debtors, showing the number of days that money owed to the business is outstanding.

- As part of credit control system, the age analysis should be regularly examined. Appropriate follow-up action will include sending out statements, phoning debtors, encouraging debtors to pay outstanding debt, offering discounts to debtors to improve receipts.
- Reviewing the debtors age analysis helps a business to keep track of the movements on debtors and to follow up on overdue accounts. Also to determine bad debts, which debtors aare not paying, and which debtors must be charged interest.
- If money owed to the business is not managed properly, it may have to look to legal remedies, or even writing off debt. That means spending money to get money.

Debtors are current assets. The business needs to take in cash to be able to pay other accounts. If debtors pay late, it places strain on the cash flow unless it is managed correctly.

	Total	**Current**	**30 days**	**60 Days**	**90 days**
Debtor A	R2 000	R1 000	R600	R400	
Debtor B	R1 500		R1 000	R500	
Debtor C	R3 000	R2 000			R1 000
Total	R6 500	R3 000	R1 600	R900	R1 000
%		46%	25%	14%	16%

Creditors reconciliation and creditors age analysis

All transactions with creditors are recorded in the relevant journals and posted to the Creditors control account in the General Ledger, as well as to the individual creditor's account in the Creditors Ledger:

- Creditors Journal (CJ) for credit purchases.
- Creditors Allowances Journal (CAJ) for purchase returns.
- Cash Payments Journal (CPJ) for cheques issued as payment to creditors and discount received.
- Cash Receipts Journal (CRJ) for returned (RD) cheques.
- General Journal (GJ). Credit interest charged on overdue accounts as well as other increases in creditors.
- General Journal (GJ). Debit transactions that reduce amount owed to creditors, including errors and omissions.

The balance of the Creditors control account in the General Ledger is checked against the Creditors List (which shows the balances of the creditors' individual accounts in the Creditors Ledger).

Control account: This is a summary account in the General Ledger. The details that support the balance in the summary account are in the Creditors Control ILdger (a subsidiary ledger).

Creditors control account: This is an account in the Balance Sheet accounts section of the General Ledger. It is a non-current liability as it should be paid within the twelve-month period. It is a summary of all the transactions with the individual creditors.

Example

GENERAL LEDGER OF FORMAT LIMITED

BALANCE SHEET ACCOUNTS SECTION

CREDITORS CONTROL **B**

		Bank & Discount received	CPJ				Balance	b/d	
		Creditors allowances	CAJ				Sundry purchases	CJ	
		Journal debits	GJ				Bank (R/D cheques)	CRJ	
		Balance	c/d				Journal credits	GJ	
							Balance	b/d	

Creditors Ledger: This is a subsidiary ledger containing individual accounts for each creditor. All transactions entered in the journals are posted to the individual account of the creditor. A balance is shown after each entry.

Creditors List: The business draws up a list (normally at the end of the month or at year end) showing the money owed to creditors on that date.

If you are reconciling the . . .	**you check the . . .**	**with the . . .**
Creditors control account	Creditors control account in the General Ledger	Creditors list containing balances of debtors' individual accounts as in the Creditors Ledger
Creditors' individual accounts	Creditors' individual accounts in the Creditors Ledger	Statement received from creditor

Why creditors' accounts and statements differ

- Information is not complete (omissions). For example, the business does not know of interest charges until they receive a statement, invoices, payments or discounts omitted.
- There may be a time difference. The creditor has not yet recorded EFT payments by the business.
- Errors by either the business in the creditor's individual account or errors on the statement received from the creditor (such as credit purchases, amounts paid or discount received entered incorrectly).

Why we do creditors reconciliation

- As a control measure, the Creditors control account is updated.
- It confirms accuracy of entries in CJ, CAJ, GJ, CPJ and CRJ as well as the creditor's individual account.
- It keeps track of credit purchases, purchases returned, payments made, discount received or interest charged on money the business owes.

Relationship between the Creditors List and the Creditors control account

GENERAL LEDGER OF OUR BUSINESS			**DEBTORS LIST OF OUR BUSINESS**	
CREDITORS CONTROL ACCOUNT			**OUR ACCOUNT**	
Payments Discount received Purchase returns Sundry entries Balance c/d	Opening balance b/d Purchases Sundry entries Balance b/d	*Opening balance* *Transactions during the month* *Closing balance* *If these two balances are not the same, look for reasons why they differ*	Creditor A Creditor B Creditor C Creditor D	Rxx xxx Rxx xxx Rxx xxx Rxx xxx Rxxx xxx

Procedure for reconciling the Creditors control account and Creditors List

Step 1 Open the Creditors control account and the Creditors List with the given balances.

Step 2 Correct errors or missions in the Creditors control account and/or in the creditor's individual account.

Step 3 Balance the Creditors control account and total the Creditors list. These two balances should be the same.

Procedure for reconciling the creditor's individual account and the statement received

Step 1 Compare the creditor's individual account with the statement received.

- The debit side of the statement is checked against the credit side of the account.
- The credit side of the statement is checked against the debit side of the account.

Step 2 Correct errors or omissions in the creditor's individual account in the Creditors Ledger by journalising and posting entries.

Step 3 Open the creditors reconciliation with the balance as per statement received.

Step 4 Correct errors or omissions in the statement received by adding omissions and correcting errors.

Step 5 You should end with the same balance as in the creditor's account.

Step 6 Prepare a remittance advice to send out with the cheque when you pay creditors. We use a remittance advice to inform creditors of errors and omissions on the statement they prepared.

The golden rule for reconciling creditors

- Subtract returns from the last invoice.
- Subtract cash payments and discount received from the oldest amount owed.

Creditors age analysis

This is an analysis of the amounts owed to creditors, showing the number of days that payments are outstanding.

- As part of credit control system, the age analysis should be regularly examined so that appropriate follow-up action may be taken.
- Reviewing the creditors age analysis helps a business to keep track of the movements on creditors and to follow up on overdue accounts.
- Creditors are current liabilities. The business needs cash available to pay the accounts. This places strain on cash flow if it isn't managed correctly. The following may happen:
  - Overpayments, when the business pays more than they owe the creditor.
  - Underpayments, when the business pays less than they owe the creditor. Interest and fines can be added to the balance not paid on time, which results in additional costs.

	Total	**Current**	**30 days**	**60 Days**	**90 days**
Creditor A	R2 000	R1 000	R600	R400	
Creditor B	R1 500		R1 000	R500	
Total	R3 500	R1 000	R1 600	R900	
%		29%	46%	25%	0%

Exercise 2.6

Lerato Khumalo, the bookkeeper at Rucco Traders, has to do the bank reconciliation for May 2.10. She asked you to answer questions about the bank reconciliation statement on 30 April 2.10, as well as some questions about the bank statement for May 2.10.

NAME OF BUSINESS: Rucco Traders BANK RECONCILIATION STATEMENT ON 30 APRIL 2.10		
	Debit	**Credit**
Credit balance according to bank statement		12 400
Credit outstanding deposit		24 600
Debit outstanding cheques :		
No. 954 (5 October 20.9)	1 346	
No. 1078 (12 April 2.10)	9 750	
No. 1084 (23 June 2.10)	20 000	
No. 1086 (20 April 2.10)	2 467	
No. 1090 (29 April 2.10)	14 895	

Questions

1 Did the Bank statement show a favourable or unfavourable balance on 30 April 2.10? Give a reason for your answer.

2 How can the deposit of R24 600 be outstanding? Give one possible reason.

3 The outstanding deposit of R24 600 includes all the receipts from 26 April to 30 April. Is it good practice to deposit cash every five days? Give a reason for your answer and make recommendations.

4 What does 'outstanding cheques' mean?

5 Explain to Ms Khumalo what is wrong with cheque 954 and how it should be handled in the records of Rucco Traders.

6 Between which dates can cheque 1078 be presented for payment?

7 Explain how to treat cheque 1084 when preparing the financial statements. The cheque was issued to a creditor, Gregor Limited.

8 Cheque 1086 was issued to the local soccer club, SoccerStars. They asked Rucco Traders to pay the supplier of their equipment, EquipSoc, instead of giving the money to the soccer club. Explain to Ms Khumalo in detail how to handle this request in the records.

9 Cheque 1090 was issued to one of the employees for his salary. All salaries are still paid by cheque. These cheques are issued on the 29th of each month to ensure that employees have their salaries available on the last day of the month. Is this the best method of paying salaries? Give a reason for your answer.

10 The bank statement shows an entry marked RD. What does this mean? How should this be dealt with in the cash journals?

11 Ms Khumalo is unsure about four cheques issued in May 2.10 for the same amount, payable as 'Cash', that must be recorded in the Cash Payments Journal. Give a possible reason for these cheques? Is it good policy to issue cash cheques? Give a reason for your answer.

12 The last part of the bank reconciliation is missing. Calculate the balance of the Bank account in the General Ledger on 30 April 2.10. Is it favourable or unfavourable?

Exercise 2.7

Part A: Bank reconciliation

The following information appeared in the records of Bathabile Gifts on 30 June 20.3, the end of the financial year.

NAME OF COMPANY: . . . **BANK RECONCILIATION STATEMENT ON 31 MAY 20.3**		
	Debit	**Credit**
Credit balance as per bank statement		15 400
Credit outstanding deposit		26 700

Debit outstanding cheques:		
No. 1554 (1 November 20.2)	9 800	
No. 2206 (23 May 20.3)	8 750	
No. 2417 (1 June 20.3)	13 200	
No. 2435 (23 August 20.3)	15 680	
Credit balance as per bank account		5 330
	47 430	47 430

NAME OF COMPANY: . . . BANK RECONCILIATION STATEMENT ON 30 JUNE 20.3		
	Debit	**Credit**
Debit balance as per bank statement	1 450	
Credit outstanding deposit		31 640
Debit outstanding cheques:		
No. 2206 (23 May 20.3)	8 750	
No. 2435 (23 August 20.3)	15 680	
No. 2578 (25 June 20.3)	1 460	
No. 2611 (30 June 20.3)	1 700	
Debit balance as per bank account	2 600	
	31 640	31 640

Questions

1 What does the debit balance of R1 450 as per bank statement in the bank reconciliation statement on 30 June 20.3 mean?

2 What does the debit balance of R2 600 as per bank account in the bank reconciliation statement on 30 June 20.3 mean?

3.1 Why does cheque 1554 not appear on the bank reconciliation statement of 30 June 20.3?

3.2 How did the business deal with cheque 1554 in their records?

4 Why does cheque 2435 appear on the bank reconciliation statement of 30 June 20.3?

5 Explain why cheque 2417 does not appear on the bank reconciliation statement of 30 June 20.3.

6 Study the dates of cheque 2435 (23 August 20.3) and cheque 2578 (25 June 20.3). Suggest a possible reason for the difference.

7 Cheque 2417 (1 June 20.3) appeared correctly on the May bank statement as R13 500. The cheque was issued to GlamGifts for merchandise. How should the business deal with the difference?

8 Why is it necessary to compare the bank reconciliation statement of 31 May 20.3 with the bank statement of June 20.3?

Part B: Creditors reconciliation

Khabine Crafts is one of the creditors of Bathabile Gifts.

NAME OF BUSINESS: Bathabile Gifts
CREDITORS LEDGER

KHABINE CRAFTS

Date		**Details**	**Fol.**	**Debit**	**Credit**	**Balance**
20.3 Jun.	1	Account rendered				5 400
	2	Invoice 124 (KH230)	CJ		2 300	7 700
	5	Cheque 2498	CPJ	4860		2 840
	5	Cheque 2498 – discount received	CPJ	540		2 300
	6	D/N 89 (C/N K124)	CAJ	300		2 000
	12	Invoice 129 (GG8)	CJ		1 670	3 670
	23	Invoice 135 (KH 276)	CJ		4 580	8 250

Statement received from creditor, Khabine Crafts:

STATEMENT OF ACCOUNT

KHABINE CRAFTS

TO: Bathabile Gifts
30 June 20.3

Account number: 1002

Date	**Details of transaction**	**Debit**	**Credit**	**Balance**
1 June 20.3	Brought forward			5 400
2 June 20.3	Invoice KH230	2 300		7 700
5 June 20.3	Receipt 1143 (Cheque 2498)		4860	2 840
6 June 20.3	C/N K124		300	2 540
23 June 20.3	Invoice KH 276	4122		6 662

28 June 20.3	Invoice KH 289	10 000		16 662

In studying the Creditors Ledger account of Khabine Crafts and the statement received from Khabine Crafts, the following errors and ommisions were discovered:

- Invoice GG8 was received from supplier GlamGifts.
- Cheque 2498 was issued to Khabine Crafts in settlement of the outstanding amount on 1 June 20.3. Discount of 10% was received.
- Invoice KH289 was issued by Khabine Crafts to Bath Crafters.
- Khabine Crafts allowed 10% trade discount on invoice KH 276.

Instructions

1 Calculate the correct balance of the account of Khabine Crafts in the Creditors Ledger of Bathabile Gifts.

2 Prepare the creditors reconciliation statement that Bathabile Gifts needs to draw up:

CREDITORS RECONCILIATION STATEMENT		

3.1 Show the effect of cheque 2498 issued to Khabine Crafts in settlement of the outstanding amount on 1 June 20.3, as well as the 10% discount received on the accounting equation of Bathabile Gifts.

Assets	**Owner's equity**	**Liabilities**

3.2 Indicate how to record the transaction in 3.1 in the General Ledger of Bathabile Gifts by listing the accounts to debit and credit.

Account to debit	**Account to credit**
Creditors control	Bank
Creditors control	Discount received

4 The merchandise purchased from Khabine Crafts on 23 June 20.3 will be sold for cash by Bathabile Gifts with a mark-up of 50% on cost. What will the effect of this sale be on the accounting equation of Bathabile Gifts?

Assets	**Owner's equity**	**Liabilities**

Exercise 2.8

Analyse the transactions for June 20.2 of Mbedzi Traders under the headings in the table.

Transactions

1. A deposit of R9 800 appeared in the Cash Recipts Journal on 28 June 20.2 but not on the bank statement for June 20.2.
2. A tenant deposited the rent for one month, R3 200, directly into the bank account. The amount appeared on the bank statement but not in the cash journals.
3. The following amounts were debited on the bank statement:
   - Stop order for owner's personal insurance premium, R 1 100.
   - Debit order for the business's cell phone account, R685.
   - Bank charges, R245.
4. The bank statement showed a dishonoured cheque of R900. The cheque was received from debtor F. Monti in settlement of her account of R950. The cheque was dishonoured due to insufficient funds (IF).
5. Cheque 655, dated for 13 November 20.1, must be cancelled. This cheque was originally issued for R7 680 to Dakalo Mulaudzi for merchandise purchased. He lost the cheque. Replace the cheque with cheque 675 on 30 June 20.2.
6. Mbedzi Traders received a cheque for R764 from a debtor. The cheque is dated for 3 July 20.2. The bookkeeper did not record it.
7. Cheque 673 for R2 450, issued to Manley Motors, was dated for 10 July 20.2. It appeared in the Cash Payments Journal but not on the bank statement.

Examples

a The Bank Statement showed a debit for the insurance premium of the business.
b Cheque 354 has not been presented for payment yet, R5 600.
c The outstanding deposit on the previous Bank Reconciliation Statement appeared on the Bank statement of this month.

No.	**Details in subsidiary journal**		**Amount**	**Bank account**		**Bank reconciliation statement**		**No entry**
	Subsidiary journal	**Name of account in General Ledger**		**Debit**	**Credit**	**Debit**	**Credit**	
a	CPJ	Insurance			✓			
b						✓		
c								✓

Value added tax (VAT)

Registering for VAT

Businesses with a turnover above the limit set by the VAT Act must register for VAT. Any other business can choose to register for VAT if it suits their purpose. Vendors (businesses) levy a tax on the supply of goods and services. VAT is included in the selling price and collected by vendors on behalf of the South African Revenue Service (SARS).

VAT rates

- Standard rate.* On all items excluding exempt items, currently 14%.
- Zero rate.* On basic goods to help less advantaged consumers, currently 0% (brown bread, milk, eggs).
- Exempt items. No VAT is levied on these goods (interest, rates, educational services and services provided by non-profit organisations).

* The Minister of Finance can change the percentages for VAT at any time.

VAT period

The VAT period can cover one month, two, six or twelve months:

- The standard tax period is two months, either on even months or odd months.
- The VAT must be submitted on or before the 25th of the month following the end of the two-month period. For example, the VAT for January and February will be submitted on or before 25 March.

VAT basis

VAT basis	Input VAT	Output VAT
Invoice basis	Claimed on receiving VAT invoice, whether or not payment has been made	Paid on issuing VAT invoice, whether or not payment has been received
Payment basis	Claimable on paying for purchases	Payable on receiving payment for transaction

VAT invoice

The following information must be included in the tax invoice:

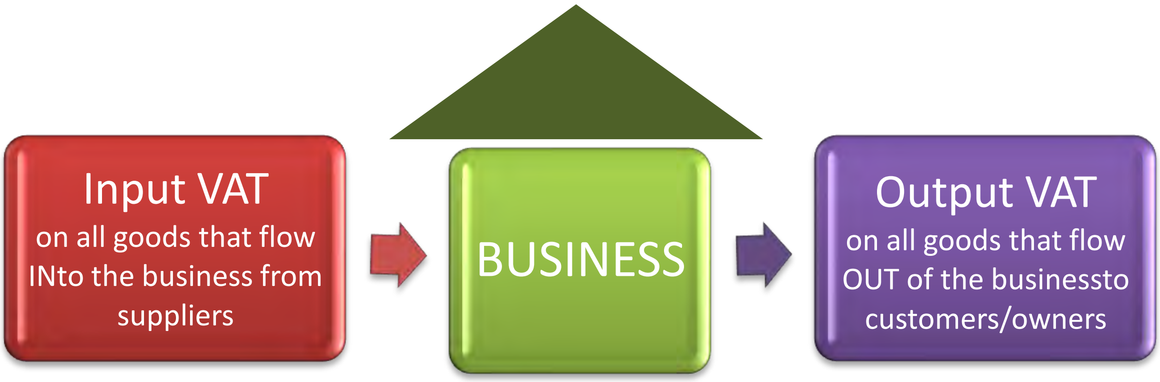
- The words VAT invoice or Tax invoice
- Invoice number
- Date
- The name, address and VAT number of the vendor or supplier
- The name, address and VAT number of the buyer if more than R500
- A description of the nature and quantity of goods and/or services bought
- The amount paid to VAT
- The rate of VAT charged
- The amount paid for the goods and/or services

Calculating VAT-inclusive and VAT-exclusive amounts

	Selling price (SP)	Calculate SP excluding VAT	Calculate VAT
Inclusive	includes VAT	$SP_{(excl)} = \frac{SP_{(incl)}}{1} x \frac{100}{114}$	$VAT = \frac{SP_{(incl)}}{1} x \frac{14}{114}$
		$SP_{(excl)} = \frac{228}{1} x \frac{100}{114}$	$VAT = \frac{228}{1} x \frac{14}{114}$
		$SP_{(excl)} = R200$	$VAT = R28$
	Selling price (SP)	**Calculate SP including VAT**	**Calculate VAT**
Exclusive	excludes VAT	$SP_{(incl)} = \frac{SP_{(excl)}}{1} x \frac{114}{100}$	$VAT = \frac{SP_{(excl)}}{1} x \frac{14}{100}$
		$SP_{(incl)} = \frac{200}{1} x \frac{114}{100}$	$VAT = \frac{200}{1} x \frac{14}{100}$
		$SP_{(incl)} = R228$	$VAT = R28$

Recording VAT in the General Ledger

A VAT amount has to be classified as either Input VAT or Output VAT.



Follow the flow of goods and/or services as shown in the diagram above.

Three accounts are used in the General Ledger:

Account	Description	Journals
Input VAT Nominal (*E*)	VAT paid on purchases or payments made	CPJ, PCJ, CJ & CAJ, GJ
Output VAT Nominal (*E*)	VAT received on sales or income	CRJ, DJ & DAJ, GJ
VAT control Balance Sheet (*A/L*)	Summary of Input VAT and Output VAT Debit balance – SARS owes money to vendor Credit balance – Vendor owes money to SARS	GJ

Examples

The formats of the three VAT accounts used in the General Ledger are shown with all possible variations:

INPUT VAT N

		Balance *(Opening balance of Input VAT on first day of month)*	b/d				Creditors control (*Creditors allowances – purchases returned to suppliers)*	CAJ	
		Bank *(VAT paid on cash purchases)*	CPJ				Bank *(VAT on asset disposal for cash)*	GJ	
		Creditors control *(VAT paid on credit purchases)*	CJ				Debtors for asset disposal *(VAT on asset disposal on credit)*	GJ	
		Petty cash *(VAT paid on petty cash purchases)*	PCJ				Sundry accounts *(Errors and omissions)*	GJ	
		Sundry accounts *(Errors and omissions)*	GJ				VAT control *(Input VAT closed off to VAT control account on last day of month)*	GJ	

OUTPUT VAT N

		Bad debts *(VAT amount on irrecoverable debts written off)*	GJ				Balance *(Opening balance of Input VAT on first day of month)*	b/d	
		Discount allowed *(VAT on discount granted to debtor)*	GJ				Bank *(VAT charged on cash sales)*	CRJ	
		Debtors control *(Debtors allowances – sales returned by debtors)*	DAJ				Debtors control *(VAT charged on credit sales)*	DJ	
		Sundry accounts *(Errors and omissions)*	GJ				Discount allowed *(VAT on discount granted to debtor is cancelled if a RD cheque)*	GJ	
		VAT control *(Output VAT is closed off to VAT control account on last day of month)*	GJ				Drawings*(VAT on goods taken by owner for personal use)*	GJ	
							Donations *(VAT on goods donated)*	GJ	
							Sundry accounts *(Errors and omissions)*		

VAT CONTROL								B	
		Balance*	b/d				Balance*	b/d	
		Bank *(Payment made to SARS)*	CPJ				Output VAT *(Closing amount)*	GJ	
		Input VAT *(Closing amount)*	GJ				Balance	b/d	
		Balance	b/d						
		Balance*	b/d				Balance*	b/d	

**The opening and closing balances will depend on whether the vendor owes money to SARS or SARS owes money to the vendor.*

Ethical issues related to VAT

- Registration as a vendor (registration when turnover limit has been reached).
- Levying tax on exempt and zero-rated items.
- Whether a business should issue a tax invoice when cash sales have taken place.
- Adjusting the books in order to claim more Input VAT or pay less Output VAT.
- Entering purchases made by the owner in the books of the business in order to claim more Input VAT.
- Not issuing invoices until payment has been received in order to decrease VAT payable on invoice basis.

Internal audit and control processes related to VAT

Management has to ensure that:

- sufficient records are kept of VAT levied on the supply of goods and/or services
- VAT invoices are issued correctly
- all invoices received are entered and filed
- all cash transactions are entered and invoices and receipts are completed
- records (source documents) are kept in a systematic order (numerical or alphabetical) so that control can take place and fraud/theft can be detected
- all payments of VAT to SARS are approved
- all payments to SARS take place in time
- tax evasion does not take place.

Exercise 2.9

Assume that TTA (Tumi's Tennis Academy) is registered for VAT. Study the following information:

Total of invoices received during May 2.11	Excl. VAT	28 250
Total of invoices issued during May 2.11	Excl. VAT	24 216
Total income earned from tennis lessons during May 2.11	Excl. VAT	15 200

Expenses for May 2.11 (VAT inclusive where applicable)	
Telephone	320
Advertising	3 000
Stationery	265
Tumi's salary	8 000

Questions

1 Is it compulsory for TTA to register for VAT? Give a reason for your answer.

2 Calculate the Output VAT for May 2.11.

3 Calculate the Input VAT for May 2.11.

4 Draw up the VAT control account for May 2.11.

GENERAL LEDGER OF TTA

BALANCE SHEET ACCOUNTS SECTION

VAT CONTROL **B**

5 Where would the balance of the VAT control account be used in the Balance Sheet for May 2.11?

6 One of Tumi's friends suggested that Tumi charge VAT even if the business is not registered for VAT. Write a short note to Tumi explaining if this is acceptable or not.

Exercise 2.10

Calculate the amount owed to SARS:

Transactions for the two-month period (including VAT unless otherwise stated)

1 Cash sales of merchandise, R90 000 (excluding VAT).
2 Credit sales of merchandise, R108 300.
3 Credit purchases of merchandise and equipment, R178 980.
4 Returns of merchandise by customers, R8 500 (excluding VAT).
5 Returns of merchandise to suppliers, R14 136.
6 An old vehicle with a carrying value of R50 000 was sold for R61 560.
7 Bad debts written off, R5 597,40.
8 Bad debts recovered, R649,80.
9 Discount allowed to customers, R6 726.
10 Discount received from suppliers, R15 390.

No.	Description (and calculations)	Amount owed to SARS increase or decrease by . . .
1		
2		
3		
4		
5		
6		
7		
8		
9		
10		
	Amount owed to SARS/Amount owed by SARS	

Term 3

Overview: Treatment of CAPS in Via Afrika's textbook

<table>
<tr><td rowspan="4">Term 3
Overview</td><td>Topic 12</td><td rowspan="2">Accounting concepts unique to a manufacturing business
The production cost statment
The Income Statement with notes for a manufacturing business
Ethical issues relating to manufacturing
Internal audit and control processes relating to manufacturing</td></tr>
<tr><td>Cost accounting</td></tr>
<tr><td>Topic 13</td><td></td></tr>
<tr><td>Budgeting</td><td>Introduction to budgeting
The projected Income Statement
The Cash Budget
Ethical issues relating to budgeting and projections
Internal audit and control processes comparing the budget and projections with actual figures</td></tr>
</table>

Projected Income Statement

Projected Income Statement: A statement that shows the projected income, expenses and profit for future financial periods.

End-of-period Income Statement	Projected Income Statement
Historical (real) income and expenses occurred	Projections of expected income & expenses in the future
Historical net profit for last financial period	Anticipated net profit for future financial period(s)

Why we draw up a Projected Income Statement

- For financial forecasting to determine future profitability when thebusiness applies for a loan.

- As a control mechanism to track actual transactions against financial forecast.
- As a managerial tool to make adjustments to income and expenses if and when necessary.

How to prepare a Projected Income Statement

Step 1 Start with the format of the end-of-period Income Statement.

Step 2 Add future periods.

Step 3 Enter real projected figures for the first financial period.

Step 4 Calculate projected figures for future financial periods:

- **Horizontal analysis:** Sales increased by 10% on a year-to-year basis and it is expected that this trend will continue.
- **Predictable items:** Wages will increase by 10% each year. Five new workers will be employed in 2.13 at a wage of R20 000 each.

STEP 1

NAME OF BUSINESS: . . . Limited
PROJECTED INCOME STATEMENT FOR THE PERIODS ENDING 28 FEBRUARY

STEP 2

STEP 3

STEP 4

	2.11	**2.12**	**2.13**	**2.14**
Sales	600 000	660 000	726 000	798 600
Cost of sales	(280 000)			
Gross profit	320 000			
Other operating income	150 000			
Income 1	60 000			
Income 2	50 000			
Income 3	40 000			
Gross operating income	470 000			
Operating expenses	(190 000)			
Expense 1	20 000			
Expense 2	30 000			
Expense 3	40 000			
Expense 4	50 000	**55 000**	**80 000**	**88 000**
Expense 5	50 000			
Expense 6				
Expense 7				
Operating profit (loss)	280 000			
Interest income	20 000			
Profit (Loss) before interest expense	300 000			
Interest expense	50 000			
Profit (Loss) before income tax	250 000			
Income tax	(75 000)			
Net profit (loss) for the period	175 000			

Exercise 3.1

Frank Mason is the owner of Frank's Furniture, a business that manufactures wooden furniture.

Part A

Indicate if the following situations will increase, decrease or have no effect on the total production cost for the financial year.

1 The supplier of the wood informed the factory that they will increase their prices by 10% from the first day of the next month.
2 All the workers who are directly involved in the production process have been trained to use new equipment. The workers will now be able to produce more units per day. They will meet their daily target without having to work overtime.
3 The manager decided to sub-let a part of the factory to an artist.
4 A new telephone system was installed in the office.
5 The commission paid to an agent is increased from 10% to 12% of total sales.

No.	Situation	Increase/Decrease/No effect
1	Supplier of wood informed us that they will increase prices by 10% from first of next month	
2	Workers in production will use new equipment to produce more units per day and meet their target without doing overtime	
3	Manager decided to sub-let part of the factory	
4	A new telephone system was installed in the office	
5	Agent's commission increased from 10% to 12% of total sales	

Part B

The information was taken from the records of Frank's Furniture for March 20.5. They produced 25 wooden tables during the month. There were no tables in production at the beginning or the end of the month. Replace the letters **A** to **P** with the correct amounts or descriptions.

PRODUCTION COST STATEMENT		
	Total	**Per table**
A	**B**	**?**
Raw materials	**C**	300
Direct labour	**D**	180
Factory overheads	**F**	**E**
Manufacturing cost	**?**	696
Work-in-progress (beginning of month)	0	0
Work-in-progress (end of month)	0	0
H	**G**	**?**

INCOME STATEMENT		
	Total	**Per table**
Sales (Cost plus 150%)	**L**	**K**
Cost of sales	**J**	**I**
M	**N**	**?**
Operating expenses	**?**	**?**
Administration cost	2 125	85
Selling and distribution cost	2 875	115
O	**P**	**?**

Part C

The information was taken from the records of Frank's Furniture for May 20.5.

- Production for May: 28 tables.
- Total fixed cost for May, R9 500.
- Total variable cost for May, R18 312.
- Selling price per table, R1 750.

Questions

1 What is the difference between fixed cost and variable cost?

2 Give one example each of fixed and variable costs.

3 Explain the break-even point.

4 Calculate the break-even point.

Exercise 3.2

The following information relates to Woodpeckers. The business produces furniture.

Balances	**2.11-02-28**	**2.10-02- 28**
Raw materials stock	?	170 000
Work-in-progress stock	260 000	230 000
Consumable stores stock: Factory	22 100	28 900
Consumable stores stock: General	5 800	7 200
Factory machinery	1 200 000	950 000
Accumulated depreciation on factory machinery	620 000	380 000
Shop and office equipment	190 000	190 000
Accumulated depreciation on shop and office equipment	52 725	28 500

Summary of transactions for year ended 28 February 2.11	
Purchases of raw materials on credit	930 000
Purchases of raw materials for cash	840 300
Raw materials issued to factory	1 820 000
Consumables stores purchased: Factory	92 951
Consumables stores purchased: Shop and office	22 400
Production wages	960 000
Salary: Factory manager	238 000
Wages: Factory cleaners	132 000
Salary: Sales staff and administration	288 000
Water and electricity: Factory	87 000
Water and electricity: General	11 780
Maintenance: Factory machinery	?
Maintenance: General	?
Sundry expenses: Factory	178 000
Sundry expenses: Shop and administration	108 000
Insurance	45 000

Additional information

1 An invoice for R9 700, received from Log Transport for the transport of raw materials to the factory, had not been recorded.

2 New machinery was purchased on 1 March 2.10. Depreciation is written off as follows: 20% p.a. on cost of factory machinery and 15% p.a. on the diminishing balance method on shop and office equipment.

3 Insurance cost is divided as follows: Factory 80%, Shop and office 20%.

4 On 1 March 2.10 the business got quotes for maintenance from two businesses:
   - Emanuel Labor suggested that we pay him a cash amount of R17 500 every month. As he said, 'No invoice means no VAT'. Maintenance for the factory is calculated at R15 000 a month.
   - Don Right quoted a total annual amount of R229 824 (including 14% VAT).
   - Woodpeckers accepted Emanuel Labor's offer. All payments were made in cash during the year.

Instructions

1 Calculate the raw materials stock on hand on 28 February 2.11.

2 Prepare the Factory overheads note to the Production Cost Statement for the year ended 28 February 2.11.

FACTORY OVERHEADS	

3 Prepare the Production Cost Statement for the year ended 28 February 2.11.

NAME OF BUSINESS: Woodpeckers **PRODUCTION COST STATEMENT FOR THE YEAR ENDED28 FEBRUARY 2.11**	

4.1 Calculate the total annual amount paid to Emanuel Labor in cash for maintenance.

4.2 What type of VAT is included in the amount R229 824 quoted by Don Right?

4.3 What effect would this type of VAT have on the amount owed to SARS for VAT?

4.4 Calculate the amount quoted by Don Right excluding the VAT.

4.5 Did Woodpeckers made the right decision by accepting Emanuel Labor's offer? Give two reasons to support your answer.

Exercise 3.3

The following details relate to T-Designs, a business that produces and sells T-shirts:

Balances	**30 June 2.11**	**30 June 2.10**
Raw materials stock	14 630	12 300
Work-in-progress stock	1 350	1 830
Finished goods stock	27 000	1 500
Consumable stores stock	2 900	5 700
Land and buildings	950 000	950 000
Factory machinery	?	30 000
Accumulated depreciation on factory machinery	?	18 000
Shop equipment	?	21 000
Accumulated depreciation on shop equipment	?	8 000

Summary of transactions for the year ended 30 June 2.11	
Purchases of raw materials on credit	26 550
Purchases of raw materials for cash	21 200
Returns of raw materials to creditors	4 300
Carriage on purchases of raw materials	2 850
Consumables stores purchased on credit	7 400
Consumables stores purchased for cash	10 200
New factory machinery purchased on 1 March 2.11	15 000
All old shop equipment sold for cash on 31 December 2.10	11 000
New shop equipment purchased on credit on 31 December 2.10	24 000
Production wages	44 000
Salary: Factory supervisor	28 000
Salary: Sales staff	28 000
Salary: Administration	8 000
Water and electricity	3 000
Maintenance: Factory machinery	5 200
Sundry expenses: Factory	1 090
Sundry expenses: Shop	730
Sundry expenses: Administration	420
Insurance	9 960

Additional information

1 Consumable stores are used as follows: 60% of cost for factory, 25% of cost for shop and rest for administration.

2 Insurance and Water & electricity are divided according to surface area: Factory is 200 m²; shop is 25 m² and office is 15 m². The annual premium of R4 800 for one of the insurance

policies was paid on 1 January 2.11.

3 The employer's contribution to the UIF was omitted from wages and salaries.

4 Depreciation must be brought into account as follows:

- On factory machinery at 20% p.a. on cost price.
- On shop equipment at 15% p.a. on the diminishing balance.

5 Information supplied by the shop:

- Mark-up on cost: 50%
- Selling price per T-shirt: R90

Instructions

Complete the following:

1 Asset disposal account:

ASSET DISPOSAL									B
Date		*Details*		*Amount*	*Date*		*Details*		*Amount*

2 Note on fixed assets to financial statements on 30 June 2.11.

NOTE TO FINANCIAL STATEMENTS ON 30 JUNE 2.11			
3	**FIXED ASSETS**	**Factory machinery**	**Shop equipment**
	Carrying value at end of previous year		
	Movements		
	Carrying value at end of current year		

3 Notes to production cost statement for year ended 30 June 2.11:

1	**RAW MATERIALS STOCK**	

3

FACTORY OVERHEADS COST	

4 Production cost statement:

PRODUCTION COST STATEMENT FOR THE YEAR ENDED30 JUNE 2.11	
Prime cost	
Total cost of production	
Add: Work-in-progress (beginning of year)	
Less: Work-in-progress (end of year)	

5 Gross profit:

Manufacturing businesses and production costs

Operating cost

The total of all cost items is shown as production costs on the Production Cost Statement and as term costs on the Income statement.

Direct materials cost: The cost can be directly (exclusively) linked with a specific unit that is produced, i.e. the direct materials cost plus the direct labour cost. Ask yourself whether you can allocate cost directly to a specific product, (for example, four screws to fasten the table top to the steel frame). The rand value of materials used to manufacture a specific product, for example the value of the wood used to make a table, is recorded as the net purchase amount (purchase price on the invoice less trade discount) plus transport costs, storage costs and handling costs.

Direct labour cost: This includes the salaries and wages of workers directly involved in the production of the product, for example machine operators) and can be identified as a specific amount of time (per hour or day) or cost per unit.

Conversion cost: The cost added to raw materials cost to convert raw materials into finished goods and are calculated as the direct labour cost plus manufacturing overheads.

Manufacturing overheads cost: The part of the cost relating to the manufacturing process, but not directly identified as part of the costs of a specific product. Manufacturing overheads include the rand value of materials necessary to produce a product, but that can't be linked to the manufacturing of a single product such as the cost of cleaning materials to clean machinery.

- Costs incurred by the production division and offices used by the production division that can't be easily allocated to a specific product, for example administrative expenses, rent expense for office space and factory buildings, utilities such as water, electricity and assessment rates, insurance of assets, maintenance and repairs on factory equipment and factory buildings, salary of the production manager, depreciation on office equipment and vehicles.
- Non-manufacturing costs such as selling, marketing and administrative expenses and that relate to the financial year rather than to the number of products manufactured, i.e. they are closed off to the Profit and loss account at year end.

Indirect labour cost: Salaries and wages of workers not directly involved in the production of the product, for example supervisors and cleaners.

Variable cost (TVC & AVC): Variable cost relates to the number of units produced. This varies in direct proportion to the number of units produced: the more units produced, the higher the total variable cost will be.

$$AVC = \frac{TVC}{Q} = Rx, xx\ per\ unit$$

T = Total for all units

Fixed cost (TFC & AFC): This is the part of the total cost that remains unchanged and does not vary depending on the number of goods produced, for example rent paid for the factory. The total fixed cost remains constant, no matter whether 1 or 10 000 units are produced.

$$AFC = \frac{TFC}{Q} = Rx, xx\ per\ unit$$

Total cost (TC): The total cost of production equals total fixed cost (TFC) plus total variable cost (TVC).

$$TC = \text{TFC} + \text{TVC} = Rx, xx$$

Average cost per unit (AC): The cost per unit produced is calculated as the total cost of production (TC) divided by the number of units produced.

$$AC = \frac{\text{TFC}}{Q} + \frac{\text{TVC}}{Q} = Rx, xx\ per\ unit$$

$$AC = \text{AFC} + \text{AVC} = Rx, xx\ per\ unit$$

Q per month	TVC	AVC	TFC	AFC	TC	AC
(A)	(B)	(C) = $\frac{(B)}{(A)}$	(D)	(E) = $\frac{(D)}{(A)}$	(F) = (B) + (D)	(G) = $\frac{(F)}{(A)}$ or (C) + (E)
2 500	R10 000	R4	R60 000	R24	R70 000	R28
5 000	R20 000	R4	R60 000	R12	R80 000	R16
7 500	R30 000	R4	R60 000	R8	R90 000	R12
10 000	R40 000	R4	R60 000	R6	R100 000	R10

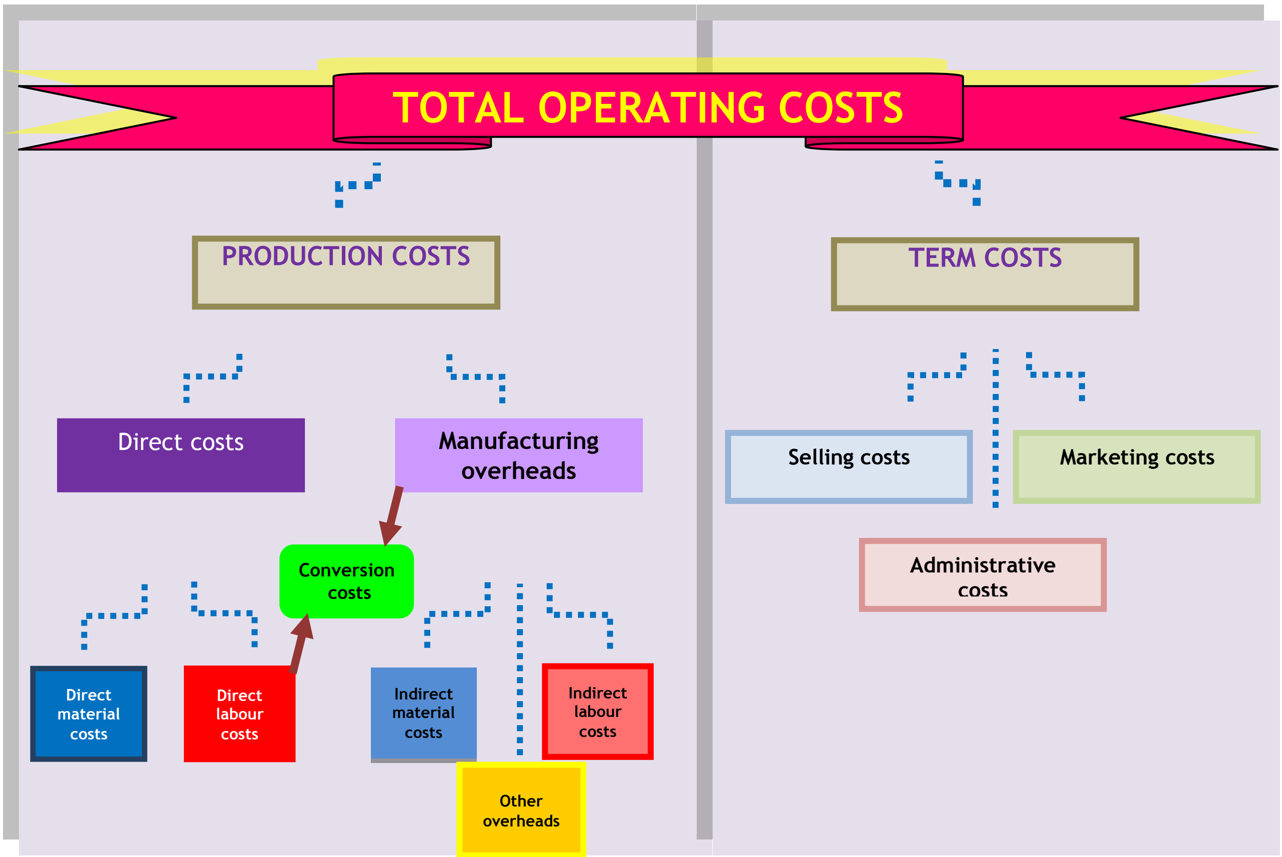
Production cost: The sum total of the direct materials cost plus the direct labour cost plus the manufacturing overheads.

Prime cost: The sum of direct materials cost plus direct labour cost.

Work-in-progress cost: This includes direct materials, labour and overheads of goods already in the production process, but the product is not yet finished.

Calculating cost per unit (known as average cost): You can calculate any cost per unit by dividing the total cost by the number of units:

$$\textit{direct materials per unit} = \frac{\textit{total direct materials cost}}{Q} = Rx, xx \textit{ per unit}$$



The break-even point (BEP)

The BEP indicates how many units must be sold in order to cover total fixed costs for the year. If the BEP is reached, the business will not make a loss. It is the point where the business will start to make a profit.

Calculating the breakeven point (BEP_q):

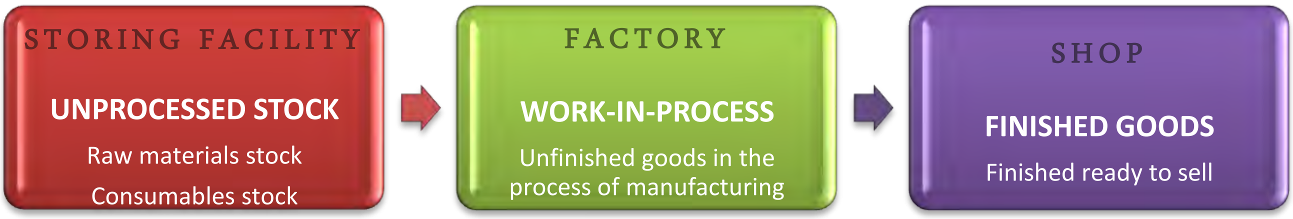
$$\mathbf{BEP_q} = \frac{\mathbf{TFC}}{\mathbf{SP - AVC}} = \boldsymbol{x\ units}$$

Calculating contribution per unit: Contribution per unit indicates the contribution of each unit sold to pay for the fixed cost or the selling price less average variable cost.

$$\mathbf{Contribution\ per\ unit = \ SP - AVC = R}\boldsymbol{x}$$

Cost accounts in the General Ledger

- A manufacturing business uses raw materials and processes them into finished products.
- It takes time to process raw materials into finished products. So stock (inventory) will be in three different stages of completion. The diagram shows the flow of stock in manufacturing:



The General Ledger of a manufacturing business contains three sections:

- The Balance Sheet accounts section
- The Nominal accounts section
- The Cost accounts section.

For practical purposes the financial year is 1 July 2019 to 30 June 2020.

GENERAL LEDGER OF A MANUFACTURING BUSINESS

BALANCE SHEET ACCOUNTS SECTION

RAW MATERIALS STOCK **B**

2019 Jul.	01	Balance *(Value of raw material not used in previous financial year)*	b/d		2020 Jun.	30	Creditors control *(Purchases returns)*	CAJ	
2020 Jun.	30	Bank*(Purchases and transport costs for cash)*	CPJ				Raw materials issued *(Value of raw material issued to factory for use in manufacturing process, normally the balancing figure)*	GJ	
		Creditors control *(Purchases and transport costs on credit)*	CJ				Balance *(Value of raw material not used in current financial year)*	b/d	
2020 Jul.	01	Balance *(Value of raw material not used in current financial year)*	c/d						

WORK-IN-PROGRESS STOCK **B**

2019 Jul.	01	Balance *(Value of unfinished goods on last day of previous*	b/d		2020 Jun.	30	Finished goods stock *(Value of finished goods ready for selling*	GJ	

		financial year)					*sent from factory to shop)*		
2020 Jun.	30	Raw (direct) materials cost *(Value of direct material used for the year)*	GJ				Balance *(Value of unfinished goods on last day of current financial year)*	b/d	
		Direct labour cost *(Value of direct labour for the year)*	GJ						
		Factory overheads cost *(Value of factory overheads for the year)*	GJ						
2020 Jul.	01	Balance *(Value of unfinished goods on first day of next financial year)*	c/d						

FINISHED GOODS STOCK — B

2019 Jul.	01	Balance *(Value of finished goods on last day of previous financial year)*	b/d		2020 Jun.	30	Cost of sales *(Value of finished goods sold as at the last day of the current financial year)*	GJ	
2020 Jun.	30	Work-in-progress stock *(Value of finished goods ready for selling sent from factory to shop)*	GJ				Balance *(Value of finished goods ready for selling on last day of current financial year)*	b/d	
Jul.	01	Balance *(Value of finished goods ready for selling on last day of current financial year)*	b/d						

CONSUMABLES STORES STOCK (INDIRECT MATERIAL) — B

2019 Jul.	01	Balance *(Value of consumables on hand on last day of previous financial year)*	b/d		2020 Jun.	30	Factory overhead costs *(Transfer value of consumables on hand)*	GJ	
2019 Jul.	01	Factory overhead costs *(Value of consumables on hand on last day of current financial year)*	GJ						

NOMINAL ACCOUNTS SECTION

SALES — N

2020 Jun.	30	Debtors allowances *(Sales returns)*	DAJ		2019 Jul.	01	Balance *(If applicable)*	b/d	
		Trading account *(Closing transfer)*	GJ		2020 Jun.	30	Bank *(Cash sales for current financial year)*	CRJ	
							Debtors control *(Credit sales for current financial year)*	DJ	

COST OF SALES — N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Trading account *(Closing transfer)*	GJ	
2020 Jun.	30	Finished goods stock *(Value of finished goods sold as at last day of current financial year)*	GJ						

RAW MATERIALS ISSUED — N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Raw materials cost *(Value of direct material used in manufacturing process)*	GJ	
2020 Jun.	30	Raw materials stock *(Value of direct material issued to factory for use in manufacturing process)*	GJ						

GROSS WAGES & SALARIES N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun	30	Direct labour cost *(Allocation of cost of direct labour used in manufacturing process)*	GJ	
2020 Jun.	30	Bank *(Payments)*	CPJ				Factory wages and salaries *(Allocation of cost of indirect labour used in manufacturing process)*	GJ	
							Administration costs *(Allocation of cost of administration staff used)*	GJ	
							Selling & distribution costs *(Allocation of cost of sales labour used in the selling & marketing process)*	GJ	

FACTORY WAGES & SALARIES N

2020 Jun.	30	Gross wages and salaries *(Allocation of cost of indirect labour used in manufacturing process)*	GJ		2020 Jun.	30	Factory overhead costs *(Allocation of cost of indirect labour used in manufacturing process)*	GJ	

ELECTRICITY N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Factory electricity *(Allocation of electricity used by factory in manufacturing process)*	GJ	
2020 Jun.	30	Bank *(Payments)*	CPJ				Administration costs *(Allocation of electricity used by administration staff)*	GJ	
							Selling & distribution costs *(Allocation of electricity used by selling & marketing staff)*	GJ	

FACTORY ELECTRICITY N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Factory overhead costs *(Transfer value of expenses incurred by factory)*	GJ	
2020 Jun.	30	Bank *(Payments)*	CPJ						

RENT N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Factory rent *(Allocation of rent of factory)*	GJ	
2020 Jun.	30	Bank *(Payments)*	CPJ				Administration costs *(Allocation of rent of administration office)*	GJ	
							Selling & distribution costs *(Allocation of rent of shop)*	GJ	

FACTORY RENT N

2019 Jul.	01	Balance*(If applicable)*	b/d		2020 Jun.	30	Factory overhead costs *(Transfer value of expenses incurred by factory)*	GJ	
2020 Jun.	30	Bank*(Payments)*	CPJ						

DEPRECIATION ON EQUIPMENT N

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Factory depreciation in equipment *(Allocation of depreciation of*	GJ	

							equipment used by factory)		
2020 Jun.	30	Accumulated depreciation on equipment*(Year-end adjustment)*	GJ				Administration costs depreciation on equipment (*Allocation of depreciation of equipment used by administration office)*	GJ	
							Selling & distribution costs depreciation in equipment *(Allocation of depreciation of equipment used by sales team)*	GJ	

FACTORY DEPRECIATION ON EQUIPMENT **N**

2019 Jul.	01	Balance*(If applicable)*	b/d		2020 Jun.	30	Factory overhead costs *(Transfer value of expenses incurred by factory)*	GJ	
2020 Jun.	30	Bank *(Payments)*	CPJ						

COST ACCOUNTS SECTION

RAW MATERIALS COST (DIRECT MATERIALS COST) **C**

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Work-in-progress stock *(Value of total direct materials transferred to work-in-progress for current financial year)*	GJ	
2020 Jun.	30	Raw materials issued *(Value of direct materials used in the manufacturing process)*	GJ				*(In real life there could be more than one type of raw material used. So we are adding them all.)*		

DIRECT LABOUR COSTS **C**

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Work-in-progress *(Value of total direct materials transferred to work-in-progress for current financial year)*	GJ	
2020 Jun.	30	Gross wages and salaries *(Cost of direct labour used in manufacturing process)*	GJ						

FACTORY OVERHEAD COSTS **C**

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Work-in-progress *(Value of total indirect costs transferred to work-in-progress for current financial year)*	GJ	
2020 Jun.	30	Factory wages *(Indirect labour cost for factory)*	GJ						
		Factory electricity *(Electricity for factory)*	GJ						
		Factory rent *(Rent of factory)*	GJ						
		Factory depreciation on equipment *(Cost of depreciation used in manufacturing process)*	GJ						

ADMINISTRATION COSTS **C**

2019 Jul.	01	Balance *If applicable*	b/d		2020 Jun.	30	Profit and loss *(Closing transfer)*	GJ	
2020 Jun.	30	Administration wages *(Used by administration office)*	GJ						
		Administration electricity *(Electricity used by*	GJ						

		administration office)							
		Administration rent *(Rent used by administration office)*	GJ						
		Administration depreciation on equipment *(Cost of depreciation used by the administration office)*	GJ						

SELLING & DISTRIBUTION COSTS **C**

2019 Jul.	01	Balance *(If applicable)*	b/d		2020 Jun.	30	Profit and loss *(Closing transfer)*	GJ	
2020 Jun.	30	Selling & distribution wages *(Cost of labour used in selling & distribution office)*	GJ						
		Selling & distribution electricity *(Electricity used by selling & distribution office)*	GJ						
		Selling & distribution rent *(Rent used by selling & distribution office)*	GJ						
		Selling & distribution depreciation on equipment *(Cost of depreciation used in selling & distribution office)*	GJ						

Financial statements of a manufacturing business

Production Cost Statement: A statement that calculates the cost of producing finished goods.

Income Statement: A statement that calculates the net profit profit for the year.

Notes to the financial statements: The notes to the production cost statement and income statement give additional information on the cost accounts.

Examples of the statements prepared for a manufacturing business

NAME OF BUSINESS: Exemplia Manufacturers PRODUCTION COST STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 2020		
	Notes	**R**
Direct materials cost	1	xx xxx
Direct labour cost	2	xx xxx
Prime cost		xx xxx
Factory overheads cost	3	xx xxx
Total cost of production		xx xxx
Work-in-progress at the beginning of the year		xx xxx
		xx xxx
Less: Work-in-progress at the end of the year		(xx xxx)
Cost of production of finished goods		xx xxx

NAME OF BUSINESS: Exemplia Manufacturers INCOME STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 2020		
	Notes	**R**
Sales		xx xxx
Less: Cost of sales		(xx xxx)
Gross profit		xx xxx
Selling & distribution cost	4	xx xxx
Administration cost	5	xx xxx
Net profit		xx xxx

NAME OF BUSINESS: Exemplia Manufacturers NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2020			
1	**DIRECT (RAW) MATERIALS COST**		**R**
	Balance at beginning of year		xx xxx
	Purchases		xx xxx
	Carriage and other costs on purchases		xx xxx
			xx xxx
	Less: Balance at end of year		(xx xxx)
			xx xxx

2	**DIRECT LABOUR COST**		**R**
	Direct wages (& salaries)		xx xxx
	Pension, medical & UIF benefits		xx xxx
			xx xxx

3	**FACTORY OVERHEADS COST**		**R**
	Indirect materials		xx xxx
	Indirect wages		xx xxx
	Pension, medical & UIF benefits		xx xxx
	Factory rent		xx xxx
	Factory electricity		xx xxx
	Depreciation on factory equipment		xx xxx
	(Any other indirect costs to be specified)		xx xxx
			xx xxx

4	**SELLING & DISTRIBUTION COST**		**R**
	Wages		xx xxx
	Pension, medical & UIF benefits		xx xxx
	Commission on sales		xx xxx
	Electricity		xx xxx
	Rent expense		xx xxx
	Depreciation on equipment		xx xxx
	Advertising		xx xxx
	Bad debts		xx xxx
	Stationery		xx xxx
	(Any other selling & distribution costs to be specified)		xx xxx

		xx xxx

5	ADMINISTRATION COST		R
	Office salaries/wages		xx xxx
	Pension, medical & UIF benefits		xx xxx
	Electricity		xx xxx
	Rent expense		xx xxx
	Depreciation on equipment		xx xxx
	Stationery		xx xxx
	(Any other administration costs to be specified)		xx xxx
			xx xxx

Ethical issues related to a manufacturing business

The following ethical issues relate to a manufacturing business:

- Product quality (you can save on costs if you use cheaper and inferior quality raw materials).
- Product age (sell-by dates, manufacturing dates, using raw materials that have passed these dates).
- Raw materials (sustainable usage).
- Support for local products (using cheap imports from overseas rather than locally produced raw materials).
- Price-fixing (where competitors decide together to increase/fix prices at certain levels).
- Theft (control processes to curb theft by workers).
- Fraud (control processes to curb fraud when allocating contracts to suppliers).

Internal audit and control processes related to a manufacturing business

Management has to ensure that:

- All orders for direct and indirect material are only done by the purchasing section.
- Orders to suppliers, invoices received and delivery notes for direct and indirect material received by the storing facility are checked for quantities, prices and shortages (back-orders).
- Direct and indirect materials may only be transferred to the factory once a requisition has been received and approved.
- Records (source documents) must be kept in a systematic order (numerical/alphabetical) so that control can take place and fraud/theft can be detected.
- Record are kept of all finished good transferred between the factory and the selling and distribution section.
- Consecutive steps in the flow of materials are delegated so that different people are responsible for the receipt and issuing of stock.
- Security measures are in place at the entry/exit to the factory and other premises.

Budgeting

Cash Budget: This is a projection of estimated amounts received and paid within a certain period. It is a tool to be used in management and internal control. The purpose of a budget is to:

- ensure that the business stays within their financial limits.
- help the business to identify risks
- help the business to find funding, if necessary.

Projected Income Statement: Drawing up a projected Income Statement assists a business to decide whether it can continue to operate with its projected income and expenses. It is used to project future income and expenses. An Income Statement is the result of operations during the past financial year. The table represents possible receipts and payments in a cash budget:

Receipts	**Payments**
Cash sales	Cash purchases
Debtors collection	Payments to creditors
Interest received on investment or bank accounts	Operating expenses paid every month
Disposal of assets for cash	Repayment of loans
Investment that matures	Cash purchase of fixed assets
Rent income	Investments
Bad debts recovered (in cash)	Money withdrawn by owner

Items that will not appear on a cash budget as they are non-cash items:

Depreciation	Bad debts
Discount allowed	Discount received
Bad debts	Trading stock* withdrawn by owner for personal use

** If the owner takes stock for personal use every month, it must be replaced and will therefore be included in purchases.*

Exercise 3.4

You are provided with the Cash Budget and the Projected Income Statement of Top Gardens. The business sells plants, garden equipment and garden furniture, as well as providing gardening services.

NAMEOF BUSINESS: Top Gardens CASH BUDGET FOR THE TWO MONTHS ENDED ON 30 APRIL 2.11		
	March 2.11	**April 2.11**
RECEIPTS		
Cash sales	63 600	52 200
Collections from debtors	36 880	35 610
Fee income	30 000	30 000
Interest of fixed deposit (10% p.a.)	700	700
Fixed deposit	0	84 000

Interest received on current account	106	280
Equipment sold	0	9 500
TOTAL RECEIPTS	131 286	212 290
PAYMENTS		
Cash purchases of stock	39 750	32 625
Payments to creditors	22 088	25 175
Salaries & wages	10 000	10 800
Materials cost	3 000	3 000
Consumable stores	200	200
Interest on loan (15% p.a.)	625	625
Payment of loan	0	50 000
Sundry expenses	3 400	3 400
TOTAL PAYMENTS	79 063	125 825
CASH SURPLUS/DEFICIT	52 223	86 465
BALANCE AT BEGINNING OF MONTH	31 800	84 023
CASH ON HAND AT END OF MONTH	84 023	170 488

Information on debtors and creditors

1 60% of total sales are cash sales.
2 Past trends indicate that debtors pay as follows:
- 50% pay in the month of sale and receive 5% discount
- 45% pay in the next month
- 5% is written off in the second month after sale.

3 The business receives cash for all services rendered.
4 60% of total purchases are cash purchases.
5 The business complies with the following terms in paying creditors: All creditors are paid in the month after purchase to receive a 5% discount.

NAMEOF BUSINESS: Top Gardens
PROJECTED INCOME STATEMENT FOR THE MONTHS OF MARCH AND APRIL 2.11

	March 2.11	**April 2.11**
Sales	106 000	87 000
Less: Cost of sales	(66 250)	(54 375)
Gross profit	39 750	32 625
Income from services rendered	30 000	30 000
Add: Other operating income	1 162	2 025
Discount received	1 162	1 325
Profit on sale of assets	0	700
Gross operating income	70 912	64 650
Less: Operating expenses	(25 487)	(25 337)
Salaries & wages	10 000	10 800
Trading stock deficit	660	540
Materials cost	3 000	3 000
Bad debts	1 700	1 860
Consumable stores	200	200
Sundry expenses	3 400	3 400

Discount allowed	1 060	870
Depreciation (Equipment)	2 467	1 667
Depreciation (Vehicle)	3 000	3 000
Operating profit	45 425	39 313
Add: Interest income	806	980
Profit before interest expense	46 231	40 293
Less: Interest expense	(625)	(625)
Net profit	45 606	39 668

Instructions

1 Calculate the carrying value of the equipment that was sold in April 2.11.

2 Was the equipment sold on 1 April 2.11 or 30 April 2.11? Give a reason for your answer.

3 Depreciation is written off at 20% p.a. on cost of equipment. Calculate the cost price of the equipment that was sold.

4 The total sales amount for January 2.11 was R85 000. Do a calculation to confirm this amount.

5 Does the business have a policy to maintain trading stock at a fixed stock base (they only replace what they sell)? Support your answer with a calculation.

6 Give a short explanation for the positive difference in the surplus between March and April.

7 Explain the difference between the surplus on the Cash Budget and the Net profit on the Projected Income Statement.

8 List three items that would never appear on a Cash Budget and explain why they do not appear on a Cash Budget.

9 Calculate the annual percentage interest earned on the current account.

10 Explain why the payment of the loan does not appear on the Projected Income Statement but the Interest on loan (Interest expense) does appear on the Projected Income Statement.

11 List two possible sources for the money used to repay the loan.

12 What is the main reason for the decrease in the net profit over the two months?

13 What mark-up percentage does the business use?

Exercise 3.5

Kenosi Lenyalo, the owner of Lenyalo Stores, presents the following cash budget for the three months ended 31 August 20.7 to you. He asked a friend to draw up the budget but does not really understand the budget.

NAME OF BUSINESS: Lenyalo Stores **DEBTORS COLLECTION SCHEDULE**				
Month	**Credit sales**	**Collections: June**	**Collections: July**	**Collections: August**
April	70 000	10 500		
May	56 000	28 000	8 400	
June	70 000	19 950	35 000	10 500
July	84 000		23 940	42 000
August	77 000			21 945
		58 450	**67 340**	**74 445**

NAME OF BUSINESS: Lenyalo Stores **CREDITORS PAYMENT SCHEDULE**				
Month	**Credit purchases**	**June**	**July**	**August**
May	32 000	30 400		
June	40 000		38 000	
July	72 000			68 400
August	56 000			–
		30 400	**38 000**	**68 400**

NAME OF BUSINESS: Lenyalo Stores CASH BUDGET FOR THE PERIOD 1 JUNE TO 31 AUGUST 20.7			
	June	**July**	**August**
RECEIPTS			
Cash sales	30 000	36 000	33 000
Collections from debtors	58 450	67 340	74 445
Loan	180 000		
Vehicle sold		10 000	
TOTAL RECEIPTS	268 450	113 340	107 445
PAYMENTS			
Cash purchases of stock	10 000	18 000	14 000
Payments to creditors	30 400	38 000	64 400
Deposit on new vehicle		15 000	
Payment on vehicle			6 750
Salaries & wages	25 000	25 000	26 750
Drawings	20 000	20 000	20 000
Rent expense	12 000	12 000	12 000
Operating expenses	3 200	3 200	3 200
Interest on loan		1 650	1 650
TOTAL PAYMENTS	100 600	132 850	148 750
CASH SURPLUS/DEFICIT	167 850	(19 510)	(41 305)
BALANCE AT BEGINNING OF MONTH	13 500	181 350	161 840
CASH ON HAND AT END OF MONTH	181 350	161 840	120 535

Instructions

Answer the questions. Support your answers with calculations, where necessary.

1 What is a cash budget and why is it important for business to have a cash budget?

2 What is the difference between cash sales and cash received from debtors in the cash budget?

3 Calculate the total sales for August 20.7.

4 Does the business receive discount from suppliers? If so, what percentage discount do they receive?

5 Lenyalo Stores allows discount to customers for prompt payment. They also write off 5% as irrecoverable in the third month after the sales. Calculate the collection policy that applies to Lenyalo Stores.

6 Will the old vehicle be sold for cash, on credit or traded in? Give a reason for your answer.

7 The business will purchase a new vehicle on 1July 20.7. According to the agreement, the business needs to pay a deposit and 20 equal payments thereafter. Calculate the cost price of the vehicle.

8 The bank granted a loan to Lenyalo Stores. The money will be received on 1 June 20.7. The business must pay a fixed amount of R18 000 every six months as well as a monthly interest payment at a fixed percentage. Calculate the interest percentage per annum.

9 Explain to Kenosi Lenyalo the difference between a surplus and a deficit.

General revision and hints for Accounting

Exam tips

It is easy to achieve excellent results in Accounting if you follow one rule: practice and more practice! You can never say, ‘I understand Accounting, I don’t have to study for the exam.’ Accounting is about presenting financial information. You need to know the concepts, basic principles and formats to be able to apply them to the given information. Preparation for the Accounting exam takes time – start now! Your ‘input’ will achieve your ‘output’ in marks.

Preparing for the exam

1 Read your textbook. If you are finding a certain concept difficult, look it up in the textbook. If you are still unsure, turn to other textbooks or use the Internet.
2 You must be able to explain any concept used in Accounting. Can you answer questions such as the following:
   - What is depreciation?
   - What is an appropriation account?
   - What does ‘limited liability’ mean?
3 Learn the formats of the basic accounts: Debtors control, Trading stock (in perpetual inventory system), Accumulated depreciation, Appropriation account, SARS: Income tax and so on. You must also be able to explain why the account must be debited or credited in a certain transaction or adjustment.
4 Learn the formats of statements like the bank reconciliation statement, production cost statement. In some questions you will be asked to prepare a certain part of a statement. You must know where it fits into the accounting records and why it should be prepared.
5 Make sure that you know all the formulas. You must be able to apply the formula as well as use the formula to find ‘missing’ information. For example, to calculate the Earnings per share (EPS), divide the net profit after tax by the number of shares issued. If the EPS as well as the number of shares issued is given, you can calculate the net profit after tax.
6 Start working through as many exam papers as possible. Keep within the allocated time for each question. It is important to show your calculations in brackets even when you are studying. Complete the question before you use the marking guidelines (given in your textbook). If you did not to do well in the question, use the marking guidelines to figure out where you went wrong and then do the question again.
7 As you work through exam papers, you will come across some theoretical questions. Compile your own summary on certain topics by using these questions. You will find that some questions are repeated quite often.
8 As you work through different exam papers, you will notice similarities in the layout of the papers. This will help you to feel more confident when you write your final exam because the paper may look familiar.

Answering an Accounting paper

1. Most exam papers are set on the assumption that you will start with question 1 and work towards the last question. It is recommended that you do it that way.
2. Time can be a problem in Accounting papers. You need to know your work so well that you do not need time to think. However, careful reading is also important. It is too late to panic when you start reading the questions. Take a deep breath and answer the paper to the best of your ability. Remember that your 'input' will help you to achieve the right 'output'.
3. Start each question by 'scanning' through the given information. Now read through the questions ('Required' or 'Instructions'). It is a good idea to mark key points (words or phrases) with a highlighter. For example, pick out the words *Asset disposal* in 'Prepare the Asset disposal account'. Highlight the words *break-even, comment, satisfied* and *explain* in a question such as: 'Calculate the break-even point and comment on it. Should Betta Bins be satisfied with the current production of 12 000 units? Explain.'
4. If you do not read the information and the instructions for each question properly, you may jump in too quickly and do unnecessary calculations, which could waste time.
5. If you have to calculate something, clearly indicate which amount is your actual answer. Show your calculations in brackets to earn part-marks. Always give a reason for a 'yes' or 'no' answer (motivate).
6. Refer to indicators, amounts or numbers in your comments. For example, 'The acid test ratio improved from 0,8 : 1 in 2013 to 1,2 : 1 in 2014.'

TOPIC		**WHAT YOU NEED TO KNOW**
Reconciliation	Bank	What to record in the Cash Receipts Journal and Cash Payments Journal, Bank account, Bank reconciliation statement, Analysis, Cash control measures, Purpose of reconciliation
	Debtors	Debtors control account, Debtors Ledger and Debtors List/Schedule, Correct Debtors control account and Debtors List Debtors age analysis, Control measures
	Creditors	Creditors control account, Creditors Ledger and Creditors List/Schedule Correct Creditors control account and Creditors List Creditors reconciliation statement, Control measures
Inventories	Recording systems	Perpetual inventory/stock system :Trading stock account, Trading account/statement Periodic inventory/stock system : Purchases account, Calculation of cost of sales, Trading account/statement Purpose, advantages and disadvantages of each system
	Valuation system	FIFO method : Purpose, advantages and disadvantages Weighted average method : Purpose, advantages and disadvantages Calculation of cost of sales, value of stock on hand and gross profit under each system
Manufacturing	Concepts	Direct (Prime) cost, Factory overheads, Production cost, Administration cost, Selling & distribution cost, Fixed cost, Variable cost, Break-even point, Control measures and advice on how to increase productivity
	Accounts and statements	Raw materials, Work-in-progress, Finished goods, Trading account, Profit and loss account Production cost statement (notes),Trading + profit/loss statement
	Calculations	Raw materials issued, Indirect materials used, Factory overheads,

		Administration cost, Selling & distribution cost, Cost of sales, Gross profit and Net profit
Fixed assets	Concepts	Depreciation, Carrying value, Asset register (also purpose). Control measures Comparing different assets and giving advice
	Calculations	Depreciation, percentage used, date on which sold or purchased
	Accounts and notes	Accumulated depreciation on vehicles or equipment, Asset disposal, Depreciation. Fixed asset note to Balance Sheet
Budget	Concepts	Purpose, control measures
	Cash budget	Analysis and interpretation Debtors collection schedule, Creditors payment schedule.
	Projected income statement	Analysis and interpretation Difference between surplus, deficit and profit, loss.
VAT	Concepts	Input VAT, Output VAT, who must register, rate
	Calculations	Inclusive or exclusive
	Accounts	Input VAT, Output VAT, VAT control
Companies	Concepts	Legal entity, Limited liability, authorised and issued shares, etc.
	Accounts	SARS: Income tax, Ordinary share dividends, Appropriation account
	Adjustments	Journal entries, General Ledger accounts, Final accounts
	Statements	Income Statement, Balance Sheet with notes Cash flow statement with notes
	Analysis	Formulas and purpose of each Comments on results.
	Annual report	Comment on director's report Duties of company secretary Comment on and explain auditor's report Difference between internal auditor and independent auditor
Other aspects	Accounting equation	For entries concerning all above topics (also account to debit or credit)
	Ethics	Code of conduct, SAICA, SAIPA, IRBA, King Code III
	Audit	Procedures (Internal and external)
	Principles	GAAP, IFRS, Accounting standards

The accounting equation and the accounting cycle

The basic elements of the accounting equation are:

$$E = A - L$$

Equity = Assets – Liabilities

So Assets = Equity + Liabilities and Liabilities = Assets– Equity.

Asset (*A*): A source of scarce resources with a physical form. A tangible asset is one you can touch. For example property, plant and equipment. A non-tangible asset (such as a patent and copyright) is something that tthe business owns as a result of a transaction that happened in the past and may probably bring future economic benefit. Assets may be:

- used in the production of goods or services to be sold by the business
- exchanged for other assets
- used to settle a liability
- distributed to the owners of the business.

Liability (*L*): A present/current obligation is a responsibility or duty to act orperform in a certain way as a result of a transaction that happened in the past and may lead to future economic benefit flowing out of the business. Liabilities may be settled by:

- payment of cash
- transfer of other assets
- provision of services
- replacement of one obligation with another
- conversion of the obligation to equity.

Equity (*E*): The remaining interest in the assets of the business after all its liabilities have been deducted, known as the interest of the owner(s) of the business.

The rule of the accounting equation:

E		=	*A*		–	*L*	
Debit	**Credit**		**Debit**	**Credit**		**Debit**	**Credit**
–	+		+	–		–	+

The double entry principle

In Accounting we use the double entry principle: entries on the debit side of accounts must equal entries on the credit side of accounts. Thus the accounting equation will always balance.

If the owner contributes capital to the business, the capital increases (E+→ credit entry) and bank increases (A+ ➔ debit entry).

- If Equity decreases, the account is debited. If Equity increases, the account is credited.
- If Assets increase, the account is debited. If Assets decrease, the account is credited.
- If Liabilities decrease, the account is debited. If Liabilities increase, the account is credited.

Elements of the accounting equation: Assets

Assets are divided into three groups.

- **Current assets** include trading stock, debtors and other receivables, as well as cash and cash equivalents. An asset is classified as current when it fulfils one or more of the following conditions:
  - the asset will be realised in the financial year or is intended for sale within that time
  - the asset is held mainly to trade
  - the asset is cash or a cash equivalent.
- **Non-current assets** include land and buildings, vehicles and equipment. An asset will be classified as non-current or fixed when it does not fulfil any of the criteria of a current asset.
- **Financial assets** include fixed deposits with a maturity date of more than twelve months.

People sometimes make the mistake of referring to current assets as short-term assets and non-current assets as long-term assets. It is assumed that short-term assets will be used or sold within twelve months and that long-term assets will be used for more than twelve months.

Elements of the accounting equation: Liabilities

Liabilities are divided into two groups.

- **Current liabilities** include creditors and other payables, bank overdraft and short-term loans. A liability is classified as current when it fulfils one or more of the following conditions:
  - the liability is intended to be settled within the financial year
  - the liability is held mainly to trade.
- **Non-current liabilities** include mortgage loans on property. A liability is classified as non-current when it does not fulfil any of the criteria of a current liability.

People sometimes make the mistake of referring to current liabilities as short-term liabilities and non-current liabilities as long-term liabilities. It is assumed that short-term liabilities will be settled within twelve months and that long-term liabilities will be settled after twelve months.

Elements of the accounting equation: Equity

Equity is divided into three groups:

- **Owners' equity** constitutes the interest of the owners in the business. The owners' equity consists of the capital contribution(s) made by the owners, drawings and other reserves (i.e. the retained income of a company).
- **Income** is an increase in economic benefits during the accounting period in the form of an increase in assets or a decrease in liabilities that results in an increase of equity (excluding a contribution from owners).

- **Expenses** are a decrease in economic benefits during the accounting period in the form of a decrease in assets or an increase in liabilities that results in an increase of equity (excluding distributions to owners).

Classifying accounts

Owners' equity	Sole trader or proprietor	Capital Drawings
	Partnership	Capital A and Capital B Drawings A and Drawings B Private account A and Private account B
	Companies	Ordinary share capital Retained income
Income	All businesses	Sales Current income Interest on current account Interest on fixed deposit Interest income Bad debts recovered Provision for bad debts adjustment (decrease) Profit with disposal of non-current assets
Expenditure	All businesses	Cost of sales Advertisement Bank charges Consumables Trade licence Stationery Repairs Wages Salaries Telephone Water and electricity Packaging Insurance Fuel Interest paid Rent expense Provision for bad debts adjustment (increase) Loss with disposal of non-current assets
	Companies	Directors' fees Auditors' fees
Non-current assets	All businesses	Land and buildings Vehicles Equipment
Financial assets	All businesses	Fixed deposit: XXX Bank (more than 12 months)
Current assets	All businesses	Debtors control Trading stock Consumables on hand Bank

		Savings account Petty cash Cash float Fixed deposit: XXX Bank (if it matures within 12 months) Accrued income Prepaid expenses Consumer deposits SARS:PAYE SARS: VAT
	Companies	SARS: Income tax
Non-current liabilities	All businesses	Mortgage loan: XXX Bank
Current liabilities	All businesses	Creditors control Accrued expenses Income received in advance Creditors for wages SARS:PAYE SARS:VAT Creditors for wages Creditors for salaries Creditors for medical fund Creditors for UIF Bank overdraft Short-term loans
	Companies	SARS:Income tax

Analysing transactions with the accounting equation

We use the following four steps to determine which account to debit and which account to credit:

Step 1 Identify the names of the two accounts

Step 2 Classify the two accounts as *E*, *A* or *L*.

Step 3 Identify what happens to each element of the accounting equation. Increase or decrease?

Step4 Use the accounting equation to determine which account to debit and which account to credit.

Transaction: The owner contributes R10 000 as capital		
Step 1	Capital and Bank	
Step 2	Capital ➔ Equity	Bank ➔ Asset
Step 3	Capital ➔ Equity ➔ Increases	Bank ➔ Asset ➔ Increases
Step 4	Capital ➔ Equity ➔ Increases ➔ Credit	Bank ➔ Asset ➔ Increases ➔ Debit
Transaction: Stationery is bought for R2 000 cash		
Step 1	Stationery and Bank	
Step 2	Stationery ➔ Equity	Bank ➔ Asset
Step 3	Stationery ➔ Equity ➔ Decreases	Bank ➔ Asset ➔ Decreases
Step 4	Stationery ➔ Equity ➔ Decreases ➔ Debited	Bank ➔ Asset ➔ Decreases ➔ Credited

Remember: If cash is paid or received, one of the two accounts will be Bank. If the transaction is a credit transaction, one of the accounts will be Debtors control (for credit sales) and Creditors control (for credit purchases).

The accounting cycle

The accounting cycle indicates the accounting procedure during the financial year(the things that need to be recorded). These include the entries that the accountant makes daily, at the end of each month and at the end of each financial year.

The financial year: This is an accounting period of twelve consecutive months. It can be:

- From 1 January 20.0 to 31 December20.0
- From 1 March 20.0 to 28 February 20.1
- From 1 July 20.0 to 30 June 20.0
- Or any other twelve consecutive months.

Daily	Transaction takes place and a source document is issued or received
	The source document is entered in the books of first entry (the journals)
	Daily entries are posted from the journals to the General Ledger and subsidiary ledger accounts (the Debtors Ledger and the Creditors Ledger)
Monthly	The journals are closed off and the totals are posted to the accounts in the General Ledger
	The accounts in the General Ledger are balanced
	A Trial Balance is prepared
Year end	The 12th trial balance is known as the Pre-adjustment Trial Balance
	Adjustments are journalised in the General Journal
	The adjustments are posted from the General Journal to the accounts in the General Ledger
	The accounts in the General Ledger are balanced
	The balances of the accounts in the General Ledger are used to prepare a Post-adjustment Trial Balance
	Closing transfers are journalised in the General Ledger
	The closing transfers are posted from the General Journal to the accounts in the General Ledger
	The Nominal accounts (income and expenditure accounts) in the General Ledger are closed off to the final accounts: · The gross profit for the year is calculated in the Trading account (final account) and transferred to the Profit and loss account · The net profit for the year is calculated in the Profit and loss account (final account) and transferred to the Capital account (sole trader) or the Appropriation account (partnership and company)
	The balances of the Balance Sheet accounts in the General Ledger are used to prepare a Post-closing Trial Balance
	The financial statements are prepared: · Income Statement · Balance Sheet · Cash Flow Statement
	The financial statements are analysed and interpreted

The accounting cycle stays the same for all businesses up to the point where net income has to be distributed.

Source documents

A source document is a document issued or received by a business, proving that a transaction has taken place. It contains information related to the nature of the transaction that has taken place and is used to enter the transaction in the books of first entry (i.e. the journals). The following information (normally) appears on source documents:

- the date
- the name of the party involved (e.g. purchased from or sold to)
- the nature of the transaction (cash or credit and terms of credit)
- the amount.

Nature of transaction	Journal	Transaction	Source document
Cash receipts	**CRJ**	Cash received for sales, delivery of services	Cash register roll Duplicate receipt
		Cash deposited directly into the bank account	Bank statement EFT
Cash payments	**CPJ**	Payments made per cheque	Cheque counterfoil
		Payments made per debit order or stop order	Bank statement
		Cash paid directly from the bank account	Bank statement EFT
	PCJ	Small amounts paid from the petty cash for day-to-day expenses	Petty cash voucher
Credit sales	**DJ**	Goods sold/services delivered on credit	Duplicate credit invoice
Credit purchases	**CJ**	Goods/services purchased on credit	Original credit invoice
Sales returns	**DAJ**	Goods sold on credit returned or discount omitted on invoice	Duplicate credit note
Purchases returns	**CAJ**	Goods purchased on credit or discount omitted on invoice	Original credit note OR duplicate debit note
Sundry transactions	**GJ**	Corrections, adjustments, etc.	Journal narration

Answers to exercises

Exercise 1.1

1 Income tax account:

GENERAL LEDGER OF JOHNSON TRADERS LIMITED									
BALANCE SHEET ACCOUNTS SECTION									
SARS: INCOME TAX									**B12**
20.0 Jul.	28	Bank	CPJ1	135 000	20.0 Jul.	1	Balance	b/d	135 000
20.0 Dec.	30	Bank	CPJ6	337 500	20.1 Jun.	30	Income tax (28% x 2 570 000)	GJ1	719 600
20.1 Jun.	29	Bank	CPJ12	278 100					
	30	Balance	c/d	104 000					
				854 600					854 600
					Jul.	1	Balance	b/d	104 000

2 Income tax amounts:

Income Statement/Statement of comprehensive income	719 600
Balance Sheet/Statement of financial position	104 000
Specific section and description in Balance sheet / Statement of financial position	Current liabilities: Trade and other payables

3 Income tax paid:

Balance at beginning of year	(135 000)
Amount in Income Statement	(719 600)
Balance at end of year	104 000
Income tax paid during year	(750 600)
(or 135 000 + 337 500 + 278 100 = 750 600)	

Exercise 1.2

1 Income tax account:

GENERAL LEDGER OF PACCO LIMITED									
BALANCE SHEET ACCOUNTS SECTION									
SARS: INCOME TAX									**B12**
20.1 Mar.	1	Balance	b/d	48 000	20.2 Feb.	28	Income tax	GJ1	514 000
20.1 Aug.	31	Bank (247 000 – 48 000)	CPJ6	199 000					
20.2 Feb.	28	Bank (514 000 – 247 000 – 58 000)	CPJ12	209 000					
	30	Balance	c/d	58 000					
				514 000					514 000
					Mar.	1	Balance	b/d	58 000

2 Balance Sheet heading:

Current assets: Trade and other receivables

3 Income tax paid:

Balance at beginning of year	48 000
Amount in the Income Statement	(514 000)
Balance at end of year	58 000
Income tax paid during year (199 000 + 209 000)	(408 000)

4 Where income tax paid appears:

Operating activities

Exercise 1.3

GENERAL LEDGER OF PLATINUM LIMITED									
BALANCE SHEET ACCOUNTS SECTION									
SARS: INCOME TAX									**B12**
20.2 Nov.	16	Balance	b/d	289 000	20.2. Nov.	1	Balance	b/d	289 000
20.3 Apr.	30	Bank	CPJ6	480 000	20.3 Oct.	31	Income tax (2 570 400 x 28 ÷ 72)	GJ1	999 600
20.3 Oct.	31	Bank	CPJ12	480 000					
	31	Balance	c/d	39 600					
				1 288 600					1 288 600
					Nov.	1	Balance	b/d	39 600

Exercise 1.4

1 Shareholders for dividends and Ordinary share dividends accounts:

GENERAL LEDGER OF SHARPCO LIMITED

BALANCE SHEET ACCOUNTS SECTION

SHAREHOLDERS FOR DIVIDENDS **B13**

20.3 Mar.	19	Bank	CPJ	118 400	20.3 Mar.	1	Balance (740 000 x 0,16)	b/d	118 400
					20.4 Feb.	28	Dividends on ordinary share (900 000 x 0,18)	GJ	162 000

NOMINAL ACCOUNTS SECTION

ORDINARY SHARE DIVIDENDS **N15**

20.3 Jun.	15	Bank (740 000 x 0,25)	CPJ 6	185 000	20.4 Feb.	28	Appropriation account	GJ1 2	347 000
20.4 Feb.	28	Shareholders for dividends (900 000 x 0,18)	GJ1 2	162 000					
				347 000					347 000

2 Dividends paid:

Balance at the beginning of the year	(118 400)
Amount in financial statements	(347 000)
Balance at the end of the year	162 000
or 118 400 + 185 000 = 303 400	(303 400)

3 Heading in cash flow statement:

Operating activities

Exercise 1.5

1 Ordinary share capital:

Balance of Ordinary share capital on 30 June 20.4	1 920 000
50 000 shares bought back (50 000 x 2,40)	(120 000)
	1 800 000
150 000 shares sold (150 000 x 2,75)	412 500
Balance of Ordinary share capital on 30 June 20.5	2 212 500

2 Ordinary share dividends:

Interim dividends [(1 920 000 ÷ 2.40) = 800 000 shares issued. 800 000 x 0,34 = 272 000]	272 000
Final dividends [800 000 – 50 000 + 150 000 = 900 000. 900 000 x 0,42 = 378 000]	378 000
Total dividends on ordinary shares	650 000

3 Appropriation account:

GENERAL LEDGER OF SAMOA LIMITED

NOMINAL ACCOUNTS SECTION

APPROPRIATION ACCOUNT **N18**

20.5 Jun	30	Income tax	GJ	232 400	20.5 Jun	30	Profit and loss	GJ	830 000
		Ordinary share dividends	GJ	650 000			Retained income	GJ	220 000
		Retained income	GJ	167 600					
				1 050 000					1 050 000

4 Shareholders' equity

Ordinary share capital	2 212 500
Retained income Accumulated profit	167 600
Shareholders' equity	2 380 100

5.1 Earnings per share (EPS of previous year: 61,6c per share)

$\frac{830\,000 - 232\,400}{900\,000} = \frac{597\,600}{900\,000}$ = 66,4c per share

5.2 Dividends per share (DPS of previous year: 51c per share)

$\frac{650\,000}{900\,000}$ = 72,2c per share

5.3 Net asset value (NAV of previous year: 267,5c per share)

$\frac{2\,380\,100}{900\,000}$ = 264,5c per share

5.4 Comments:

EPS: Increased from 61,6c to 66,4c per share
DPS: Increased from 51c to 72,2c per share
NAV: Decreased from 267,5c to 264,5c per share
Conclusion: The shareholders should be satisfied with the EPS and DPS. Although the NAV has decreased slightly, only the new 150 000 shareholders will be unhappy. The higher dividends that were paid in the current year resulted in a lower retained income. The effect of this is the lower NAV.

6 Proceeds from shares:

(150 000 x 2,75) – (50 000 x 2,40) = 412 500 – 120 000 = 292 500

Exercise 1.6

1 Missing amounts:

	Company A Limited	Company B Limited	Company C Limited

Cash effects of operating activities	760 000	435 000	**738 000**
Cash effects of investing activities	(2 340 000)	**(502 000)**	(367 000)
Cash effects of financing activities	**645 000**	210 000	(120 000)
Net change in cash and cash equivalents	**(935 000)**	143 000	251 000
Cash and cash equivalents at beginning of year	430 000	(27 000)	**(124 000)**
Cash and cash equivalents at end of year	(505 000)	**116 000**	127 000

2 Cash flow activities:

Company A	The profit for the year and changes in working capital resulted in a cash inflow.
	The business invested a lot of funds in non-current assets.
	The business increased its funds by issuing or applying for a loan.
	The cash outflow for the year was more than the cash inflow.
	The positive bank balance at the beginning of the year changed into a bank overdraft, due to the amount used for acquiring non-current assets.
Company B	The profit for the year and changes in working capital resulted in a cash inflow.
	The amount used for acquiring non-current assets was not less than the cash inflow from operating and financing activities.
	The business increased its funds by issuing or applying for a loan.
	The positive change in the cash and cash equivalents resulted in the bank overdraft being paid off.
	The business is now in a better cash position.
Company C	The profit for the year and changes in working capital resulted in a very good cash inflow.
	Funds were used for acquiring non-current assets.
	The business did not get any funds from shares or loans. It paid off a loan.
	The funds generated were used to pay off the bank overdraft.
	The business is now in a better cash position.

3 Shareholders:

Company: C
Motivation: The company's cash flow from operating activities seems much better, if compared with other amounts in the cash flow statement. The net cash inflow for the year was better than that of the other businesses and it resulted in a more positive bank balance.

Exercise 2.1

Accounts:

GENERAL LEDGER OF SHABANGU TRADERS

BALANCE SHEET ACCOUNTS SECTION

VEHICLES **B**

20.8 Mar.	1	Balance		350 000	20.9 Feb.	1	Asset disposal		70 000
Nov.	30	Creditors control		120 000		28	Balance		400 000
				470 000					470 000
20.9 Mar.	1	Balance		400 000					

ACCUMULATED DEPRECIATION ON VEHICLES **B**

20.9 Feb.	1	Asset disposal		49 300	20.8 Mar.	1	Balance		150 000
	28	Balance		134 900	20.9 Feb.	1	Depreciation		3 300

						28	Depreciation (26 400 + 4 500)		30 900
				184 200					184 200
					Mar.	1	Balance		134 900

Calculations:

Depreciation on vehicle sold: 15% x (70 000 – 46 000) x $^{11}/_{12}$ = R3 300

Depreciation on remaining vehicles:

15% x [(350 000 – 70 000) – (150 000 – 46 000)]

= 15% – (280 000 – 104 000) = R26 400

Depreciation on new vehicle: 15% x 120 000 x $^{3}/_{12}$ = R4 500

ACCUMULATED DEPRECIATION ON EQUIPMENT B

					20.8 Mar.	1	Balance (90 000 – 46 000)		44 000
					20.9 Feb.	28	Depreciation		22 000
									66 000

ASSET DISPOSAL B

20.9 Feb.	1			70 000	20.9 Feb.	1	Accumulated depreciation on vehicles (46 000 + 3 300)		49 300
				1 300			Creditors control		22 000
				71 300					71 300

DEPRECIATION B

20.9 Feb.	1	Accumulated depreciation on vehicles		3 300	20.9 Feb.	28	Profit and loss		56 200
Feb.	28	Accumulated depreciation on vehicles		30 900					
		Accumulated depreciation on equipment		22 000					
				56 200					56 200

Exercise 2.2

1 Fixed asset register:

ASSET REGISTER OF THABO CO

EQUIPMENT

Number : SIM078/RT

Date purchased : 1 March 20.5

Cost price : R80 000

Depreciation method : 20% p.a. on carrying value

Date	**Depreciation for year**	**Accumulated depreciation**	**Carrying value**
28 February 20.6	16 000	16 000	64 000
28 February 20.7	12 800	28 800	51 200
28 February 20.8	**10 240**	**39 040**	**40 960**
1 December 20.8	**6 144**	**45 184**	**34 816**
NOTE :	Traded in at R33 000 to Africa Enterprises ~~Profit~~/**Loss: . . . R1 816. . .**		

Calculations:
Depreciation on 28 Feb. 20.8: 20% x 51 200 = R10 240
Depreciation on 1 Dec. 20.9: 20% x 40 960 x $^{9}/_{12}$ = R6 144

2 Asset disposal account:

GENERAL LEDGER OF THABO CO

BALANCE SHEET ACCOUNTS SECTION

ASSET DISPOSAL **B**

20.8 Dec.	1	Equipment		80 000	20.8 Dec.	1	Accumulated depreciation on equipment		45 184
							Creditors control		33 000
							Loss on sale of asset		1 816
				80 000					80 000

3 Note for fixed assets:

3	FIXED ASSETS	Land & buildings	Vehicles	Equipment	Total
	Carrying value at beginning of year	480 000	113 000	143 360	736 360
	Cost	480 000	260 000	280 000	1 020 000
	Accumulated depreciation	–	(147 000)	(136 640)	(283 640)
	Movements				
	Additions (at cost)	440 000	360 000	160 000	960 000
	Disposals at carrying value	0	–	(34 816)	(34 816)
	Depreciation for the year	0	(95 000)	(31 624)	(126 624)
	Carrying value at end of year	920 000	378 000	236 920	1 534 920
	Cost	920 000	620 000	360 000	1 900 000
	Accumulated depreciation	0	(242 000)	(123 080)	(365 080)

Calculations:
Depreciation on vehicles for year:
Old: 25% x 260 000 = 65 000
New: 25% x 360 000 x $^{4}/_{12}$ = 30 000
Total: R95 000
Depreciation on equipment for year:
Remaining: 20% x [(280 000 – 80 000) – (136 640 – 39 040)] = 20 480
New on 1 Dec. 20.8: 20% x 70 000 x $^{3}/_{12}$ = 3 500
New on 1 Feb. 20.9: 20% x (86 000 + 4 000) x $^{1}/_{12}$ = 1 500
Total: 6 144 + 20 480 + 3 500 + 1 500 = R31 624
Additions to equipment: 70 000 + 86 000 + 4 000 = 160 000
Equipment on 28 Feb 20.9: 280 000 – 80 000 + 70 000 + 86 000 + 4 000 = R360 000
Accumulated depreciation on equipment on 28 Feb 20.9: 136 640 + 31 624 – 45 184 = R123 080

Exercise 2.3

Part A

1 Asset disposal account:

GENERAL LEDGER OF THABO CO

BALANCE SHEET ACCOUNTS SECTION

ASSET DISPOSAL

Date		*Details*		*Amount*	*Date*		*Details*		*Amount*
2.10 May	31	Vehicles		110 000	2.10 May	31	Accumulated depreciation on vehicles		71 500
		Profit on sale of assets		6 500			Bank		45 000
				116 500					116 500

2 Accumulated depreciation on vehicles:

ACCUMULATED DEPRECIATION ON VEHICLES

Date		*Details*		*Amount*	*Date*		*Details*		*Amount*
20.10 May	31	Asset disposal		71 500	2.10 Mar.	1	Balance		198 000
20.11 Feb.	28	Balance		196 000	May	31	Depreciation		5 500
					2.11 Feb.	28	Depreciation		64 000
				267 500					267 500
					Mar.	1	Balance		196 000

Calculations:

Depreciation: (20% x 110 000 x 3) + (20% x 110 000 x $^3/_{12}$) = 66 000 + 5 500 = 71 500

Balance (2.10-03-01): [3 vehicles x 20% x 110 000 x 3 yrs] = 198 000

Depreciation: Old: [2 vehicles x 20% x 110 000] = 44 000

New : 20% x 200 000 x $^6/_{12}$ = <u>20 000</u>

64 000

3 Note for fixed assets:

NOTE TO FINANCIAL STATEMENTS ON 28 FEBRUARY 2.11

3	**FIXED ASSETS**	**Land & buildings**	**Vehicles**
	Carrying value at beginning of year	300 000	132 000
	Cost price	300 000	330 000
	Accumulated depreciation	–	(198 000)
	Movements		
	Additions	160 000	200 000
	Disposals at carrying value	–	(38 500)
	Depreciation	–	(69 500)
	Carrying value at end of year	460 000	224 000
	Cost price	460 000	*420 000
	Accumulated depreciation	–	(196 000)

*330 000 – 110 000 + 200 000

Part B

1 Budget:

Summary of expected income (receipts) and expected expenses (payments) for a certain period Control measure

2 Total revenue for the year:

618 300 + 222 800 + 279 900 = 1 121 000

3 Total fuel and repair costs for the year:

439 680 + 290 640 + 136 840 = 867 160

4 Why Ms Hono should be concerned:

Yes, there is reason for concern: Income is much less: Expected 1 500 000, actual 1 121 000 Costs are much higher: Expected 710 000, actual 867 160 Result in lower profit: Expected 790 000, actual 253 840

5 Concerns about the taxis:

Taxi 1: Age : Very old (11 years) Carrying value: R1 Income/km : (618 300÷68 200) R9 Cost/km : R6,40 Profit/km: R2,60 The vehicle is old: Although still earning a lot, the cost is high and will increase due to age Action: Replace vehicle.
Taxi 2: Age: 3 years Carrying value: R144 000 Income/km : (222 800÷69 200) R3,22 Cost/km : R4,38 Loss/km : R1,16 Something is wrong here. The vehicle is only 3 years old (not too old). It drives much further than taxi 1 but the income is much lower (loss per kilometre). Action: Investigate driver, routes, driving skills, etc.
Taxi 3: Age: 1 year Carrying value: R240 000 Income/km: (279 900÷31 100) R9 Cost/km : R4,40 Profit/km : R4,60 This a good vehicle, well operated. Action: Keep.

Exercise 2.4

Calculations for using weighted average stock valuation method:

Cost of sales:

200 @ R1 500	300 000
(100 – 20) @ R1 500	120 000
(90 @ R1 600) + R300	144 300
50 @ R1 800	90 000
Total: 420 pairs	R654 300
Average price per pair	R1 557,86

Cost of sales: 380 pairs sold @ R1 557.86 = R591 986.80

Gross profit: Sales – Cost of sales = R775 200 – R591 986,80 = R183 213,20

Value of stock on hand: 40 x R1 557,86 = R62 314,40

1 Cost of sales (FIFO and periodic):

200 @ R1 500	300 000
(100 – 20) @ R1 500	120 000
(90 @ R1 600) + R300	144 300
10 @ R1 800	18 000
Cost of sales	582 300

2 Profit:

(Sales – Cost of sales) = R775 200 – R582 300 = R192 900

3 Value of stock on hand:

40 x R1 800 = R72 000

4 Cost of sales (FIFO + perpetual):

Stock available:
200 @ R1 500 = R300 000
80 @ R1 500 = R120 000
Average price: $\frac{\text{R420 000}}{280}$ = R1 500
Sold 90 : Cost of 90 sold = 90 x R1 500 = R135 000
Stock left: (280 – 90) 190 @ R1 500 = R285 000
Purchased: (90 @ R1 600) + R300 = R144 300
Average price: $\frac{\text{R429 300}}{280}$ = R1 533,21
Sold 120: Cost of 120 sold = 120 x 1 533,21 = R183 985,20
Stock left: (280 – 120) 160 @ R1 533,21 = R245 313,60
Purchased: 50 @ R1 800 = R90 000
Average price: $\frac{\text{R335 313}}{210}$ = R1 596,73
Sold 110+60: Cost of 170 sold = 170 x R1 596,73 = R271 444,10
Total cost of sales : 135 000 + 183 985,20 + 271 444,10 = R590 429,30

5 Calculations and advice:

	Weighted average	**FIFO + Periodic**	**FIFO + Perpetual**
Cost of sales	R591 986,80	R582 300,00	R590 429,30
Gross profit	R183 213,20	R192 900,00	R184 770,70
Stock on hand	R72 000,00	R72 000,00	R63 869,20 (40 x R1 596,73)

Comment (Effect on financial statements):
FIFO + Periodic shows highest profit and realistic correct value of stock on hand.
The FIFO + periodic system shows more realistic results. The weighted average method diminishes the effect of fluctuating prices. The business can choose which method to use as long as they use the method

consistently and do not change to another system.

Exercise 2.5

1 Value of stock on hand on 30 June 2.12:

Average price: $\frac{176\ 750 + 24\ 000}{1\ 500 + 200} = \frac{200\ 750}{1\ 700}$ = R118,09

Number of T-shirts on hand: 200 + 1 500 – 1 430 = 270

Value of stock on hand: 270 x R118,09 = R31 884,03

2 Cost of sales for the year:

1 430 x R118,00 = R168 868,70

Although customers returned some of the T-shirts, the business lost the value. They could not return the T-shirts to the suppliers and had to donate them. (This would be true in the periodic inventory system.)

(1 430 – 130) x R118,09 = R153 517

The business uses th perpetual system. They will cancel the stock returned on the cost of sales account. They will record the loss due to the 130 items donated in the Profit and loss account,which affects the net profit.

3 Total sales for the year:

Number of T-shirts sold at full price: 1 430 – 130 – 110 = 1 190

Sales:

1 190 x R200= R238 000

+ 110 x R100 = R11 000

R249 000

4 Gross profit for the year:

249 000 – 168 868.70= R80 131,30 (periodic system)

249 000 – 153 517 = R95 483,00 (perpetual system)

5 Effect of decision to purchase T-shirts from street vendors:

Calculation of R76 762,40:

Average price of T-shirts: $\frac{(24\ 000 + 176\ 750 + 48\ 000)}{1\ 700}$ = R146,32

Sales (1 430 x R200)	286 000
Cost of sales (1 430 x R146,32)	(209 237.60)
Gross profit	76 762.40

Any of the following:

Unethical to use Proudly South African logo if you're not sure where merchandise comes from.

Unethical to sell poorer quality goods at same price (R200) as goods of better quality.

The gross profit achieved is only R3 368,90 more than it would have been. The decision was more harmful than profitable.

The business lost customers due to the poor quality of the T-shirts.

The relationship between the business and some suppliers could be harmed.

Negative publicity could affect future sales.

Exercise 2.6

1 Bank balance:

Favourable balance = credit balance according to bank statement.

2 Possible reasons:

Deposit made on last day of month, bank could have done bank statement from 25th to 24th of next month, bank did not record the deposit.

3 Reason and recommendations:

No, it gives the opportunity for theft. The money is needed in the bank account for day-to-day payment. Money must be deposited every day.

4 'Outstanding cheques':

Cheques not yet presented to bank for payment.

5 How to handle cheque 954:

It is stale – older than six months and must be cancelled in the Cash Receipts Journal.

6 Dates:

Between 12 April 2.10 and 12 October 2.10.

7 How to treat cheque 1084:

In the Balance Sheet: Add the amount to the Bank account balance in Cash and cash equivalents. Add the amount to the Creditors control balance in Trade and other payables.

8 How to handle cheque 1086:

Cancel cheque in Cash Receipts Journal. Issue a new cheque to EquipSoc and record in Cash Payments Journal. The cheque will appear on the bank reconcilation statement until it is paid.

9 Method of paying salaries:

No, some banks only clear cheques after 10 days – salary cheques are exceptions. The employee must still deposit cheque in bank.

10 How to handle RD cheque:

A cheque received from a debtor is dishonoured – no funds available. Cancel the receipt by recording this in the Cash Payments Journal. Debit the debtor's account and the Debtors control account by full amount.

11 Issuing cash cheques:

Cash cheques can be used for wages, petty cash, drawings by owner. It is not a good idea to issue cash cheques – if a cheque is lost, any person can cash it.

12 Favourable or unfavourable Bank account:

12 400 + 24 600 – (1 346 + 9 750 + 20 000 + 2 467 + 14 895) = (R11 458) Unfavourable balance.

Exercise 2.7

Part A

1 Debit balance of R1 450:

The balance is unfavourable (bank overdraft) – the business owes the bank money (it is a liability).

2 Debit balance of R2 600:

The balance is favourable – the bank has money in the bank (it is an asset).

3.1 Cheque 1554:

It is older than six months (stale).

3.2 How to handle cheque 1554:

It must be stopped at the bank and cancelled in the Cash Receipts Journal.

4 Cheque 2435:

It is a postdated cheque issued by the business. It should appear on the bank reconciliation statement until it is presented for payment on 23 August 20.3.

5 Cheque 2417:

It may have been presented for payment to the bank already.

6 Cheque 2435 (23 August 20.3) and cheque 2578 (25 June 20.3):

All cheques must be recorded in chronological order as soon as they are issued, irrespective of the date of payment (control measure). Cheque 2435 was issued during May. Cheque 2578 was only issued in June.

7 How to deal with Cheque 2417:

The business should make an additional entry for R300 (13 500 – 13 200) in the Cash Payments Journal. The amount should also be in the Trading stock column.

8 Reason for comparing May bank reconciliation statement with June bank statement:

The bank reconciliation statement includes items not yet recorded by the bank. It is important to ensure that the bank recorded the items.

Part B

1 Correct balance:

8 250 – 1 670 – (10% x 4 580) = R6 122

2 Creditors reconciliation statement:

CREDITORS RECONCILIATION STATEMENT		
	Debit	**Credit**
Balance as per Creditors statement		16 662
Discount omitted	(540)	
Correction – wrong invoice	(10 000)	
		6 122

3.1 Effect of cheque 2498:

Assets	**Owner's equity**	**Liabilities**
–4 860	+540	–5 400

3.2 Accounts to debit and credit:

Account to debit	**Account to credit**
Creditors control	Bank
Creditors control	Discount received

4 Effect of sale on accounting equation:

Assets	**Owner's equity**	**Liabilities**
+6 183	+2 061	
–4 122		

Exercise 2.8

Transactions:

No.	**Details in subsidiary journal**		**Amount**	**Bank account**		**Bank reconciliation statement**		**No entry**
	Subsidiary journal	**Name of account in General Ledger**		**Debit**	**Credit**	**Debit**	**Credit**	
1			9 800		✓			
2	CRJ	Rent income	3 200	✓				
3	CPJ	Drawings	1 100		✓			
3	CPJ	Telephone/Cell phone	685		✓			
3	CPJ	Bank charges	485		✓			
4	CPJ	Debtors control	900		✓			
5	CPJ	Trading stock/inventory	7 680	✓				
	CPJ	Trading stock/inventory	7 680		✓			
6								✓
7						✓		

Exercise 2.9

1 VAT registration:

Businesses with an annual turnover of R1 000 000 or more must register for VAT. TTA's turnover is less than that.

2 Output VAT:

14% x (24 216 + 15 200) = R5 518,24

3 Input VAT:

Trading inventory : 14% x 28 250 = 3 955

Expenses : $^{14}/_{114}$ x (320 + 3 000 + 265) = 440,26 Total Input VAT : 3 955 + 440,26 = R4 395,26

4 VAT control account:

GENERAL LEDGER OF TTA

BALANCE SHEET ACCOUNTS SECTION

		VAT CONTROL							**B**
		Input VAT		4 395,26			Output VAT		5 518,24
		Balance	c/d	1 122,98					
				5 518,24					5 518,24
		Balance	b/d	1 122,98			Balance	b/d	1 122,98

5 Balance of the VAT control account:

Under Trade and other payables in current liabilities

6 Note to Tumi:

This is unethical as it would be exploiting customers. They can use tennis courts free of charge and this benefit should be passed on to the customers.

Exercise 2.10

Amount owed to SARS to nearest cent:

No.	**Description (and calculations)**	**Amount owed to SARS increase or decrease by . . .**
1	Cash sales of merchandise, R90 000 (excl. VAT)	✓✓12 600
2	Credit sales of merchandise, R108 300	✓✓13 300
3	Credit purchases of merchandise and equipment, R178 980	✓✓ (21 980)
4	Returns of merchandise by customers, R8 500 (excl. VAT)	✓✓ (1 190)
5	Returns of merchandise to suppliers, R14 136	✓✓1 736
6	An old vehicle with a carrying value of R50 000 was sold for R61 560	✓✓7 560
7	Bad debts written off, R5 597,40	✓✓ (687,40)
8	Bad debts recovered, R649,80	✓✓79,80
9	Discount allowed to customers, R6 726	✓✓ (826)
10	Discount received from suppliers, R15 390	✓✓1 890
	Amount owed to SARS/~~Amount owed by SARS~~	☑ **12 482,40**

Exercise 3.1

Part A

Increase, decrease or no effect on cost of production:

No.	Situation	Increase/Decrease/No effect
1	Supplier of wood informed us that they will increase prices by 10% from first of next month	Increase (Raw materials increase)
2	Workers in production will use new equipment to produce more units per day and meet their target without doing overtime	Decrease (Direct labour decreases)
3	Manager decided to sub-let part of the factory	Decrease (Factory overheads decrease)
4	A new telephone system was installed in the office	No effect (Administration cost)
5	Agent's commission increased from 10% to 12% of total sales	No effect (Selling and distribution cost)

Part B

Correct amounts or descriptions:

PRODUCTION COST STATEMENT		
	Total	**Per table**
Primary/prime/direct cost [25 x (300 + 180) = 25 x 480]	**12 000**	**?**
Raw materials **(25 x 300)**	**7 500**	300
Direct labour **(25 x 180)**	**4 500**	180
Factory overheads **[(696 – 480) x 25]**	**5 400**	**216**
Manufacturing cost	**?**	696
Work-in-progress (beginning of month)	0	0
Work-in-progress (end of month)	0	0
Total cost of production of finished goods [(7 500 + 4 500) + 5 400 = 12 000 + 5 400] or (696 x 25)	**17 400**	**?**

INCOME STATEMENT		
	Total	**Per table**
Sales (Cost plus 150%) **(696 x $^{250}/_{100}$ = 1 740) (1 740 x 25 or 17 400 x $^{250}/_{100}$)**	**43 500**	**1 740**
Cost of sales (all tables sold)	**17 400**	**696**
Gross profit (43 500 – 17 400)	**26 100**	**?**
Operating expenses	**?**	**?**
Administration cost	2 125	85
Selling and distribution cost	2 875	115
Net profit [26 100 – (2 125 + 2 875)]	**21 100**	**?**

Part C

1 Fixed cost and variable cost:

Fixed cost: Cost that does not change in relation to production. It must be paid irrespective of production levels. Variable cost: Cost that varies with production output. It is directly related to the levels of production.

2 Examples of fixed and variable costs:

Fixed cost: Any factory cost or administration cost

Variable cost: Raw materials, Direct labour, Seling & distribution cost

3 Break-even point:

Point where business produces enough products to cover its cost/point where there is no profit or loss

4 Break-even point:

$\frac{9\ 500}{1\ 750 - (^{18\ 312}/_{28})} = \frac{9\ 500}{1\ 750 - 654} = \frac{9\ 500}{1\ 096}$ = 8,668 tables = 9 tables

Exercise 3.2

1 Raw materials stock on hand:

Available at beginning of year	170 000
Purchases (930 000 + 840 300)	1 770 300
Carriage on purchases	9 700
	1 950 000
Available at end of year	(130 000)
Raw materials issued	1 820 000

2 Factory overheads note:

FACTORY OVERHEADS	
Consumables (28 900 + 92 951 – 22 100)	99 751
Indirect labour (238 000 + 132 000)	370 000
Water and electricity	87 000
Maintenance (15 000 x 12)	180 000
Sundry expenses	178 000
Depreciation (620 000 – 380 000)	240 000
Insurance ($^{80}/_{100}$ x 45 000)	36 000
	1 190 751

3 Production Cost Statement:

NAME OF BUSINESS: Woodpeckers **PRODUCTION COST STATEMENT FOR THE YEAR ENDED28 FEBRUARY 2.11**	
Direct/raw materials cost	1 820 000
Direct labourcost	960 000
Prime cost	2 780 000
Factory overheads cost (work with)	1 190 751
Total cost of production	3 970 751
Add: Work-in-progress (beginning of year)	230 000
(ww)	4 200 751
Less: Work-in-progress (end of year)	(260 000)
Cost of production of finished goods	3 940 751

4.1 Total annual amount paid:

17 500 x 12 = R210 000

4.2 Type of VAT:

Input VAT

4.3 Effect:

Decrease amount owed to SARS. Can claim it back.

4.4 Amount quoted by Don Right excl.VAT:

$229\ 824 \times \frac{100}{114} = 201\ 600$

4.5 Decision and reasons:

No. It’s unethical not to pay VAT due to the government. If Don Right’s quote was accepted, Input VAT could have been claimed. The amount paid for maintenance would then be less (R201 600 instead of R210 000).

Exercise 3.3

1 Asset disposal account in the General Ledger:

ASSET DISPOSAL **B**

Date		*Details*		*Amount*	*Date*		*Details*		*Amount*
2.10 Dec.	31	Shop equipment		21 000	2.10 Dec.	31	Accumulated depreciation on shop equipment (8 000 + 975)		8 975
							Bank		11 000
							Loss on sale of asset		1 025
				21 000					21 000

2 Note on fixed assets to financial statements on 30 June 2.11:

NOTE TO FINANCIAL STATEMENTS ON 30 JUNE 2.11			
3	**FIXED ASSETS**	**Factory machinery**	**Shop equipment**
	Carrying value at end of previous year	12 000	13 000
	Cost	30 000	21 000
	Accumulated depreciation	(18 000)	(8 000)
	Movements		
	Additions at cost	15 000	24 000
	Disposals at carrying value	. . .	(12 025)
	Depreciation for the year	(7 000)	(2 775)
	Carrying value at end of current year	20 000	22 200
	Cost	45 000	24 000
	Accumulated depreciation	(25 000)	(1 800)

3 Notes to production cost statement for year ended 30 June 2.11:

1

RAW MATERIALS STOCK	
Balance at beginning of year	12 300
Purchases (21 200 + 26 550 – 4 300)	43 450
Carriage on purchases	2 850
	58 600
Less: Balance at end of year	(14 630)
Raw material used	43 970

3

FACTORY OVERHEADS COST	
Consumables [(5 700 + 10 200 + 7 400 – 2 900) x 60%]	12 240
Depreciation	7 000
Indirect labour (28 000 + 1% of 28 000)	28 280
Water & electricity (3000 x $^{200}/_{240}$)	2 500
Sundry expenses	1 090
Maintenance	5 200
Insurance [9 960 – ($^{6}/_{12}$ x 4 800)] x $^{200}/_{240}$	6 300
	62 610

4 Production cost statement:

PRODUCTION COST STATEMENT FOR THE YEAR ENDED30 JUNE 2.11	
Raw materials	43 970
Direct labour	44 440
Prime cost	88 410
Factory overheads	62 610
Total cost of production	151 020
Add: Work-in-progress (beginning of year)	1 830
	152 850
Less: Work-in-progress (end of year)	(1 350)
Cost of production of finished goods	151 500

5 Gross profit:

Sales (126 000 x $^{150}/_{100}$)	189 000
Less: Cost of sales (1 500 + 151 500 – 27 000)	(126 000)
Gross profit	63 000

Exercise 3.4

1 Carrying value:

Cash received	9 500
Less Profit on sale of asset	700
Carrying value of equipment	8 800

2 Date of sale and reason:

Equipment was sold on 1 April 2.11. Depreciation decreased from R2 467 to R1 667 in April 2.11.

3 Difference in depreciation:

2 467 – 1 667 = 800
Depreciation on equipment sold for March 2.11 is R800.
Depreciation for March : 800 = 20% x Cost x $^{1}/_{12}$
Original price was : 800 x 12 x $^{100}/_{20}$ = R48 000
Cost price

4 January sales:

Bad debts written off in second month after sales.
5% of January credit sales = Bad debts in March R1 700.
Credit sales for January : 1 700 x $^{100}/_{5}$ = 34 000
Credit sales = 40% of total sales
Total sales: 34 000 x $^{100}/_{40}$ = 85 000

5 Fixed stock base:

Fixed stock base means they replace what they sell, so Cost of sales = Total purchases.
Cash purchases for March = 60% of total sales : 39 750
Total purchases : 39 750 x $^{100}/_{60}$ = 66 250 = Cost of sales for March
Or: Total purchases for March = 66 250
Credit purchases for March : 40% x 66 250 = 26 500
Amount paid in April after 5% discount : 26 500 x 95% = 25 175

6 Difference in surplus:

86 465 – 52 223 = R34 242
The fixed deposit matured and Top Gardens received the cash. The business may have used the money to repay their loan with the surplus of R34 000. The rest of the receipts and payment was relatively constant.

7 Difference between surplus and net profit:

Surplus: Difference between receipts and payments (remainder of cash received after all payments were made).
Net profit: Difference between income received or receivable and expenditure paid or payable within an accounting period.

8 Items not on the Cash Budget:

Discount received
Discount allowed
Depreciation
Bad debts
Trading stock deficit
All are non-cash items representing value lost or received reather than cash received or paid.

9 Annual percentage increase:

Interest earned during March = R106
Annual amount : 106 x 12 = 1 272
Opening bank balance = R31 800
$\frac{1\ 272}{31\ 800}$ x 100 = 4% p.a.
Or: $\frac{106}{31\ 800}$ x 100 x 12 = 4% p.a. or: $\frac{(280 \times 12)}{84\ 023}$ x 100 = 4% (rounded)

10 Payment of loan and Interest on loan (Interest expense):

The Balance Sheet shows what the business is worth. It shows the assets and liabilities at a fixed time. A loan is a liability. Payment of the loan will have an effect on the Balance Sheet, not on the Income Statement. The net profit, the difference between the income and expenses for a certain period, is calculated on the Income Statement. Interest on the loan is a finance cost, which will have an effect on the profit.

11 Possible sources for money to repay loan:

Fixed deposit which matured Cash surplus of March

12 Decrease in net profit:

Decrease in sales or decrease in gross profit

13 Mark-up percentage:

Mark-up = $\frac{\text{Profit}}{\text{Cost of sales}} \times 100$

$= \frac{39\ 750}{66\ 250} \times 100 = 60\%$ Or: $\frac{32\ 625}{54\ 375} \times 100 = 60\%$

Exercise 3.5

1 Cash budget and importance:

Cash budget: It is a forecast of how much cash will be received or paid during a certain period. Importance: The business needs a cash budget to monitor business activities. It is a control instrument. It should be a guideline for spending as well as for targets set for income.

2 Difference between cash sales and cash received from debtors:

Cash sales: Cash to be received for goods sold in that specific month. Cash received from debtors: Goods are also sold on credit. Not all debtors pay at the end of the month of sales. From past experience business can draw up a collection policy that gives them an indication of when they can expect debtors to pay their outstanding debt. The debtors collection schedule helps you with the calculation.

3 Total sales for August:

Cash sales for August:	33 000	
Credit sales for August:	77 000	(according to debtors collection schedule)
Total sales	R110 000	

4 Discount from suppliers and percentage:

Yes, they receive 5,26% discount from their suppliers.

5 Collection policy of Lenyalo Stores:

Using payments for credit sales in June, written off: 5%

Received in second month after sales: $\frac{10\ 500}{70\ 000} \times 100 = 15\%$

Received in first month after sales: $\frac{35\ 000}{70\ 000} \times 100 = 50\%$

Received in month of sales: Should be 30%. [100 – 15 – 50] (30% x 70 000 = 21 000)

Received less: 21 000 – 19 950 = 1 050 = discount Discount percentage: $\frac{1\ 050}{21\ 000}$ x 100 = 5% Credit sales collected as follows: 30% in month of sale after allowing 5% discount 50% in month after sale 15% in second month after sale 5% written off as irrecoverable

6 Old vehicle:

Sold for cash. It is recorded in the cash budget as a receipt.

7 Cost price of the vehicle:

15 000 + (20x 6 750) = R150 000

8 Interest percentage per annum:

Monthly interest: 1 650 Annual interest: 1 650 x 12 = 19 800 Interest percentage: $\frac{19\ 800}{180\ 000}$ x 100 = 11% p.a.

9 Difference between surplus and deficit:

Surplus: Total amount of cash received during month more than amount of cash paid out. Deficit: Total amount of cash received during month less than amount of cash paid out.