

FINANCIAL ACCOUNTING

for Rwandan Schools

Senior

4

Student Book

Experimental Version

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FOREWORD

Dear Student,

Rwanda Basic Education Board (REB) is honoured to present Senior 4 Financial Accounting book for the students of Accounting Profession Option which serves as a guide to competence-based teaching and learning to ensure consistency and coherence in the learning of the Financial Accounting. The Rwandan educational philosophy is to ensure that you achieve full potential at every level of education which will prepare you to be well integrated in society and exploit employment opportunities.

The government of Rwanda emphasizes the importance of aligning teaching and learning materials with the syllabus to facilitate your learning process. Many factors influence what you learn, how well you learn and the competences you acquire. Those factors include the relevance of the specific content, the quality of teachers' pedagogical approaches, the assessment strategies and the instructional materials available. In this book, we paid special attention to the activities that facilitate the learning process in which you can develop your ideas and make new discoveries during concrete activities carried out individually or in groups.

In competence-based curriculum, learning is considered as a process of active building and developing knowledge and meanings by the learner where concepts are mainly introduced by an activity, situation or scenario that helps the learner to construct knowledge, develop skills and acquire positive attitudes and values.

For efficiency use of this textbook, your role is to:

- Work on given activities which lead to the development of skills;
- Share relevant information with other learners through presentations, discussions, group work and other active learning techniques such as role play, case studies, investigation and research in the library, on internet or outside;
- Participate and take responsibility for your own learning;
- Draw conclusions based on the findings from the learning activities.

To facilitate you in doing activities, the content of this book is self-explanatory so that you can easily use it yourself, acquire and assess your competences. The book is made of units as presented in the syllabus. Each unit has the following structure: the unit title and key unit competence are given and they are followed by the introductory activity before the development of Financial Accounting and concepts that are connected to real world problems more especially to production, finance and economics.

The development of each concept has the following points:

- Learning activity which is a well set and simple activity to be done by students in order to generate the concept to be learnt;
- Main elements of the content to be emphasized;
- Worked examples; and
- Application activities to be done by the user to consolidate competences or to assess the achievement of objectives.

Even though the book has some worked examples, you will succeed on the application activities depending on your ways of reading, questioning, thinking and handling calculations problems but not by searching for similar-looking worked out examples.

Furthermore, to succeed in Financial Accounting, you are asked to keep trying; sometimes you will find concepts that need to be worked at before you completely understand. The only way to really grasp such a concept is to think about it and work related problems found in other reference books.

I wish to sincerely express my appreciation to the people who contributed towards the development of this book, particularly, REB staff, development partners, Universities Lecturers and Secondary School Teachers for their technical support. A word of gratitude goes to Secondary Schools Head Teachers, Administration of different Universities (Public and Private Universities) and development partners who availed their staff for various activities.

Any comment or contribution for the improvement of this textbook for the next edition is welcome.

Dr. MBARUSHIMANA Nelson

Director General, REB

ACKNOWLEDGEMENTS

I wish to express my appreciation to the people who played a major role in the development of this Financial Accounting book for Senior 4 students in Accounting Profession Option. It would not have been successful without active participation of different education stakeholders.

I owe gratitude to different universities and schools in Rwanda that allowed their staff to work with REB in the in-house textbooks production initiative.

I wish to extend my sincere gratitude to Universities Lecturers, Secondary school teachers and staff from different education partners whose efforts during writing exercise of this book were very much valuable.

Finally, my word of gratitude goes to the Rwanda Basic Education Board staffs who were involved in the whole process of in-house textbook Elaboration.

Joan MURUNGI

Head of CTRLR Department

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UNIT 1

GENERAL INTRODUCTION AND OVERVIEW OF ACCOUNTING



Key unit competence: To be able to apply the accounting concepts



Introductory activity

Read the following case study and answer the given questions using the knowledge acquired in entrepreneurship subject.

Accounting is an essential function of any business entity. It gives the framework to record all the business transactions and events that happen during the working of the business entity. Accounting is the language of business, with books of accounts being its script and debit-credit its style, i.e., the way of expressing it. According to the American Accounting Association, Accounting is the process of identifying, measuring, and communicating information to permit judgment and decisions by the users of accounts. According to the American Institute of Certified Public Accountants, Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions, and events, which are at least of a financial character and interpreting the result thereof.

Accounting is an art as well as a science. Accounting is an art of recording, classifying, and summarizing all business transactions. It is a science as well as it follows certain guiding accounting principles and standards. It records financial transactions only, which can be expressed in terms of money. First, the transactions are recorded and then classified and summarized to interpret the business's financial performance and position. One needs to keep in mind that Accounting and Accountancy are two different concepts.

Accounting is the recording, classifying, and summarizing of business transactions to ascertain the financial performance and position of the business firm. On the other hand, Accountancy is the body of knowledge based on principles for recording, classifying, and summarizing business transactions to help in the decision-making function of management..

1. Accounting gives the ----- to record all the business transactions.
 - b) Framework
 - c) Process
 - d) Money
 - e) Classification
2. Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions, and events which are, in part at least of a financial character and interpreting the result thereof. This accounting definition is given by:
 - a) Institute of Certified Public Accountants of Rwanda
 - b) American Accounting Association
 - c) American Institutes of Certified Public Accountants
 - d) International Financial Regulation System
3. Accounting is called science because it follows certain guiding -----
4. Accounting records only ----- transactions
5. Who are the users of accounting information?

1.1 Meaning and Purpose of Accounting

Activity 1.1



Figure 1.1: Business activities

Observe the picture above and answer the following question:
Why is accounting important to everyone in our community?

1.1.1 Meaning of accounting

Accounting is defined as the process of identifying, recording, classifying and summarizing economic data so as to come up with useful information to help users make informed decisions. Many businesses carry out transactions. Some of these transactions have a financial implication i.e. either cash is received or paid out. Examples of these transactions include selling goods, buying goods, paying employees and so many others.

Accounting is involved with identifying these transactions measuring (attaching a value) and reporting on these transactions. If a firm employs a new staff member then this may not be an accounting transaction. However, when the firm pays the employee salary, then this is related to accounting as cash involved. This has an economic impact on the organization and will be recorded for accounting purpose. A process is put in place to collect and record this information; it is then classified and summarized so that it can be reported to the interested parties.

Accounting, as a preamble, could be termed the language of business. It is the common media through which people of all walks can effectively communicate business matters and understand one another equally.

It is the language accountants use to communicate i.e. record business transactions and summarize results of business operations. Accounting is the art of recording, classifying, and summarizing in a significant manner, and in terms of money, transactions, and events of a financial character, and interpreting the results thereof. It encompasses the recording of information of economic value to a business. The information then forms the basis for judgment by the users.

1.1.2 The objectives of accounting

Accounting has many objectives; including letting people and organizations know:

- If they are making a profit or a loss;
- What their business is worth;
- What a transaction was worth to them;
- How much cash they have;
- How wealthy they are;
- How much they are owed;
- How much they owe to someone else;
- Enough information so that they can keep a financial check on the things they do.

However, the primary objective of accounting is to provide information for decision making. The information is usually financial, but can also be given in volumes, for example the number of cars sold in a month by a car dealership or the number of cows in a farmer's herd herd (this kind of non-financial information, however is more useful in management/managerial accounting than it is in financial accounting). So, for example, if a business recorded what it sold, to whom, the date it was sold, the price at which it was sold, and the date it received payment from the customer, along with similar data concerning the purchases it made, certain information could be produced summarizing what had taken place. The profitability of the business and the financial status of the business could also be identified, at any particular point in time. It is the primary objective of accounting to take such information and convert it into a form that is useful for decision making.

1.1.3 Branches of Accounting

Accounting, in all its broadness, can be sub-divided into areas of specialization;

- a) **Financial accounting**; concerns itself with the collection and processing of accounting data and reporting to interested parties inside and outside the firm.
- b) **Tax accounting**; deals with the determination of the firm's tax liability which could be, Value-added tax (VAT), customs duty, Pay As You Earn (PAYE), corporation tax, etc.
- c) **Cost accounting**; helps establish costs relating to the production of a good or service and allocating it to the various factors that contributed to the cost of production.
- d) **Managerial accounting**; deals with the generation of accounting information to be used categorically by the firm's internal management in their day-to-day decision making.
- e) **Auditing**; concerns itself with the vouching and verification of transactions from the financial accounting to determine that they are a true representation of the business' activity i.e. the true and fair view of the company's state of affairs.

Other subdivisions of accounting include forensic accounting which combines accounting, auditing, and investigative skills to examine the finances of an individual or business, fiduciary accounting which is the recording of transactions associated with a trust or estate and accounting information system which is a computer-based method, it tracks accounting activity that has been combined with information technology resources.



Application activity 1.1

1. Explain the term accounting
2. What do you understand by accounting information
3. Mention two objectives of accounting
4. State the uses of accounting information
5. Mention five different branches of accounting
6. State two differences between financial accounting and management accounting

1.2 Users of Accounting Information

Activity 1.2



Refer to the knowledge acquired in Entrepreneurship and state who you think need accounting information of a certain business.

Today, more people than ever before recognize the importance of accounting information and the profound effect that unethical and misleading financial reports can have on a business, its owners, its employees, its lenders, and the financial markets.

The people who use accounting information to make decisions can be classified into three categories:

- Those who manage a business
- Those outside a business enterprise who have a direct financial interest in the business
- Those who have an indirect financial interest in a business

These categories apply to governmental and not-for-profit organizations as well as to profit-oriented ventures.

Note that the users may also be classified into internal and external users of accounting information. Internal users are those within an organization who use financial information to make day-to-day decisions. External users are those outside of the organization who use the financial information to make decisions or to evaluate an entity's performance and position

1.2.1 Management

Management refers to the people who are responsible for operating a business and meeting its goals of profitability and liquidity. In a small business, management may consist solely of the owners. In a large business, managers are not necessarily the owners and thus may be agents of the owners. Managers must decide what to do, how to do it, and whether the results match their original plans. Successful managers consistently make the right decisions based on timely and valid information. Note that managers and other employees are internal users of accounting information.

1.2.2 Users with a direct financial interest

Another group of decision makers who need accounting information are those with a direct financial interest in a business. They depend on accounting to measure and report information about how a business has performed. Most businesses periodically publish a set of general-purpose financial statements that report their success in meeting the goals of profitability and liquidity. These statements show what has happened in the past, and they are important indicators of what will happen in the future. Many people outside the company carefully study these financial reports. The two most important groups are investors (including owners) and creditors.

1.2.2.1 Investors

Those are current and future stockholders who may invest in a business and acquire a part ownership in it are interested in its past success and its potential earnings. A thorough study of a company's financial statements helps potential investors judge the prospects for a profitable investment. After investing, they must continually review their commitment, again by examining the company's financial statements.

1.2.2.2 Creditors

Most companies borrow money for both long- and short-term operating needs. Creditors, those who lend money or deliver goods and services before being paid, are interested mainly in whether a company will have the cash to pay interest charges and to repay the debt at the appropriate time. They study a company's liquidity and cash flow as well as its profitability. Banks, finance companies, mortgage companies, securities firms, insurance firms, suppliers, and other lenders must analyze a company's financial position before they make a loan. Note that investors and creditors are primary external users of accounting information.

1.2.3 Users with an indirect financial interest

In recent years, society as a whole, through governmental and public groups, has become one of the largest and most important users of accounting information. Users who need accounting information to make decisions on public issues include tax authorities, regulatory agencies, and various other groups.

1.2.3.1 Tax Authorities

Government at every level is financed through the collection of taxes. Companies and individuals pay many kinds of taxes, including national, and city income taxes; Social Security and other payroll taxes; excise taxes; and sales taxes. Each tax requires special tax returns and often a complex set of records as well. Proper reporting is generally a matter of law and can be very complicated. The Internal Revenue Code, for instance, contains thousands of rules governing the preparation of the accounting information used in computing federal income taxes.

1.2.3.2 Regulatory Agencies

Most companies must report periodically to one or more regulatory agencies at the national and local levels. For example, all publicly traded corporations must report periodically to Capital Market Authority (CMA). (CMA) is a public institution established by Law No.23 /2017 of 31/05/2017 responsible for developing and regulating the capital markets industry, commodities exchange and related contracts, collective investment schemes and warehouse receipts system. Companies listed on Rwanda Stock Exchange (RSE) must meet the special reporting requirements of their exchange. Another example of a regulatory agency is the National Bank of Rwanda – All financial institutions are required to report periodically to the National Bank of Rwanda.

1.2.3.3 Other groups

Labor unions study the financial statements of corporations as part of preparing for contract negotiations; a company's income and costs often play an important role in these negotiations. Those who advise investors and creditors—financial analysts, brokers, underwriters, lawyers, economists, and the financial press—also have an indirect interest in the financial performance and prospects of a business. Consumer groups, customers, and the general public have become more concerned about the financing and earnings of corporations as well as the effects that corporations have on inflation, the environment, social issues, and the quality of life.

Note that a part from managers and employees who are internal users, all other users are external users of financial information



Application activity 1.2

1. State three categories of users of accounting information
2. Match the terms below with the type of user of accounting information (Some answers may be used more than once):
 1. Tax authorities
 2. Investors
 3. Management
 4. Creditors
 5. Regulatory agencies
 6. Labor unions and consumer groups
 - a. Internal user
 - b. Direct external user
 - c. Indirect user
3. Why the following are interested accounting information
 - a) Creditors
 - b) Tax authorities
 - c) Investors
 - d) General public

1.3 Forms of Business Organizations

Activity 1.3

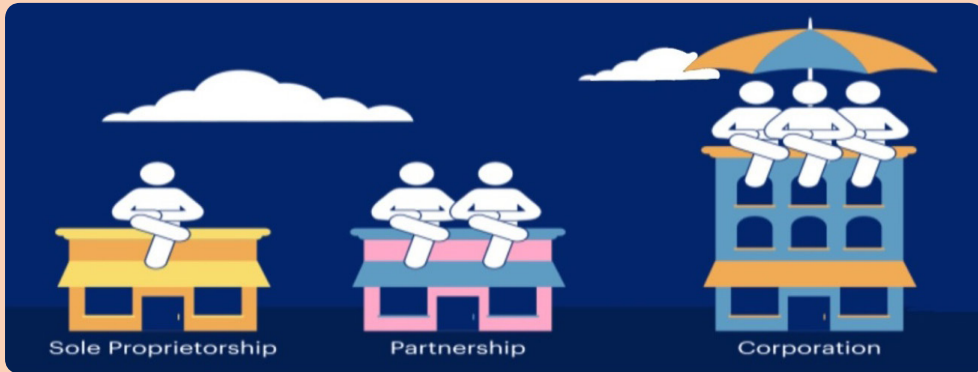


Figure 1.3: Forms of business of organizations

Read the following case study and answer the given questions

Kamariza, a bright final year student was waiting for her result to be declared. While at home, she decided to put her free time to use. Having a painting talent, she tried decorating clay pots and bowls with designs. She was excited at the praise showed on her by friends on her work. She even managed to sell few pieces of unique hand pottery for her home to people living in and around her village. Operating from home, she was able to save on rental payments. She gained a lot of popularity by word of mouth publicity as a sole proprietor. She further perfected her skills of painting pottery and created new designs. All this generated great interest among her customers and provided a boost to the demand for her products. By the end of summer, she found that she had been able to make a profit of FRW 100,000. She felt motivated to take up this work as a career. She has, therefore, decided to set up her own business.

She can continue running the business on her own as a sole proprietor, but she needs more money for doing business on large scale. Her father has suggested that she should form a partnership with her cousin to meet the need for additional funds and for sharing the responsibilities and risks. Besides, he believes that it is possible that the business might grow further and may require forming a company.

- a) She is in a dilemma as to what form of business organisation she should go in for?
- b) Which factors to be considered in selecting an appropriate form of business?

To start a business, a potential owner must have a sufficient amount of capital and must choose an appropriate form of business organization. The three basic forms of business organization are the sole proprietorship, the partnership, and the corporation. Accountants recognize each form as an economic unit separate from its owners. Legally, however, only the corporation is separate from its owners. The characteristics of corporations make them very efficient in amassing capital, which enables them to grow extremely large. As even though corporations are fewer in number than sole proprietorships and partnerships, they contribute much more to the economy in monetary terms. .

1.3.1 A sole proprietorship

Sole means “single” or “one.” *Proprietor* means “owner.” A sole proprietorship, therefore, is a business owned by one person. It is sometimes simply called a *proprietorship*. Being a sole proprietor does not mean working alone. Based on the operation’s size and scope, a sole proprietorship may have many managers and employees. The oldest and most common form of business organization, the sole proprietorship is the easiest business form to start. Little or no legal paperwork (forms and documents) is required. The success or failure of the business depends heavily on the efforts and talent of the owner.

A sole proprietorship advantages and disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> ▪ Easy to set up ▪ Limited paper work ▪ All profits go to owner ▪ Owner has complete control over the business ▪ Few regulations to follow ▪ Less stringent reporting obligations ▪ Can be highly flexible 	<ul style="list-style-type: none"> ▪ Limited expertise ▪ Hard to raise money ▪ Owner has all the risks ▪ Hard to attract talented employees ▪ Susceptible to continuity issues in the event of death or illness of the owner ▪ It may lead to long working hours for the owner-manager

1.3.2 A partnership

A partnership is a business owned by two or more persons, called *partners*, who agree to operate the business as co-owners. The partners share the profits and losses of the business according to agreed proportions.

The partners share between them ownership of the business and the obligation to manage its operations. Professional people, such as accountants, solicitors and doctors, commonly organize their business activities in the form of partnerships. Accounting statements are required as a basis for allocating profits between the partners and, again, for agreeing tax liabilities with the Tax Revenue Authority. Business partners usually enter into a written, legal agreement. This agreement specifies each partner's investment in money or property, responsibilities, and percentage of profits and losses. Partnerships are often formed when a business needs more capital than one person can invest. Partnerships are not always small.

A Partnership advantages and disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> ▪ Easy startup ▪ Pooled skills and talents and possible division of roles and responsibilities ▪ More money available ▪ Shared risks and losses between more people ▪ Less stringent reporting requirements-no requirements for making accounts publically available ▪ In most jurisdictions there are no company taxes on the business – Taxes are distributed to partners and then subject to personal tax 	<ul style="list-style-type: none"> ▪ Unlimited liability – partners are jointly personally liable for all debts ▪ Risk of conflict ▪ Costs associated with setting up partnership agreement ▪ Loss of autonomy ▪ Slow decision making due to the need for consensus between partners ▪ There might be issues of continuity in case partners die ▪ Subjection to dissolution in case a partner dies or leaves unless the partnership agreement provides otherwise

1.3.3 A corporation

A corporation, on the other hand, is a business unit chartered by the state and legally separate from its owners (the stockholders). The stockholders, whose ownership is represented by shares of stock, do not directly control the corporation's operations. Instead, they elect a board of directors to run the corporation for their benefit. In exchange for their limited involvement in the corporation's operations, stockholders enjoy limited liability; that is, their risk of loss is limited to the amount they paid for their shares.

Thus, stockholders are often willing to invest in risky, but potentially profitable, activities. Also, because stockholders can sell their shares without dissolving the corporation, the life of a corporation is unlimited and not subject to the whims or health of a proprietor or a partner. The business owner(s) may “incorporate” to obtain money needed to expand. To raise this money, organizers sell shares of stock to hundreds or even thousands of people. These shareholders, or stockholders, are the corporation’s legal owners.

A Corporation advantages and disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> ▪ Limited liability – Personal liability protection ▪ Easier to raise money through issue of shares ▪ Easy to expand ▪ Perpetual existence - Easy to transfer ownership – the business survives the initial owners ▪ Credibility – This form of business conveys credibility to creditors, lenders and other stakeholders 	<ul style="list-style-type: none"> ▪ Complex process for setting up - More costs to start ▪ More complex to organize ▪ More regulations to comply with Possible conflicts of interests - Agency problem – Board of Directors and management may aim to fulfill personal interests in decision making ▪ Higher taxes – Business is subject to corporate income tax and shareholders pay taxes on dividends

Other forms of businesses

A part from the above three main types of businesses we also have other forms of entity that may not necessarily be referred to as businesses but they relate to businesses and some authors refer to them as other forms of businesses. Those are:

- **Cooperatives:** members come together to start the business to satisfy their needs/common interest
- **Not for profit entity:** they are started to just offer a given service or good mostly to their members or to a particular group of people with common interest but they do not have profit as the motive.
- **Parastatal:** is a company wholly owned by the government



Application activity 1.3

1. Mr. Gasagure is a sole proprietor. Over the past decade, his business has grown from operating a neighborhood corner shop selling different items to retail chain with three branches in the city. Although he looks after the varied functions in all the branches, he is wondering whether he should form a company to better manage the business.
 - a) Explain two benefits of remaining a sole proprietor
 - b) Explain two benefits of converting to a limited liability company
2. Match the descriptions on the left with the forms of business organizations on the right:
 1. Pays dividends
 2. Owned by only one person
 3. Multiple co-owners
 4. Management appointed by board of directors
 5. Most numerous but usually small in size
 6. Biggest segment of the economy
 - (a) Sole proprietorship
 - (b) Partnership
 - (c) Corporation

1.4 Accounting Concepts



Activity 1.4

Why do you think accounting concepts and conventions are important to a business entity?

Accounting concepts, conventions, or principles are the basic ground rules that must be followed when financial accounts are prepared and presented. They are also referred to as assumptions or prepositions that underlie the preparation and presentation of financial statements.

1.4.1 Business entity assumption

This concept states that business is regarded as a separate entity different/distinct from owners and managers. This means assets and liabilities of the business should be separated from those of the owners.

1.4.2 Monetary unit assumption/ Money measurement concept

This concept states that only items which can be expressed in monetary terms/value are to be recorded in book. An economic entity's accounting records include only quantifiable transactions. For example, certain economic events that affect a company, such as hiring a new chief executive officer or introducing a new product, cannot be easily quantified in monetary units and, therefore, do not appear in the company's accounting records.

1.4.3 Time period assumption

This concept states that financial statements must be prepared on regular intervals. Most businesses exist for long periods of time, so specific time periods must be used to report the results of business activity. Depending on the type of report, the time period may be a day, a month, a year, or another arbitrary period. However, the most common reporting period is one year. Using artificial time periods leads to questions about when certain transactions should be recorded. For example, how should an accountant report the cost of equipment expected to last five years? Reporting the entire expense during the year of purchase might make the company seem unprofitable that year and unreasonably profitable in subsequent years. Such issues like allocation of the cost of an asset over its useful life are dealt with in subsequent units/levels.

1.4.4 Accrual basis accounting

This concept states that a transaction is recorded when it occurs rather than when cash is paid or received. In most cases, the principle requires the use of accrual basis accounting rather than cash basis accounting. **Accrual basis accounting**, which adheres to the revenue recognition, matching, and cost principles discussed below, captures the financial aspects of each economic event in the accounting period in which it occurs, regardless of when the cash changes hands. Under cash basis accounting, revenues are recognized only when the company receives cash or its equivalent, and expenses are recognized only when the company pays with cash or its equivalent.

According to the accruals assumption, in computing profit revenue earned must be matched against expenditure incurred in earning it. This is also known as matching convention.

1.4.5 Historical Cost principle

The principle states that assets are recorded at cost, which equals the value exchanged at their acquisition. Even if assets such as land or buildings appreciate in value over time, they are not revalued for financial reporting purposes if they are measured on historical cost basis.

1.4.6 Going concern principle

Unless otherwise noted, financial statements are prepared under the assumption that the company will continue in operation for the foreseeable future. Therefore, it is assumed that the entity has neither the intention nor the need to enter into liquidation or to cease trading. If such a need or intention exists, the financial statements will have to be prepared on a different basis and they would mention such a basis.

1.4.7 Consistency Concept

Consistency refers to using the same methods for the same items (i.e. consistency of treatment) either from period to period within a reporting entity or in a same period across entities.

1.4.8 Principle of conservatism/ prudence

As per the conceptual framework, prudence is described as the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and incomes are not overstated and liabilities and expenses are not understated. Accountants must use their judgment to record transactions that require estimation. The number of years that equipment will remain productive and the portion of accounts receivable that will never be paid are examples of items that require estimation. In reporting such financial data, accountants follow the **principle of conservatism**, which requires that the less optimistic estimate be chosen when two estimates are judged to be equally likely. For example, suppose a manufacturing company's Warranty Repair Department has documented a three-percent return rate for product X during the past two years, but the company's Engineering Department insists this return rate is just a statistical anomaly and less than one percent of product X will require service during the coming year. Unless the Engineering Department provides compelling evidence to support its estimate, the company's accountant must follow the principle of conservatism and plan for a three-percent return rate. Losses and costs—such as warranty repairs—are recorded when they are probable and reasonably estimated. Gains are recorded when realized.

1.4.9 Materiality principle

Accountants follow the **materiality principle**, which states that the requirements of any accounting principle may be ignored when there is no effect on the users of financial information. Certainly, tracking individual paper clips or pieces of paper is immaterial and excessively burdensome to any company's accounting department. Although there is no definitive measure of materiality, the accountant's judgment on such matters must be sound. Several thousand francs may not be material to an entity such as BRALIRWA, but that same figure is quite material to a small business.

1.4.10 Duality/ double entry concept

It requires a transaction to be recorded twice (dual recording). The dual aspect rule is recognition that every transaction involves giving and receiving effect. When somebody gives something, another must receive it. This is in effect a requirement for double-entry bookkeeping. Double entry is a principle rule or principle in accounting and is thoroughly explored in later chapters. For now, it suffices to mention that the receiving account is debited while the giving account is credited. Double-entry therefore means that one account is debited while another is credited. The meaning of debit and credit are also explained in later chapters.



Application activity 1.4

1. The recognition that every transaction has two sides to it, is the leading principle of
 - b) Accrual concept
 - c) Duality concept
 - d) Matching concept
 - e) Going concern concept
2. The ----- concept means that similar items in a set of accounts should be given similar accounting treatment and it should be applied from one period to another.
 - a) Going concern
 - b) Prudence
 - c) Consistency
 - d) Materiality

3. Accounting does not record non-financial transactions because of -----

- a) Economic entity concept
- b) Accrual concept
- c) Monetary unit concept
- d) Going concern concept

4. Recognize the accounting concept in the following:

- a) The transactions are recorded at their original cost.
- b) The business will run for an indefinite period.
- c) Every transaction has two effects to be recorded in the books of accounts.
- d) Accounting treatment once decided should be followed period after period.

1.5 Accounting cycle

Activity 1.4



Describe the Accounting cycle

Accounting cycle is the process which is followed by accountants and bookkeepers in processing raw financial data into output information in form of financial statements. This process ranges from occurrence and documentation of transactions up to the production of final accounts or financial statements. It is called a cycle because the same procedure is repeated from one financial year to another. When the financial year ends, books are closed and the financial statements extracted, when the new financial year starts, the same books are opened and the same procedure followed. It is therefore a cycle.

The accounting process or cycle is described below.

Stage 1: Occurrence and documentation of business transactions

Business transactions must be concluded first before anything is documented and recorded. When a business transaction occurs, the immediate thing to do is to prepare a business document to show evidence of the transaction. Documents are means of accountability. Various parties including auditors will want to ascertain whether the transactions took place and were authorized by examining the documents. Besides for accountability, documents are also important as sources of generating the information to be entered into books of

account. The key documents normally prepared are invoices, payment vouchers, receipts, cheques, local purchase orders, delivery notes, goods received notes, bank paying-in slips, etc.

Stage 2: Entering transactions into journals

Journals are books of original or prime entry. They are the first books to which transactions are entered. Information entered into journals is generated from the documents described above. There are several types of journals, the major ones include the general journal, sales journal/sales day book, purchases journal/purchases day book and the cash book (the cash book is sometimes taken to be part of the ledger). Details of these journals including their preparation will be treated later.

Stage 3: Posting of transactions to the ledger

The information which had been entered into the journals is posted to the ledger. It is therefore true to say that the journal feeds the ledger. A ledger is a book which contains a collection of accounts. For easy of recording, the ledger is sometimes subdivided into subsidiary ledgers. Detailed information on preparation of the ledger will be seen later.

Stage 4: Preparation of the trial balance

At the end of a period, normally a month, all accounts are closed or balanced off and the trial balance is extracted. A trial balance is a list of debit and credit balances extracted from the ledger. Its purpose is to check the accuracy of the double entry i.e. to check whether the double entry was complete and to check whether no arithmetical errors of addition or subtraction were made in the balancing of the ledger. If the double entry rule was not observed, the trial balance will not balance, like wise if arithmetical errors were made, it will not balance.

Stage 5: End of year adjustments and preparation of financial statements/ final accounts

Financial statements are prepared from the trial balance. However, before this is done, the trial balance needs to be adjusted at the end of the year in order to make it up-to-date. The major adjustments or provisions made before preparation of final accounts include, provision for depreciation, provision for bad and doubtful debts, adjustments prepaid expenses and incomes, accrued expenses and incomes, provision for corporation taxes, appropriations such as provisions for dividend, transfers to reserve, etc.

Once the above adjustments have been made, financial statements are prepared. The major financial statements include the income statement also called the trading profit and loss account sometimes abbreviated as the profit and loss account. This account or statement shows the profitability of the business. Another major statement is the balance sheet which shows the assets of the business and the claims against the assets. These claims are the owner's equity and liabilities. The third major statement is the cash flow statement which shows the source of cash and how it was disbursed. These are the financiers of the assets of the business. These financial statements will be treated in more details later.

Stage 6: Analysis and interpretation of financial statements

This is not supposed to be the work of an accountant but is the domain of the financial analyst. Strictly speaking, the work of an accountant stops at the preparation of financial statements. However, an accountant could also analyze and interpret his statements. Though it could be advisable to have another independent person to analyze and interpret the accounts.

Analysis and interpretation of financial statements makes the statements user friendly. Lay people in accounting cannot read the figures in the financial statements and the jargon used by accountants. These people need to be told in simple terms whether the business is healthily operating in terms of profitability, solvency/ liquidity etc. Analysis and interpretation of financial statements is majorly done by the use of accounting ratios.



Application activity 1.5

1. What is the accounting cycle?
2. What is the main purpose of accounting cycle?
3. What is the name of the book in which the transactions are initially recorded with brief explanation of the debit and credit analysis?
4. Which is the list of debit and credit balances of the ledger account?
5. What is the main objective of preparing a financial statement?
6. Why the specific process of accounting is called accounting cycle?
7. In the accounting cycle, which step immediately comes before analyzing transactions?

1.6 Accounting equation

Activity 1.6



Describe the Accounting cycle



Figure 1.6: Accounting Equation

Observe the above figure and describe what an accounting equation is.

The ability to read financial statements requires an understanding of the items they include and the standard categories used to classify these items. The accounting equation identifies the relationship between the elements of accounting.

A business owns properties. These properties are called assets. The assets are the business resources that enable it to trade and carry out trading. They are financed or funded by the owners of the business who put in funds. These funds, including assets that the owner may put is called capital. Other persons who are not owners of the firm may also finance assets. Funds from these sources are called liabilities.

The total assets must be equal to the total funding i.e. both from owners and non-owners. If all the resources of the business are supplied by the owner, the accounting equation will be presents as follows:

Assets = Capital

However, some of the assets normally have been provided by some other person than the owner. This indebtedness of a firm is referred to as Liabilities.

Therefore, the equation is now referred to as:

$$\begin{array}{ccccc} \boxed{\text{Assets}} & = & \boxed{\text{Capital}} & + & \boxed{\text{Liabilities}} \\ \boxed{\text{Assets}} & - & \boxed{\text{Liabilities}} & = & \boxed{\text{Capital}} \end{array}$$

Each item in this equation is briefly explained below:

Assets

An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. An example is if a business sells goods on credit then it has an asset called a debtor. The past event is the sale on credit and the resource is a debtor. This debtor is expected to pay so that economic benefits will flow towards the firm i.e. in form of cash once the customers pays.

Current assets typically include cash and assets the company reasonably expects to use, sell, or collect within one year. Current assets appear on the balance sheet (and in the numbered list below) in order, from most liquid to least liquid. **Liquid assets** are readily convertible into cash or other assets, and they are generally accepted as payment for liabilities.

Assets are classified into two main types:

- a) Non-current assets (formerly called fixed assets)
- b) Current assets

Non-current assets are acquired by the business to assist in earning revenues and not for resale. They are normally expected to be in business for a period of more than one year. Current assets are not expected to last for more than one year. They are in most cases directly related to the trading activities of the firm. Examples of non-current assets include:

Major examples include:

- Land and buildings
- Plant and machinery
- Fixtures, furniture, fittings and equipment
- Motor vehicles

Current assets typically include cash and assets the company reasonably expects to use, sell, or collect within one year. Current assets appear on the balance sheet (and in the numbered list below) in order, from most liquid to least liquid. Liquid assets are readily convertible into cash or other assets, and they are generally accepted as payment for liabilities.

Current assets are not expected to last for more than one year. They are in most cases directly related to the trading activities of the firm. Examples include:

- Stock of goods – for purpose of selling. Inventory is the cost to acquire or manufacture merchandise for sale to customers. Although service enterprises that never provide customers with merchandise do not use this category for current assets, inventory usually represents a significant portion of assets in merchandising and manufacturing companies.
- Accounts receivable are amounts owed to the company by customers who have received products or services but have not yet paid for them.
- Other debtors – owe the firm amounts other than for trading.
- Cash at bank
- Cash in hand
- Marketable securities include short-term investments in stocks, bonds (debt), certificates of deposit, or other securities. These items are classified as marketable securities—rather than long-term investments—only if the company has both the ability and the desire to sell them within one year.
- Prepaid expenses are amounts paid by the company to purchase items or services that represent future costs of doing business. Examples include office supplies, insurance premiums, and advance payments for rent. These assets become expenses as they expire or get used up.

Liabilities

A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

Liabilities are the company's existing debts and obligations owed to third parties. Examples include amounts owed to suppliers for goods or services received (accounts payable), to employees for work performed (wages payable), and to banks for principal and interest on loans (notes payable and interest payable). An example is when a business buys goods on credit, then the firm has a liability called creditor. The past event is the credit purchase and the liability being the creditor the firm will pay cash to the creditor and therefore there is an out flow of cash from the business.

Liabilities are also classified into two main classes

- i) Non-current liabilities (or long term liabilities)
- ii) Current liabilities.

Liabilities are generally classified as short-term (current) if they are due in one year or less. Long-term liabilities are not due for at least one year.

Non-current liabilities are expected to last or be paid after one year. This includes long-term loans from banks or other financial institutions.

Current liabilities last for a period of less than one year and therefore will be paid within one year. Major examples:

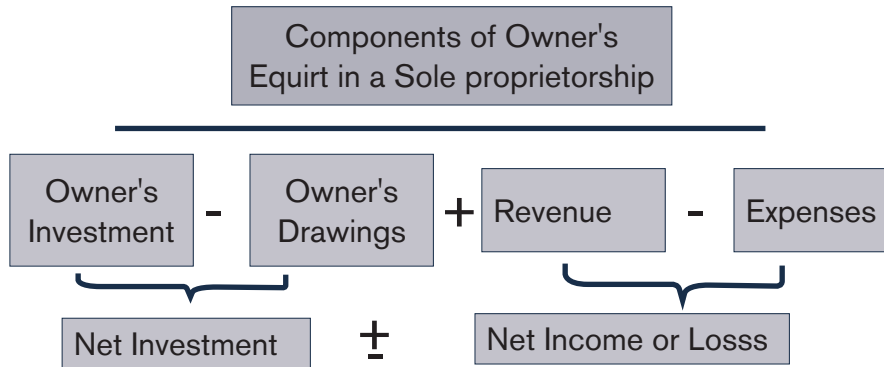
- Trade creditors/ or accounts payable: owed amounts as a result of business buying goods on credit.
- Other creditors: owed amounts for services supplied to the firm other than goods
- Bank overdraft: amounts advanced by the bank for a short-term.
- Accrued expenses

Capital (Equity)

Equity is the residual interest in the assets of the entity after deducting all its liabilities. Owner's Equity represents the amount owed to the owner or owners by the company. Algebraically, this amount is calculated by subtracting liabilities from each side of the accounting equation. Owner's equity also represents the net assets of the company. Items like introduced capital, profit/ loss and drawings appear under equity. By rearranging the accounting equation, we can define owner's equity in this way::

Owner's equity = Assets – Liabilities

In a sole proprietorship or partnership, owner's equity equals the total net investment in the business plus the net income or loss generated during the business's life. Net investment equals the sum of all investment in the business by the owner or owners minus withdrawals made by the owner or owners. The owner's investment is recorded in the owner's capital account, and any withdrawals are recorded in a separate owner's drawing account. For example, if a business owner contributes FRW 10,000,000 to start a company but later withdraws FRW 1,000,000 for personal expenses, the owner's net investment equals FRW 9,000,000. Net income or net loss equals the company's revenues less its expenses. Revenues are inflows of money or other assets received from customers in exchange for goods or services. Expenses are the costs incurred to generate those revenues.



Example: Johnson Company had assets of FRW 140,000 and liabilities of FRW 60,000 at the beginning of the year, and assets of FRW 200,000 and liabilities of FRW 70,000 at the end of the year. During the year, FRW 20,000 was invested in the business, and withdrawals of FRW 24,000 were made. What amount of income did the company earn during the year?

Beginning of the year

Assets		Liabilities		Owner's equity
FRW 140,000	=	FRW 60,000	+	FRW 80,000

During the year

Investment	20,000
Withdrawals	24,000
Net Income	?

End of the year

FRW 200,000		FRW 70,000		FRW 130,000
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Answer

Net income FRW 54,000

Start by finding the owner's equity at the beginning of the year. (Check: FRW 140,000 - FRW 60,000 = FRW 80,000).

Then find the owner's equity at the end of the year. (Check: FRW 200,000 - FRW 70,000 = FRW 130,000).

Then determine net income by calculating how the transactions during the year led to the owner's equity amount at the end of the year. (Check FRW 80,000 + 20,000 - FRW 24,000 + 54,000 = 130,000)

Illustration on construction of the accounting equation

1. John started his business with cash of FRW 25,000,000

Accounting equation

Asset =		Liabilities	+	Owner's equity
Cash	25,000,000 =	-	+	Capital 25,000,000

Note: The business got an asset called cash from its owner and the owner's investment in the business called capital.

2. From the cash resources he purchases a lorry for 15,000,000

Accounting equation

Assets =		Liabilities	+	Owner's equity
Lorry	15,000,000			
Cash	<u>10,000,000</u>	-	+	Capital <u>25,000,000</u>
	25,000,000	-		25,000,000

Note: The business obtained another asset called a lorry and the asset called cash reduces by 15,000,000 since it was used to pay for the lorry. Capital remains unchanged.

3. He bought stock of goods for 10,000,000 on credit

Accounting equation

Assets	=	Liabilities	+	Owner's equity	
Lorry	15,000,000				
Stock	10,000,000	Trade creditors	10,000,000	+	Capital 25,000,000
Cash	<u>10,000,000</u>	-			
	35,000,000	-		35,000,000	

Note: The business obtained additional asset called stock but also incurred a liability to trade creditors since the stock was bought on credit. Owner's equity remains unchanged.

4. He sold half of the goods for 6,000,000 on credit

Accounting equation

Assets		=	Liabilities		+	Owner's equity	
Lorry	15,000,000					Capital	25,000,000
Stock	5,000,000					Add profit	1,000,000
Debtors	6,000,000		Trade creditors	10,000,000			
Cash	<u>10,000,000</u>			<u>10,000,000</u>			<u>26,000,000</u>
	36,000,000						36,000,000

Note: The stock sold for 6,000,000 was bought at a cost of 5,000,000; a profit of 1,000,000 was earned. Profit is added to capital and increases owner's equity.

Note: Since stock was sold on credit, the business got additional asset called debtors or account receivable. Debtors are expected to pay the business at a later date.

5. He paid five million Rwandan francs to the suppliers of the goods (creditors)

Accounting equation

Assets =			Liabilities		+	Owner's equity	
Lorry	15,000,000					Capital	25,000,000
Stock	5,000,000					Add profit	1,000,000
Debtors	6,000,000		Trade creditors	5,000,000			
Cash	<u>5,000,000</u>			<u>5,000,000</u>			<u>26,000,000</u>
	31,000,000						31,000,000

Note: Both creditors and cash reduced by 5,000,000 because creditors were paid cash.

6. He sold the remaining balance of stock at 5,500,000 cash

Accounting equation

Assets =		Liabilities	+	Owner's equity
Lorry	15,000,000			
Debtors	6,000,000			Capital 25,000,000
Cash	<u>10,500,000</u>	Trade creditors	5,000,000	Add profit 1,500,000
	<u>31,500,000</u>		<u>5,000,000</u>	<u>26,500,000</u>
	31,500,000		31,500,000	

Note: The stock sold had cost 5,000,000, since it was sold for 5,000,000; additional profit of 500,000 was made. Stock now disappears completely since all of it was sold and cash increases by 5,500,000.

7. He received 4,000,000 cash from debtors, paid advertising bill of 1,000,000 cash and paid accountant his salary 300,000 cash.

Accounting Equation

Assets =		Liabilities	+	Owner's equity
Lorry	15,000,000			
Debtors	2,000,000			Capital 25,000,000
Cash	<u>13,200,000</u>	Trade creditors	5,000,000	Add profit 200,000
	<u>30,200,000</u>		<u>5,000,000</u>	<u>25,200,000</u>
	30,200,000		30,200,000	

Note: Payment of advertizing bill and accountant's salary are called expenses and reduced profit from 1,500,000 to only 200,000. The net increase in cash is 2,700,000 after the above transactions.

8. Obtained a long-term loan of 10,000,000 from a bank and deposited it on the bank account.

Accounting Equation

Assets =		Liabilities	+	Owner's equity
Lorry	15,000,000			
Debtors	2,000,000			Capital 25,000,000
Bank	10,000,000	Bank loan	10,000,000	
Cash	<u>13,200,000</u>	Trade creditors	5,000,000	Add profit 200,000
	<u>40,200,000</u>		<u>15,000,000</u>	<u>25,200,000</u>
	40,200,000		40,200,000	

Note: The loan was deposited on the bank account and it is reflected as an asset. Cash at bank is sometimes abbreviated as simply bank. The liabilities also increases by 10,000,000 because of the loan acquired.

9. Used 100,000 of the business to campaign for a local election.

Accounting equation

Assets	=	Liabilities	+	Owner's equity
Lorry 15,000,000				Capital 25,000,000
Debtors 2,000,000				Add profit <u>200,000</u>
Bank 10,000,000		Bank loan 10,000,000		25,200,000
Cash <u>13,100,000</u>		Trade creditors 5,000,000		Less drawings 100,000
<u>40,100,000</u>		<u>15,000,000</u>		<u>25,100,000</u>
40,100,000				
		40,100,000		

Note: Campaigning for local election is a non-business activity according to the business entity concept. This is called a drawing and reduces the owner's equity. As observed above, it is subtracted from capital and also cash of the business reduces by 100,000.

The Accounting equation can be expressed in a simple report called the Balance Sheet or statement of financial position. The basic format is as follows:

Balance sheet using the vertical format which is shown below:

Name of business

Balance sheet as at date

Assets

Non-current assets

	FRW	FRW
Land & Building	XX	
Plant & Machinery	XX	
Fixture, furniture & fittings	XX	
Motors vehicles	XX	
Total Non-current Assets		XX

Current Assets

Stocks/ inventories	XX	
Debtors/ Trade receivables	XX	
Cash at bank	XX	
Cash in hand	XX	
Total current assets		XX

Total assets

Equity and liabilities

Capital

Opening balance	XX	
Profit/ Loss	XX	
Drawings	XX	
Closing balance		XX

Non-current liabilities

5 years loan	XX	
2 years loan	XX	
Total non-current liabilities		XX

Current liabilities

Creditors/ trade payables		
5 Months Loan		
Bank Overdraft		
Total Current liabilities		XX

Total liabilities

Total equity and liabilities		XX
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Please pay attention to the format. The Non-Current assets are listed in order of permanence as shown i.e. from Land and Buildings to motor vehicles. The Current Assets are listed in order of liquidity i.e. which asset is far from being converted into cash. Example, stock is not yet sold, (i.e. not yet realized yet) then when it is sold we either get cash or a debtor (if sold on credit). When the debtor pays then the debtor may pay by cheque (cash has to be banked) or cash. The current Liabilities are listed in order of payment i.e. which is due for payment first. Bank overdraft is payable on demand by the bank, then followed by creditors.

Note that in the vertical format, current liabilities are deducted from current assets to give net current assets. This is added to Non-Current assets, which give us net assets. Net assets should be the same as the total of Capital and Non-Current liabilities.

John's Balance Sheet at the end of all transactions

Assets

Non-current Assents	FRW	FRW
Lorry		15,000,000

Current Assets

Debtors	2,000,000	
Bank	10,000,000	
Cash	13,100,000	25,100,000

Total Assets		40,100,000
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Equity and liabilities

Capital	25,000,000	
Add: Profit	200,000	
Less: Drawings	100,000	25,100,000

Non-current liabilities

Bank loan		10,000,000
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Current liabilities

Trade creditors		5,000,000
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Total equity and liabilities		40,100,000
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Application activity 1.6

1. Which of the following is not an asset?
 - a) Building
 - b) Cash balance
 - c) Trade receivables
 - d) Loan from Kamanzi
2. Which of the following is a liability?
 - a) Machinery
 - b) Trade payables for goods
 - c) Moto vehicles
 - d) Cash at bank
3. Which of the following items are shown under the wrong headings:

Assets

Cash at bank
Fixtures
Creditors
Buildings
Trade receivables
Capital

Liabilities

Loan from Gasana
Machinery
Moto vehicles
Inventory of goods

4. Which of the following is incorrect?
 - a) $\text{Assets} - \text{Capital} = \text{Liabilities}$
 - b) $\text{Liabilities} + \text{Capital} = \text{Assets}$
 - c) $\text{Liabilities} + \text{Assets} = \text{Capital}$
 - d) $\text{Assets} - \text{Liabilities} = \text{Capital}$

5. Which of the following is incorrect?

	Assets FRW	Liabilities FRW	Capital FRW
(a)	7,850	1,250	6,600
(b)	8,200	2,800	5,400
(c)	9,550	1,150	8,200
(d)	6,540	1,120	5,420

6. Mutabaruka has a business that has been trading for some time. You are given the following information as at 31/12/2021.

	FRW
Buildings	11,000
Furniture & Fittings	5,500
Motor Vehicles	5,800
Stocks	8,500
Debtor	5,600
Cash a bank	1,500
Cash in hand	400
Creditors	2,500
Capital	30,800
Loan (long term)	5,000

You are required to prepare a simple Balance Sheet as at 31 December 2021

7. Mukamana sets up a new business. Before he actually sells anything he has bought motor vehicles of FRW 3,000, premises of FRW 7,000, stock of goods FRW 2,000. He still owes FRW 800 in respect of stock purchased. He had borrowed FRW 4,000 from Kanyemera. After the events just described and before trading starts, he had FRW 300 cash in hand and FRW 600 cash at bank.

You are required to calculate the amount of his capital.



End of unit assessment

1. Mention two objectives of accounting?
2. Mention five different branches of accounting?
3. Why Creditors, Tax authorities, Investors, and general public are interested in accounting information?
4. Match the terms below with the type of user of accounting information (Some answers may be used more than once):
 1. Tax authorities
 2. Investors
 3. Management
 4. Creditors
 5. Regulatory agencies
 6. Labor unions and consumer groups
 - a. Internal user
 - b. Direct external user
 - c. Indirect user
5. Match the descriptions on the left with the forms of business organizations on the right:
 1. Pays dividends
 2. Owned by only one person
 3. Multiple co-owners
 4. Management appointed by board of directors
 5. Most numerous but usually small in size
 6. Biggest segment of the economy
 - (a) Sole proprietorship
 - (b) Partnership
 - (c) Corporation
6. Discuss in brief any four concepts of Accounting.

7. Which of the following is a form of internal control that ensures the ledger is balanced?

- a) Financial statements
- b) Sequentially numbered source documents
- c) Trial balance
- d) Journal entries

8. In each of the following pairs of activities, tell which activity is done first in the accounting cycle

- (a) Close the accounts or adjust the accounts
- (c) Record the transactions in the journal or prepare the initial trial balance
- (b) Analyze the transactions or post the entries to the ledger
- (d) Prepare the post-closing trial balance or prepare the adjusted trial balance

9. You are to complete the gaps on the following table?

	Assets	Liabilities	Capital
	FRW	FRW	FRW
(a)	55,000	16,900	?
(b)	?	17,200	34,400
(c)	36,100	?	28,500
(d)	119,500	15,400	?
(e)	88,000	?	62,000
(f)	?	49,000	110,000

10. Mugabowindekwe has the following items in his balance sheet as on 30 June 2021. Capital FRW 41,800, Creditors FRW 3,200, Fixtures FRW 7,000, Motor Vehicles FRW 8,400, Stock of goods FRW 9,900, Debtors FRW 6,560, Cash at bank FRW 12,900 and Cash in hand FRW 240

During the first week of July 2021:

- a) He bought extra stock of goods FRW 1,540 on credit.
- b) One of the debtors paid him FRW 560 in cash.
- c) He bought extra fixture by cheque FRW 2,000.

You are to draw up a balance sheet as on 7 July 2021 after the above transactions have been completed.

UNIT 2

ACCOUNTING SOURCE DOCUMENTS



Key unit competence: To be able to prepare accounting source documents



Introductory activity

BYISHIMO met with a businessperson on church who requested him to be supplied with bars of pieces of soap at a price of FRW 750 each bar. When BYISHIMO delivered 50 boxes of pieces of soap and that, without any evidence, he was not paid the full amount of money they agreed upon.

1. Has this situation ever happened to you?
2. When and what happened?
3. What mistake did BYISHIMO make?
4. Assume you were the one in such a situation, what would you do?
5. What advice would you give to BYISHIMO and the businessperson?
6. What lessons do you learn from the above situation?

During the course of its business, a company sends out and receives many source documents. The details on these source documents need to be recorded, otherwise the business might forget to ask for some money, or forget to pay some, or even accidentally pay something twice. In other words, it needs to keep records of source documents – of transactions – so that it can keep tabs on what is going on. The following sections explain some of the main source documents

2.1 Pro-forma Invoice

Activity 2.1



NYIRANGARAMA Enterprise, a manufacturer business, wants to purchase green and yellow bananas as raw materials in producing “AKARUSHO”. It has a number of potential suppliers of green and yellow bananas and it is very hard and difficult to select one of them to deal with.

- a) What is the accounting document which will be issued by potential suppliers to be sent to NYIRANGARAMA Enterprise in order to select the best supplier among the others?
- a) How does it look like?

A proforma invoice is a preliminary bill of sale sent to buyers in advance of a shipment or delivery of goods. The invoice will typically describe the purchased items and other important information, such as the transport charges. Proforma invoice is different from a simple price quotation in that it is a binding agreement although the terms of sale are subject to change. Most proforma invoices provide the buyer with a precise sale price. It includes an estimate of any commissions or fees, such as applicable taxes. Although the proforma invoice may be subject to change, it represents a good faith estimate to avoid exposing the buyer to any unexpected significant charges once the transaction is final.

The purpose of a proforma invoice is to streamline the sales process. Once you send the proforma invoice, the customer agrees to the price and then you send the goods or services. Instead of being a demand for payment, proforma invoices are good faith estimate that lets the customer know exactly what to expect.

Here are some of the other uses of a proforma invoice:

- It is frequently sent to declare the value of goods for customs for a smooth delivery process;
- Proforma invoice is ideal when you don't have all the details required for a commercial invoice;
- Some clients use it for internal purchase approval process.

Although it contains exact cost details associated with the sale, it is not an official demand for payment. No guidelines dictate the exact presentation or format of a proforma invoice, and it may or may not resemble other commercial invoices.



Application activity 2.1

1. State the meaning of the proforma invoice
2. Give the purpose of the proforma invoice
3. Read the following statement and answer to the questions below:

BANANA GROWERS Company is required to inform to NYIRANGARAMA Enterprise how the following items may be supplied:

- 10 tons of green banana
- 20 tons of yellow banana

Required:

Through which document this information is sent? Prepare it

2.2 Purchase Order

Activity 2.2



Analyze the image below and answer to the questions below:

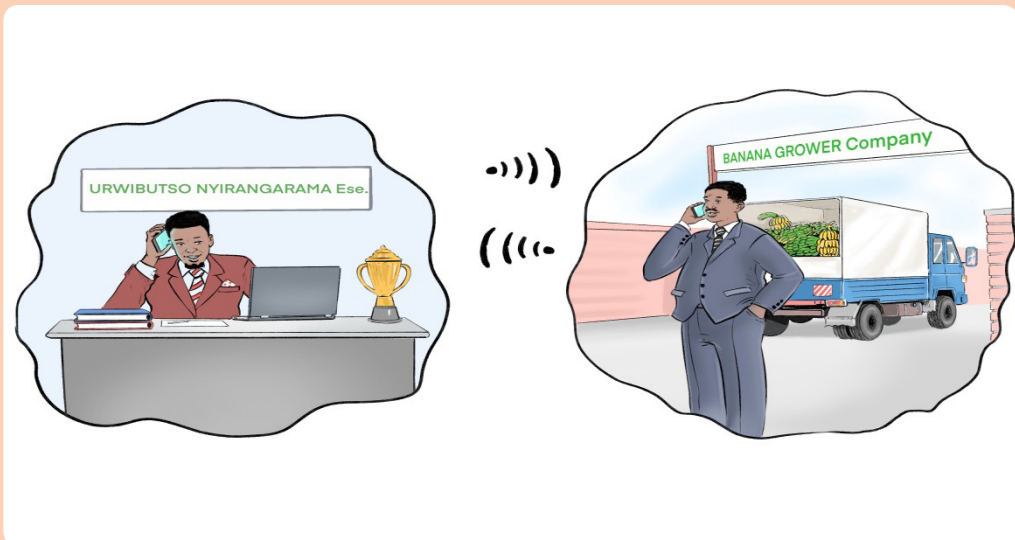


Figure 2.2: Purchase order

1. When is this document issued?
2. What is its content?

A purchase order is a document of a company which details goods and services that a company wishes to purchase from another company. Two copies of the purchase order are often made, one is sent to the company from which goods and services will be purchased and the other is kept internally so that the company can keep track of its orders. Purchase orders are often sequentially numbered.

This allows buyers to place orders with suppliers without immediately making payment.

The seller uses purchase orders as a way to offer buyers credit without risk because the buyer is legally obligated to pay for products and services when they have been delivered. Once accepted by seller, a purchase order becomes a legally binding contract. If there is not an existing contract that governs the relationship between buyer and seller, the purchase order can take its place. This offers legal protection for both buyer and seller.

Purchase order plays an important role in case of conflict, it is a contract between buyer and seller to deliver goods at the agreed price and the buyer must pay within the due date. If any party misses its obligation, another party can use the purchase order as the evidence in the court.

Each purchase order has its own number, known as the purchase order number, to assist both buyer and seller in tracking delivery and payment of each request.

A purchase order will contain the order details including the following:

- The company name of the buyer;
- Vendor information including the seller's company name;
- The product(s) or service(s) to be purchased;
- Purchase order number;
- Quantity purchased;
- Price per unit;
- Delivery location;
- Payment terms, when the invoice will be paid, such as on receipt of delivery, net 30 of net 60, or a specific due date.

Both parties use this document as the reference during the business transactions, buyers expected to receive the same goods at the same price as mentioned in the purchase order. The seller expects to make a sale base on the buyer order.



Application activity 2.2

1. State the meaning of the purchase order
2. Give the purpose of the purchase order
3. Read the following statement and answer to the questions below:

NYIRANGARAMA Enterprise orders to BANANA GROWERS Company to supply the stated items:

- a) 10 tons of green banana
- b) 20 tons of yellow banana

Required: (a) Through which document this order is sent?
(b) You are required to a purchase order

2.3. Delivery note



Activity 2.3

Analyze the case study below and answer to the questions:

BANANA GROWER Company, the supplier of green and yellow banana to NYIRANGARAMA Enterprise, has supplied mentioned items to its customer in terms and conditions with the order. This conformity is justified by the fact that when delivering, the supplier has accompanied the items by written evidence and the buyer proves this delivery by a goods received note.

1. What are the activities made by the two people?
2. What is the document prepared and sent to the receiver?

Delivery note, also known as goods delivery note is a document prepared by the seller to accompany the delivery of the goods to the buyer. It provides proof of the physical transfer of goods to the buyer who himself/herself or his/her authorised agent, signs the note to acknowledge delivery of the goods. It gives a brief description of the goods as to quantity, number of packages, nature and quality of goods being delivered.

Whoever signs the note should ensure that the description of the goods as to quantity, quality, etc. agrees with the goods actually delivered. A qualified signature should be given if goods are opened or damaged on receipt. The goods are then taken into stock and recorded in the store books for costing purposes. The delivery note is therefore the source document for recording transactions in the stores book.

The delivery note certifies the delivery of goods to the buyer, who must sign it to make it clear that the goods have been delivered in accordance with the conditions established. When a customer places an order with you, you should aim to send the goods as soon as you can. If a delivery note is created to send with the shipment, it can be used as a checklist and, as previously mentioned, it can serve as proof of delivery. Also, it is an added service that puts the customer's mind at ease. It is useful because, suppliers can confirm that everything went as planned with the delivery and after it is being signed and returned, it serves as proof that all goods were received and the recipient is satisfied. It also gives customer an overview of the products they've ordered as it allows them to cross check the products they received with their order.



Application activity 2.3

1. What is the goods delivery note?
2. State the importance of the goods delivery note.
3. Draw up and fill in the goods delivery note basing on the following data:
 - Name of the seller: BANANA GROWERS Company
 - Name of the buyer: NYIRANGARAMA Enterprise
 - Items supplied:
 - * 10 tons of green banana for FRW 500 each kg
 - * 20 tons of yellow banana for FRW 600 each kg
 - Issuance date : 24th March 2022
 - Number of the document: 12345

2.4. Goods received note

Activity 2.4



Analyze the case study below and answer on the questions:

BANANA GROWERS Company, the supplier of green and yellow banana to NYIRANGARAMA Enterprise, has supplied mentioned items to its customer in terms and conditions with the order. This conformity is justified by the fact that when delivering, the supplier has accompanied the items by the goods delivery note and the buyer proves this delivery by written evidence.

- a) What are the activities made by the two people?
- b) What is the document prepared and sent by the receiver (buyer)?

Goods received note (GRN) is a document that of a company that lists the goods that a business has received from the supplier. The goods received note is usually prepared by a business' own warehouse or goods receiving area. It is also known as received note, which is used as the evidence that goods are delivered and the customer already received. Moreover, both suppliers and customers use goods received note to compare between order and delivery quantity.

However, the goods received note is the most important document both for suppliers and customers. Goods received note ensures that the provided goods are received by the customer, and at the time of billing the goods received note is attached with the invoice for the cross-reference. It helps customers and suppliers make and keep a binding agreement, and empower organizations to keep stock of inventory levels. Here are its features:

- Name of supplier's organization
- Product details such as name, size, type, technical specifications, etc.
- Delivery time and date;
- Product quantity;
- Signature of the supplier'
- Name and signature of the receiver;
- Goods received note number.



Application activity 2.4

1. What is the goods received note?
2. State the importance of the goods received note.
3. Draw up and fill in the goods received note basing on the following data:
 - a) Name of the seller: BANANA GROWERS Company
 - b) Name of the buyer: NYIRANGARAMA Enterprise
 - c) Items received:
 - 10 tons of green banana for FRW 500 each Kg
 - 20 tons of yellow banana for FRW 600 each Kg
 - d) Issuance date : 24th March 2022
 - e) Number of the document: 54321

2.5 Invoice



Activity 2.5

Analyze the case study below and answer on the questions:

BANANA GROWER Company, the supplier of green and yellow banana to NYIRANGARAMA Enterprise, has supplied mentioned items to its customer in terms and conditions with the order. This conformity is justified by the fact that when delivering, the supplier has accompanied the items by the goods delivery note and the buyer has sent goods received note as the delivery confirmation. Then, the seller informs the buyer how much money he/she has to pay for through a written supporting document.

- a) What are the activities made by the two people?
- b) What is the document prepared and sent by the seller?

Invoice is a commercial document issued by the seller to the buyer, relating to a sale transaction and indicating the products, quantities and agreed upon prices for products or services the seller had provided the buyer.

An invoice serves an important purpose in business accounting; it demonstrates a client's obligation to pay you for your services. An invoice offers verification in writing, of the payment agreement between your business and its client. Invoices set your payment terms and enable you to get paid faster for your services.

The main elements that each invoice must include are the following:

- a) The word Invoice;
- b) Seller's name and address, contact details and company registration number (if any);
- c) Buyer's name and address;
- d) Date: invoice issue date, payment due date, delivery date;
- e) A unique invoice reference number;
- f) Description of services or products including quantity, cost per unit and total item cost;
- g) Total amount charged with tax information;
- h) Available payment methods, including bank account number and reference code identifying the customer.

Invoicing before delivering the goods or services is a practical option when working on small orders. This approach comes with increased pressure to deliver the goods or services, but eliminates the possibility of non-payment. Receiving upfront payment helps improve cash flow, particularly in small businesses. Invoicing after the delivery of goods requires a high level of trust and can be risky. Rectifying instances of non-payment costs money in legal costs or debt collection agency fees.

Note that an invoice is primarily a demand for payment, but it is used for other purposes as well. Most accounting software packages can generate an invoices, however in smaller businesses with paper based systems, invoices are produced on multi part stationary, or photocopied or carbon-copied. The top copy will go to the customer and the other duplicates will be used by various people within the business.



Application activity 2.5

1. What is the invoice?
2. State the importance of the invoice.
3. Draw up and fill in the invoice basing on the following data:
 - a) Name of the seller: BANANA GROWERS Company
 - b) Name of the buyer: NYIRANGARAMA Enterprise
 - c) Items received:
 - 10 tons of green banana for FRW 500 each kg
 - 20 tons of yellow banana for FRW 600 each kg
 - d) Issuance date : 24th March 2022
 - e) Number of the document: 53100
 - f) Trade discount applied : 3%
 - g) VAT : 18%

2.6 Receipt



Activity 2.6

Analyze the case study below and answer on the questions:

As mentioned on the invoice above provided by the seller to its customer, the buyer makes payment of the full amount of the invoice in cash, the seller receives the paid amount. This payment is proved by a written document provided by the seller and sent to the buyer.

- a) What are the activities made by the two people?
- b) What is the document prepared and sent by the seller?

Receipt is mainly a document confirming that a payment has been received. It is a written document triggered by the receiving of something of value from a third party. This document acknowledges that the item has been received. A receipt may contain the date of the transfer, a description of the item received,

the amount paid for the item, any sales tax charged as part of the transfer and the form of payment (such as with cash or a credit card).

Receipts are usually associated with the delivery of goods or services from a supplier. They can be used for several reasons, including the following:

1. To document the transfer of ownership to the buyer;
2. As a control, so that the buyer has proof of the amount paid;
3. To form the basis for an accounting entry to record the underlying transaction;
4. To document ownership for insurance purposes;
5. As a proof of delivery from the supplier, in case goods are returned under warranty;
6. To provide evidence that a sales tax paid as part of the transaction, so that the buyer is not liable to pay a use tax.

The purposes of the receipt are many. First of all, it serves as accounting records. Also, it gives the customer a written proof of the transaction in case they have a claim in regard to the items being bought. Receipt can be issued to record that something was transferred.

A receipt may be automatically generated by the seller (such as by cash register) or under more informal of low-volume circumstances, a receipt may be produced manually by the seller.



Application activity 2.6

1. What is the receipt?
2. State the importance of the receipt.
3. Draw up and fill in the receipt basing on the following data:
 - a) Name of the seller: BANANA GROWERS Company
 - b) Name of the buyer: NYIRANGARAMA Enterprise
 - c) Amount received: FRW19,458,200
 - d) Reason for the payment: goods supplied
 - e) Date of payment: 24th March 2022
 - f) Number of the document: 1357

2.7 Cheque

Activity 2.7



Analyze the case study below and answer the following questions:

A number of people make transactions of depositing and withdrawing their money to their bank account with a financial institution. Most of the time, the depositing transaction is made between the financial institution and any depositor to a specified bank account. The withdrawal transaction sometimes involves paying attention because it may happen that it is not the true beneficiary to receive cash from the bank. That is why the document used to perform this transaction must contain full and correct information.

- a) What are the activities made by the different people with the financial institutions?
- b) What are the documents used by the people at bank and those issued by the financial institutions to their customers?

A cheque is a written order from a bank current account holder, addressed to his/ her bank to pay a stated sum of money to or to the order of the person named on the order or to its bearer. Only a person operating a bank account can use a cheque as a means of payment. The person writing the cheque, known as the drawer, has a transaction banking account where the money is held. The drawer writes the various details including the monetary amount, date and the payee on the cheque and signs it, ordering his/ her bank, known as the drawee, to pay that person or company the amount of money stated. The cheque may also be defined as the negotiable instrument instructing a financial institution to pay a specific currency from a specified transactional account held in the drawer's name with that institution. Both the drawer and payee may be natural persons or legal entities. Cheques are important because they provide alternative means of holding cash for the cash owner. A person cannot hold money in the amount of millions. It would be too unsafe to carry or travel with having money in bulk amount, in that case cheques provide easier and safer medium to hold cash.

Cheques are a type of bill of exchange that was developed as a way to make payments without the need to carry large amounts of money.

A cheque must have at least the following items:

1. **Drawer:** the person or entity whose transaction account is to be drawn. Usually, the drawer's name and account is preprinted on the cheque and the drawer is usually the signatory;
2. **Payee:** is the person or entity who is to be paid the amount;
3. **Drawee:** is the bank or other financial institution where the cheque can be presented for payment. This is usually preprinted on the cheque;
4. **Amount:** the currency amount usually must be written in words and in figures. The currency is usually the local currency, but may be a foreign currency;
5. The word "cheque" in both text and title;
6. An order to pay a specified sum of money;
7. The place of payment;
8. Date of drawing;
9. Place of drawing;
10. The account number of drawer;
11. The signature of the drawer.

Types of cheques

There are various types of cheques which are used by the issuer according to their requirements and terms of payments. Each type of cheque has its own merits and demerits as per both drawers as well as drawee respective. Hence, let us discuss each type of cheques along with their features and uses in brief.

Bearer cheque

The bearer cheques are those which can be redeemed in cash by anyone who holds them or whose name is mentioned over the cheque. In other words, it is negotiable financial instrument encased by anybody without endorsement who present the cheque in the bank and doesn't require identification as well and this is because it is risky type of the cheque. Typically, such cheques are issued by the owner to the most trustworthy and credible person or party. In case of loss of bearer cheques, the issuer can cancel such cheque from the bank to avoid the risk of fraud.

Order cheques

When the term bearer is strike-off (cancelled) by the issuer, such cheques are converted into order cheque. Order cheques are payable to the specific person whose name is mentioned on the beneficiary column or any other person who is endorsed by the original beneficiary.

Self-cheque

Whenever the issuer or account holder utilizes his own cheque for self-payment or withdrawal of money from his own account, such cheque is known as self cheque. In the case of self cheque, the beneficiary column is filled by the term "SELF" instead of any other person's name. Self-cheques are usually present by the owner for the purpose of immediate and big withdrawal funds instead of other methods like ATM, etc.

Account payee/ crossed cheques

When the issued cheque is crossed twice with two parallel lines at its top corner, then such cheque is converted into account payee cheque. An account payee cheque is only payable into the bank account of the beneficiary. Such cheque is considered the safest type of cheque and is used mostly during business transactions by traders to pay the salaries of employees, due invoices and other expenses.

Such cheques are also called "crossed cheques", however, there are basically three conditions of crossing as follows:

- a) Whenever the cheque is simply crossed by two parallel lines at the top corner such crossing can be termed as a general crossing. Such crossing indicates that payment should be credited in a bank account only whether in payee or anyone else account endorsed by the original beneficiary.
- b) If a cheque is crossed at the top corner by two parallel lines and at the same time the term "account payee only" is also written between such parallel lines, such crossing is known as Account payee crossing which ensures the remittance of payment in the payee bank account only.
- c) If the drawer wishes to pay a certain amount in any specific bank only, he/she can simply mention the name of the bank between two parallel lines over the body of cheque which ensures that the payment will be done in the bank account of mentioned banks only. Such crossing is known as a special crossing.

Bankers cheque

The banker's cheque is issued either by the bank itself or on the behalf of its customers for the purpose of clearing various outstanding or payments like rent payment, electricity charges, maturity payments etc. in other words, the drawer of the banker cheque is the bank itself or any other person or entities and the payee could be anybody like the person, firms, company, etc.

The payment of such cheque is guaranteed by the bank as unlike other types of cheque, there is no need to deposit money to the issuer's account. The banker cheque cannot be transferred to anyone i.e. it is non-negotiable.

Travelers cheque

A traveler's cheque is nothing but a cheque which is used by the individuals during travelling abroad and don't want to carry a huge amount (cash) with themselves to avoid the risk of theft. Such cheques can be encased or used for the payment purpose abroad by the owner where the foreign currencies are exchanged/accepted.

Post-dated cheques

If a cheque is drawn by the drawer to pay a specific amount to any person/firm on a future specified date, in this case, a post-dated cheque is issued. A post-dated cheque ensures the payment on a future specified date only; this means it cannot be encashed before the mentioned date.

Such cheques are used in the business where the goods or services are sold on a credit basis, repayment of the debt, rent payment etc. a post-dated cheque is also used as security during the delivery of goods from one party to another.

Blank cheque

A blank cheque is typically used during a business deal where a person of firm signs a deal with the company for dealership/ invoices or any other services of whenever the amount of funds and date of payment is not sure.

A blank cheque neither contains the date of payment nor the sum of money which are generally filled by the beneficiary itself after a mutual discussion in a future specified date. However, it is risky to issue a blank cheque; the issuer generally mentions a maximum limit over such cheque to minimize risk.

Nominative cheque

Nominative cheque represents a document that someone (considered a giver or issuer) uses to make a payment to another (called a bearer or beneficiary)

without to use cash. The beneficiary or favored of that payment is the legal or natural person whose name is on it. The nominative cheque is characterized because it stipulates an amount that the natural person of legal entity named in it will withdraw from the issuer's bank. It is to be cashed or deposited exclusively by the payee who is explicitly named on the cheque.

It cannot be deposited into an account of a third person, other than of the beneficiary. However, nominative cheque can be delivered or assigned to third party through an endorsement. It must be taken into account that there are nominative cheques that do not allow to be endorsed. If it is observed that the cheque has a "to the order", it means that it could be endorsed. On the contrary, it cannot be endorsed if it has the stipulation "not to order". In order to cash the cheque, it must be presented at the bank, either to exchange it for cash or to deposit it in an account in the name of the beneficiary, within a specified period of time from the issue date indicated on the cheque.

The issue of the cheque may avoid or revoke it if the indicated period of time is exceeded and the cheque has not yet been presented at the bank for collection.

Endorse a cheque.

Endorsement of cheque means giving signature for transferring. The word endorsement came from Latin word "indorsum". Here "In" means above and "dorsum" means backside. Even in this electronic age, the cheque is still the payment method used by many employers. To deposit or cash a cheque it must first be endorsed. There are three basic types of endorsement:

a. Blank or general endorsement

A blank endorsement is made when the payee named on the cheque supports it by putting his/ her name on the cheque; signing the back of the cheque completes the negotiation that allows the transfer of the money ordered by the cheque. A blank endorsement is the most common type of endorsement and is the least restrictive, as it does not limit marketability. Anyone else can negotiate a cheque with a blank endorsement.

b. Restrictive endorsement

A restrictive endorsement is made by writing "deposit only" on the first line of the cheque and then signing the name below.

Restrictive endorsement limits marketability. "Deposit only" is the most common form of restrictive endorsement and is used to avoid further negotiation of the cheque. A cheque with a restrictive endorsement can only be deposited into

account in the name of the signer. One of the ways for the casher to minimize their risk of loss is by placing their restrictive endorsement on the cheque.

c. Special endorsement

A special endorsement allows a payee to make a cheque payable to another person or entity. A cheque with a special endorsement is signed when you want to deliver the cheque to someone else. It is different from a blank cheque because the blank cheque can only be cashed or deposited by the person to whom the cheque is being assigned. Make a special endorsement you must write “pay to the order of [name of the person to whom the cheque will be delivered]” and sign their name below.

Advantages and disadvantages of a cheque

Advantages

- It is more convenient than carrying cash around;
- Payments can be stopped if necessary;
- Cheques are safer crossed;
- One does not have to count notes and risk making counting mistakes;
- Cheques can be drawn anytime;
- Some are negotiable and can be endorsed in favor of a third party;
- They can be post-dated;
- They can be traced if lost;
- They can be posted cheaply;
- The customer is sent a statement at the end of each month.

Disadvantages

- Cheques are not legal tender and other creditors may refuse to accept them;
- They may be valueless if the drawer has no funds on his/her account;
- Depositing cheque into an account is time consuming;
- Cheque can be tampered with or forged by changing the figures;
- Cheques are not suitable for small amounts;
- People without bank account will be inconvenienced by crossed cheques;
- Bank charges are levied on cheque books and dishonored cheques.

Dishonoring a cheque

When a person presents a cheque in a bank and the bank refuses to make payments as instructed, then we say that the cheque has been dishonored. In most cases, we say the cheque bounced.

Reasons for dishonoring a cheque:

- When a cheque is not properly dated;
- When a cheque is damaged i.e. some parts missing and can't be read;
- When it has been altered with some information changed;
- When it's stale cheque i.e. more than six months old;
- If it is a post dated cheque i.e. if the date is a future date; e.g. a cheque dated 25th March 2022 and presented 20th March 2022;
- When the amount in figures differs from the amount in letters (in words);
- Insufficient funds on the drawer's account (cheque without provision);
- When the account from which the cheque is issued has been already closed;
- Missing items on the cheque;
- Signature is not matching, i.e. if the signature differs from the specimen, the bank will suspect that it is forged.



Application activity 2.7

1. What is a cheque?
2. State the importance of a cheque.
3. What are the main items of a cheque?
4. List out the types of a cheque
5. Distinguish different forms of cheque endorsement
6. State some advantages and disadvantages of using the cheque.

2.8 Credit note

Activity 2.8



Analyze the case study below and answer the questions:

BANANA GROWER Company, the supplier of green and yellow banana to NYIRANGARAMA Enterprise supplied the stated items to its customer. At delivery, the customer finds that some items don't match with the order and decides to return them to the supplier. On its return, the seller accepts the return of the returned items and draw up document as an evidence of this transaction.

- g) What are the activities made by the two people?
- h) What is the document prepared and sent by the receiver (buyer)?

Credit note

A credit note, also known as a credit memo, is another document originating from the seller to the buyer. It is used to correct an overcharge on an invoice or to certify the credit of set-off the return of goods by the seller. Where returns goods to the supplier, his/ her liability is reduced and in this case the customer should send back the goods, accompanied by a goods returned note, where purchases return and consequently ask for a credit note from the supplier. Credit notes issued during the period provide information on goods that have been returned by the customer of sales returns, allowances for overcharges, rebates, etc. and this information is recorded in the relevant books of account for the period. By issuing a credit note, the seller promises to pay back the reduced amount or adjust it in a subsequent transaction.

The various reasons for the credit note may include the following:

1. Sales return or certain goods or services rejected by the recipient;
2. Goods damaged in transit or in some other way;
3. Error in the price of goods or services in the original invoice;
4. Over payment by the recipient on the original invoice;
5. When the available discount has not been applied at the time of preparation of the invoice;
6. When the seller wants to cancel a payment pending from the buyer.



Application activity 2.8

1. What is a credit note?
2. State the importance of a credit note.
3. Draw up and fill in a credit note basing on the following data:
 - a) Name of the seller: BANANA GROWERS Company
 - b) Name of the buyer: NYIRANGARAMA Enterprise
 - c) Items returned/ damaged:
 - 50 Kg of green banana for FRW 500 each kg
 - 20 Kg of yellow banana for FRW 600 each kg
 - d) Issuance date : 24th March 2022
 - e) Number of the original invoice: 53100

2.9 Debit note

Activity 2.9



Analyze the case study below and answer on the questions:

BANANA GROWERS Company, a supplier of green and yellow banana of NYIRANGARANA Enterprise, forgot to charge to its customer the cost of transportation of the supplied items. It informs to the buyer the reason of charging this cost through a written document. On its turn, after being informed, the buyer accepts to pay this cost.

- a) What are the activities made by the two people?
- b) What is the document prepared and sent by the seller)?

A debit note is a document sent by the seller to the buyer to correct an undercharge in an invoice. The effect of the debit note is to increase the customer's account. Debit notes provide information to correct undercharge on goods or in respect of other charges and this information is then recorded in the relevant books of account.

This note is issued by the in goal to:

- i) Rectify a favorable mistake to buyer which it has been clearly fixed only after the sending of an invoice.
- ii) Request additional payment as interests due a delay period made by the buyer in the payment of this invoice
- iii) Charge the customer who fails to return the packaging cases or containers not charged for in an invoice.

Incoming debit notes are received from creditors, outgoing debit notes are sent to debtors.



Application activity 2.9

1. What is the debit note?
2. State the importance of the debit note.
3. Draw up and fill in the debit note basing on the following data:
 - i) BANANA GROWERS Company sent a debit note concerning the transport cost to NYIRANGARAMA Enterprise for goods supplied on 24th March 2022
 - ii) The transport cost is amounting to FRW 50,100 and were not charged to the customer at the moment of issuing the invoice.
 - iii) Issuing date: 25th March 2022
 - iv) Number of the debit: 202020

2.10 Petty cash voucher

Activity 2.10



NYIRANGARAMA Enterprise operates a number of transactions; the cheque became a very important means of settling its business accounts, such that most payments requiring sums of money are made by cheque. Nevertheless, there are certain accounts that require small amounts for settlement. Expenses for the kitchen, cleaning, postage etc. are settled by small amounts of money which usually are not done by cheque. Sometimes, items like stationery, travelling expenses, small ledger accounts, advances to casual workers, etc. are required urgently and the procedure for preparing a cheque for the purpose is rather long. The alternative is to keep some cash to meet such minor and urgent payments. The amount of cash kept in the office to meet minor and urgent expenses is called *petty cash, float or imprest*. The clerk in charge of handling petty cash payments is known as a petty cashier.

- a) From the case study above, state the source document which is required.
- b) Give its format

A petty cash voucher is an accounting term used to describe the form that is used to record the transactions taken from a petty cash funds.

The petty cash voucher is a specially designed form used by a petty cashier. It states the nature of payment, the amount, date, the authority for the payment and the person to be paid to. It also acts as evidence for receipt of such cash as the recipient must sign it immediately after receiving the cash. It should be numbered serially. Petty cash vouchers are used as a source of information for recording the petty cash book, which records petty cash transactions.

Petty cash voucher has on it the following features:

- a) Space for the date transactions are made;
- b) The amount of money disbursed;
- c) The name of the person being given the money;
- d) The reason why the money was given out;

Importance of the petty cash voucher

There are so many reasons why petty cash voucher is very important in many businesses. The following are the major reasons why the petty cash voucher is vital:

- a) These vouchers help to financially control the petty cash accounts in order to make sure that no one can abuse or mismanage the funds in the petty cash fund
- b) It can provide solid evidence when it comes the reconciliation of the amount of cash that is left in the petty cash fund.



Application activity 2.10

1. What is a petty cash voucher?
2. State the importance of a petty cash voucher.
3. Draw up and fill in a petty cash voucher basing on the following data:
 - Company name: NYIRANGARAMA Enterprise
 - Purpose of expenditure:
 - Travelling expense: FRW 30,000
 - Kitchen expenses: FRW200,000
 - Cleaning expenses: FRW 150,000
 - Casual labor expenses: FRW 45,000
 - Beneficiary name: KEZA
 - Date of payment: 26th March 2022

Note that the above list does not exhaust all the source documents that you will find in a business or any other organizational setting. Examples of other source documents not described in details include quotation, statement, remittance advice and many others.



End of unit assessment

1. What is a source document?
2. Explain concisely the following terms:
 - (i) invoice
 - (ii) credit note
 - (iii) debit note
 - (iv) cheque
 - (v) receipt
 - (vi) purchase order
3. Among the documents commonly used in business are as follows:
 - Cheque
 - Petty cash voucher
 - Debit note

Required: list under each of the above headings the details information to describe the document
4. Explain briefly but concisely the following business terms:
 - a) Delivery note
 - b) Goods received note
5. What is the primary function of a sales invoice which a customer has received from a supplier:
 - a) It is a receipt for money paid;
 - b) It is a demand for immediate payment by the supplier;
 - c) It is a record of goods purchased by the customer;
 - d) It is a demand for payment within an agreed time from the supplier

6. Which of the following correctly describes the function of a credit note issued by a supplier to one of its customers?
- a) A demand for payment;
 - b) An agreed allowance which can be deducted from the next invoice payment;
 - c) A loan available to the customer;
 - d) A document used by the supplier to cancel part or all of a previously issued invoice
7. Which of the following correctly describes the term “debit note”?
- i) It is issued by a supplier to a customer to demand payment in full for goods supplied
 - ii) It is issued by a supplier to the customer to correct an undercharge
 - iii) It is issued by a customer when goods are delivered
 - iv) It is issued by a customer to a supplier to cancel an invoice received
8. The following transactions took place in the business of KALISA Company, a sole trader. On 1st January 2022, purchased the following goods on credit from KARAKE Company, a sole trader:
- i) 5,000 kg of sugar at FRW 1,500 each
 - ii) 15,000 kg of beans at FRW 700 each
 - iii) 50,000 kg of rice at FRW 1,200 each

You are required to design the appropriate source document from which the above transactions were extracted, indicating the amount of money that was actually due for payment considering that :

- Trade discount applied is 5%
- VAT applied is 18%
- Number of the document: 505050

UNIT 3

JOURNALIZING FINANCIAL TRANSACTIONS

 **Key unit competence:** To be able to journalize financial transactions



Introductory activity

Peter MUGABONAKE is a sole trader in Muhanga, selling construction materials. During the year 2021, he had made a number of transactions and thought he had earned a good profit but did not know how much. This is because he was not aware of sales realized during the period and purchases made. He also had neither idea on other income nor expenditure for the same period. Besides, it was very hard for him to know what to plan for the forthcoming year. He advised himself to go for deep checking on invoices for the period, but failed because some disappeared! Due to that critical situation, he was late to declare and pay tax and consequently charged and paid penalties. What was a mistake Peter MUGABONAKE did? What is your advice to him? What do you think as a sustainable answer to avoid that mistake from happening again?

In principle, transactions must be recorded daily into the books or the accounting system. For each transaction, there must be a document that describes the business transaction. This unit describes first the double entry bookkeeping system and later the books of original entry used before posting transactions into ledgers which will be covered under unit 4.

3.1. Double-Entry Bookkeeping System

Activity 3.1



Suppose that you are hired as a book keeper of a given shop in your locality. You are required to identify a suitable bookkeeping system that will help to produce good financial reports and explain your choice.

3.1.1 Meaning of Double Entry Bookkeeping System

It is a recording system in which there is dual recording of transactions. Under a double entry bookkeeping system, a transaction must be recorded twice i.e. in two accounts or books. The principle or the rule of the double entry states that for every debit entry there must be a corresponding credit entry and for every credit entry there must be a corresponding debit entry. For each transaction total debits must equal total credits. Double entry is very important in accounting. Failure to conform to the rule of double entry will mean that accounts including the balance sheet will not balance.

Debit and credit

Under double entry system accounts are debited and credited. It is important at this time to understand what these words mean. Debit and credit are means of either increasing or decreasing an account. They replace plus or minus used in arithmetic. Depending on the nature or type of an account, debiting or crediting could mean either increasing or decreasing it.

An Account

An account is a record in a summarized form and in chronological order of transactions that took place in an organization. It is a heading under which related transactions are brought together i.e. different transactions are classified into their respective accounts.

In manual accounting systems, accounts are recorded in "T" form.

Eg:

Cash A/C	
Debit	Credit

It is conventional that the left hand side of an account is the debit side while the right hand side is the credit side. The words debit and credit may not have to be reflected in the account because it is common knowledge that the left hand side is debit and the right hand side is credit.

In the computerized accounting system, an account is written with a running balance as shown below:

CASH A/C				
Date	Particulars	Debit	Credit	Balance

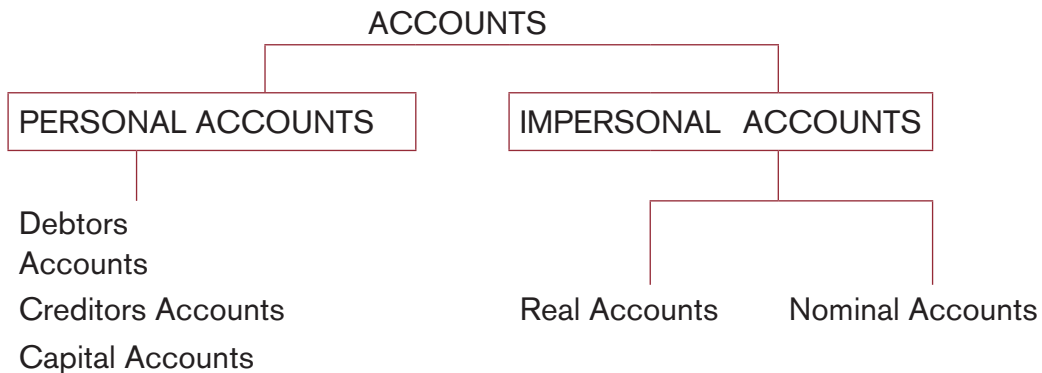
Classification of Accounts

Accounts in the ledger are mainly classified into two categories namely:

- a) Personal accounts
- b) Impersonal accounts

These accounts will be opened according to the requirements of the business.

Below is an illustration to show the classification of accounts



They are explained as below:

Personal Accounts

These are accounts, which have names of business, persons or firms. They mainly fall under debtors' accounts, creditors' accounts, drawings and capital accounts.

- a) Debtors' accounts:** These records the accounts of person or organization to whom the business has sold goods on credit or to who the business has extended another credit.
- b) Creditors' accounts:** These record the accounts of persons or organizations from whom the business has bought goods on credit or from whom a business has taken another credit.
- c) Drawings account:** Drawings is a term used whenever the business owner reduces: the business resources for his personal/ private use. Drawings reduce business funds and therefore the drawings account is treated as a reduction in capital. It is debited whenever a drawing is made. At the end of financial period all entries of drawings are added up and the total debited on the capital account. This implies that the capital account (owner's resources in the business) is reduced to the extent of drawings. In addition, when the owner takes out some of the goods for his own use; this debits drawings account and credits purchases account.

d) Capital Account: This account will record the transactions of the business and the proprietor/ owner. Thus any amount invested by the proprietor is recorded in this account.

Impersonal Accounts

a) Real Accounts: These are accounts which record tangible items i.e. physical items or things which we can see, touch or feel. They are mainly assets accounts like Land, machinery, motor vehicles, cash, stock, etc.

b) Nominal Accounts: These are accounts which record intangible items i.e. they record things which we cannot see physically, touch or feel. They are either expenses or incomes accounts. Eg. Rent, Salaries, interests received, discount received, sales, purchases, etc.

The following table is useful in understanding double entry

Types of Accounts	Increase	Decrease	Normal balance
Asset	Debit (Dr)	Credit(Cr)	Debit(Dr)
Liability	Cr	Dr	Cr
Capital and reserves	Cr	Dr	Cr
Income/revenue	Cr	Dr	Cr
Expense/cost	Dr	Cr	Dr

Any asset A/C eg. Bank A/C

Increase	Decrease
+	-

Any Liability A/C eg. Creditor's A/C

Decrease	Increase
-	+

Capital or reserves A/C

Decrease	Increase
-	+

Any income/revenue A/C eg. Sales A/C

Decrease	Increase
-	+

Any expense A/C eg. Salaries A/C

Increase

+

Decrease

-

Accounts and Double entry

A classification of accounts enables us to establish rules for making double entry. When completing double entry three points should be considered:

- a) What two accounts are affected?
- b) What types of accounts are they?
- c) Which account is to be debited and which account is to be credited?

Nature of ledger balances

Debit balances: These may be classified as assets, expenses or losses

Credit balances: These are classified as liabilities, incomes and gains.

Determination of the accounts affected and Description of the impact on the accounts (increases or decreases)

Example

Identify the accounts affected by the following transactions and show action to take when recording the accounts in the double entry system.

1. Owner puts cash into business
2. Paid creditor KAGABO by cheque
3. Bought goods on credit from Wellars
4. A debtor KARAKE paid us in cash
5. Received rent payment in cash
6. Owner withdraws cash from business for personal use
7. Paid commission by cheque
8. Bought furniture on credit from Omar
9. Sold goods receiving cash payment
10. Bought goods paying in cash

11. Sold goods on credit to KARAKE
12. Some of the goods bought from Omar were returned back to him for default reasons
13. KARAKE returned to us some of the goods bought, as they were in excess of his order.

Answer

	Transaction	Effect	Double entry action
	Owner puts cash into business	Asset of cash increased Capital increased	Debit cash A/C Credit capital A/C
	Paid a creditor KAGABO by cheque	Liability of KAGABO is decreased Asset of bank is decreased	Debit KAGABO A/C Credit bank A/C
	Bought goods on credit from Wellars	Asset of stock is increased Liability of Wellars is increased	Debit purchases A/C Credit Wellars A/C
	A debtor KARAKE paid us by cheque	Asset of cash is increased Asset of debtor KARAKE decreases	Debit cash A/C Credit KARAKE A/C
	Received rent payment in cash	Asset of cash is increased Income generated	Debit cash A/C Credit rent received A/C
	Owner withdraws cash from business	Expense of drawing incurred Asset of cash decreased	Debit drawings A/C Credit cash A/C
	Paid commission by cheque	Expense of commission incurred Asset of cash decreased	Debit commission A/C Credit cash A/C
	Bought furniture on credit from Omar	Asset of furniture increased Liability of Omar increased	Debit furniture A/C Credit Omar A/C
	Sold goods receiving payment in cash	Asset of cash increased Asset of stock decreased	Debit cash A/C Credit sales A/C

Bought goods making payment in cash	Asset of stock increased	Debit purchases A/C
	Asset of cash decreased	Credit cash A/C
Sold goods on credit to KARAKE	Asset of debtor increased	Debit KARAKE A/C
	Asset of goods decreased	Credit sales A/C
We returned goods to Omar	Liability of Omar decreased	Debit Omar A/C
	Asset of stock decreased	Credit returns outwards A/C
Goods returned to us by KARAKE	Asset of stock increased	Debit returns inwards A/C
	Liability of KARAKE decreased	Credit KARAKE A/C



Application activity 5.1

- Write short notes on the following:
 - Personal account
 - Real account
 - Nominal account.
- From the following names of ledger accounts in the books of a trader, rule columns headed assets, liabilities, Gains and expenses in each column place the right items.

Plant and machinery	Premises	Rent received
Salaries	Wages	Rates & insurance
Vehicles	Stock	Bank loan
Cash in hand	Creditors	Electricity
Office expenses	Sales	debtors

- The following are some of the most commonly found accounts in the ledger. Classify them into (i) Personal (ii) Real and (iii) Nominal

Capital	Insurance	Office expenses
Trade expenses	Postage	Debtors
Rent and rates	Bank loan	Drawings
Creditors	Motor expenses	Electricity & lighting
Sales	Wages	Purchases
Stock	Furniture	Purchases returns
Motor cars	Cash	Sales returns

4. Complete the following table, identify the accounts affected by each transaction, and state whether the account is to be debited or credited.

Transaction	Account to be debited	Account to be credited
(i) Goods bought on credit from Kalisa		
(ii) Paid by Kalisa cheque		
(iii) Motor van bought by cheque		
(iv) A debtor settled his account by cheque		
(v) Sold on credit to MUGABO		
(vi) Sold Goods receiving payment in cash		
(vii) Bought private furniture from business cash		
(viii) MUGABO returned some of the goods sold to him		
(ix) Paid a creditor by cheque		
(x) Paid insurance direct from owner's pocket		
(xi) Bought machinery from AKEZA Machinery Ltd on credit		
(xii) Returned to AKEZA Machinery Ltd some of the machinery bought		

3.2 General Journal

Activity 3.2



Referring to the knowledge gained from entrepreneurship O Level describe the general journal and give its format.

This is the book of original entry also known as journal proper or principal journal, which is used to record items of a non-routine nature which cannot be recorded in other book of prime entry. Unlike the subsidiary books, transactions in the general journal are entered on a double entry basis and in order of their occurrence. It is ruled with columns for date, details, folio and debit and credit

amount columns and each transaction recorded therein is a true reflection of how such a transaction will appear in the ledger. A debit entry in the journal is still a debit entry in the ledger and likewise, a credit entry in the journal will be a credit entry in the ledger for accounts concerned. Even though the journal is operated on double entry lines like the ledger, it means subsidiary to the ledger. Whatever is entered in the journal has to be transferred to the ledger for permanent record.

An illustration of a general journal format is as shown:

GENERAL JOURNAL

Date	Details	F	Debit	Credit

A journal entry must have a narration which is a brief explanation of what has taken place. The narration gives some reason why one account has to be debited while the other is credited and also some reference as the origin of the transaction.

Notes:

Details/Account title: the name of the account involved in the transaction is entered in this column plus a narration or explanation of the transaction.

Folio: this column shows the reference where the account can be found in the ledger especially the page number of the account in the ledger. At times instead of using folio, LP standing ledger page is used. In real World, this column is largely referred to as reference.

Date: Dates at which transactions occurred are entered into this column.

Use of a general journal

The general journal serves many useful purposes such as the recording of:

- Opening balances at the beginning of a financial period
- Purchase or sale on credit of non-trading items like non-current assets.
- Correction of errors made during the recording of transaction, balancing and closing accounts in the ledger.
- Transfer of amounts from one account to another in the ledger.

- Adjustments in accounts in respect of items relating to succeeding and preceding periods not connected with the present accounting period, which have not been taken into account.
- Adjustments at the close of the period (e.g. depreciation, bad debts, interest on capital)
- Closing accounts of a business at the end of its financial period.

Preparation of the General Journal

Illustration

The following transactions are for AKEZA LTD for the month of October 2021. Enter them into a general journal.

Oct. 1 Started business with FRW 20,000,000 cash

Oct. 2 Purchase land for the business at FRW 3,000,000 by cash

Oct. 4 Purchased office equipment on credit from Equipment Suppliers Ltd at FRW 2,000,000

Oct. 5 Obtained bank loan of FRW 8,000,000 it was deposited to a bank A/C

Oct. 15: Made part payment of FRW 1,500,000 to Equipment Suppliers Ltd by cheque.

Oct. 17: Bought motor vehicle from TOYOTA RWANDA at a cost of FRW 15,000,000

Made cash payment of FRW 10,000,000, paid FRW 3,000,000 by cheque and promised to pay balance later

Oct. 20: Sold a portion of land that was fully un-utilized for cash FRW 500,000

Oct. 25: Fully settled the balance of FRW 2,000,000 by cheque due to TOYOTA RWANDA for the motor vehicle

Oct. 30: FRW 800,000 business cash was used to entertain relatives from upcountry.

Answer

Date	Details	F	Debit (FRW)	Credit (FRW)
Oct.1	Cash A/C Capital to record cash used to start a business		20,000,000	20,000,000
Oct. 2	Land A/C Cash A/C Being land purchased by cash		3,000,000	3,000,000
Oct. 4	Office equipment A/C Equipment Suppliers Ltd A/C Being equipment purchased on credit		2,000,000	2,000,000
Oct. 5	Bank A/C Loan A/C Being acquisition of a bank loan		8,000,000	8,000,000
Oct.15	Equipment suppliers Ltd A/C Bank A/C To record part payment to Equipment Suppliers ltd		1,500,000	1,500,000
Oct.17	Motor vehicle A/C Cash A/C Bank A/C TOYOTA RWANDA A/C Being motor vehicle purchased from TOYOTA RWANDA		15,000,000	10,000,000 3,000,000 2,000,000
Oct.20	Cash A/C Land A/C Being sale of land sold		500,000	500,000

Oct.25	TOYOTA RWANDA A/C Bank A/C		2,000,000	2,000,000
	Being full payment of outstanding amount to TOYOTA RWANDA			
Oct. 30	Drawings A/C Cash A/C		800,000	800,000
	Being cash used for a private affair			

Record of opening balances

The journal proper is used to record the opening balances of assets, liabilities and capital before they are posted to the respective ledger accounts. Where capital is not known at the start of the period and where assets and liabilities are given the opening journal helps to ascertain that capital. The double entry system establishes a balancing concept in accounting (i.e. total debits should always equal to total credits). Therefore, $\text{Assets} = \text{Liabilities} + \text{Capital}$ as assets are debits whereas liabilities and capital are credits. The journal is thus debited with assets items and credited with liabilities items. The amount needed to strike the balance on the credit side is capital

Example 1

Miss KEZA, commenced business on January 2022 with a Toyota pick-up van valued at FRW 27,500,000; land at FRW 50,000,000 and cash in hand FRW 100,000,000. She also owed FRW 7,000,000 to her sister SIFA for money lent. You are required to record an opening entry for Miss KEZA.

Answer

Date	Details	F	Debit (FRW)	Credit(FRW)
2022	Motor vehicles		27,500,000	
Jan.1	Land		50,000,000	
	Cash in hand		100,000,000	
	SIFA Loan Account			7,000,000
	Capital			170,500,000
	To record opening balances on Jan. 1. 2022			

Assets= Liabilities + Capital

Assets: 27,500,000 + 50,000,000 + 100,000,000 = 177,500,000

Liability = 7,000,000

Capital = Asset - liability

Capital = 175,000,000 - 7,000,000 = **FRW 170,500,000**

Example 2

Pass entries in the general journal to record the following transactions:

- a) Purchase a delivery van worth FRW 202,500,000 from RWANDAMOTOR paying half amount by cheque
- b) Took out of stock of goods valued at FRW 100,000 for own use.
- c) A credit note issued to Jane B. for FRW 30,000 was posted to the credit of Janine B.
- d) The bank statement indicated bank charges of FRW 15,000 which I had not yet recorded in the books.
- e) An invoice received for a credit purchase of furniture for FRW 800,000 debited to purchases account.

Answer

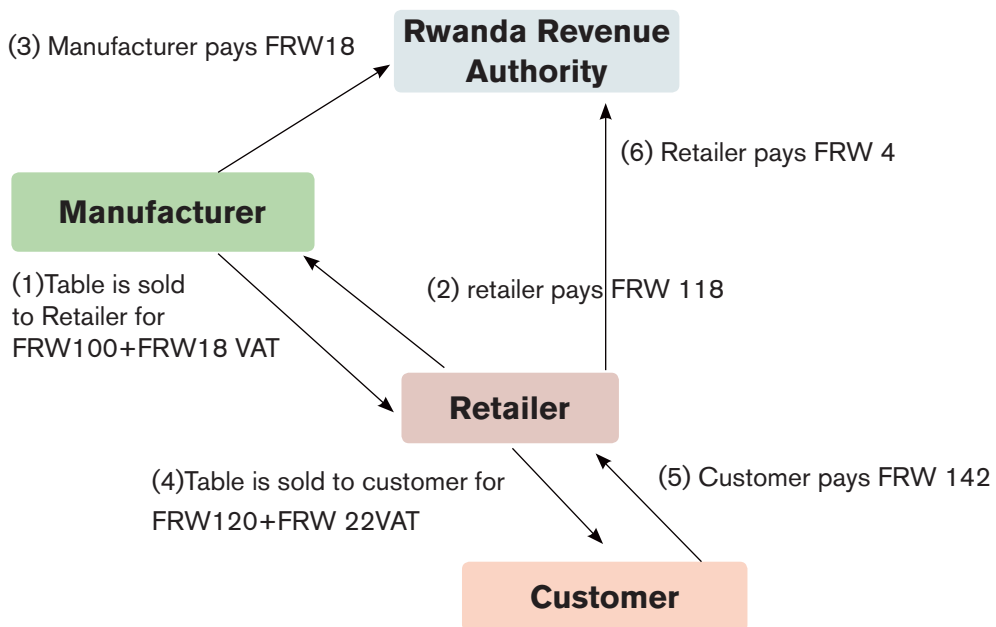
Date	Details	F	Debit (FRW)	Credit(FRW)
A	Delivery van A/C Bank A/C RWANDAMOTOR A/C Being record of a purchase of delivery van		202,500,000	101,250,000 101,250,000
B	Drawings A/C Purchases A/C Goods withdrawn for own use		100,000	100,000
C	Janine B. A/C Jane B. A/C credit note which was by mistake credited to Janine B is now corrected		30,000	30,000

D	Bank charges A/C		15,000	
	Bank A/C			15,000
	record of bank charges not recorded in the cashbook			
E	Furniture A/C		800,000	
	Purchases A/C			800,000
	Purchase of fixed asset debited in purchases account			

3.2.1 Journal entries for VAT

What is VAT?

Value Added Tax (VAT) is a tax charged on the supply of goods and services in Rwanda. The concept underlying VAT is that the tax is paid by ultimate consumer of the goods or services but that everyone in the supply of chain must account for and settle up the net amount of VAT they have received in the VAT tax period usually one month. If they have received more in VAT than they have paid out in VAT, they must send the difference to Rwanda Revenue Authority. If they have paid out more than they have received, they will be reimbursed the difference (known as VAT refund). The rate of VAT in Rwanda is 18%. The following exhibit shows, through an example, how the system works.



In the above example,

1. A manufacturer sells a table to a retailer for FRW 100 plus VAT of FRW 18
2. The retailer pays the manufacturer FRW 118 for the table
3. The VAT on that sale (FRW 18) is sent by the manufacturer to Rwanda revenue Authority (RRA)
4. The retailer sells the goods to customer (i.e. the consumer) for FRW 120 plus VAT of FRW 22.
5. The customer pays FRW 142 to the retailer for table.
6. The amount of VAT paid for the goods by retailer to the manufacturer (FRW 18) is deducted from the VAT received by the retailer from the customer (FRW 22) and the difference of FRW 4 is then sent to RRA.

Only the ultimate consumer has actually paid VAT. Unfortunately, everyone in the chain has to send the VAT charged at the step when they were in the role of seller. In theory, the amount received in stages by Rwanda Revenue Authority will equal the amount of VAT paid by the ultimate consumer in the final stage of supply chain.

VAT paid on inputs (purchases) is called **input VAT** or **VAT deductible** while VAT received from sales is known as **output VAT** or **VAT collectible**

The VAT Account

All registered business must account for VAT on all the taxable supplies they make and all the taxable goods and services they receive. They must also keep a summary (called a VAT Account) on the totals of input tax for each VAT tax period. All these records must be kept up to date.

Journal entries for VAT

Example 1

A construction materials Shop (NYACOM) situated in Nyarugenge District sold materials of construction to Mr KALIMA of MUHANGA District valued at FRW 972,500 VAT included according to the information on the invoice No 075/C.M/2021 sent by NYACOM to Mr KALIMA.

Required: Calculate the VAT charged and record the transaction in general journal of NYACOM.

Answer:

$$\text{VAT} = \text{FRW } 972,500 \times 18/118 = \text{FRW } 148,347$$

Details	Dr (FRW)	Cr (FRW)
Debtor KALIMA A/C	972,500	
To Sales A/C		824,153
VAT A/C		148,347

Example 2

The following transactions have been made by MGK Ltd. You are required to journalize them.

- a) 10/1/2022 Bought goods for FRW 16,520,000 inclusive of VAT on credit to ABC Ltd.
- b) 25/1/2022 Sold all the goods bought on 10/1 for FRW 18,000,000 before tax by cheque.
- c) 15/2/2022 Declared and paid the VAT to Rwanda Revenue Authority (RRA) by cheque.

Note: the VAT rate being 18%.

Answer:

a) $\text{VAT} = 16,520,000 \times 18/118 = 2,520,000$

Net amount from VAT = $16,520,000 - 2,520,000 = 14,000,000$

b) Net amount = 18,000,000

Add: VAT 18% = 3,240,000

Amount with VAT 21,240,000

c) VAT payable = VAT collectible - VAT deductible
= $3,240,000 - 2,520,000 = 720,000$

Date	Details	Dr	Cr
10/01/22	Purchases A/C	14,000,000	
	VAT A/C	2,520,000	
	To Creditors (ABC Ltd)		16,520,000
25/01/22	Bank A/C	21,240,000	
	To Sales A/C		18,000,000
	VAT A/C		3,240,000
15/02/2022	VAT A/C (VAT payable)	720,000	
	To Bank A/C		720,000

3.2.2 Journal entries for payroll information

Salaries and wages usually form a substantial part of a business's expenditure, especially in service organisations. However, salaries and wages expenditure does not arise in the same way as other cash and credit purchases.

The entries in the accounting system that are made in respect of salaries and wages are known as payroll transactions.

To understand payroll transactions, you need to have a basic understanding of the main statutory and voluntary transactions which are processed through payroll.

Gross pay:

Gross pay is the total amount that the employer owes the employee before any deductions have been made.

Statutory deductions:

Income tax and **employees' social security contributions** are known as statutory deductions from gross pay, because the law (statute) requires employers to make these deductions from individuals' salaries.

Employees pay their income tax under the income tax system. This means that each time an employee is paid by their employer, the income tax for that period (eg monthly) is deducted from their wages by the employer. At regular intervals the employer then pays the income tax over to the tax collecting authority on the employees' behalf.

Employees must also pay employees' social security contributions to the tax authorities. Social security contributions are just another form of tax, calculated

differently from income tax. An individual employee's social security contributions are deducted from the employee's wages and paid over to the tax authorities, together with the employee's income tax.

Voluntary deductions

An employee may choose to have other (voluntary) deductions made from gross pay. These items can only be deducted from an employee's gross salary if the employer has the employee's written permission to do so.

For example, if an employee chooses to make pension contributions, this money is deducted from gross pay and transferred to a pension administrator to provide a pension for the employee on retirement.

Other voluntary deductions include the repayment of a loan from the business (for example, to repay a season ticket loan for travel to work).

Net pay

Once all deductions have been made, the amount paid to the employee is called net pay. It is sometimes referred to as 'take home pay'.

Employer's social security contribution (statutory)

The employer is also required to pay an additional amount of social security contributions for each employee, known as the employer's social security contributions. This is yet another form of tax, but the difference is that it is only suffered by the employer. There is no deduction from the employee's gross pay for the employer's social security contributions. Employer's social security contributions are paid by the employer to the tax authorities.

Employer's pension contribution (voluntary)

The employer may make a voluntary contribution to the employee's pension. Again, this is in addition to the gross pay. Therefore, it increases the 'total cost' of employing individuals. However, it is not deducted from the gross pay.

Accounting for Payroll transactions

Payroll is accounted for using the double entry bookkeeping rules that we are familiar with. The following example is a simple illustration of recording payroll transaction in the context of Rwanda. Note that the example includes RSSB maternity leave contribution which was not talked about in the above deductions, however it is a common statutory deduction in Rwanda.

Example

The total column of payroll TXL Ltd showed the following information on 31st January 2022:

Gross Salary	PAYE	RSSB		RSSB		RSSB		Net salary	RSSB CBHI Em- ployee 0.5%	Balance due
		SSF		HI		Maternity leave				
		Employer (5%)	Employee (3%)	Employer (7.5%)	Employee (7.5%)	Employer (0.3%)	Employee (0.3%)			
10,816,000	3,228,800	540,800	324,480	811,200	811,200	32,448	32,4448	6,419,072	32095	6,386977

Assuming that personnel accounts are settled by 1st every month and Accounts payable to RSSB and RRA are to be settled before 15th every month; show the accounting entries in the books of TXL Ltd from 31st January to 15th February just after settling accounts payable relating to the information above.

Answer

Date	Details	Dr	Cr
31/01/22	Salaries A/C	12,200,448	
	To Personnel A/C		6,386,977
	RRA (PAYE)		3,,228,800
	RSSB(SSF)		865,280
	RSSB (HI)		1,622,400
	RSSB (Maternity leave)		64,896
	RSSB (CBHI)		32,095
01/02/22	Personnel A/C	6,386,977	
	To Bank A/C		6,386,977
15/02/22	RRA (PAYE)	3,228,800	
	RSSB(SSF)	865,280	
	RSSB (HI)	1,622,400	
	RSSB (Maternity leave)	64,896	
	RSSB (CBHI)	32,095	
	To Bank A/C		5,813,471

3.2.3 Types of discounts

Discounts can be defined as follows:

A trade discount is a reduction in the listed price of goods, given by a wholesaler or a manufacturer to a retailer. It is often given in return for bulk purchase orders.

A cash(settlement) discount is a reduction in amount payable in return for payment in cash, or within an agreed period.

Examples are given below

i) Trade discount

It is discount that you receive from the seller at the time of buying goods (may be because of buying higher quantity or due to your business relations with the seller etc) and the same is deducted or adjusted in the invoice. The supplier's invoice states the actual amount payable, net of trade discount.

E.g: Gross sales: FRW 700,000

Trade discount: 5%

Calculation:

Gross sales	700,000
Trade discount (5%)	<u>35,000</u>
Net sales	665,000

Accounting treatment of trade discounts

Trade discounts are not recorded in the accounting books. The net amount of invoice will be used in recording the goods purchased or sold.

In the books of supplier:

Dr: Debtor A/C	665,000	
Cr: Sales A/C		665,000

In the books of debtor

Dr: Purchases A/C	665,000	
Cr: Suppliers A/C		665,000

ii) Cash discount

It is a reduction allowed to a customer who pays before the end of credit period. A credit period is a length of time that a customer is allowed to delay payment. The customer qualifies for the cash discount only when he pays before the end the credit period but within agreed period of time.

Note: cash discount is always recorded in the books of accounts.

Cash discount is in two types: Discount allowed and discount received.

Discounts allowed: they occur when the company accepts the payment from a customer of a lesser amount than the amount due because he paid promptly. It is treated as an expense because it reduces the amount charged to the customer.

Dr: Discount allowed A/C

Cr: Debtors A/C

At the end of the accounting period, the balance on the discount allowed account is transferred to the debit of the profit and loss account as an expense.

Besides when it is received from the supplier, it is called **discount received** and it is treated as an income because it reduces the obligation toward the supplier and it is recorded as under:

Dr: Suppliers A/C

Cr: Discount received A/C

Example 1

Albert has sold goods to William on credit for FRW 5,000,000. It is then agreed that if William pays within 20 days of his purchase, he can receive 10% as discount. If William performed payment within 20 days, show the journal entries for both parties.

Answer:

a) In the books of Albert (seller)

Dr: Cash A/C	4,500,000	
Discount allowed	500,000	
Cr: Debtors (William) A/C		5,000,000

b) In the books of William (buyer)

Dr: Suppliers (Albert) A/C	5,000,000	
Cr: Cash A/C		4,500,000
Discount received A/C		500,000

Example 2

On 20th January 2022, Denis purchased from Alfred 1000 units of item at FRW 5300 each. As Denis is a regular customer, Alfred has to offer 2% discount for bulk purchase and 5% discount for immediate payment.

Determine how much has invoiced to Denis and show the accounting entries for both parties.

Answer:

Calculations: Total sales:	1000x5300 =	5,300,000
Less trade discount (2%)		<u>106,000</u>
		5,194,000
Less cash discount (5%)		<u>259,700</u>
Net cash paid by Denis		4,934,300

Journal entries

a) In the books of Alfred (the seller)

Dr: Cash A/C	4,934,300	
Discount allowed A/C	259700	
Cr: Sales A/C		5,194,000

b) In the books of Denis (Customer)

Dr: Purchases A/C	5,194,000	
Cr: Cash A/C		4,934,300
Discount received A/C		259700



Application activity 3.2

Enter the following transaction into the general journal properly showing the double entry. The transactions are for AKANYANA Ltd for the month of January 2022

- Jan.1 Bought goods on credit from Peter for FRW 400,000
- 2 Bought goods on credit from Jane for FRW 200,000
- 3 Sold goods to John on credit for FRW 1,000,000
- 4 Sold goods to Mary on credit for FRW 400,000
- 5 Returned goods worth FRW 50,000 to peter because they were defective
- 10 Received part payment of FRW 800,000 cash from John for goods taken on credit
- 12 Made part payment to Peter FRW 80,000 cash
- 14 Purchased goods for FRW 60,000 on credit from Jane
- 15 Mary rejected and returned goods worth FRW 40,000
- 16 Received a cheque of FRW 150,000 from Mary as part for payment for goods taken on credit
- 17 Paid rent cash FRW 100,000
- 18 Returned goods worth FRW 50,000 to Jane because they were defective
- 17 Paid rent cash FRW 100,000
- 18 Returned goods worth FRW 50,000 to Jane because they were defective
- 19 Paid Jane FRW 150,000 by cheque
- 20 Sold goods to John on credit for FRW 800,000
- 22 Bought goods for FRW 100,000 paying cash
- 23 Sold goods cash FRW 500,000
- 24 Sold goods for FRW 4,000,000 receiving payment by cheque immediately.
- 25 Purchased goods for FRW 100,000 from Peter

26 Paid Peter FRW 80,000 cash

27 John rejected and returned goods worth 100,000

28 Received a cheque of FRW 200,000 from John for goods sold to him on credit

29 Paid for electricity FRW 50,000 by cheque and FRW 100,000 cash

30 Paid rent FRW 60,000 by cheque

31 Paid salaries FRW 150,000 cash and FRW 160,000 by cheque

3.3 Sales Journal

Activity 3.3



Describe the books of original entry which records credit sales of goods

Sales day book/Sales Journal

This is the book of original entry in which daily credit sales are recorded from copies of invoices issued to debtors before posting to the ledger. Each credit sale is recorded in chronological order in the sales daybook, the personal account of the customer in the ledger is debited with the amount of sale. At the end of the week or month or any other posting period, the sales journal is totaled to ascertain the total credit sales for the period. This total is then credited to the sales account in the ledger, thus completing the double. If the posting is done accurately, the sum of individual amounts to the individual customers' accounts in the ledger should agree with the amount of credit sales.

Format of Sales Journal or Sales Daybook

Date	Account debited(Debtors' account)	Invoice No	LP	Amount

Example 1

The following credit transactions took place in the firm of AKALIZA during the month of February 2022.

Feb. 2 Sold 50 sacks of Cement at FRW 10,000 each on credit to BAHIZI

Feb. 2 Sold 70 sacks of cement at FRW 10,500 each on credit to Horizon Ltd

Feb 3 Sold 500 sacks of cement at FRW 10,500 each on credit to Fair Constructors Ltd less a 2% trade discount.

Feb 10 Sold 600 sacks of cement at 10,200 each on credit to Real Constructors Ltd, receiving half the amount in cash.

Answer

AKALIZA Sales Journal

Date	Account debited(Debtors' account)	Invoice No	LP	Amount
Feb. 2022				
2	BAHIZI			500,000
2	Horizon Ltd			735,000
3	Fair Constructors Ltd			5,145,000
10	Real Constructors Ltd			3,060,000
	Total posted to Sales A/C			9,440,000

Example 2

A company sold goods to the following people on credit during the month of September 2021:

Sept. 1 John for FRW 450,000 Invoice No 301

4 BAHATI for FRW 1,000,000 Invoice No 303

6 Joseph for FRW 900,000 Invoice No 404

7 Anitha for FRW 500,000 Invoice No305

Answer

Sales Daybook

Date	Account debited (Debtors' account)	Invoice No	LP	Amount
Sept. 2021				
1	John	301		450,000
4	BAHATI	303		1,000,000
6	Joseph	404		900,000
7	Anitha	305		500,000
	Total posted to Sales A/C			2,850,000



Application activity 3.3

Record the following transactions in MUGISHA's sales Journal

Jan-22		Amounts FRW
1st	Credit sales to Neema	480000
	BAZIZI	520000
8th	Credit sales to Musa	330000
	Shakilla	280000
10th	Credit sales to Musa	250000
	BAZIZI	300000
28th	Credit sales to Neema	320000
	Shakilla	400000

3.4 Purchases day book/ Purchases Journal

Activity 3.4



Referring to the competences acquired from senior two, describe the use of purchases journal.

This subsidiary book contains day-to-day records, in chronological order, of information on purchases. As each credit purchase is recorded from the invoice into the purchases day book, the personal account of the credit supplier in the ledger is credited. At the end of the month or other posting period, the total in the purchases day book representing total credit purchases for that period, is ascertained and posted to the purchases account in the ledger to record the credit purchases in the ledger and also to complete the double entry. This debit total extracted from the purchases day book should agree with the sum of the individual amounts credited to the individual creditors' accounts in the ledger. In the details column of the purchases account in the ledger, the word "totals" is used to indicate that it is a summary total posted and in the folio column, PDB is used to show that the total was extracted from the purchases day book.

Format of Purchases Journal

Date	Account credited (Creditors' account)	Invoice No	LP	Amount

Example 1

During the month of February 2022 AKALIZA had the following transactions in its business:

February 1 Purchased 2000 sacks of cement at FRW 9,000 each on credit from CIMERWA.

2 Bought 2,500 sacks of cement at FRW 8,500 each on credit from SIMBA cement less 2.5% trade discount

13 bought 1000 sacks of cement at FRW 9,200 each from HIMA cement on credit.

Enter the above transactions in a purchases day book.

Answer

**AKALIZA
PURCHASES JOURNAL**

Date	Account credited (Creditors' account)	Invoice No	LP	Amount
Feb. 2022				
1	CIMERWA			18,000,000
2	SIMBA CIMENT			20,718,750
13	HIMA CIMENT			9,200,000
	Total posted to purchases A/C			47,918,750

Example 2

Record the following transactions into the purchase journal

Jan. 1 Bought goods on credit from Tom for FRW 2,000,000 Invoice No 199

2 Bought goods on credit from Moses for FRW 4,000,000 Invoice No 200

8 Bought goods on credit from Josias for FRW 5,000,000 Invoice No 201

10 Bought goods on credit from Joy for FRW 10,000,000 Invoice No 202

Answer

Purchases day book

Date	Account credited(Creditors' account)	Invoice No	LP	Amount
Jan. 2022				
1	TOM	199		2,000,000
2	MOSES	200		4,000,000
8	JOSIAS	201		5,000,000
10	JOY	202		10,000,000
	Total posted to purchases A/C			21,000,000



Application activity 3.4

Record the following transactions in MUGISHA's Purchases Journal

Mar-22		Amounts FRW
1st	Credit purchases from MIKA	5,400,000
	NGENZI	6,000,000
6th	Credit purchases from MUCYO	4,200,000
	NGENZI	3,000,000
16th	Credit purchases from MUSABE	4,500,000
	MUCYO	2,400,000
28th	Credit purchases from MUSABE	2,800,000
	NGENZI	4,100,000

3.5 Sales Returns/Returns Inwards Journal

Activity 3.5



List as many reasons as you can think of why (a) retail customers and (b) trade customers may return goods to the seller

This book is used to record credit note issued for goods returned to the seller his/her credit customer. The individual items are recorded in the sales returns day book as credit notes issued, and are immediately posted to the credit of the personal accounts of the customers concerned in the ledger. At the end of the posting period, the total in the sales returns Journal representing total sales returns is debited to the sales returns inwards account in the ledger to complete the double entry and to record the sales returns in the ledger.

Format of sales returns day book

Date	Account credited(Debtors' account)	Credit note No	LP	Amount

Example 1

Record the following transactions in MUGISHA's sales returns journal

Jan. 2022		Amounts (FRW)
10th	Goods returned to us by Neema	22,000
	Musa	16,000
23rd	Goods returned to us by Musa	18,000
	Bazizi	25,000
31st	Goods returned to us by Shakilla	33,000

Answer

Sales returns journal

Date	Account credited (Debtors' account)	Credit note No	LP	Amount (FRW)
Jan.2022				
10th	NEEMA			22,000
	MUSA			16,000
23rd	MUSA			18,000
	BAZIZI			25,000
31st	SHAKILLA			33,000
	Total posted to Returns inwards A/C			114,000

Example 2

Record in a suitable book of prime entry the following transactions which took place in the firm of AKALIZA for the month of February 2022

Feb. 5 BAHIZI returned 5 sacks of Cement worth FRW 10,000 each sold to him on 2nd February, credit note No 005 issued.

7 Horizon Ltd returned 3 defective sacks which they had bought on credit for FRW 10,500 each, credit note No 006 issued.

Answer

Sales returns journal

Date	Account credited(Debtors' account)	Credit note No	LP	Amount (FRW)
Feb.2022				
5th	BAHIZI	5		50,000
7th	HORIZON LTD	6		31,500
28th	Total posted to Returns inwards A/C			81,500



Application activity 3.5

Record the following transactions in Sales Return Journal

Sept. 2021		Amounts (FRW)
3rd	Goods returned to us by John	45,000
8th	Returned defective goods by Bahati	150,000
11th	Goods returned to us by Anitha	18,000
14th	Joseph reject and returned goods worth	25,000

3.6 Purchases Returns/Returns outwards Journal

Activity 3.6



Suppose that your company needs to keep the separate books of prime entry according to its transactions. Discuss the book of original entry under which credit notes received from your suppliers will be recorded.

This book is used to record particulars of all credit notes received from suppliers in respect of goods returned by the buyer to the seller. Goods purchased may be returned if they do not conform to the order as to quality, if they were

damaged in transit and credit is claimed from each supplier. Individual credit notes received for goods returned are recorded in the returns journal in a similar to purchases. At the end of the period, the purchases returns journal is totaled to ascertain the total credit notes received for the period. This is then credited to the returns outwards account in the ledger. If the goods returned were subject to a trade discount, the necessary adjustment should be made when preparing the returns advice claim for dispatch to the supplier.

Format of purchases returns day book

Date	Account debited (Creditors' account)	Credit note No	LP	Amount

Example 1

Record the following transactions in the appropriate subsidiary book of AKALIZA for the month of February 2022

Feb. 3 Returned 100 sacks of cement to SIMBA Cement bought at FRW 8500 each and received a credit note No12

Feb.4 60 sacks of cement costing FRW 9200 each were returned to HIMA cement and a credit note No 14 was received

Answer

Date	Account debited (Creditors' account)	Credit note No	LP	Amount (FRW)
3	SIMBA Cement	12		850,000
4	HIMA cement	14		552,000
	Total posted to credit of Returns Outwards A/C			1,402,000

Example 2

The following are MUYIZERE's transactions which he carried out in the month of March 2022. Prepare his purchases returns day book.

1st March Bought goods from SULFO RWANDA 8 Cartons of Soap at FRW 87,500

5th March Bought goods from Omar 7 cartons of Naomi at FRW 8,700; cartons of OMO at FRW 7,500

10th March Bought goods from 30 boxes of biscuits at FRW 2,500

20th March Bought goods from KABANDA 5 bags of sugar at FRW 55,000

25th March Returned to SULFO RWANDA 2 cartons of cowboy at FRW 9850 as damaged and 2 cartons of soap at FRW 87,500

30th March returned to KABANDA 3 bags of sugar at FRW 55,000 as damaged and 1 bag of salt at FRW 10,000.

Answer

Date	Account debited (Creditors' account)	Credit note No	LP	Amount
Mar-22 25th	SULFO RWANDA 2 cartons of cowboy at 9850 2 cartons of soap at 87,500			19,700 175,000
30th	KABANDA 1 bag of salt at 10,000 3 bags of sugar at 55,000			10,000 165,000
	Total posted to purchases returns A/C			369,700



Application activity 3.6

KAMUZINZI is a sole trader in Kigali, the following are transactions he made during the month of June 2021.

June 1st Credit purchases from: Bertin FRW 2,500,000; Mathew FRW 14,500,000 Andrew FRW 35,000,000

4th Credit sales to: David FRW 41,000,000; Zouzu FRW 34,000,000; Blaise FRW 27,000,000

10th Credit purchases from: Thomas FRW 14,700,000; Bertin FRW 10,000,000; Mathew FRW 19,000,000

12th Goods returned to Bertin FRW 3,500,000; Mathew FRW 5,000,000

15th Goods returned by Zouzu FRW 2,500,000; Blaise FRW 3,000,000

20th Credit purchases from: Thomas FRW 18,600,000; Bertin FRW 25,000,000; Mathew FRW 8,000,000

22nd Credit sales to: Zouzu FRW 15,000,000; David FRW 22,000,000

25th Goods returned to: Thomas FRW 2,000,000; Mathew FRW 1,500,000

30th Zouzu returned goods worth FRW 1,800,000

You are required to prepare his returns outwards day book

3.7 Cash Book

Activity 3.6



KARUMUGABO a sole trader in your locality had numerous cash transactions in his business, and needs to keep a separate book under which cash and cheque transactions will be recorded, he asks you as professional accountant to design a book that will help him to respond to his need.

3.7.1 Nature and purpose of a cash book

Most of the numerous transactions of a trader involve the receiving and paying of cash. There are many slogans displayed prominently in shop as “Pay Cash Today, for Credit Come Tomorrow”. The commonest book of accounts is the cashbook, which contains all records of payments and receipts of cash. Cash here means bank notes, coins, money orders, credit transfers, cheques or other form of monetary payment or receipt acceptable in settlement of business debts. The cash book is said to be both a book of original entry and ledger. Thus, its full name is cashbook ledger. It is a book of original entry because any receipt or payment of cash is first recorded in this book before being posted to another ledger account. It is important to note therefore that there is no subsidiary book for cash transactions other than the cashbook, and credit transaction must not be recorded in the cash book.

The cashbook is a ledger account because for every debit or credit entry made in it, there must be a corresponding credit or debit entry in other accounts in the ledger. Further, once a record is made in the cashbook, it is permanently kept therein. The double entry rule applicable to recording entries in the cash book is debit receipts and credit payments, which is consistent with the double entry

principle of debiting the account that is receiving value and crediting the one giving value.

In brief, a business that keeps record of a cash book as an original book of entry need not post separate bank and cash accounts into the ledger, as the cash book serves the entire purpose.

3.7.2 Types of Cash Book

i) One-column Cash Book

One-column cash book is the simplest version of a cash book being a mere ledger ruling with debit and credit columns and columns for dates, details, folio and amounts as shown. On the debit side are entered all cash receipts and on credit side the cash payments. This is a typical cash account for businesses which do not use and accept cheques.

A one column cash book is illustrated as follows:

Date	Details	Folio	Amount	Date	Details	Folio	Amount
2022	Capital - cash		FRW	2022	Cash purchases		FRW
	Cash sales				Payments to creditors		
	Receipts from debtors				Purchases of capital items		
	Cash sales of capital items				Expenses		
	Sundry cash incomes				Cash drawings		

Example

From the following transactions during the month of January, write Souza's one column cash book. She started business on 1st January 2022 having transferred FRW 9,600,000 from his private bank account to the business office.

January 1st Paid FRW 480,000 for rent for the month and made purchase of FRW 3,830,000.

2nd Paid FRW 380,000 for stationery and FRW 192,000 for stamps

4th Cash sales FRW 1,728,000

7th Paid FRW 288,000 in respect of wages to assistant.

10th Borrowed FRW 4,800,000 from Joyce, a friend.

13th Bought a used Pick-up for FRW 9,216,000 from AKAGERA Garage against FRW 1,920,000 deposit

19th Cash sales FRW 4,224,000

20th Paid wages for two weeks, FRW 576,000

23rd Bought FRW 6,240,000 goods from ABC Wholesalers Ltd. on credit

29th Drew FRW 2,880,000 for private use

30th Cash sales FRW 2,688,000

31st Paid another FRW 5,760,000 off pick-up account.

Answer

Souzane Cash book for the month of January 2022

Date	Details	Folio	Amount	Date	Details	Folio	Amount
2022			FRW	2022			FRW
1-Jan	Capital A/C		9,600,000	Jan.1	Rent		480,000
4	Sales		1,728,000	1	Purchases		3,830,000
	Joyce loan				Statonery&		
10	A/C		4,800,000	2	Postage		572,000
19	Sales		4,224,000	7	Wages		288,000
30	Sales		2,688,000	13	Motor vehicle		1,920,000
				20	Wages		576,000
				29	Drawings		2,880,000
					AKAGERA		
				31	Garage		5,760,000
					Balance c/d		6,734,000
			<u>3,040,000</u>				<u>3,040,000</u>
Feb. 1	Balance b/d		6,734,000				

ii) Two-column Cash Book

A two column cash book has two amount columns on each side of the book. On the debit side, one column represents cash receipts, while the other represents bank receipts. Similarly, the cash and bank columns appear on the credit side to represent their respective payments.

The cash book is balanced by comparing totals of each account column on either side in the same way the ledger accounts are balanced off.

Example

The following transactions were extracted from the books of KAGABO for the period of March 2022.

March 1st balance brought forward

Cash FRW 2,400,000

Bank FRW 3,840,000

March 1st Paid rent cash FRW 240000

2 Made payments for telephone and postage by cash FRW 38,400

4 Paid cash for sundry expenses FRW 24000

8 Sold goods and was paid by cash FRW 5,920,000

10 Received payment by cheque from Naome MUKAMA FRW 384,000

11 Deposited cash in bank FRW 2,880,000

13 Payment by cheque was made to Barnabe FRW 2,025,000

20 Paid for advertisement in cash FRW 115,200

29 Sent cheque to William FRW 720,000

31 Drew a cheque for own use FRW 480,000

31 Paid FRW 1,248,000 cash into bank

Required: Show the above transactions in a two column cash book, balance it off and bring down the balances.

Answer

KAGABO

Cash book for the month of March 2022

Date	Details	F	Cash	Bank	Date	Details	F	Cash	Bank
2022			FRW	FRW	2022			FRW	FRW
Mar.1	Balance b/d		2,400,000	3,840,000	Jan.1	Rent		240,000	
8	Sales Naome		5,920,000		1	Telephone & postage sundry		38,400	
10	MUKAMA			384,000	2	expenses		24,000	
11	Cash	C		2,880,000	7	Bank	C	2,880,000	
31	Cash	C		1,248,000	13	Barnabe Advertise-ment			2,025,000
					20			115,200	
					29	William			720,000
					31	Drawings			480,000
						Bank	C	1,248,000	
						Balance c/f		3,774,400	5,127,000
			8,320,000	8,352,000				8,320,000	8,352,000
Feb. 1	Balance b/d		3,774,400	5,127,000					

iii) Three column Cash book

A three column cash book has an additional column on the debit side, to record discounts allowed and on the credit side the additional column records discounts received.

Every debit entry made in the cash book for discount allowed has a corresponding credit entry in the debtor's ledger, in the account of debtor being allowed the cash discount. Similarly, every credit entry of discount received made in the cash book, has a corresponding debit entry in the creditor's ledger in the account of the creditor from whom discount is received.

At the end of accounting period, amounts in the discount column are separately added up for each column. Note that the discount columns, unlike the cash and bank columns are not balance off. Each discount column shows the actual totals. The totals are then posted into the general ledger in the respective discount accounts.

The total of discount allowed column is posted on the debit side of discount allowed account. Likewise the total of the discount received columns are posted on the credit side of the discount received account.

It is important for you to understand the alternative method whereby a three column cash book is used. In this case, each individual discount entry is made in the general ledger, in the concerned account, instead of posting of posting in it only total amounts.

Example

Write up a three column cash book for KAREGEYA for details given below, balance off at the end of the month and show the discounts accounts in the general ledger in March 2022

Mar.1	balance brought forward	Cash	4,600,000
		Bank	9,300,000
3	Bought goods by cheque		2,800,000
5	Cash sales to date		4,400,000
8	Banked cash		2,500,000
10	Paid by cheque the following in each case a cash discount of 5% is received John 1,600,000; Herman 3,000,000; Jackson 1,400,000		
12	Received by cheque in each cash discount of 3% is allowed Simon 4,000,000; Berna 3,000,000; Mathew 2,000,000		
14	Bought furniture by cheque		2,900,000
16	cash drawings		1,000,000
18	Cash sales paid directly into bank		3,500,000
22	Paid salary by cash		1,500,000
25	Cashed cheque		1,800,000
26	Paid Andrew 2,000,000 less 4% discount received cash from MIKA 2,500,000 4% discount was received		
30	Paid wages in cash		1,300,000

KAREGEYA

Cash book for the month of March 2022

Date	Details	F	Discount	Cash	Bank	Date	Details	F	Discount	Cash	Bank
2022	Balance			FRW	FRW	2022				FRW	FRW
Mar.1	b/d			4,600,000	9,300,000	Mar.3	Purchases			FRW	2800000
5	Sales			4,400,000		8	Bank	C		2,500,000	
8	Cash	C			2,500,000	10	John		80,000		1520000
12	Simon		120,000		3,880,000	10	Herman		150,000		2,850,000
12	Berna		90,000		2,910,000	10	Jackson		70,000		1,330,000
12	Mathew		60,000		1,940,000	14	Furniture				2,900,000
18	Sales				3,500,000	16	Drawings			1,000,000	
25	Bank	C		1,800,000		22	Salary			1,500,000	
28	MIKA		100,000	2,400,000		25	Cash	C			1,800,000
						26	Andrew		80,000	1,920,000	
						30	Wages			1,300,000	
							Balance			4,980,000	
							c/f				10,830,000
											13,200,000
											24,030,000
											380,000
											13,200,000
											24,030,000
Feb. 1	Balance										
b/d				4,980,000	10,830,000						

General ledger

Dr	Discount allowed A/C	Cr
Total for the month	370,000	
(Cash book)		

Dr	Discount received A/C	Cr
	Total for the month	380,000
	(Cash book)	

3.7.3 Contra entries

In a cash book, the payment of cash into bank and withdrawal of cash from the bank account are recorded on the same page but on the opposite sides. These are referred to as contra entries and are indicated by letter “C” written in the folio column. Thus the completing of double entry in the same page of a cash book is what is referred to as **a contra entry**.

Example: entries are complete as

- | | |
|------------------------|---------------------------------|
| a) Cash paid into bank | b. Withdrawal of cash from Bank |
| Dr: Bank Account | Dr: Cash Account |
| Cr: Cash Account | Cr: Bank Account |

Note: Cheques drawn for own use must not be treated as a contra since this is for personal use and not for office use; hence the debit entry is made in the “Drawings Account”. A contra is also defined as the balance of an account that represents a deduction from another account e.g. provision for depreciation, bad debts, reserves, etc.



Application activity 3.7

From the following transactions enter the relevant transactions in the cash book and open up the ledger for discount accounts

Jan. 2022		Amounts
1st	Started business with cash at bank	10,000,000
2nd	Bought goods on credit from Musa	5,000,000
4th	Sold goods on credit to Nunu	6,000,000
8th	Cash sales to date	3,000,000
	Paid Musa FRW 5,000,000 by cheque less	
12th	10% cash discount	
14th	Paid rent in cash	400,000
18th	Bought machine by cheque	2,200,000
22nd	Withdrew FRW 3,000,000 for office use	
24th	cash sales paid direct into bank	5,000,000
25th	Cash purchases	1,000,000
26th	Banked FRW 1,000,000	
28th	Bought stationery by cheque	4,000,000
29th	Bought more goods on credit from Juma	500,000
	Received cash from Nunu 4,000,000 less	
31st	10% cash discount	

3.8 Petty Cash Book

Activity 3.8



BAHIZI is a Wholesaler in Nyarugenge Matheus, selling electronic items import from CHINA. In order to avoid holding big amount of money in his office, he uses cheques in all business transactions, including receipts and payments. Few days later, he failed to handle small expenses which normally require the use of cash other than cheques. In your groups, discuss the simple way may be used to handle those small expenditure.

3.8.1 Petty cash

The cheque has become a very important means of settling business accounts, such that most payment requiring large sum of money are made by cheque. Nevertheless, there are certain accounts that require small amounts for settlement. Expenses for the kitchen, cleaning, postage etc. are settled by small amounts of money which usually are not done by cheque. Sometimes, items like stationery, travelling expenses, small ledger accounts, advance to casual workers, etc. are required urgently and the procedure for preparing a cheque for the purpose is rather long. The alternative is to keep in the office to meet minor and urgent expenses is called petty cash, float or imprest. The clerk in charge of handling petty cash payments is known as a petty cashier

3.8.2 Petty cash voucher

This is a specially designed form used by a petty cashier. It states the nature of payment the amount, date, the authority for the payment and the person to be paid to. It also acts as evidence for receipt of such cash as the recipient must sign it immediately after receiving the cash. It should be numbered serially. Petty cash vouchers are used as source of information for recording the petty cash book, which records petty transactions.

3.8.3 The petty cash book

This is the book of account in which petty cash transactions are recorded. The petty cashier is provided with a strong cash box in which the petty cash is kept and locked in a drawer. The petty cashier also keeps payment vouchers which serve as source documents for information to be recorded in the petty cash book. The vouchers state the date for payment brief details of the nature of payment, the amount of payment, the recipient of the money, the authority for payment, payments analysis etc.

Each recipient of petty cash fund must fill in and sign a petty cash voucher which is checked and approved by the accountant before cash is paid out. The petty cashier must retain the payment voucher as evidence of the payment. At all times, the total of amount appearing in the payment vouchers and the balance of cash in hand in the cash box should add up to the original amount of money given to the petty cashier as petty cash.

The petty cash book is a book of original entry and an account for petty cash transactions. Petty cash transactions are first recorded in this book before being posted to the ledger. It forms a separate ledger book.

The petty cash book is ruled in columns. The debit side has got columns for date, folio, details and amount, while the credit or payment side has got columns for date, details, folio, a total amounts column, plus analysis columns in which various petty cash payments are analyzed such as sundry expense, stationery and postage, telephone and telegrams etc. the debit side records the amount of money received as petty cash plus any petty cash in hand brought forward from previous period. The credit side records payments made out of petty cash and each day's payment is analysed in the relevant column. The daily total is posted to the total payments column. At the end of the period, the amounts in the analysis columns are added. The sum of the analysis column totals should agree with the sum of the totals column. The difference between the sum of the total payments column and the amount received column on the debit side represents the balance of petty cash in hand carried forward to the next period. There is an automatic check of the petty cash book as horizontal totals and vertical totals must agree. The following example illustrates the ruling and preparation of the petty cash book.

MUVUNYI keeps a petty cash book. On 1st January 2022 his petty cash was given as FRW 240,000 and he made the following payments in the course of the month:

Jan. 2022		Amounts
1st	Postage stamps	22,000
5th	String and paper	8,800
7th	Milk and tea leaves	4,800
11th	Bus fare for messenger	5,600
13th	Mugisha a creditor	48,000
14th	Cleaning materials	10,000
16th	Stationery	5,200
18th	Postage stamps	20,000
23rd	Glue and sellotape	4,000
27th	Cleaning materials	6,000
28th	Bus fare for messenger	6,400
30th	Duplicating ink	9,600

Required:

- a) Enter the above transactions in a suitable ruled petty cash book for the month of January and show the balance of petty cash in hand on 31st January 2022. Use appropriate analysis columns.
- b) Post total columns to their relevant ledger accounts.

MUVUNYI

Petty cash book for the month of January 2022

Date	F	Details	Amount	Date	Particulars	F	Totals	Post- age	Cleaning	Stationery	Sundry exp	Ledger
2022			FRW	2022				FRW	FRW	FRW	FRW	FRW
Jan. 1		Balance	240,000	Jan. 1	Postage Stamps		22,000	22,000				
				5	Strings and paper		8,800				8,800	
				7	Milk & tea leaves		4,800				4,800	
				11	Bus fare for messenger		5,600				5,600	
				13	Mugisha		48,000					48,000
				14	Cleaning material		10,000		10,000			
				16	Stationery		5,200			5,200		
				18	Postage Stamps		20,000	20,000				
				23	Glue & sellotape		4,000			4,000		
				27	Cleaning material		6,000		6,000			
				28	Bus fare for messenger		6,400				6,400	
				30	Duplicating ink		9,600			9,600		
					Total disbursements		150,400	42,000	16,000	18,800	25,600	48,000
					Balance c/d		89,600					
		Totals	<u>240,000</u>				<u>240,000</u>					
Feb. 1		Balance b/d	89,600									

General ledger

Dr	Postage Account	Cr
----	-----------------	----

Jan. 31 st Petty cash	42,000	
----------------------------------	--------	--

Dr	Cleaning Account	Cr
----	------------------	----

Jan. 31 st Petty cash	16,000	
----------------------------------	--------	--

Dr	Sundry Expenses Account	Cr
----	-------------------------	----

Jan. 31 st Petty cash	25,600	
----------------------------------	--------	--

Dr	Stationery Account	Cr
----	--------------------	----

Jan. 31 st Petty cash	18,800	
----------------------------------	--------	--

PURCHASE LEDGER

Dr	MUGISHA Account	Cr
----	-----------------	----

Jan. 31 st Petty cash	48,000	
----------------------------------	--------	--

3.8.4 The Imprest System

This is the modern system of keeping petty cash. Under the imprest system, a petty cashier is provided with a fixed sum of money at the beginning of a given period out of which petty cash payments are made. At the end of each balancing period, the petty cashier is given a sum of money equal to the payments or disbursements made during the period.

Features of the Imprest System

- At any time, the sum of the petty cash in hand plus disbursements as shown by the payment vouchers should always equal the original amount given to the petty cashier
- The amount of money to the cashier to restore the imprest is the total of the payment vouchers or disbursements. This amount plus the petty cash in hand automatically restores the initial imprest. The act of restoring the imprest is also called reimbursement, or renewing the float, as imprest is also called sometimes.
- Total disbursements are equal to the cash or cheque debited in the petty cash book to restore the imprest.

d) Double entry is exercised between the petty cash book, the cash book and nominal expenditures.

1) Petty cash advance:

Dr: Petty cash A/C

Cr: Cash A/C

2) Monthly Payments:

Dr: Nominal A/C

Cr: Petty cash A/C

3) Reimbursement:

Dr: Petty cash A/C

Cr: Cash A/C

Advantages of the Imprest System

1. It makes it easy to verify the arithmetical accuracy of the cash book by using the horizontal and vertical analysis column totals; cross-casting.
2. The petty cashier is always accountable for the imprest amount
3. The system facilitates good internal control as at any given time the petty cashier's cash in hand plus the amount paid as shown by the payment vouchers must always add up to the imprest amount.
4. Deficiencies are limited at any time to the balance of imprest cash not yet spent.
5. Usage of the system allows for sound cash management.

Advantages of Using Petty Cash System

1. It allows the recording of cash items in the cash book to be more objective yet tidy. The petty cash items, involves small amounts, which can cause a lot of entries in the cash book that would make it hard to manage, especially in a busy business environment.
2. The use of this system allows limited cash to be in the business premises. This ensures that only a limited amount may be lost in case of theft, as the bulk of it will have been banked.
3. It facilitates day to day activities to run smoothly since urgent issues requiring small cash amounts can be handled quickly instead of waiting for long process of approving and signing cheques for various payments.
4. It creates flexibility in the organization's cash management.

5. It saves time because the small cash payments are delegated to the petty cashier while the accountant concentrates on other major issues in the business entity.
6. It helps to control the flow of expenditure easily, especially cash expenditure.

Amounts in the analysis columns for payments are posted to their respective ledger accounts to complete the double entry. The balance in the petty cash book appears in the trial balance as an asset and in the balance sheet among current assets, proving further that the petty cash book is both a book of original entry and a ledger book.

Example 2:

HABINEZA maintains a petty cash book on the imprest system. The imprest being FRW300,000. The following transactions took place in February 2022.

Feb.1st Received imprest from the cashier of FRW 300,000

3 Bought postage stamps of FRW 20,000

7 Bought stationery FRW50,000

8 Paid travelling allowance FRW 40,000

10 Paid window cleaning expenses FRW 60,000

12 Paid Runner's account in the purchases ledger FRW 50,000

14 Paid subscriptions for trade association FRW 20,000

17 Paid office cleaning expenses FRW 20,000

18 Received FRW 300,000 from the cashier

19 Paid for travelling expenses FRW 100,000

22 Bought electric light bulbs FRW 20,000

25 Paid Runner's account in the purchases ledger FRW 25,000

26 Paid travelling expenses FRW 10,000

27 Paid for sugar, tea and milk FRW 30,000

Required:

Enter the transactions into a petty cash book under the analysis column: Postage and stationery, travelling expenses, sundries and a ledger column. Balance the cash book showing the reimbursement required to restore the imprest and the balance brought forward at 1st March 2022.

Answer

HABINEZA

PETTY CASH BOOK FOR THE MONTH OF FEBRUARY, 2022

Receipts	F	Date	Particulars	F	Totals	Postage & stationery	Travelling expenses	Cleaning expense	Sundries	Ledger
FRW		2022			FRW	FRW	FRW	FRW	FRW	FRW
300,000		Feb 1	Cash							
		3	Stamps		20,000	20,000				
		6	Peter		40,000					40,000
		7	Stationery		50,000	50,000				
		8	Travelling		40,000		40,000			
		10	Cleaning		60,000			60,000		
		12	Runner		50,000					50,000
		14	Subscriptions		20,000				20,000	
		17	Cleaning		20,000			20,000		
300,000		18	Cash							
		19	Travelling		100,000		100,000			
		22	Light bulbs		20,000				20,000	
		25	Runner		25,000					25,000
		26	Travel		10,000		10,000			
		27	Kitchen		30,000				30,000	
			Total		485,000	70,000	150,000	80,000	70,000	115,000
185,000		28	Cash							
785,000		28	Bal. c/d		300,000					
300,000		Mar.1st			785,000					



Application activity 3.8

1. State the advantages of using imprest system of petty cash
2. Mark NDUWAYEZU is a sole trader in a business know as MANDU Traders Ltd. He keeps his petty cash on an imprest system, amount being FRW 200,000. The following are the petty cash transactions for the month of March 2022.

March 1 st Petty cash in hand	25,750
2 nd Petty cash restored to imprest system amount	?????
5 th Paid wages	29,890
9 th Cost of e-mail	13,580
13 th Paid wages	29,200
15 th Bought foolscap paper	15,450
19 th Paid wages	29,700
21 st Bought postage stamps	12,100
24 th Paid wages	29,980
26 th Paid to Liane, a creditor	11,760
30 th Bought envelopes	9,700
31 st Petty cash reimbursed	?????

Required:

1. Write up the petty cash book to record the above transactions, showing the entries restoring the petty cash imprest amount
2. Post relevant entries into the ledger.

Notes : your analysis columns should show:

- a) Wages
- b) Postage and telegrams
- c) Stationery
- d) Ledger



End of unit assessment

MUGISHA commenced a stationery business on 1st January, 2022 with his salary savings of FRW 50,000,000 which he was keeping with BANK OF KIGALI. He transformed his personal account into a business account and there after the salary had to be channeled to his account with I&M Bank. He also took his sister as his assistant in the business and she was to be paid a salary of FRW 500,000 per month.

During the month of January, he carried out the following transactions:

Jan. 1 He withdrew FRW 10,000,000 for use in day-to-day operations of the business.

Jan. 2 Bought stationery worth FRW 15,000,000 from KBG Stationers on credit, and also transferred his furniture worth FRW 10,000,000 from home for use in the business.

Jan. 3 Bought further stock of stationery at FRW 18,000,000 and paid by cheque. He also paid FRW 1,500,000 for transporting the stationery to the place of work paying cash.

Jan. 5 Cash sales were FRW 8,000,000. He also sold stationery to Lycée de Kigali at FRW 14,000,000 on credit.

Jan. 7 Paid KBG Stationers FRW 9,000,000 by cheque for stationery previously bought, and returned some spoilt stationery worth FRW 700,000 on the same day.

Jan. 10 Bought Stationery at worth FRW 20,000,000 from Kigali Stationary LTD on account.

Jan. 13 Lycée de Kigali paid FRW 6,000,000 by cheque and returned some items worth FRW 800,000 which had not been ordered for.


Jan.20 Sold books worth FRW 23,000,000 to FAWE Girls School on condition that payment is made before the end of the month.

Jan. 25 Paid salary to his assistant by cheque.

Required: To record the above transactions into the books of original entry.

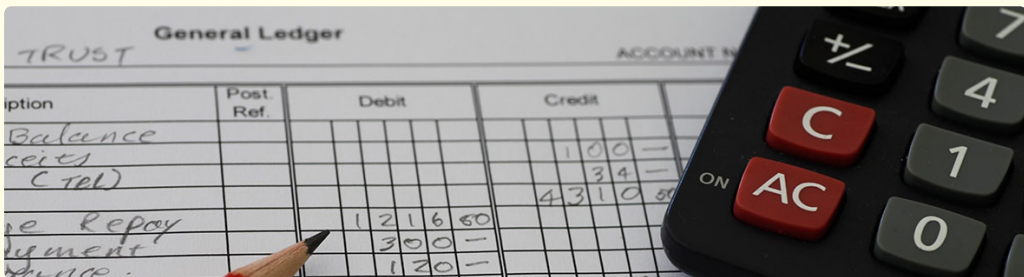
UNIT 4

POSTING JOURNAL ENTRIES

 **Key unit competence:** To be able to post journal entries



Introductory activity 4



Description	Post. Ref.	Debit	Credit
Balance			100-
sales			34-
(Tel)			4310 00
Repay		1216 50	
ment		300-	
ANCE		120-	

Figure 4.1: Posting journal entries

What is the purpose of posting transactions in the ledger?

4.1 Meaning, types, and format of ledgers

Activity 3.8



Explain the terms “posting” and “ledger”.

In unit 1 you learnt that business transactions are recorded in the books of account in two stages: (i) Journalizing, and (ii) Posting into the ledger. You have learnt the first stage of journalizing various transactions in Unit 3. In this unit you will learn about the second stage i.e. posting in the ledger. This involves posting journal entries into various accounts in the ledger, and balancing off the accounts.

4.1.1 Meaning of ledger

A business may use many accounts in recording its transactions. Each account is placed on a separate page in a bound or loose-leaf book, or on a separate card in a tray of cards. If the accounts are kept in a book, the book is called the ledger. Actually as used in accounting, the word ledger means a group of accounts or place of storage of accounts. Transactions are posted from the journal to the ledger. Posting simply means transferring journal entries to the ledger accounts. An account was earlier defined as an accounting record of increases and decreases in a specific asset, liability, or owner's equity, revenues and expenses. Ledger accounts summarize all transactions listed in the books of prime entry.

4.1.2 Types of ledgers

Ledgers are broadly categorized under (i) General Ledgers and (ii) Subsidiary Ledgers

General Ledger

The general ledger is also referred to as nominal ledger and it is the main ledger of an organization. Whenever we use the term ledger, we are referring to the general ledger, unless we specify otherwise. It is supposed to contain all the ledger accounts of an organization used to update each account. In case there are too many accounts in the organization, it is only the control accounts that should appear in the general or main ledger and others are recorded in the subsidiary ledgers. In manual accounting system, the general ledger is a big bound book with hard covers. Each page in the book represents an account. As observed above, the general ledger is supposed to contain all accounts of the organization. However, for easy of recording and retrieval of accounts, the general ledger is separated into subsidiary ledgers which are explained below.

Subsidiary ledgers

In order to avoid crowding of the general or main ledger with all accounts, subsidiary ledgers are created. Subsidiary ledgers are subdivisions of the general ledger. It is only the major accounts called control accounts that appear in the general ledger. Details of the general ledger accounts can be seen in the subsidiary ledgers.

Types of subsidiary ledgers are (i) Debtors or sales ledger and (ii) Creditors or purchase ledger.

Debtors' subsidiary ledger (Sales ledger)

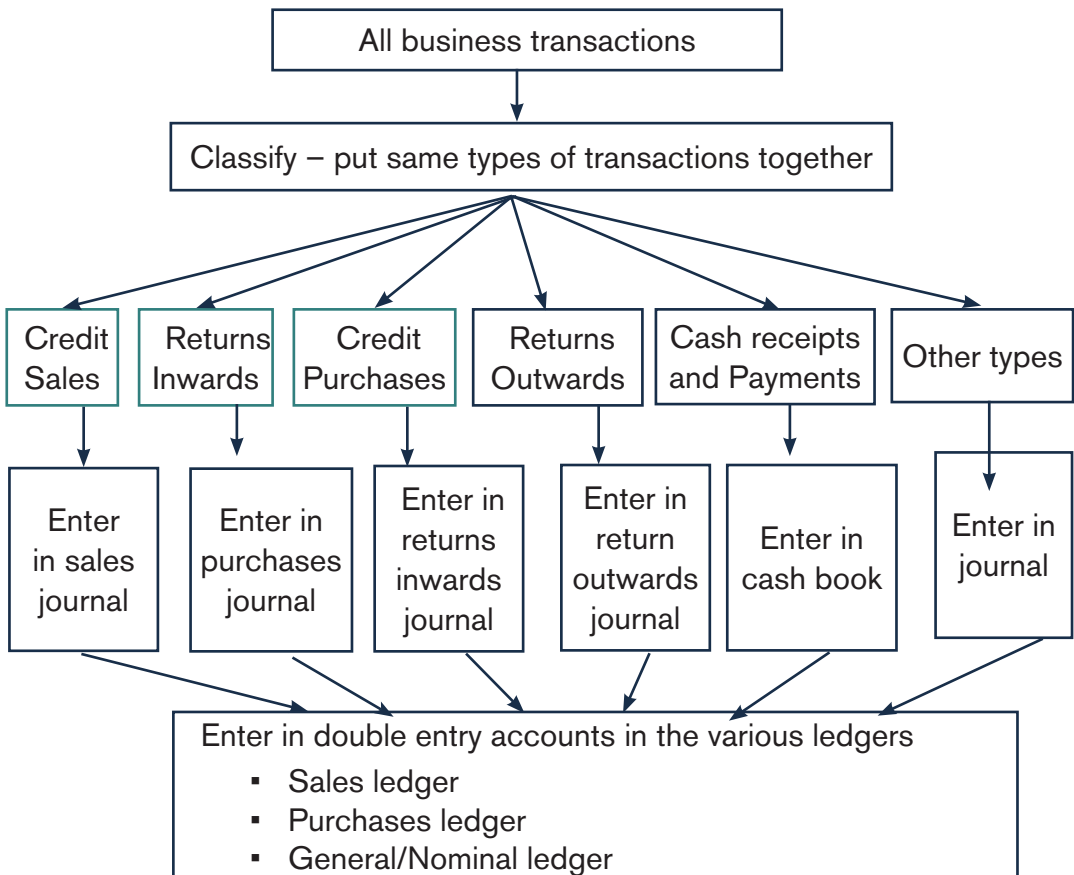
It is often difficult to show each and every debtor's account and its transactions in the general ledger. To overcome this problem, a debtor's subsidiary ledger is prepared. This subsidiary ledger shows the position of each debtor's account. The total of individual debtor's account balances in the debtors or sales subsidiary ledger should reconcile with the balance of debtors control account in the general ledger.

Creditors' subsidiary ledger (Purchases ledger)

The creditor's subsidiary ledger shows the details of each creditor's account. It is not possible to show this in the general ledger. The total of individual creditors' account balances in the creditors' or purchase subsidiary ledger should reconcile with the creditors control account in the general ledger.

The following diagram illustrates how transactions fall in the books of original entry earlier discussed in the previous unit and then how the books of original entry feed those transactions into ledgers

A diagram of books commonly used



4.1.3 Format of the ledger account

A ledger account can be written in two ways.

Format 1 T – Account Format

Organizations with manual accounting systems use T – Account format of the ledger account. The simple T- account form used in accounting textbooks is often very useful for illustration purposes. However, in practice, the account forms used in ledgers are much more structured. The T – Account format necessitates balancing off or closing the ledger account at the end of the period because it has no running balance. This format is shown below.

Debit (Dr)				TITLE OF ACCOUNT				Credit (Cr)			
Date	Narrative	Folio	Amount	Date	Narrative	Folio	Amount				

In this account the date will show the opening period of the asset, liability, capital, revenue or expense i.e. the balance brought forward. It will also show the date when a transaction took place.

The detail column (also called the particulars column) shows the nature of the transaction and reference to the corresponding account. The Folio Column for purpose of detailed recording shows the reference number of the corresponding account. The amount column shows the amount of the asset, liability, capital, revenue or expense.

The left side of the account is called the debit side and the right side is called the credit side. All assets and expenses are shown or recorded on the debit side while all the liabilities, capital and revenues are recorded on the credit side. Each type of asset, liability, revenue and expense must have its own account whereby all transactions affecting them are recorded in this account. For the double entry to be reflected in the accounts, every debit entry must have a corresponding credit entry. The transactions affecting these accounts are posted in the account as debit entry and credit entry to complete the double entry.

Format 2 With a running balance

Most computerized accounting systems use this format. Whenever a debit or credit is entered, the balance automatically adjusts. This format does not necessitate balancing off or closing the ledger account. This format is shown below.

Date	Explanation (Narrative)	Folio	Debit (FRW)	Credit (FRW)	Balance (FRW)



Application activity 4.1

1. From which of the following a ledger account is prepared
 - a) Transactions
 - b) Journal
 - c) Events
 - d) None of above
2. The process of transferring of items from journal to their respective ledger accounts is called as.
 - a) Entry
 - b) Arithmetic
 - c) Balancing
 - d) Posting
3. The left hand side of the ledger account is referred to as.
 - a) Footing
 - b) Credit side
 - c) Debit side
 - d) Balance
4. Ledger is a principle book that contains
 - a) Real accounts only
 - b) Personal accounts only
 - c) All accounts
 - d) Nominal accounts only

4.2 Posting entries to the ledger

Activity 4.2



Refer to Entrepreneurship Subject and answer the following question.

Mr. Mugabo commenced a business on 1 January 2021. All expenses were paid by cheque and any cash received was banked daily. The following is a summary of the transactions, which took place during the first year of trading:

- a) On 1 January 2021, Mr. Mugabo commenced business with FRW5,000 which he lodged to the business bank account
- b) During the period, total purchases amounted to FRW4,000 and payments made to suppliers were FRW3,550. On 31 December, 2021 FRW450 was still due to suppliers in respect of these purchases
- c) Sales for the year totaled FRWF9,000 all on credit. Amounts received from customers 101 during the year were FRW8,100. On 31 December, 2021, FRW900 was still owing from customers
- d) Mr. Mugabo purchased a van in December costing FRW2,500
- e) Administration Expenses were FRW2,300 for the year

Required: Write up the ledger accounts for Mr. Mugabo

Transferring journal entries to the ledger accounts is called posting. This phase of the recording process accumulates the effects of journalized transactions into the individual accounts. The aim of this section is to make you understand how the posting is done. Do not forget your knowledge of double entry.

Examples of how transactions are posted from the journal to the ledger

Please refer to previous unit on the general journal prepared for AKEZA Ltd

The journal

Date	Account titles and explanations	LP	Dr	Cr
Oct. 1	Cash A/C	1	20,000,000	
	Capital A/C			20,000,000

The ledger

Cash A/C Page 01		Capital A/C Page 02	
	FRW	FRW	FRW
Capital	20,000,000		Cash 20,000,000

The above diagram shows the posting from the journal to the ledger. In the ledger account, before putting the figure, the title of the second account necessary for the completion of the double entry is inserted. Eg. In the cash account, capital is mentioned before the figure and likewise in the capital account, cash is mentioned before the figure.

Illustration 1

Let now complete posting all the transactions recorded in AKEZA Ltd's general journal into its ledger (Refer to general journal prepared by AKEZA in unit 3)

AKEZA Ltd's Ledger accounts

Cash A/C

Page 1

	FRW		FRW
Oct. 1 Capital	20,000,000	Oct. 2 Land	3,000,000
20 Land	500,000	17 Vehicle	10,000,000
		30 Drawings	800,000

Capital A/C

Page 2

	FRW		FRW
		Oct. 1 Cash	20,000,000

Land A/C

Page 3

	FRW		FRW
Oct. 2	3,000,000	Oct. Cash	500,000

Office Equipment A/C

Page 4

	FRW		FRW
Oct. 4 Equipment suppliers Ltd	2,000,000		

Equipment Suppliers Ltd A/C

Page 5

	FRW		FRW
Oct. 15 Bank	1,500,000	Oct. 4 Office equipment	2,000,000

Bank A/C

Page 6

	FRW		FRW
Oct. 5 Loan	8,000,000	Oct. 15 Equipment Suppliers	1,500,000
		17 Vehicle	3,000,000
		25 Toyota Rwanda	2,000,000

Loan A/C

Page 7

	FRW		FRW
		Oct. 5 Bank	8,000,000

Motor vehicle A/C Page 8

	FRW		FRW
Oct. 17 Cash	10,000,000		
Bank	3,000,000		
Toyota Rwanda	2,000,000		

Toyota Rwanda A/C Page 9

	FRW		FRW
Oct. 25 Bank	2,000,000	Oct. 17 Vehicle	2,000,000

Drawings A/C Page 10

	FRW		FRW
Oct. 30 Cash	800,000		

Illustration 2

- The following transactions took place during the month of May 2021 for the business of Joseph Tumsigye:

2021	
May 1	Started firm with capital in cash of FRW 250,000
May 2	Bought goods on credit from the following persons: R Kelly FRW 54,000; P Combs FRW 87,000; J Role FRW 25,000; D Mobile FRW 76,000; I. Sims FRW 64,000.
May 4	Sold goods on credit to: C Blanes FRW 43,000; B Long FRW 62,000; F Skin FRW 176,000.
May 6	Paid rent by cash FRW 12,000.
May 9	C Blanes paid us his account by cheque FRW 43,000.
May 10	F Skin paid us FRW 150,000 by cheque.
May 12	We paid the following by cheque: J Role FRW 25,000; R Kelley FRW 54,000.
May 15	Paid carriage by cash FRW 23, 000.
May 18	Bought goods on credit from P Combs FRW 43,000; Mobile FRW 110,000.
May 21	Sold goods on credit to B Long FRW 67,000.
May 31	Paid rent by cheque FRW 18,000.

Required: Record the above transactions in the appropriate accounts.

Answer**DR** **Capital account** **CR**

	1/5 Cash	250,000
--	----------	---------

DR **Cash in Hand account** **CR**

1/5 Capital	250,000	6/5 Rent	12,000
		15/5 Carriage	23,000

DR **R Kelly (Creditor) account** **CR**

	2/5 Purchases	54,000
--	---------------	--------

DR **P Combs (Creditor) account** **CR**

	2/5 Purchases	87,000
	18/5 Purchases	43,000

DR **J Role (Creditor) account** **CR**

12/5 Bank	25,000	2/5 Purchases	25,000
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DR **D Mobile (Creditor) account** **CR**

	2/5 Purchases	76,000
	18/5 Purchases	110,000

DR **I Sims (Creditor) account** **CR**

	2/5 Purchases	64,000
--	---------------	--------

DR **C. Blanes (Debtor) account** **CR**

4/5 Sales	43,000	4/5 Bank	43,000
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DR	B Long (Debtor) account		CR
4/5 Sales	62,000		
21/5 Sales	67,000		

DR	F Skin (Debtor) account		CR
4/5 Sales	176,000	10/5 Bank	150,000

DR	Sales account		CR
		4/5 C Blanes	43,000
		4/5 F Long	62,000
		4/5 F Skin	176,000
		4/5 B Long	67,000

DR	Bank account		CR
9/5 C Blanes	43,000	12/5 J Role	25,000
10/5 F Skin	150,000	12/5 R Kelly	54,000
		31/5 Rent	18,000

DR	Carriage expenses account		CR
15/5 Cash	23,000		

DR	Rent expense account		CR
6/5 Cash	12,000		
31/5 Bank	18,000		

DR	Purchases account	CR
2/5 R Kelly	54,000	
2/5 P Combs	87,000	
2/5 J Role	25,000	
2/5 D Mobile	76,000	
2/5 L Sims	64,000	
18/5 P Combs	43,000	
18/5 D. Mobile	100,000	
	459,000	



Application activity 4.2

Refer to unit 3 in application activity 3.2 and post entries from AKANYANA Ltd general journal into ledgers.

4.3 The sales journal and sales ledger



Activity 4.3

What uses would the seller have for the copies of the sales invoice?

In unit 3, you learnt that, rather than having only one book of original entry and one ledger, most businesses use a set journals and a set of ledgers. In this section, you will learn more about sales journal also called Sales day book and sales ledger. You will also learn how cash and credit sales are entered in these books.

4.3.1 Cash sales

As you have already learnt, when goods are paid for immediately, they are described as “cash sales”, even where the payment has been made by cheque or transfer of funds from the customer’s bank account into the seller’s bank account. For accounting purposes, in such cases we do not need to know the names of and addresses of neither customers nor what has been sold to them and, as a result, there is no need to enter such sales in the sales journal.

Credit card payments

When customers pay immediately by credit card, so far as recording details of the customer is concerned, this is treated as if it were a payment made by cash. No record is required for accounting purposes concerning the contact details of the customer. However, it is still a credit transaction and it does result in a debtor being created – the credit card company. The double entry would be a credit to the sales account and a debit to the credit card company's account in the sales ledger.

4.3.2 Credit sales

In all but the smallest business, most sales are made on credit. In fact, the sales of many businesses consist entirely of credit sales. For each credit sale, the selling business gives or sends a document to the buyer showing full details of the goods sold and prices of the goods. As you learnt in unit 3, this document is an invoice. It is known to the buyer as a purchase invoice and to the seller as a sales invoice. The seller keeps one or more copies of each sales invoice for his own use.

4.3.3 Making entries in the sales journal

Sales journal also called a Sales Day Book. It records all the sales invoices issued by the firm during a particular period. The format is as follows (with simple records of invoice).

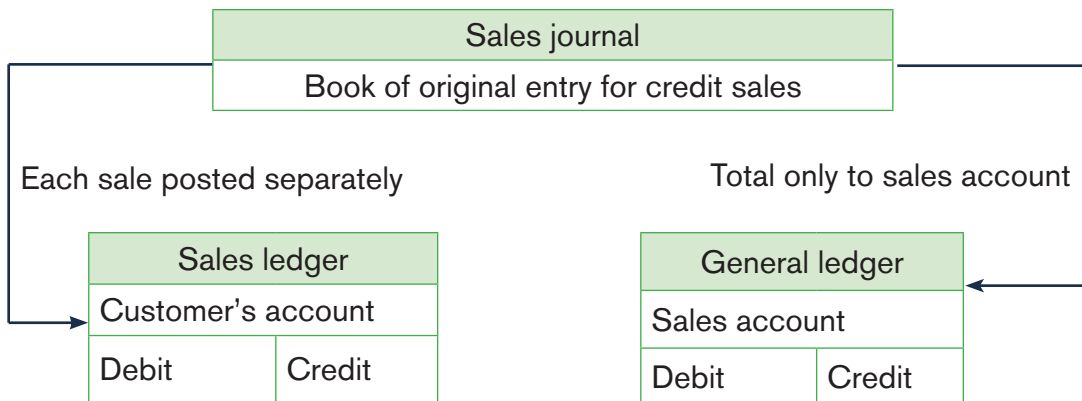
SALES JOURNAL			Page 5
Date 2021	Detail	Folio	Amount Frw
1 st March	Kanyamibwa	SL. 10	200.00
3 rd March	Maniragaba	SL. 19	350.00
5 th March	Musanabera	SL. 8	150.00
Total			700.00

4.3.4 Posting credit sales to the sales ledger

Instead of having one ledger for all accounts, we now have a separate sales ledger for credit sale transactions. It was described in section 4.1.

1. The credit sales are now posted, one by one, to the debit side of each customer's account in the sales ledger.
2. At the end of each period, the total of the credit sales is posted to the credit of sales account in the general ledger

Posting credit sales



4.3.5 Examples of posting credit sales

Example 1

The sales journal in 4.3.3 is now shown again. This time, posting is made to the sales ledger and the general ledger. Notice the completion of the folio columns with reference to numbers.

SALES JOURNAL			Page 5
Date 2021	Detail	Folio	Amount FRW
1 st March	Kanyamibwa	SL. 10	200.00
3 rd March	Maniragaba	SL. 19	350.00
5 th March	Musanabera	SL. 8	150.00
Total			700.00

The individual entries in the sales journal are posted to the debit side of the debtor's accounts in the sales ledger and the total is posted on the credit side of the sales account in the general ledger.

Sales Ledger

Kanyamibwa

2021		Folio	FRW	FRW
1/3	Sales	SL. 10	200.00	

Maniragaba

2021	Folio	FRW	FRW
3/3	Sales	SL. 19	350.00

Musanabera

2021	Folio	FRW	FRW
5/3	Sales	SL. 8	150.00

General Ledger

Sales

Folio	FRW	2021	Folio	FRW
		5/3	Credit sales	700.00

Example 2 Referring to AKANYANA Ltd's general ledgers accounts in application activity 4.2, the following are AKANYANA Sales ledgers.

The debtors' accounts or account or accounts receivable shown in the general ledger summarized all debtors' transactions without detailing the individual debtors involved in the transactions. This subsidiary ledger is not part of the double entry. The double entry was already accomplished in the general ledger. However, it is necessary to keep individuals accounts in order to monitor their transactions and balances.

John's A/C

		FRW			FRW
Jan. 3	Sales	1,000,000	Jan. 10	Cash	800,000
20	Sales	800,000	27	Returns inwards	100,000
			28	Banks	200,000

Mary's A/C

		FRW			FRW
Jan. 3	Sales	400,000	Jan. 15	Returns inwards	40,000
			16	Bank	150,000



Application activity 4.3

You are to enter the sales journal from the following details. Post the items to the relevant accounts in the sales ledger and then show the transfer to the sales account in the general ledger.

2021		FRW'000
March 1	Credit sales to Hope	310
March 3	Credit sales to Fiston	285
March 6	Credit sales to Moses	38
March 10	Credit sales to Hope	74
March 17	Credit sales to Tite	534
March 19	Credit sales to Yusuf	92
March 27	Credit sales to Mike	44
March 31	Credit sales to Betty	112

4.4 The purchases journal and purchases ledger

Activity 4.3



Think back to what you learnt about the list of items contained in the sales journal (sales day book). What do you think is the list of items recorded in the purchases journal (purchases day book)?

In this section, you will continue your look at the journals and ledgers by looking in more detail at the purchases journal (or purchases day book) and the purchases ledger. Having already looked at the sales side of transactions in section 4.3, you are now going to look at them from the side of purchases. Much of what you will learn in this section is almost identical to what you learn in section 4.3. This should not come as a surprise. After all, you are looking once more at how transactions are processed in journals and ledgers and the process ought to be similar as you move from the sales side to the purchases side of similar transactions. If it weren't, accounting would be a far more complex subject than it is.

4.4.1 Making entries in the purchases journal

From the purchases invoices of goods bought on credit, the purchaser enters the details in the purchase journal (purchases day book). There is no need to show details of goods bought in purchases journal. This can be found by looking at the invoices themselves. It has the following format (including records of invoices).

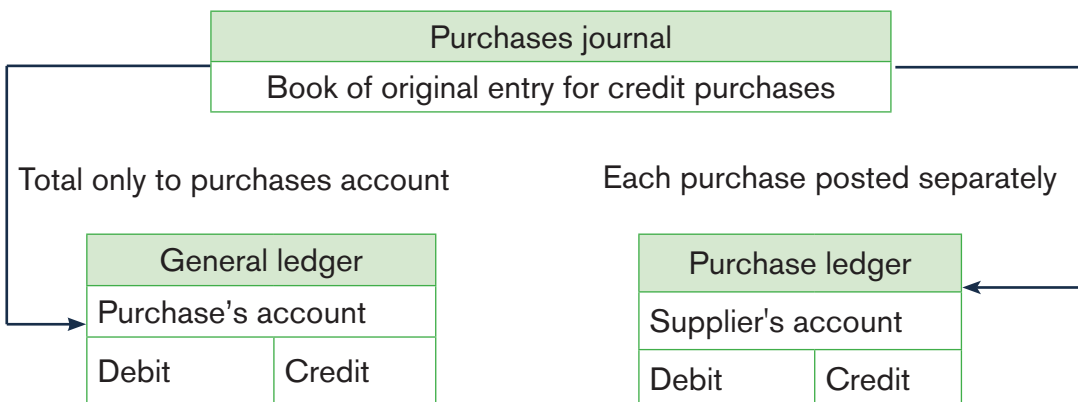
PURCHASES JOURNAL			Page 15
Date 2021	Description /Detail	Folio	Amount FRW
1/5	Mutabaruka	PL. 10	400.00
2/5	Kwibuka	PL. 20	350.00
Total			750.00

4.4.2 Posting credit purchases to the purchase ledger

We now have a separate purchases ledger. The double entry is as follows:

- The credit purchases are posted one by one, to the credit of each supplier's account in the purchases ledger.
- At the end of each period the total of the credit purchases is posted to the debit of purchases account in the general ledger.

Posting credit purchases



4.4.3 Examples of posting credit purchases

Example 1

The purchases journal shown in 4.4.1 is now shown again but, this time, posting is made to the purchases ledger and general ledger. Note the completion of the folio columns indicating that the posting had been completed.

Purchases Ledger

Mutabaruka

		2021	Folio	FRW
	1/5	Purchases	PL. 10	400.00

Kwibuka

		2021	Folio	FRW
	2/5	Purchases	PL. 20	350.00

General Ledger

Purchases

2021	Folio	FRW
Credit purchases for the month		750.00

Example 2

Referring to AKANYANA Ltd's general ledgers accounts in application activity 4.2, the following is AKANYANA purchases ledger.

Peter's A/C

		FRW			FRW
Jan. 5	Returns outwards	50,000	Jan. 1	Purchases	400,000
12	Cash	80,000	25	Purchases	100,000
26	Cash	80,000			

Janes's A/C

		FRW			FRW
Jan. 18	Returns outwards	50,000	Jan. 2	Purchases	200,000
19	Bank	150,000	14	Purchases	60,000



Application activity 4.4

Post the journal entries below into the ledgers

Purchase Journal		Page 49		
2021		Invoice number	Folio	Amount (FRW'000)
Sept. 1	Baptiste	9/101	PL 16	560
8	Harriet	9/102	PL 29	1,380
19	Bosco	9/103	PL 55	230
30	Gabriel	9/104	PL 89	<u>510</u>
	Transferred to purchases account		GL 63	2,680

4.5 Balancing off (closing) Accounts

Activity 4.5



1. What is the purpose of balancing off accounts?
2. Explain the process of balancing off accounts.

At the end of specific period most often a month, all ledger accounts are closed or balanced off. The purpose of doing this is to obtain the net balances on each account at the end of the month. After the accounts have been closed, a trial balance can be extracted.

Procedure for balancing off accounts

1. Draw two lines below each side of an account. The upper line should be single and the bottom lines should be double. Remember to leave one blank line between the last figure and the first line closing the account. This blank line is where the balance carried forward (c/f) or carried down (c/d) will be put.
2. Add up all the figures on both the debit and credit sides without inserting the totals. Having ascertained the side with the greater total, that total is put on both sides of the account.

3. Determine the difference by which the two sides were not previously agreeing and insert it on the deficient side and call that difference the balance carried down or carried forward. You should remember that the difference you obtain i.e. the balance carried down is put on the blank line which you had reserved.
4. In order to complete the double entry recording of the balances, the balance brought down or brought forward is put on the opposite side of the account below the totals. The date to be indicated is the opening date of the following month.

Note: Bal. c/f and bal. c/d mean the same thing and are used interchangeably. They mean balanced at the end of the period. Likewise, bal. b/f and bal. b/d are used interchangeably and mean the opening balances. With the above knowledge, we are now ready to close or balance off the ledger accounts for AKEZA Ltd as presented in section 4.2.

Illustration 1

Balancing off AKEZA Ledger accounts

Cash A/C			
	FRW		FRW
Oct. 1 Capital	20,000,000	Oct. 2 Land	3,000,000
20 Land	500,000	17 Vehicle	10,000,000
		30 Drawings	800,000
		31 Bal. c/d	<u>6,700,000</u>
	<u>20,500,000</u>		<u>20,500,000</u>
Nov 1 Bal b/d	6,700,000		

Capital A/C			
	FRW		FRW
Oct. 31 Bal c/d	<u>20,000,000</u>	Oct. 1 Cash	<u>20,000,000</u>
	<u>20,000,000</u>		<u>20,000,000</u>
		Nov. 1 Bal. b/d	20,000,000

Land A/C

		FRW			FRW
Oct. 2	Cash	3,000,000	Oct. 20	Cash	500,000
				Bal. c/d	
			31		<u>2,500,000</u>
		<u>3,000,000</u>			<u>3,000,000</u>
Nov. 1	Bal b/d	2,500,000			

Office Equipment A/C

		FRW			FRW
Oct. 4	Equipment suppliers Ltd	<u>2,000,000</u>	Oct. 31	Bal c/d	<u>2,000,000</u>
		<u>2,000,000</u>			<u>2,000,000</u>
Nov. 1	Bal. b/d	2,000,000			

Equipment Suppliers Ltd A/C

		FRW			FRW
Oct. 15	Bank	1,500,000	Oct. 4	Office equipment	2,000,000
Oct. 31	Bal. c/d	<u>500,000</u>			
		<u>2,000,000</u>			<u>2,000,000</u>
Nov. 1	Bal. b/d				500,000

Bank A/C

		FRW			FRW
Oct. 5	Loan	8,000,000	Oct. 15	Equipment Suppliers Ltd	1,500,000
			17	Vehicle	3,000,000
			25	Toyota Rwanda	2,000,000
			31	Bal. c/d	<u>1,500,000</u>
		<u>8,000,000</u>			<u>8,000,000</u>
Nov 1	Bal. b/d	<u>1,500,000</u>			

Loan A/C

		FRW			FRW	
Oct. 31	Bal c/d	<u>8,000,000</u>		Oct. 5	Bank	8,000,000
		<u>8,000,000</u>				<u>8,000,000</u>
				Nov 1	Bal. b/d	<u>8,000,000</u>

Motor vehicle A/C

		FRW			FRW
Oct. 17	Cash	10,000,000			
	Bank	3,000,000			
	Toyota Rwanda	<u>2,000,000</u>	Oct. 31	Bal. c/d	<u>15,000,000</u>
		<u>15,000,000</u>			<u>15,000,000</u>
Nov. 1	Bal. b/d	15,000,000			

Toyota Rwanda A/C

		FRW			FRW
Oct. 25	Bank	<u>2,000,000</u>	Oct. 17	Vehicle	<u>2,000,000</u>

Drawings A/C

		FRW			FRW
Oct. 30	Cash	800,000	Oct. 31	Bal. c/d	<u>800,000</u>
		<u>800,000</u>			<u>800,000</u>
Nov. 1	Bal. b/d	800,000			

Illustration 2

The following balances were extracted from the books of Mukasa's business on 31/5/2021.

	FRW
Creditors	3,000,000
Debtors	7,000,000
Rent	500,000
Electricity	300,000
Capital	5,000,000

Loan	2,000,000
Drawings	500,000
Cash	5,000,000
Bank	3,300,000

During the month of June 2021, the following transactions occurred.

- June 1 Bought goods on credit for FRW 6,500,000
- 2 Sold goods on credit for FRW 8,000,000
- 4 Received a cheque of FRW 5,000,000 from a debtor and banked it.
- 7 Paid creditors FRW 1,500,000 cash and FRW 500,000 by cheque
- 10 Rejected and returned goods worth FRW 300,000 to a creditor
- 12 A debtor rejected and returned goods worth FRW 1,00,000
- 14 Banked FRW 1,500,000 cash
- 16 Paid rent cash FRW 400,000 and FRW 800,000 by cheques and electricity FRW 250,000 cash
- 20 Withdrew FRW 1,000,000 from the bank and put into the cash box for payment of cash expenses
- 22 Paid FRW 2,000,000 by cheque in respect of retiring the loan
- 25 Fearing the consequences of the land bill, he sold the land inherited from his father for FRW 10,000,000 cash. He used FRW 5,000,000 for his marriage ceremonies and the rest of the money he put into his business
- 27 Received cash of FRW 100,000 and a cheque FRW 2,000,000 from a debtor and banked both cash and cheque
- 30 Used business cash of FRW 300,000 for a social evening with his friends at a club.

Required: Prepare Mukasa's ledger accounts and extract balances on 30/6/2021 (Ignore subsidiary ledgers)

Answer

Mukasa's Ledger

Purchase A/C

2021		FRW'000			FRW'000
June 5	Creditors	<u>6,500</u>	June 30	Bal c/d	<u>6,500</u>
		<u>6,500</u>			<u>6,500</u>
July 1	Bal b/d	6,500			

Creditors' A/C

2021		FRW'000			FRW'000
June 7	Cash	1,500	June 1	Bal b/d	3,000
7	Bank	500	1	Purchases	6,500
10	Returns out	300			
30	Bal c/d	<u>7,200</u>			
		<u>9,500</u>			<u>9,500</u>
			July 1	Bal b/d	7,200

Debtors' A/C

2021		FRW'000			FRW'000
June 1	Bal b/d	7,000	June 4	Bank	5,000
2	Sales	8,000	12	Returns in	100
			27	Cash	100
			27	Bank	2,000
			30	Bal c/d	<u>7,800</u>
		<u>15,000</u>			<u>15,000</u>
July 1	Bal b/d	<u>7,800</u>			

Sales A/C

2021		FRW'000			FRW'000
June 30	Bal c/d	<u>8,000</u>	June 2	Debtors	<u>8,000</u>
		<u>8,000</u>			<u>8,000</u>
			July 1	Bal b/d	8,000

Return Outwards A/C

2021		FRW'000			FRW'000
June 30	Bal c/d	<u>300</u>	June 10	Creditors	<u>300</u>
		<u>300</u>			<u>300</u>
			July 1	Bal b/d	300

Return Inwards A/C

2021		FRW'000			FRW'000
June 12	Debtors	<u>100</u>	June 30	Bal c/d	<u>100</u>
		<u>100</u>			<u>100</u>
July 1	Bal b/d	100			

Rent A/C

2021		FRW'000			FRW'000
June 1	Bal b/d	500			
16	Cash	400			
16	Bank		June 30	Bal c/d	<u>1,700</u>
		<u>800</u>			
		<u>1,700</u>			<u>1,700</u>
July 1	Bal b/d	1,700			

Electricity A/C

2021	FRW'000		FRW'000
June 1 Bal b/d	300		
16 Cash	<u>250</u>	June 30 Bal c/d	<u>550</u>
	<u>550</u>		<u>550</u>
July 1 Bal b/d	550		

Loan A/C

2021	FRW'000		FRW'000
June 22 Bank	<u>2,000</u>	June 1 Bal c/d	<u>2,000</u>
	<u>2,000</u>		<u>2,000</u>
		July 1 Bal b/d	2,000

Capital A/C

2021	FRW'000		FRW'000
		June 1 Bal b/d	5,000
June 30 Bal c/d	<u>10,000</u>	25 Cash	<u>5,000</u>
	<u>10,000</u>		<u>10,000</u>
		July 1 Bal b/d	10,000

Drawings A/C

2021	FRW'000		FRW'000
June 1 Bal b/d	500		
June 30 Cash	<u>300</u>	June 30 Bal c/d	<u>800</u>
	<u>800</u>		<u>800</u>
July 1 Bal b/d	800		



Application activity 4.5

Refer to application activity 4.2, post the entries and balance off AKANYANA Ltd ledger accounts.



End of unit assessment

You are required to enter the following transactions in the ledgers and balance off the accounts

2010

- Jan. 01 Started business with \$ 20 000 capital, which was deposited in the bank
- Jan. 03 Paid rent for premises by cheque \$ 1 000
- Jan. 04 Bought goods on credit from PPP for \$ 580 and KAN for \$ 2 400
- Jan. 04 Purchased motor van for \$ 5 000 paying by cheque
- Jan. 05 Cash sales of \$ 1 000
- Jan. 10 Paid motor expenses in bank \$ 75
- Jan. 12 Paid wages in cash at bank \$ 120
- Jan. 17 Bought goods on credit from PPP \$ 670
- Jan. 18 Returned goods to PPP \$ 70
- Jan. 20 Sold goods for \$ 800, payment being received as a cheque, which was banked immediately
- Jan. 24 Paid insurance by cheque \$ 220
- Jan. 31 Paid wages in cash \$ 135 and electricity by cheque \$ 78

UNIT 5

EXTRACTING A TRIAL BALANCE



Key unit competence: To be able to extract a trial balance



Introductory activity 4

Observe the images below and answer the questions:



Figure 5.0: Trial balance

- Make a comparison between the above three images
- What would happen if the content of the right side of the image 2 is increased without increasing the content of its left side?

5.1 Meaning, purpose and limitations of Trial Balance

Activity 5.1



- a) What does the book keeper do after balancing off ledger account?
- b) How does he/she proceed?

5.1.1 Meaning of trial balance

A trial balance is simply a list of account balances. It can also be defined as a statement of debit and credit totals of balances extracted from the various accounts in the ledger with a view to test the arithmetic accuracy of books. It may also be defined as a table in which all the ledger accounts are listed with their corresponding balances with the purpose of controlling at the end of the month the general equality of all the recordings in the journal and their posting too the ledger accounts..

5.1.2 Purpose of trial balance

- i) It gives the balances of all the accounts of the ledger. The balance of any account can be found from the trial balance without going through the pages of the ledger;
- ii) It is the check on the accuracy of posting. If the trial balance agrees, it proves:
 - a. that both the aspects of each transaction are recorded;
 - b. That the books are arithmetically accurate.
- iii) It facilitates the preparation of profit and loss account ant the balance sheet.
- iv) Important conclusion can be delivered by comparing the balances of two or more than two years with the help of trial balances of those years.

Though agreement of the trial balance is not an absolute proof of the accuracy of the books, disagreement is an obvious fact that an error has been committed. You will see on the unit on error correction that there exist errors that do not affect the trial balance. When such errors are made, the trial balance can still balance despite those errors.

5.1.3 Limitations of the trial balance

Agreement of the trial balance is not a sound proof that the book keeping has been carried out perfectly. There are certain book-keeping errors that do not affect the agreement of the trial balance. This limits the scope of a trial balance as a financial statement.

The following are the important limitations of the trial balance:

- The trial balance can be prepared only in those concerns where double entry system of book keeping is adopted. This system is too costly.
- A trial balance is not a conclusive proof of the arithmetical accuracy of the books of account. If the trial balance agrees, it doesn't mean that now there are absolutely no errors in books. On the other hand, some errors are not disclosed by the trial balance.
- If a trial balance is wrong, the subsequent preparation of trading, profit and long account and the balance sheet will not affect the true picture of the concern.



Application activity 5.1

- a) What is the trial balance?
- b) What is its content?
- c) What is the main purpose of preparing the trial balance?
- d) How can you know that an error is committed when preparing the trial balance?
- e) What are the limitations of the trial balance?
- f) How would correct trial balance be?

5.2 Preparation of the trial balance

Activity 5.2



- a) What does the book keeper do after balancing off ledger account?
- b) How does he/she proceed?

As mentioned above, a trial balance is a list of debit and credit balances extracted from the ledger and aimed at checking the accuracy of the accounting process. Accounts with net debit balances i.e. before closing the account, the total on the debit side was more than the total on the credit side. Meaning balance carried down is on the credit side and balance brought down on the debit side, will appear on the debit side of the trial balance. Likewise accounts with net credit balances will appear on the credit side of the trial balance. Ideally, all asset accounts (except bank in case of bank overdraft or debtors in case of advance received), expenses accounts and drawings account are expected to have debit balances. If you get credit balances on these accounts, it might mean that your working was wrong. Similarly, all liability accounts, revenue or income account, capital account and reserve accounts are expected to have credit balances. If you get a debit balance on any of these accounts, then it is an indication that you are wrong.

In the trial balance, asset account balances are recorded in the debit column while the accounts for liabilities and capital are recorded in the credit column. The nominal accounts which relate to expenses and losses are recorded in the debit column of the trial balance, but those that relate to items of income and revenue are recorded in the credit column of the trial balance.

When constructing a trial balance therefore, place assets (e.g. motor vehicles, stock, cash in hand and at bank, debtors, etc.); expenses (e.g. salaries and wages, rent and rates, discounts allowed, etc.), in the debit column and liabilities (e.g. creditors, bank overdraft, unpaid salaries, etc.), revenues or incomes (e.g. sales, discounts received, rent received, etc.), in the credit column.

The following is the procedure to prepare the trial balance:

- Before you start off with the trial balance, you need to make sure that every ledger account is balanced off;
- Prepare a worksheet. The column headers should be for the account name and the corresponding columns for debit and credit balances;
- For every ledger account, transfer to the trial balance worksheet the account name along with account balance in appropriate debit or credit column;

- Add up the amounts of the debit column and the credit column. Ideally, the totals should be the same.

Illustration 1

Referring to the application activity 4.5 above, prepare AKANYANA Ltd's trial balance knowing that the closing ledger balances are the following:

Particulars	Balance
Returns outwards	100,000
Sales	6,700,000
Purchases	860,000
Debtors	910,000
Rent	160,000
Electricity	150,000
Bank	3,930,000
Cash	690,000
Returns inwards	140,000
Salaries	310,000
creditors	350,000

Answer

AKANYANA Ltd's trial balance for the period ended

Particulars	Debit	Credit
Purchases	860,000	
Debtors	910,000	
Rent	160,000	
Electricity	150,000	
Bank	3,930,000	
cash	690,000	
Returns inwards	140,000	
Salaries	310,000	
Creditors		350,000
Sales		6,700,000
Returns outwards		100,000
Total	7,150,000	7,150,000

Illustration 2

Let the following trial balance of NIYOBYOSE and Sons Company:

Particulars	Debit	credit
Customers	310,584	
Automotive expenses		134,280
Office equipment	180,000	
Capital	714,600	
Vehicles	225,000	
Advertising	36,000	
Wages		284,760
Purchases	2,682,636	
Water and electricity		66,240
Sales		3,583,176
General expenses	82,356	
Insurance		103,320
Suppliers		306,900
Rent and taxes	315,000	
Drawings		126,000
Bank	58,500	
Total	4,604,676	4,604,676

Required : Rewrite the trial balance correcting any items you consider incorrect.

Answer

Particulars	Debit	Credit
Customers	310,584	
Automotive expenses	134,280	
Office equipment	180,000	
Capital		714,600
Advertising	36,000	
Vehicle	225,000	
Wages	284,760	
Purchases	2,682,636	

Water and electricity	66,240	
Sales		3,583,176
General expenses	82,356	
Insurance	103,320	
Suppliers		306,900
Rent and taxes	315,000	
Drawings	126,000	
Bank	58,500	
Total	4,604,676	4,604,676



Application activity 5.2

- How account balances are listed in the trial balance?
 - What are the main ledger accounts with debit balances?
 - What are the main ledger accounts with credit balances?
 - What does credit balance of bank account mean?
- e) The following are balances in the books of ISHEJA Plc for the period ended 31st March 2010: FRW
- Bank overdraft.....24,160
 - Sales.....131,340
 - Commission income.....13,670
 - Debtors.....41,300
 - Postage and stationery... 6,000
 - Repairs to buildings.... 6,200
 - Heating.....2,130
 - Purchases.....112,100
 - Cash in hand..... 1,100
 - Creditors..... 26,950
 - Premises.....269,000
 - Owner drawings..... 7,150

Required: find out its capital and prepare the trial balance for the period ended.



End of unit assessment

1. The following items were extracted from MUHIRE'S ledger account for the year ending on 31st December 2014:

Details	Amount (FRW)
Stock	96,000
Sales	860,000
Rent	5,000
Cash at bank	10,500,000
Debtors	2,100,000
Creditors	1,420,000
Motor van	8,200,000
Equipment	1,945,000
Rent payable	543,000
Telephone	1,810,000
Land	920,000
Salaries and wages	1,460,000
Insurance	690,000
Raw materials	200,000
2 year loan	17,567,000
Bank overdraft	300,000

Required: Calculate the level of the owner's capital and then prepare the trial balance for the period ended.

2. Rewrite the following trial balance correcting any items you consider to be incorrect:

Particulars	Debit (FRW)	Credit (FRW)
Cash in hand	17,500	
Bank overdraft	30,000	
Discount allowed		20,000
Purchases	255,000	
Sales		475,000
Furniture and fittings		100,000
Motor vehicles	215,000	
Capital	125,000	
Drawings		35,000
Returns outwards	12,500	
Loan repaid during the year		15,000
Returns inwards		7,500
Discount received	10,000	
Advertising	27,500	
Stationery	17,500	
Debtors	50,000	
Interest received		7,500
Creditors		100,000
Total	760,000	760,000

UNIT 6

CORRECTION OF ERRORS



Key unit competence: To be able to correct errors



Introductory activity 4

SHUMBUSHO is a sole proprietor whose business is to buy and sale shoes made in local materials, operating in RUBAVU District. His accountant is not qualified in recording financial transactions. At the end of 2020, after recording transactions in the books and preparing a trial balance, he was surprised to see that the total balances in the debit and credit sides were not agreed. In the subsequent year, the trial balance was agreed, but some source documents were not recorded.

1. What were the causes of imbalance between debit and credit sides of trial balance?
2. If you are hired by SHUMBUSHO to help in the above two cases, how can you assist him?

While recording transactions, posting to the various accounts and extraction of list of account balances, it is possible for errors to be committed. Such errors may or may not affect the totals of the list of account balances. Recall that if the totals of the list of account balances are equal, then this shows arithmetical accuracy in recording and posting of transactions. Now it should be said, this does not mean non-existence of errors. It is possible for some errors not to affect the totals being equal for the list of account balances. Some errors can affect too the total of list of account balances. There are two major types of errors in accounts:

- Errors that do not affect the List of account balances (trial balance)
- Errors that do affect the List of account balances (trial balance).

6.1 Errors that do not affect a trial balance

Activity 6.1



ABIKIZA is an accountant in the company of MUNEZERO Ltd specialized in buying and selling milk in MUHANGA District. When closing the period ended 2021, the trial balance agreed. After investigation, it was found that there were some errors in source documents and others were committed in recording. ABIKIZA thought that all errors committed must affect the agreement of a trial balance. Required: As someone with skills in identification and rectification of errors, what types errors committed by ABIKIZA?

These are errors not disclosed by the trial balance. Agreement of a trial balance is not an absolute proof that the book-keeping has been correctly done. There are certain book-keeping errors that do not affect the agreement of the trial balance. It will actually balance even if such errors have been committed in the course of book-keeping. These are:

Error of omission

It occurs when entities for certain transaction are completely omitted from the books, such that there is no record of such transaction in the firm's ledger and hence the error is not reflected in the trial balance. E.g. the purchases of goods for FRW 1,000 from supplier not recorded in the purchases and the creditor's account is an example of an error of omission.

Error of commission

This type of error is committed when a book-keeper posts entries of a transaction in a wrong account of the same class. E.g. if the goods sold to MUGISHA on credit for FRW 5,000 are debited in the account of MAHORO then this will be an error of commission.

Error of compensating / Compensating error

This error is committed when two errors of the same magnitude on either side of the ledger, are committed in the books, such that the errors counter-act or cancel out each other. E.g. the purchases account was over added by FRW 50 and similarly, the sale account had also been over-added by FRW 50.

Error of duplicating

It is when one transaction is entered twice or more in the books. E.g. a sale of goods to NIWEMWALI FRW 50,000 recorded two times in both sales day books and debtors Account.

Complete reversal of entries

Under this, correct accounts are used but each item is shown on the wrong side of the account. e.g. receipt of cash from Karenzi FRW 42,000 is entered on the debits side of his account and credited in the cash book.

Error of the original entry

This error arises when an entry is incorrectly made in a book of original entry. e.g. an invoice for FRW 12,000, MUKUNZI a creditor, is misread as FRW120,000. This also includes error of transposition where numbers in the amount are transposed e.g. 54 becomes 45. If the wrong amount is posted on both sides, this will not be detected.

Error of principle

It arises when entries of transactions are posted to the wrong class of accounts. e.g. purchases of motor van posted to the expenses account instead of machine A/C.



Application activity 6.1

- i) What do you understand by errors that do not affecting a trial balance?
- ii) List the errors not affecting the agreement of a trial balance

6.2. Errors that affect a trial balance



Activity 6.2

BAHOZE, an independent auditor in HUYE District, was asked to conduct an audit in CYUZUZO Co ltd dealing with cultivating and selling rice. While auditing the books of prime entry and financial statements, she realized that the trial balance total debit was different from credit balance. After certain investigation, it was observed that some errors were committed in recording.

1. How to call the errors committed by CYUZUZO Co Ltd accountant?
2. Which types of these errors?

These errors relate to incorrect additions, subtraction or entries made on wrong side of the books. They are disclosed by a trial balance because the totals of debit and credit sides do not agree.

Transposition errors

These are book keeping errors committed when the order of figures of amount reversed. This affects the trial balance if the error is made on one side of the transaction.

e.g. IRANZI the book keeper, had posted correctly to the ledger FRW11,200 received from Mukono Ltd, but entered the amount in the cash FRW11,020 or cheque for FRW43,000 received from a debtor was recorded incorrectly in the cashbook FRW34,000.

Arithmetical errors

These are errors that result from wrong addition and subtraction of amounts in books of original entry. Such errors are termed in the examination question as either under cast or overcast.

e.g. The page in purchases daybook was overcast by FRW 750

Single entry errors

These are book-keeping errors committed when the dual aspect of transactions is not recorded along the principles of double entry system. An amount is recorded only in one side, either as a debit entry or a credit entry without completing the double entry. E.g. a cheque off FRW 27,240 received from a debtor was returned by the bank unpaid. This fact was recorded in his personal account in the ledger but not in the cashbook.

Omission of ledger balances from the trial balance

When extracting a trial balance from the ledger balances, and where a balance of items is omitted, the trial balance total will obviously not agree.

Mis-posting errors

These errors may arise in the following circumstances:

- i) An account is debited instead of being credited or vice versa. E.g. a cheque of FRW 5,600 received from a debtor was entered correctly in the cashbook but was posted to the debit side of his personal account in the ledger.

- ii) An amount is posted into an account twice. Also, when it is debited or credited twice. Example a credit sale of goods to Willy for FRW 13,800 was posted on the credit of his personal account twice.
- iii) An expense transaction is credited as income or an income transaction is debited as an expense. Example: discounts allowed FRW 8,400 has been posted to credit side of discounts received account.
- iv) Error of transferring balances from the general ledger to the trial balance
- v) Omission of a general ledger account

Location of trial balance errors

Errors that cause a trial balance to disagree should be located and corrected in order to agree the trial balance. The following logical procedure is followed to trace such errors:

- 1) Check the arithmetical accuracy of the debit and credit column totals of the trial balance
- 2) Divide the difference on the trial balance by 2, look for this as a separate entry on the greater side of the trial balance as a wrong entry. If located, correct by entry below the existing totals.
- 3) Check entries of amounts transferred from the various ledgers if correct
- 4) Check the preliminary balancing totals in the various ledgers if arithmetically correct.
- 5) Check if ledger postings have been made correctly from the various day books and other source documents.
- 6) Check totals and sub-totals in the daybooks, petty cash book.



Application activity 6.2

1. Name the error committed to each of the following:
 - i) Sales under-casted
 - ii) Discount allowed credited in discount received
 - iii) Cash payment to a creditor entered in the cashbook only

2. Francis made one error when he posted the total value of invoices from the purchases daybook to the general ledger. He posted FRW 274,865,000 to the debit side of the purchases account. The correct total was FRW 274,685,000. The credit entries were entered correctly. How is the trial balance affected by this error?
 - i) The total of the debit balances and the total of credit balances will agree, but will be over casted
 - ii) The total of the debit balances and the total of the credit balances will agree, but will be understated
 - iii) The total of the debit balances will exceed the total of the credit balances
 - iv) The total of the credit balances will exceed the total of the debit balances

6.3. Correction of errors that do not affect the trial balance

Activity 6.3



You are given the following errors:

1. Invoice from a seller ALICE not recorded in the books of prime entry
2. Goods purchased from Umwali credited in Umulisa's account
3. Electricity bill of FRW 7,500 recorded as FRW 5,700 in both electricity and cash a/c.

Required:

- i) What is the relationship between those errors?
- ii) How to correct those errors?

6.3.1. Record journal entries in the general ledger to correct errors not disclosed by the trial balance.

The errors which do not affect the agreement of the trial balance totals are corrected by passing journal entries. The correction of these errors must still follow the double entry principle.

In this case:

DR: The account wrongly credited

CR: The correct account

OR

DR: The correct account

CR: The account wrongly debited

Error of omission

Example 1

A record of purchases of machinery by cheque FRW 48,000 was completely omitted from the books.

Answer

The journal entries for the correction:

Journal

Account title	Dr	Cr
Machinery A/C	FRW 48,000	
Bank A/C		FRW48,000
Being the correction of omission of a purchases invoice no... from the books		

Error of commission

Example 2

A sale of goods on credit FRW28,000 to Mbabazi was entered by error in the accounts of Mugisha

Journal

Account title	Dr	Cr
Mbabazi A/C	FRW 28,000	
Mugisha A/C		FRW 28,000
(Being the correction of comission of a sale invoice wrongly entered in Mugisha A/C now corrected)		

Error of complete reversal

Example 3

A payment of cash FRW1,500 to ISHIMWE was entered on the receipt side of the cash A/C, and also by error credited to ISHIMWE A/C.

The journal

ISHIMWE	3,000	
Cash		3,000

Duplication error

Example 4

A purchase of goods by cash FRW 16,500 was by error recorded twice.

Cash A/C	16,500	
Purchases		16,500

Compensating errors

Example 5

The purchases account was over added by FRW 50 and similarly, the sale account had also been over-added by FRW 50.

Dr Sales A/C	50	
Cr Purchases A/C		50

Error of the original entry

Example 6

An invoice for FRW 12,000, MUKUNZI a creditor, is misread as FRW 120,000.

Dr MUKUNZI	100,000	
CR Purchases		100,000

Errors of principle

Example 7

Purchases of motor van posted to the expenses account instead of motor van A/C.

Dr Motor Van A/C		
CR Expenses A/C		

Exercises

1. Prepare journal entries necessary to correct the following errors:

The auditor of the books of accounts of Ntugasaze's business for the year ending 31st December 2011 revealed the following errors:

- b) Furniture purchased for FRW 2,000 had been debited to the purchases account
- c) Goods purchased from Rwanda Group of companies for FRW 2,500 were credited to the account of Rwanda and company
- d) An invoice from Kanimba firm for FRW 7,800 was omitted
- e) Goods sold to Umutoni for FRW 1,750 were entered in the sales daybook or sales book as FRW 1,570.
- f) The salaries and wages account was over added by FRW 350 and the rent received account had been over added by FRW 350.

Answer

- a) Dr Furniture A/C FRW 2,000
Cr Purchases' A/C FRW 2,000
 - b) Dr Rwanda and Company A/C FRW 2,500
Cr Rwanda group of Companies FRW 2,500
 - c) Dr Purchases A/C FRW 7,800
Cr Kanimba A/C FRW 7,800
 - d) Dr Umutoni FRW 180
Cr sales FRW 180
 - e) Dr Salaries and wages A/C FRW 350
Cr Rent received A/C FRW 350
- 2 Listed below are five errors which were used as examples earlier in this topic. Write out the journal entries which would correct these errors.
 - a) A business receives an invoice for FRW 250,000 from a supplier which was omitted from the books entirely.
 - b) Repairs worth FRW 150,000 were incorrectly debited to the non-current asset (machinery) account instead of the repairs account.
 - c) The bookkeeper of a business reduces cash sales by FRW 280,000 because they were not sure what the FRW 280,000 represented. In fact, it was a withdrawal on account of profit.

- d) Telephone expenses of FRW 540,000 are incorrectly debited to the electricity account.
- e) A page in the sales day book has been added up to FRW 28,425,000 instead of FRW 28,825,000.

Answer

a) DEBIT Purchases FRW 250,000
 CREDIT Trade payables FRW
 250,000

A transaction previously omitted

b) DEBIT Repairs A/C FRW 150,000
 CREDIT Non-current asset Machinery A/C FRW
 150,000

The correction of an error of principle: Repairs costs incorrectly added to non-current asset costs

c) DEBIT Drawings FRW 280,000
 CREDIT Revenue FRW
 280,000

An error of principle, in which sales were reduced to compensate for cash withdrawals not accounted for

d) DEBIT Telephone expenses FRW 540,000
 CREDIT Electricity expense FRW
 540,000

Correction of an error of commission: telephone expenses wrongly charged to the electricity account

e) DEBIT Trade receivable FRW 400,000
 CREDIT Revenue FRW
 400,000

The correction of a casting error in the sales day book

(FRW 28,825,000 - FRW 28,425,000) = FRW 400,000



Application activity 6.3

The books of Kamali on 31st December 2016 revealed the following errors:

- i) A machine purchased for FRW 15,000,000 had been debited to the purchases account
- ii) Goods sold to MAHIRWE for FRW 3,000,000 had been recorded in MAHORO's account
- iii) A purchase of goods by cash for FRW 6,500,000 had been recorded both on the debit and credit as FRW 5,600,000
- iv) The wages account was understated by FRW 2,000,000 as also the sales account by the same amount.
- v) A sale of goods by cheque for FRW 5,000,000 had been completely omitted from the books.
- vi) Cash received from a debtor for FRW 4,000,000 was debited in the debtors account and credited in the cash account

6.4 Correction of errors that affect the trial balance

Activity 6.4



The book keeper of a certain business has committed the following errors:

1. Cash payment was entered correctly in cash but no corresponding entry made
2. Motor insurance was credited to distribution expenses

Required: How to correct the above errors

6.4.1. Journal entries to correct errors affecting a trial balance

For the correction of these errors, a suspense account is opened and the difference in the trial balance is posted in this account, if the debit side of a trial balance is smaller than this amount is debited in the suspense account and vice versa. When the errors are discovered, they are corrected by double entry through the suspense account. When all the errors have been discovered and corrected, the balance on the suspense account is eliminated. In this case:

a) DR: Respective account if omitted

CR: Suspense A/C

b) DR: Suspense A/C

CR: respective account if omitted

c) If any debit entry has been made on credit side then to correct it, double amount must be debited and vice versa.

Example 1

In IRAKOZE books at year end, an imbalance in the list of account balances was revealed. Investigation revealed the following errors.

- i) A sale of goods on credit for FRW 1,000,000 had been omitted from the sales account
- ii) Delivery and installation costs of FRW 240,000 on a new item of plant had been recorded as a revenue expense.
- iii) Settlement discount of FRW 150,000 on paying a supplier, had been taken, even though the payment was made outside the time limit.
- iv) Inventory of stationery at the end of the period of FRW 240,000 had been ignored.
- v) A purchase of raw materials of FRW 350,000 had been recorded in the purchases account as FRW 850,000.
- vi) The purchase returns day book included a sales credit note for FRW 230,000 which had been entered correctly in the account of the receivable concerned, but included with purchases returns in the general ledger.

Required: Prepare journal entries to correct each of the above errors. Narratives are not required.

Answer

			FRW'000'	FRW'000'
i)	DEBIT	Suspense	1,000	
	CREDIT	Revenue		1,000
ii)	DEBIT	Plant	240	
	CREDIT	Delivery cost		240
iii)	DEBIT	Purchases	150	
	CREDIT	Creditor		150

iv)	DEBIT	Inventory of stationery	240	
	CREDIT	Stationery expenses		240
v)	DEBIT	Suspense a/c	500	
	CREDIT	Purchases		500
vi)	DEBIT	Purchases returns	230	
	DEBIT	Sales returns	230	
	CREDIT	Suspense a/c		460

Example 2

An accountant of KAZUNGU LTD prepared a trial balance for his company for the month of December 2017, but failed to balance. The total on the debit side was more than the total on credit side by FRW 33,000. He opened a suspense account for the difference and proceeded to prepare final accounts.

During the month of January 2018 he discovered the following mistakes which had been made in December 2017:

1. Purchases account had been under cast by FRW 2,000
2. Payment of FRW 555,000 by cheque for insurance was properly recorded in the cash book but was posted to insurance account by mistake as FRW 515,000
3. A sales invoice of FRW 300,000 was not recorded in the sales day book and therefore not posted to the ledger
4. The credit side of the sales account was under added by FRW 4,000
5. Motor vehicle repairs costing FRW 50,000 was debited to Motor Vehicle account
6. Payment of FRW 680,000 cash to John a creditor was properly recorded in John's account but was wrongly recorded in cash book as FRW 670,000
7. The bookkeeper had made a mistake by debiting ledger fee of FRW 15,000 to the cash book but properly recorded in the ledger fee account
8. Sale of goods for FRW 600,000 on credit to Mbabazi was properly recorded in the sales account but was wrongly recorded in Uwimbabazi account
9. The bank column of the cash book credit side was over added by FRW 1,000

10. A credit note issued for FRW 800,000 was properly recorded in the customer's account but was wrongly recorded in the other account necessary for completion of double entry as FRW 820,000
11. Discount received of FRW 6,000 was debited to discount allowed account

Required: prepare journal entries to correct all the errors

Solution

KAZUNGU LTD general journal for correction of errors

	Account titles	LP	Dr	Cr
12.	Purchases Suspense		2,000	2,000
13.	Insurance Suspense		40,000	40,000
14.	Debtors Sales		300,000	300,000
15.	Suspense Sales		4,000	4,000
16.	Repairs Motor vehicle		50,000	50,000
17.	Suspense Cash		10,000	10,000
18.	Suspense bank		30,000	30,000
19.	Mbabazi Uwimbabazi		600,000	600,000
20.	Bank Suspense		1,000	1,000
21.	Suspense Returns inwards		20,000	20,000
22.	Suspense Discount allowed Discount received		12,000	6,000 6,000

6.4.2. Opening, preparing and clearing Suspense account

For the correction of errors affecting trial balances a suspense account is opened and the difference in the trial balance is posted in this account. If the debit side of a trial balance is smaller, then this amount is debited in the suspense account and when the credit side is smaller, then this amount is credited in suspense account.

Definition

A suspense account is a ledger account in which items owing to insufficient data are temporarily recorded i.e. when a difference in a trial balance is disclosed. For example, suppose that an accountant draws up a trial balance and finds that, for some reason they cannot immediately discover why the total debits exceed total credits by FRW 162,000. They know that there is an error somewhere, but for the time being they open a suspense account and enter a credit of FRW 162,000 in it. This serves two purposes:

1. Because the suspense account now exists, the accountant will not forget that there is an error (of FRW 162,000) to be sorted out.
2. Now that there is a credit of FRW 162,000 in the suspense account, the list of account balances.

When the cause of the FRW 162,000 discrepancy is tracked down, it is corrected by means of a journal entry.

It must be stressed that a suspense account can only be temporary. Postings to suspense account are only made when the bookkeeper does not know yet what to do, or when an error has occurred. Mysteries must be solved, and errors must be corrected. When all these errors are discovered and corrected, the balance on the suspense account is eliminated.

Example 1

Suppose it turned out that the accountant had accidentally failed to make a credit of FRW 162,000 to purchases. The journal entry would be:

DEBIT	Suspense a/c	FRW 162,000
CREDIT	Purchases a/c	FRW 162,000

To close off suspense a/c and correct error

Example 2

The bookkeeper of MURINZI Co made a transposition error when entering an amount for sales in the sales account. Instead of entering the correct amount of FRW 37,453,000 they entered FRW 37,543,000 transposing the 4 and 5. The trade receivable were posted correctly, and so when total debits and credits on the ledger accounts were compared, it was found that credits exceeded debits by FRW $(37,543,000 - 37,453,000) = \text{FRW } 90,000$

The initial step is to equalize the total debits and credits by posting a one sided debit entry of FRW 90,000 to a suspense account.

When the cause of the error is discovered, the double entry to correct it should be logged in the journal as:

DEBIT	Revenue	FRW 90,000
CREDIT	Suspense	FRW 90,000

To close off suspense a/c and correct transposition error

- 1) Typically, they are two main reasons why suspense accounts may be recorded.
- 2) On the extraction of the trial balance, the debits are not equal to the credits and the difference is put to a suspense account.
- 3) Of course, the other one is when the book keeper performing double entry is not sure where to post one side of an entry he may debit or credit a suspense account.

Example 3:

From the above example of KAZUNGU LTD, prepare a suspense account

Solution

Debit	Suspense a/c		Credit
	FRW		FRW
Sales	4,000	Bal b/d difference in the trial balance	33,000
Cash	10,000	Purchases	2,000
Bank	30,000	Insurance	40,000
Returns inwards	20,000	Bank	1,000
Discount allowed	6,000		
Discount received	6,000		
	76,000		76,000



Application activity 6.4

You are assisting the accountant of Nara Ltd in preparing the accounts for the year ended 31st December 2020. You draw up a trial balance and you notice that the credit side is greater than the debit side by FRW 5,608,000. You entered this difference in a suspense account.

On investigation, the following errors and omissions are found to have occurred.

- a) An invoice of FRW 1,328,000 for general insurance has been posted to cash but not to the ledger account.
- b) A customer went into liquidation just before the year end, owing Nara Ltd FRW 428,000. The amount was taken off trade receivables but corresponding entry to expense the irrecoverable debt has not been made.
- c) A cheque paid for purchases has been posted to the purchases account as FRW 5,296,000 when the cheque was made out for FRW 5,926,000
- d) Motor insurance for the year for FRW 1,611,000 was credited to distribution expenses.

Required:

- i) Show the journal entries required to clear the suspense account
- ii) Show the suspense account in ledger account form.



Skills Lab

Preparing the trial balance as at 31st March 2020, the difference was FRW 130,000 debit. Following on your inquiry, the following errors and omissions were rectified in the relevant accounts.

- i) A balance on a customer's account who owed FRW 10,000 had been listed as FRW 100,000
- ii) A sum of FRW 20,000 which was part of the bad debts amount w/o in 2019 was recovered in January 2020 and had been debited to bad debts account.
- iii) Rates paid in advance at 1st April 2019 of FRW 15,000, correctly dealt within the previous year's accounts, had not been entered in the rates account for the current year.

- iv) Closing stock at cost FRW 150,000 had been wrongly entered on stock-sheets as FRW15,000
- v) Goods returned by a customer valued at FRW 10,000 had been entered in the sales ledger only.
- vi) Discounts received correctly entered in the cash book at FRW 25,000 had not been transferred to the discounts received account.

REQUIRED:

Preparation of suspense account to reflect the correcting entries




End of unit assessment

1. When posting an invoice for car repairs, FRW 870,000 was entered on the correct side of the motor expenses account. The invoice was for FRW 780,000. What correction should be made to the motor expenses account?
 - i) Debit FRW 90,000
 - ii) Credit FRW 90,000
 - iii) Debit FRW 1,650,000
 - iv) Credit FRW 1,650,000
5. A suspense account shows a credit balance of FRW 130,000. This balance could be due to which of the following?
 - i) Omitting a sale of FRW 130,000 from the receivables account
 - ii) Recording a purchase of FRW 130,000 twice in the purchases account
 - iii) Failing to write off a bad debt of FRW 130,000
 - iv) Recording an electricity bill paid of FRW 65,000 by debiting the bank account and crediting the electricity account.
5. UWAYO's trial balance includes a suspense account with a credit balance of FRW 280,000. She has discovered that a supplier's invoice for FRW 140,000 was entered twice in the purchases day book. What is the balance on the suspense account after this error is corrected?
 - A FRW 0
 - B FRW 140,000 credit
 - C FRW 280,000 credit
 - D FRW 420,000 credit

UNIT 7

CONTROL ACCOUNTS

 **Key unit competence:** To be able to prepare control accounts



Introductory activity

While preparing a trial balance after drawing up UMULISA's lists of debtors' and creditors' balances at the end of the period, it was challenging to have the debtors' and creditors' balance carried down to be included in a trial balance as they are drawn from several personal ledger accounts. It was further noticed that some errors were committed due to UMULISA's insufficient skills in bookkeeping. Required: (i) Which approach UMULISA can use to ensure that the information provided don't contain errors that could be very difficult to find (ii) As someone with accounting skills, advise her on what to do in order to find out the appropriate balances to be recorded in a trial balance.

7.1 Meaning and purpose of control account

Activity 7.1



Sales day book and purchases day books are totaled periodically (often a month). The individual entries in day books will have been entered one by one in the appropriate personal accounts contained in the receivables and payables ledgers. As these personal accounts are not part of the double entry system, their appropriate balance or total of day books are posted to other accounts to check the accuracy of entries made in the debtors and creditors personal accounts.

1. How do we call those accounts in which these balances are posted?
2. What is the purpose of preparing those accounts?

7.1.1. Meaning of Control Account

Control account is a summary account appearing in the general ledger for the purpose of controlling all the detailed entries in the ledger to which it relates. It is a total account inserted in a ledger to make itself balancing. Control accounts are also referred to as total accounts because it is only totals from day books or other subsidiary books of account which are posted to them.

The balance in a control account should be the same as the total of the individual balances extracted from the related subsidiary ledger giving proof of the arithmetical accuracy of the book-keeping entries in the ledger.

Control accounts in the general ledger represent the total of all the accounts in some other ledgers. The accuracy of these ledgers is proved by the control accounts and they are also called as self-balancing ledger or adjustment accounts. Control accounts are used chiefly for receivables and payables.

7.1.2. Purpose of control accounts

Check the accuracy of entries made in the personal accounts

They provide a check on the accuracy of entries made in the personal accounts in the receivables ledger and payables ledger. It is very easy to make a mistake in posting entries, because there might be hundreds of entries to make. Figures might get transposed. Some entries might be omitted altogether, so that an invoice or a payment transaction does not appear in a personal account as it should.

- a) Compare the total balance on the receivables control account with the total of individual balances on the personal accounts in the receivables ledger.
- b) Compare the total balance on the payables control account with the total of individual balances on the personal accounts in the payables ledger.

It is possible to identify the fact that errors have been made.

Assist in the location of errors

Where postings to the control accounts are made daily or weekly, or even monthly, the control accounts could also assist in the location of errors. If errors are made in the ledger, the control A/C will not reconcile with individual balances extracted from the subsidiary ledgers. When a control account does not reconcile with the sum of individual balances extracted from the subsidiary ledger, it may be an indication that some errors were made.

Detection of fraud

Since all entries pass through the control A/C, it is very easy to detect fraud committed by manipulation of accounts in the ledger. Control accounts are normally under the charge of senior or responsible officials who have the responsibility of controlling fraud. If a control account balance is different from the sum of individuals' accounts, then either fraud or mistakes were committed. Control accounts strengthen an organization's internal control by detecting and checking fraud and also location and therefore correction of errors.

Internal check where there is separation of bookkeeping duties

Where there is a separation of clerical (bookkeeping) duties, the control account provides an internal check. The person posting entries to the control accounts will act as a check on a different person whose job is to post entries to the receivables and payables ledger accounts.

A balance can be extracted quickly for producing a trial balance or statement of financial position

To provide receivables and payables' balances more quickly for producing a trial balance or statement of financial position, a single balance on a control account is obviously extracted more simply and quickly than many individual balances in the receivables or payables ledger. This means also that the number of accounts in the double entry bookkeeping system can be kept down to a manageable size, since the personal accounts are memorandum accounts only and the control accounts instead provide the accounts required for a double entry system.

Note that while this may be an arrangement, control accounts are the accounts that serve the role of memorandum account

Enhancing management efficiency

Control accounts enhance management efficiency because creditors' and debtors' balances can be obtained at first glance on a duly balanced-off (closed) control accounts. The speed at which these figures are obtained is faster. This saves time wasted in balancing-off and adding up all individual debtors' or creditors' balances.

Determination of credit sales and credit purchases

In single entry and incomplete records and in Receipts and Payments accounts, the credit sales and credit purchases are often missing. These figures can be determined by constructing control accounts.



Application activity 7.1

Referring to the activities of previous lessons:

- i) What is a control account?
- ii) Why is it necessary to have control accounts in a business organization? Justify your answer.

7.2 Sales Ledger control account/ Debtors' control account



Activity 7.2

Below are the total balances from total lists of individual debtors accounts in the books of MURENZI Enterprises operating in Muhanga District:

	FRW
Debtors balance	10,000
Cash received from debtors	8,000
Discount allowed	500
Sales returns	1,000

From this information, give the name of control account to be prepared by MURENZI's accountant.

7.2.1 Meaning of Sales ledger control account / Debtors' control account

Debtors control account reflects the total amount owed by all individual debtors. The balance of the debtors control account must be equal to the total of debtors list, which represents the amounts owed by the individual debtors obtained from the individual balances in the various subsidiary ledger accounts for each debtor. This subsidiary ledger is known as the debtor's ledger.

The debtors' control account or accounts receivable control account balance should reconcile with the sum of all individual debtors' balances extracted from debtor's subsidiary ledgers also known as the sales ledger.

7.2.2 Information for debtors' control account

Sales ledger control accounts	Sources
1. Opening debtors	List of debtor's balances drawn up at the end of the previous period
2. Credit sales	Total from sales journal
3. Return inward	Total of returns inward journal
4. Cheque received	Cash book: bank column on received side. List extracted or total of a special column which has been included in the cash book.
5. Cash received	Cash book: cash column on received side list extracted or total of a special column which has been included in cash book.
6. Closing debtor	List of debtors' balances drawn up at the end of the period
7. Contra	When debtors are at the same time creditors

Entries

Format of a Sales Ledger control account/ debtors control account

Debit		Credit	
Bal b/d	XX	Bal b/d	XX
Penalty	XX	Bad debts	XX
Bad debts recovery	XX	Bank/cash	XX
Credit Sales	XX	Discount allowed	XX
Right entry	XX	Contra	XX
Debtor's Refunds	XX	Wrong entry	XX
Dishonored cheque (bank)	XX	Sales return	XX
Total of other charges (from journal or sales day book).	XX		
Interest on overdue account	XX	Balance C/D	XX
Balance C/D	<u>XX</u>		

Because totals are used, the accounts are often known as Total accounts. Thus a control account for a sales ledger could be known as either sales ledger, control account or as a total Debtors control A/C

ILLUSTRATION 1

The following information was obtained from the books of UWINGENEYE relating for the year ended 31st December 2021:

Date	Details	FRW
Jan	Sales ledger balance b/f	218,000
	Totals for the month 31 st :	
	Dec total credit sales	825,000
	Total cash received from customers	300,000
	Total discounts allowed	39,500
	Total returns from customers	63,800
	Total bad debts written off	9,800
	Total refunds to customers	20,000
	Total cheques received from customers	25,000
	Total dishonored cheques	12,800

Required: Prepare a debtors' control account.

Answer

Debit	Debtor's control account		Credit
	FRW		FRW
Balance	218,000	Total cash from customers	30300,000
Total credit sales	825,000	Total discounts allowed	39,500
Total refunds to customers	20,000,	Total returns from customers	63,800
Total dishonored cheques	12,800	Total bad depts W/O	9,800
		Total cheques from customers	25,000
		Bal c/d	<u>637,700</u>
	<u>1,075,800</u>		<u>1,075,800</u>

ILLUSTRATION 2

The following details were extracted from the books of ABC Ltd Company for the year ended 31st/12/2016.

	FRW
Debtors' balance 1/1/2016	4,000,000
Cash received from debtors	25,000,000
Bad debts written off	100,000
Sales returns	200,000
Debtors cheques dishonored	150,000
Discount allowed	700,000
Credit sales	30,000,000

Required: From the above information, prepare a debtors' control account.

Answer

Debit	Debtor's control account	Credit	
	FRW	FRW	
Bal b/d	4,000,000	Cash	25,000,000
Debtors cheque dishonored	150,000	Bad debts w/o	100,000
Credit sales	30,000,000	Sales returns	200,000
		Discount allowed	700,000
		Bal c/d	8,150,000
	<u>34,150,000</u>		<u>34,150,000</u>



Application activity 7.2

1. A business maintains a receivables ledger control account. A debt of FRW 1,500,000 is to be written off. Which of the following entries is correct (ignore VAT)?
 - a) Debit: Personal account of the customer, credit irrecoverable debts expense, FRW 1,500,000
 - b) Debit: irrecoverable debts expense, credit: receivables ledger control, FRW 1,500,000

c) Debit: receivables ledger control, credit: irrecoverable debts expense, FRW 1,500,000

d) Debit: irrecoverable debts expense, credit: personal account of the customer, FRW 1,500,000

2. The following information was extracted from the books of Mugisha and Co. Ltd for the month of June 2020

		FRW
sales ledger balances June 1	Dr	1,634,200
	Cr	64,300
Credit sales		1,734,380
Cash sales		389,590
Cheque received from customers		1,325,250
Petty cash received from debtors		24,240
Interest charged to debtors on overdue Accounts		15,460
Debtors cheque dishonored		33,800
Debt collection expenses charged to debtors		9,760
Discount allowed		304,340
Returns inwards		19,770
Bad debts written off		18,600
sales ledger debit balance transferred to purchases ledger		22,800
sales ledger balance June 30	Cr	35,900

Prepare a sales ledger control account.

7.3 Creditor's control account/ purchases ledger control account

Activity 7.3



These are the total balances from total lists of individual creditors' accounts in the books of KAREKEZI Enterprises operating in Gicumbi District:

FRW

Creditors' balance	10,000
Cash paid to creditors	8,000
Discount received	500
Purchases returns	1,000

From this information, give the name of control account to be prepared by KAREKEZI's accountant.

7.3.1. Meaning of Creditor's control account/ purchases ledger control account

Creditors' control account reflects the total amount owed to all the individual creditors. The balance of the creditors control account must equal the total of the creditors list, which represents the amounts owed by the individual creditors obtained from the individual balances in the various subsidiary ledger accounts for each creditor. This subsidiary ledger is known as the creditors' ledger.

The creditors control account balance should reconcile with the sum of all creditors' balances extracted from the creditors subsidiary ledger (purchases ledger). In this way, a creditors' control account is like a trial balance for the subsidiary ledger to which it relates.

7.3.2 Information for creditors' control account

Purchases/creditors' ledger control accounts	Sources
1. Opening creditors	List of creditor's balances drawn up at the end of the previous period.
2. Credit purchases	Total from purchases journal
3. Return outwards	Total of return outwards journal

4. Cheque paid	Cash book: bank column on payment side. List extracted or total of special column which has been included in the cash book
5. Cash paid	Cash book: cash column on payment side. List extracted or total of special column which has been included in the cash book.
6. Closing creditors	List of creditors' balances drawn up at the end of the period.
7. Contra	When creditors are at the same time debtors

Entries

Dr	Format of creditors Control account	Cr
Bal b/d.....xx	Bal b/d.....xx	
Bank/cash A/C.....xx	Credit purchases.....xx	
Purchases return.....xx	Refund.....xx	
Dicount received.....xx	Dishonored cheque xx	
Contra.....xx		

ILLUSRATION 1

From the following information, prepare the creditors control account

Date	Details	Amount	FRW
1 Jan 2021	Purchases ledger balance b/f		950,000
	Totals of the month:		
	Total credit purchases		3,355,000
	Total returns outward		469,000
	Total discount received		244,000
	Total cheque paid to suppliers		2,060,000
	Total cash paid to suppliers		580,000

Answer

Creditor's control a/c

Debit		Credit	
	FRW		FRW
Total returns outwards	469,000	Balance b/d	950,000
Total discounts received	244,000	Total credit purchases	3,355,000
Total cheques paid to suppliers	2,060,000		
Total cash paid to suppliers	580,000		
Bal c/d	952,000		
	4,305,000		4,305,000

ILLUSTRATION 2

The following details were obtained from the books of a company for the year ended 31st December 2020:

	FRW
Creditors' balances 1/1/2020	2,500,000
Cash paid to suppliers	16,000,000
Credit purchases	17,000,000
Purchases returns	300,000
Discount received	500,000

Required: Prepare creditors' control account.

Answer

Debit		Creditors' control a/c		Credit	
	FRW		FRW		FRW
Cash paid to suppliers	16,000,000	Bal b/d	2,500,000		
Discount received	500,000	Credit purchases	17,000,000		
Purchases returns	300,000				
Bal c/d	2,700,000				
	19,500,000				19,500,000

Notes

1. Contra Entries: In a control A/C we will most likely find that a debtor's A/C has debit and credit balance. This situation arises because some debtors are also creditors. If a debtor who is also a creditor has no balance on the

debtor A/C, then the balance on the creditors A/C cannot be noted off and it must therefore remain in the debtors' ledger as the credit balance (contra). This scenario can also happen in the creditor's A/C. Hence, it is also common in control A/Cs to find a creditor's A/C has a small debit balance and a bigger credit balance.

2. When writing up control accounts imagine you are writing up the personal accounts but in totals. It means items debited in a personal account will be debited in the control account also and vice versa. It is clear that the final balance of the control accounts for particular sales and purchases should agree with the total of the balances in the individual accounts in the ledger.
3. Control accounts are prepared on monthly basis. Control a/c balances are shown in the trial balance on the assumption that all entries in the debtors' and creditors' ledger are correct and later transferred to the balance sheet either as current Assets (Debtors) and current liabilities for (creditors).
4. Credit balance in the debtor's ledger and debit balance in the Creditor's ledger: sometimes, a debtor's account might have a credit balance and a Creditors a/c a debit balance. Such a situation would arise due to more cash received from debtors or paid to creditors. Any credit balances on accounts in the debtors' ledger will be shown as credit balance on debtors control account. Any debit balances on accounts in the creditor's ledger will be shown as a debit balance on the creditors control a/c.



Application activity 7.3

The following information was extracted from the books of CYUSA Ltd for the month of January 2021

		FRW
Purchases ledger balances January 1	Dr	32,530
	Cr	1,502,400
Credit purchases		1,435,520
Cash purchases		550,000
Cheque paid to suppliers		1,436,300
Petty cash paid to creditors		13,860
Interest charged by creditors		9,760
Debtors cheque dishonored		33,800
Discount received		128,500

Returns outwards		20,000
sales ledger debit balance transferred to purchases ledger		22,800
Purchases ledger balance January 30	Dr	18,600

Prepare a sales ledger control account.

7.4 Control account reconciliation

Activity 7.4



UWAMAHORO is a sole trader operating her business in Rubavu District buying and selling fish. When preparing the debtors' and creditors' control accounts at the end of a month, their balances failed to agree with the total debtors' and creditors personal individual accounts due to lack of sufficient accounting skills.

1. What may be the causes of disagreement between control account and personal ledger accounts?
2. Advise UWAMAHORO on what to do in order to get the same balance in debtor' and creditors' personal ledger accounts with control accounts

7.4.1 Importance of sales account/purchases account control reconciliation

A control account, as earlier explained, acts as a trial balance or a check to correct double entries in the ledger. It follows therefore that the balance carried down on a control account must equal the total of list of balances in the concerned ledger account. For instance, the balance carried down in the creditors' or debtors' control account. Where a difference occurs, it is an indication of an error. If the error is located, an attempt is made to reconcile both balances by correcting the double entries as required.

ILLUSTRATION 3

An accountant prepared a debtors control account. The balance on the account was FRW 27,000,000 on 31/12/2019. The list of balances from individual debtors' ledger accounts amounted to FRW19,600,000 on 31/12/2019.

The following errors were located:

- a) Cash of FRW 540,000 received from debtors was correctly entered in the cash book but entered as FRW 1,540,000 in the control account.
- b) Sales returns of FRW 600,000 were entered on the wrong side of the debtors control account.
- c) A cheque of FRW 500,000 received from a debtor was dishonored. This was entered only in the sales ledger and not in the control account.
- d) Bad debts amounting to FRW 2,000,000 were written off in the sales ledger but no entry was made in the control account.
- e) A sale of goods to James for FRW 1,500,000 on credit was omitted from the control account
- f) On a certain day, the sales day book's total was FRW 20, 800,000 but was posted to control account as FRW 28,000,000.

Required: Make corrections to the control accounts so that the adjusted control account balance reconciles with the list of individual debtors' balances

Debit	Debtor's Control A/C	Credit
	FRW	FRW
Bal B/F (Unadjusted)	27,000,000	
Cash Deducted Wrongly	1,000,000	Sales Returns Posted on wrong account
Dishonored Cheque	500,000	1,200,000
Credit Sales	1,500,000	Bad Debts
		2,000,000
		Overstated Sales
		7,200,000
		Bal. C/D - Adjusted
		19,600,000
	<u>30,000,000</u>	<u>30,000,000</u>

Note: the control account should have shown a balance of FRW 19,600,000 on 31/12/2019 which reconciles with the total of individual debtors' balances on the same day. The closing balance of FRW 27,000,000 in the control account is wrong.

ILLUSTRATION 4

MAHORO operates control accounts in the nominal ledger. On June 30 2004, the following amounts were obtained from his ledger.

Debtors control accounts balance (debit) FRW 960,000

Creditors control account balance (credit) FRW 375,000

A list of balances from debtors and creditors on 30 September 2004 were as follows:

Total debtor's balances FRW 829,000

Total creditors balances FRW 320,000

The following errors were later discovered:

- 1) The sales day book had been overcast by FRW 115,000 and purchases day book under cast by FRW 63,000.
- 2) Returns inwards totaling FRW 33,000 for the month of September had not been posted to the control account.
- 3) A credit balance in the purchases ledger of FRW 25,000 had been omitted from the list of balances.
- 4) An amount of FRW 28,000 in the purchases ledger has been set off against a contra account in the sales ledger but this is not recorded in either of the control accounts.
- 5) A sum of FRW 13,000 being discount received was correctly entered in the cash book but was over casted by FRW 64,500 in the respective personal account.
- 6) A dishonored cheque of a customer for FRW 45,000 had not been entered in the control accounts.

Required:

- i) Entries in the debtors control account and creditors control account.
- ii) A corrected statement showing the total of the debtors and creditors balances

Solution

i)

Dr	Corrected debtor's control account		Cr
2004	FRW	2004	FRW
Sept 30 Balance b/d	960,000	Sept 30 sales overcast	115,000
Sept 30 Bank: Dish. cheques	45,000	Sept 30 Returns inward	33,000
		Sept 30 set off: purch. Ldger	100,000
		Sept 30 Balance c/d	28,000
			829,000
	<u>1,005,000</u>		<u>1,005,000</u>
Oct 1 bal b/d	829,000		

Dr	Corrected debtor's control account		Cr
2004	FRW	2004	FRW
Sept 30 set off: sales ledger	28,000	Sept 30 balance b/d	375,000
Sept 30 Balance c/d	45,000	Sept 30 purchases under cast	63,000
	<u>438,000</u>		<u>438,000</u>
		Oct 1 Balance b/d	410,000

ii)

a) Total of debtor's balance:	FRW
Balance brought forward	829,000
b) Corrected total of creditors balance:	FRW
Balance brought forward	320,500
Add:	
Credit balance omitted	25,000
Overcast of discount received	64,500
Balance as per the corrected	
Creditors control A/C	<u>410,000</u>

Skills Lab



The following figures were extracted from the books of MUTESI Ltd for the month of June 2017

		FRW
Purchases ledger balances 1st June	Dr	3,500
Sales ledger balances	Cr	184,600
	Dr	476,000
Credit purchases	Cr	13,500
Credit sales		394,000
Cash sales		689,400
Cash sales		206,000
Returns inwards		44,000
Returns outwards		25,000
Receipts from trade debtors		8,900
Payment to trade creditors		526,000
Discounts received		386,400
Discounts allowed		47,500
Bad debts written off		69,900
Interest charged to debtors		12,400
Debtors' cheque dishonored		3,600
Purchases ledger credits transferred to sales ledger		8,700
Purchases ledger balances 30th June		12,300
Sales ledger balances	Dr	4,800
	Cr	16,900

Required: From the above information, prepare the Debtors Ledger and Creditors ledger control accounts.



End of unit assessment

1. Define a control account
2. Which of the following items will appear as an item posted to the payables ledger?
 - a) Irrecoverable debts written off
 - b) Returns inwards of the period
 - c) Trade discounts received in total in the period
 - d) Settlement discounts received in total in a period
3. The following entries appeared in the receivables ledger control account for June. Balance b/f 1 June FRW 7,500,000, sales FRW 20,000,000, receipts from customers FRW 8,000,000, irrecoverable debts written off FRW 900,000. What was the balance at 30 June?
 - a) FRW 3,600,000
 - a) FRW 19,500,000
 - b) FRW 20,400,000
 - c) FRW 18,600,000
4. The trial balance of MULIHANO, a trader taken out on 30th September, 2019 failed to agree. To help locate the error, he prepared sales and purchases control accounts from the following information:

	FRW
Sales ledger debit balances (1/10/2003)	227,200
Sales ledger credit balances (1/10/2003)	420
Purchases ledger debit balances (1/10/2003)	1,270
Purchases ledger credit balances (1/10/2003)	147,200
Balances for the year to 30/9/2004:	
Credit sales	402,120
Credit purchases	160,560
Sales returns	2,120
Purchases returns	4,500
Cash payments to creditors	222,700

Bad debts written off	4,700
Cash received from debtors	411,000
Dishonored cheques	9,000
Carriage charged to customers	3,600
Discounts allowed	20,110
Discounts allowed on dishonored cheques	450
Debit balances in sales ledger transferred to purchase ledger	2,000

The list of balances extracted from the personal ledgers was as follows:

	FRW
Debtors: Debit balances	206,160
Credit balances	540
Creditors: Debit balances	83,115
Credit balances	825

Required:

- a) Prepare control accounts
- b) State the amount of the error and in which ledger it occurred.

UNIT 8

RECEIVING MONEY AND THE BANKING SYSTEM



Key unit competence: To be able to explain banking system



Introductory activity



Observe the above picture and answer the questions below.

1. Enumerate the components of banking system in Rwanda
2. Define clearing system
3. State the procedures for preparing pay-in-slip
4. What are the factors to be considered by a teller before processing cheques of bank customers?

8.1 The banking system

Activity 8.1



The Central Bank supervises and controls the operations of the formal financial sector. There are currently 16 commercial banks in Rwanda and a number of microfinance institutions and rural savings and credit co-operatives. You are required to differentiate commercial banks with Microfinance institutions.

8.1.1 Banking system in Rwanda

There are various ways that business can receive money, the main methods are:

- Cash
- Cheque
- Credit and Debit cards
- Electronic receipts

Banking procedures for various kinds of receipts should be fully understood and you should observe whenever transactions are possible. This lesson concerned with the practical aspects of banking the payments received by business. Before dealing with these aspects however it would be useful to understand some background details about the clearing bank system.

The banking system in the Rwanda consists of the following components:

- a) The national bank of Rwanda (BNR) is the central bank which regulates and play a supervisory role over the banking industry
- b) Clearing banks, retails banks or banks which provide microfinance service include:
 - i) Urwego Opportunity bank
 - ii) Copedu ltd
 - iii) Equity bank Rwanda limited
 - iv) Banque populaire du Rwanda ltd
 - v) Bank of Kigali

Note: Note: this is not an exhaustive list of Rwandan banks – Rwanda has around 16 banks including development bank and cooperative banks. We also have currently above 400 institutions that provide microfinance services including Umurenge SACCOs. There is currently an initiative aiming at consolidating these microfinance institutions to reduce them down to 30 institutions across the country

- c) Microfinance services which are a type of banking service that is provided to unemployed or low income individuals or group who otherwise have no access to financial services. Small loans are made so that people can start and operate a business. The borrowers pay back the loan over time.

Banking financial intermediaries and non-banking financial intermediaries

Banking financial intermediaries are financial institutions that accept deposits and create credit or extra deposits by use of cheques. They extend loans to borrowers using part of primary deposits and extra deposits created. Commercial banks are an example of banking financial intermediaries.

Non-banking financial intermediaries: these are financial institutions which do not create credit or extra deposits by use of cheques or which do not receive deposits at all.

They extend loans to the borrowers using primary deposits got from surplus lending units

Example of non-banking financial intermediaries

- Insurance companies
- Pension funds
- Development bank

Banking financial Intermediaries

Create credit
Short term lending
High interest loans
Use of cheques

Non-Banking financial Intermediaries

Do not create credit
Long term lending for some
Low interest loans
Don't use of cheques

8.1.2 The clearing system

Clearing is the mechanism for obtaining payment for cheques.

Banks settle cheques and credits through the clearing system. Once the values of cheques passed between the banks at the end of particular day's clearing have been determined, the resulting debts arising between the banks need to be settled.

For Example, Urwego Opportunity bank may be asking for settlement of equivalent of frw 20,000 million worth of cheques drawn on Copedu Ltd bank paid in by its customers into their accounts at local branches. In turn Copedu

Ltd may have Frw 25,000 million worth of Urwego Opportunity cheques paid into branches of Copedu bank Ltd.

	FRW'm
Urwego Opportunity Bank owes Copedu Ltd	25,000
Copedu Ltd owes Urwego Opportunity Bank	20,000
Net debt: Urwego Opportunity bank owes Copedu	5,000

In short, at the end of a day's banking, banks owed money to other banks, and are owed money in return. These debts are settled through accounts which the banks maintain at the national bank. The balances on these accounts are termed operational balances.

8.1.3 Banking Services

Retail banking

Traditionally the main services offered by banks to their customers were current accounts and savings accounts. In recent years however the range of services has expanded so that now the retail banks may offer.

- Credit cards
- Investments
- Share dealing
- Loans
- Home insurance
- Travel insurance
- Foreign currency
- Pet insurance
- Wealth management

In addition, branches will have specialist accounts and services for business customers and may have advisors available to deal with the requirements of large and small commercial enterprise.



Application activity 8.1

1. What is the bank clearing system?
 - A It is the mechanism for obtaining payment for Cheques
 - B It moves cash between banks
 - C It sets credit levels for banks' business customers
 - D It arranges long term loans for bank customers

2. Groupe Scolaire Mater Dei Nyanza is a Boarding School located in Southern Province; Nyanza District. It has a bank account in bank populaire, its cheques equivalent to Frw 12,000,000 was drawn in Bank of Kigali, and in turn, bank populaire have paid Cheques of client of bank of Kigali equivalent to Frw 18,000,000.

How much each bank should be reimbursed?

8.2. Remittance advices

REMITTANCE ADVICE				
Tel:252525		TIN:100000000		
Advice :6/151		Remittance		
		Date:10 July 2021		
Name of company		Account number:		
Address				
Date	Invoice Credit note number	Invoice	Credit note	Payment
03/05/2021	Invoice No 3189	480.00		480.00
11/6/2021	Credit Note No 118		86.40	(86.40)
TOTAL PAYMENT				<u>393.60</u>

Activity 8.2



Observe the picture above and answer the following questions

- Which of the following statements is true with respect to a remittance advice note?
 - It is sent to a customer to advise them of the amount due
 - It is sent to the bank to instruct them to make a payment
 - It is sent to a supplier to advise them of the amount being paid
 - It is an internal document recording amounts received from customers

2. Anna sends cheques to a supplier and encloses with it a document detailing the invoice being paid. What is this document called?
 - A Supplier's statement
 - B Debit note
 - C Remittance advice
 - D Remittance list
3. Narvinda buys goods from Jamal for \$ 2,500. He returns half of the goods on 15 May. Which of the following documents would be issued by Jamal for the return of the goods?
 - A Invoice
 - B Credit note
 - C Debit note
 - D Remittance advice
4. Malindra sent a payment to Nicholas along with a document detailing the items and invoices the payment related to. What is this document known as?
 - A Debit note
 - B Credit note
 - C Remittance advice
 - D Delivery note
5. What is the document that a business sends to customers to summarise transactions at the end of an accounting period?
 - A Remittance advice
 - B Statement of account
 - C Credit note
 - D Invoice
6. What is the purpose of a remittance advice?
 - A It provides details of amounts being paid
 - B It identifies goods that have been received by the business
 - C It identifies goods that have been dispatched by the business
 - D It provides details of Cheques to be issued

Receipts will be accompanied by documentation. This enables the receiving business to check that the correct amount is accurately processed and recorded. For example, Tax revenues will be recognized in the books of accounts when cash is received. Cash is considered as received when notification of tax remittance is received.

Documentation Advices

Documents which are used to record transactions in the books of account of the company are called source documents. Source documents were covered in details in detail in unit 1 of this text. When a cheque arrives from a trade (business) customer, it is usually accompanied by a remittance advice.

A remittance advice shows which invoices a payment covers.

For example, LB Company sends a cheque payment of RWFFRW 37,360,000 to NT Company this payment is accompanied by remittance advice note explaining the invoice and credit note that the payment relates to



Application activity 8.2

1. J. Savério has a key customer, Cyprien Rugamba. The terms of the agreement are that Cyprien Rugamba settle amounts due to J. Savério on the last day of the month following the month of invoice, with credit notes being settled in that same period too.

A remittance advice note must accompany payments.

Below is an extract from J. Savério's sales ledger showing recent transactions with Cyprien Rugamba and an uncompleted remittance advice note.

Cyprien Rugamba

Date 20X8	Details	FRW'000	Date 20X8	Details	FRW'000
14 Feb	Invoice 4560	8,472	16 Feb	Credit note 56	332
15 Mar	Invoice 4591	3,295	27 Mar	Credit note 67	875
19 Mar	Invoice 5003	2,031	31 Mar	Bank	7,265
12 Apr	Invoice 5115	4,067			

Complete the remittance advice note as at 30 April 20X8

2. Cyami Ltd sold FRW 100,000 worth of goods to Maso Co in November 2020 and the sales to Maso will grow at the rate of 10% per month. All sales made by Cyami Ltd to Maso Co are on credit and it is estimated that 60% of sales made to Maso Co will be paid in the month following sale; the remaining will be paid two months after sale. All Payment from Maso Co to Cyami Ltd are done by end of month and these are accompanied by a remittance advice. How much will appear on the remittance advice as at 28 February 2021

A FRW 133,100

B FRW 106,000

C FRW 116,600

D FRW 128,260

8.3 Banking cash

Capital 5.005.000.000 Frw
 B.P. 175 Kigali
 Tél : (+250) 719888880
 (+250)
 Téléx: 0000
 Téléfax : (+250) 02536637738
 TVA : 00

R.C.A 019 KIGALI
 Télégr.: Kigalibank
 KGLBANK RW
 SWIFT BKIGRWRW

Cash Deposit Slip / Versement en espèces

RWF 20 000

Beneficiary / Bénéficiaire :
 Account/Compte N°
 Of / de

Twenty thousand francs RWF
 (in words / en lettres)

Paid in by / Déposant
 Name / Nom : KANIMBA Jean
 Address / Adresse :

Comment / Observation
 Mortgage Reg fees

Date & Signature of Deposit
 Date et signature du Déposant
 16th 03 2021

Total en compte
 Total deposited

A rendre
 Given back

DETAIL	
X 5000	
10 X 2000	
X 1000	
X 500	
X 100	
X 50	
X 20	
X 10	
X 5	
X 1	
TOTAL	

The bank is not liable for errors in the creditor's account number
 La banque décline toute responsabilité en cas d'indication erronée du numéro de compte à créditer

Stamp / Cachet

For Bank use only / Réservé à la Banque

L.P.N

Activity 8.3



From the picture answer the following questions

1. What are the qualitative characteristics of paying in slips?
2. State Procedures for preparing a paying-in slip

8.3.1 The paying-in slips

When a business or an individual wants to pay money into the bank, then normally a paying-in slip must be used. The bank treats this as a kind of summary document which 'totals up' the cash (or other forms of money) which is being banked.

A paying-in slip will look similar to the one shown above.

Pay-in-slip is an outline presented in banks and is used to deposit money into a bank account. Each pay-in-slip has a counterfoil which is returned to the depositor accordingly sealed and signed by the bank officer. This source document relates to bank transactions. When an individual needs to deposit checks or cash in his bank account he usually fills out a slip to show the number of his account, the date, and the details of the deposit. Some deposits will consist of checks, and the depositor will list each check with the check number and the whole amount of the deposit. **Pay-in-slip** gives details regarding date, account number, the amount deposited (in cash or cheque), and the name of the account holder and approval.

The Importance of the Paying –In Slip

- Bank printed pay-in-slip provided by the bank free of charge is used by the account holder for depositing cash as well as cheque into his bank account
- Copy of pay-in-slip remains with the bank after depositing cash or cheque into the bank. This part of the pay –in –slip is used by the bank for making entries in the registers of the bank.
- Pay-in-slip can be used as legal evidence or documentary proof of cash or cheque deposited into the bank
- Business and company can use pay-in-slip for entries in cashbook
- Pay-in-slip is useful to the auditor to verify the entries passed in the cashbook

8.3.2 Procedure for Preparing a Paying –In-Slip

The following procedures are good practice to follow when preparing money for banking

Step 1 Count the cash as described above.

Step 2 Add up, on a separate piece of paper, how much cash you are banking.

Step 3 Compare the calculated total to the total according to the cash register.

Step 4 Calculate any discrepancy between the cash counted and the cash register total. If it is large then it should be investigated, but if it is small then it may be ignored, depending on company Policy.

Step 5 Enter the total for each denomination of note in the appropriate place on the paying in slip.

Step 6 Add up the numbers again to check the total and enter it in the 'total cash' box.

8.3.3 Security

Holding cash creates problems and careful Security procedures are required

Theft by staff

This risk can be reduced by being careful about the people the business employs; their references should be checked properly and they should be monitored closely for their first few months of work

Cash register security

The cash register should be secure, with keys needed to operate it. Staff should be trained to make them aware of the importance of keeping their keys safe and of not leaving the cash register open. Cash registers which are activated by different keys unique to each member of staff can give a breakdown of sales by staff member. This is another aid to preventing theft, as it will indicate staff who are not entering sales and pocketing the customer's money.

Safes

If possible, cash should be removed from the till regularly (so that there is only a relatively small amount in the till) and stored in a safer place. The ideal place would be a safe.

The safe should be in a place out of view of the customer. The number of safe keys should be kept to a minimum and access to the keys should be restricted.

Frequent banking

In general, cash should be taken to the bank on a regular and frequent basis; this minimizes the amount of money on the business premises. This may be particularly important if the amount of money the business can hold is limited under its insurance policy.

It is not a good idea to let the same person go to the bank every day at the same time. For security reasons it is better to vary the member of staff who takes the money to the bank and the time of day it is taken.

Cash should never be sent by post, if it is lost or stolen there is no way to trace or recover it.



Application activity 8.3

You are preparing the day's takings for banking. When you have sorted and counted the notes you find you have the following.

- (a) Five FRW 5,000 notes
- (b) Twenty FRW2,000 notes
- (c) Thirty-five FRW1,000 notes
- (d) Sixty FRW 500 notes
- (e) Six bags each containing thirty 100 franc coins
- (f) Two bags each containing ten 50 franc coins
- (g) Ten bags each containing fifty 20 franc coins
- (h) Other coins worth FRW10,500 in total

Prepare the paying in slip so that the cash can be banked.

8.4 Cheques



Activity 8.4



From the picture above, answer the following question

Rwanda Education board (REB) has issued a purchase order to ABC Ltd hotel for a meeting room and catering for 50 persons involved in curriculum development. The purchase order was composed by one meeting room, breakfast and lunch. At the end of assignment ABC hotel provided an invoice to REB amounted to FRW 1,000,000. An Accountant of REB processed the payment by Cheque. What is the information to be contained on a valid cheque?

A cheque is an unconditional order in writing addressed by a person to a bank, signed by the person giving it, requiring the bank to pay on demand a sum certain in money to or to the order of a specified person or bearer.

When a firm opens a current account with the bank, a cheque book containing cheques is issued. The cheques allow the firm to make payments against the account with the bank. When a firm issues a cheque to its creditors for payments, it authorizes the bank to honour payments against the firm's account with the bank.

8.4.1 Format of Cheques

Cheques are a reasonably common method of payment. They are a written order to the bank, signed by the bank's customer to pay a certain amount to another person or company. The cheque must be banked by the payee and then clear into their account before the money is available for use.

Generally, it takes around three working days for a cheque paid into a bank account to clear into that account. At this point, the funds can be drawn on by the recipient of the cheque. The clearing system is used for this process.

There are three parties involved in a cheque:

Drawee: The bank that has issued the cheque and will have to pay the cheque

Payee: The person to whom the cheque is being paid (eg the supplier)

Drawer: The person who is writing and signing the cheque in order to make a payment (eg the customer).

When cheques are paid into a bank account (using a paying-in slip) they will appear as a counter credit' on the bank statement of the business receiving the money.

8.4.2 Receiving cheques

It is best practice to follow these procedures when an individual customer pays by cheque.

Step 1: Examine the face of the cheque to ensure all the details are correct.

- Date (including the year)
- Payee name
- Amount in both words and figures

Step 2: Make sure that the cheque is signed by the drawer.

8.4.2 Banking cheques

The details required on the paying-in slip when cheques are banked include:

- Name of drawer (or endorser)
- Amount of cheque
- Total value of cheques banked

8.4.3 Returned/dishonoured cheques

After a cheque has been received and banked, the bank may find it necessary to return the cheque to the payee and to remove its amount from the payee's bank account. This is because the cheque has been dishonoured for payment.

A cheque would be dishonored because:

- Stale cheques
- Post – dated cheques
- Insufficient funds
- Differences in amounts in words and figures



Application activity 8.4

1. Complete the following statements by selecting from the picklist below.

Statement	Term
In respect of Cheques, the person to whom the cheque is payable is the	
In respect of Cheques, the person writing and signing the cheque in order to make the payment is the	
In respect of Cheques, the bank which has issued the cheque and will have to pay the cheque (the customer's bank) is the	

Picklist:

- Drawee
- Drawer
- Payee

2. What elements to be considered in processing a cheque?

8.5 Receipt of debit and credit card payment



Activity 8.5



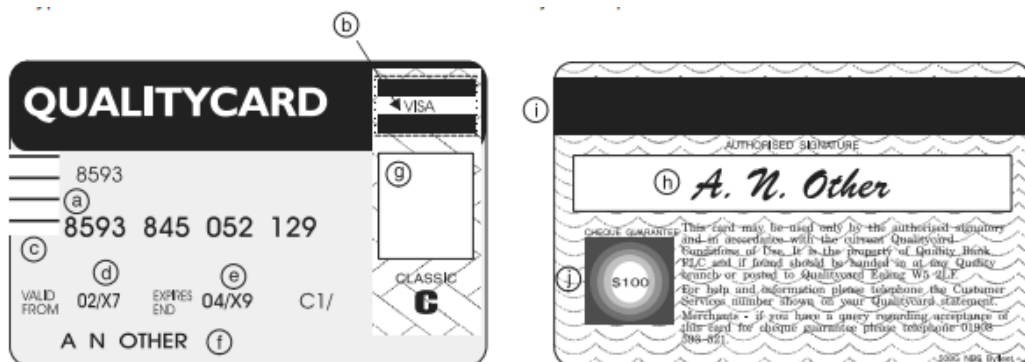
From the picture above, answer the following questions

1. State feature of visa card?
2. Where does debit card and credit card used?

Debit and credit card payments have become progressively more popular as methods of payment over the last few years. They are used primarily by individuals rather than by companies (although companies do own credit cards which are generally allocated to members of staff for their use to pay business expenses). Most retail outlets which accept credit and charge cards now use an electronic system known as EFTPOS (Electronic Funds Transfer at Point of Sale)

8.5.1 Debit and credit cards

A typical card would look like this and the letters (a) and (j) are explained below.



Feature	Explanation
a. Card number	Each card issued has a unique number allocated to it
b. VISA	This is the type of credit card.
c. Quality card	This is the issuing company. There are many different issuing companies (mainly banks and building societies).
d. 02/X7	This is the date from which the card can be used.
e. 04/X9	This is the date on which the card expires.
f. A N Other	The name of the card holder is also on the front of the card.
g. Hologram	This is a special security device which seeks to prevent forgery of the card.
h. Signature strip	This holds the specimen signature of the card holder.
i. Magnetic strip	This black strip holds all the information on the card (except the signature) in code enabling a computer to read it.

There are two main types of card, and we will look at them in turn.

- Credit cards
- Debit cards

Credit cards

A **credit card payment** involves three transactions and three parties (see below). Whilst credit is involved, for a supplier receiving payment in this way, credit card payments are treated as cash.

Transaction	Comments
Purchase of goods from a supplier by card holder	On producing their card to a supplier for goods and/or services, the card holder can obtain what they require without paying for it immediately
Payment of supplier by card issuer	The supplier recovers from the card issuer the price of goods or services less a commission which is the card issuer's profit margin.
Payment of card issuer by card holder	At monthly intervals the card issuer sends to the card holder a statement. The card holder may either settle interest-free within 28 days or they may pay interest on the balance owing after 28 days. They are normally required to pay a minimum amount or a percentage of the amount outstanding.

Card issuers often charge a flat yearly membership fee as well as charging interest. Most banks and finance houses issue either Visa or MasterCard credit cards, some issue both. American Express issues its own credit card (Optima).

Accepting a credit card receipt

Credit card transactions can be accepted remotely over the telephone or via the internet or at point of sale. Retailers using a point-of-sale system will have a checkout terminal that includes a credit card swiper or NFC (near-field communication) reader to enable contactless payments for systems such as Apple Pay or Android Pay. Some businesses, such as restaurants, have mobile credit card processors. A credit card isn't linked to your current account and is a credit facility that enables you to buy things immediately, up to a pre-arranged limit, and pay for them at a later date. The cost of the purchase is added to your credit card account and you get a statement every month.

Debit cards

The same procedures are used for debit card receipts. For the Customer, the difference is that debit card payments are made directly from their bank account. Debit cards are used to pay for goods in shops and to withdraw money at cash machines. The money is automatically taken from your current account when you spend it, so you must have enough money in your account or an agreed overdraft to cover the transaction.



Application activity 8.5

1. A customer wants to pay for items bought over the internet from a supplier used infrequently by the business. Which payment method is most appropriate?

Credit card
Debit card
A cheque
Cash

8.6 Electronic receipts and retention of documents



Activity 8.6

1. What is POS machine and where can be used?
2. Peter works in a public hospital as an Accountant and he is a student at master's level in project management in one of private universities. He uses part of his salary to pay tuition fees. What is an appropriate method of transferring his tuition fees; Frw 150,000 per month to account number of university?

Customers may chose to transfer money owed to another business by other electronic methods of transfer. Electronic transfers methods include BACS direct credit, CHAPS and faster payments.

8.6.1 BACS direct credit

A direct credit is a deposit of money by a payer directly into a payee's bank account. Direct credit payments are usually made electronically. This method may be used by businesses when they pay salaries and suppliers. When making payments, details of each recipient's bank account and the amount to be paid are submitted to the BACS clearing centre. The payments are then taken directly from the business's bank account and paid in to each recipient's bank account.

Tools Used For Direct Credit

Mobile Banking: Keeping money exchange transactions through a cell phone, mobile Banking refers to provision Banking and Financial service with the help of mobile telecommunication devices.

Point of sales (POS) is portable machine that allows businesses to receive cash payments with bank card like debit card.

8. 6.2 CHAPS (Clearing House Automated Payment System)

Payment by direct credit reduces the payer's bank balance on the date the payment is made. Unlike a cheque, the funds transfer is performed instantaneously so there is no chance for the business to stop the payment, and the bank cannot refuse payment once it has been made, due to insufficient funds. CHAPS transfers are commonly used for large amounts such as transferring funds to solicitors for the purchase of property. Payment by CHAPS reduces the payer's bank balance on the date the payment is made.

8. 6.3 Faster payments

Most large banks now allow their customers to make small and medium-sized payments via the internet using the faster payments system. This system enables customers to send same-day payments from their bank account to the recipient's bank account, The business must follow various security procedures to access its bank account online, then enter the recipient's details and authorize the payment. Usually the payment is deducted immediately from the business's account, and is available almost immediately in the recipient's account (around two hours). A faster payment reduces the business's bank balance on the date of payment.

8.6.4 Retention of documents

In the event of queries regarding individual transaction or bank account credits, the retailer will need to produce relevant copies of the receipts. It is therefore essential that all copy receipts are kept in a safe place, preferably in date order, for a minimum period of six months and sometimes even longer.



Application activity 8.6

1. Which of the following is an example of a payment which is most appropriate for settlement using BACS?
 - A Paying a regular sum to a supplier
 - B Paying a regular, but variable sum to a supplier
 - C Paying wages and salaries to employees
 - D Making irregular payments to overseas suppliers

2. For a large organization which of the following transactions would be most efficiently made by online transfer?

- A Quarterly utility bills
- B Purchase of office sundries
- C Monthly employee salaries
- D Refunds to customers



End of unit assessment

1. Which of the following is not a method of payment by a customer?

- A A cheque
- B A journal
- C A credit card
- D A debit card

2. Which of the following are services banks may offer?

- i) Investments
 - ii) Paying accounts payable on behalf of a business.
 - iii) Share dealing
 - iv) Posting entries to the general ledger.
- A (i), (ii), (iii)
 - B (i), (iii)
 - C (ii), (iii), (iv)
 - D (i), (iv)

3. A customer wants to pay for items bought over the internet from a supplier used infrequently by the business. Which payment method is most appropriate?

- A Credit card
- B Debit card
- C A cheque
- D Cash

4. What is the bank clearing system?

- A It is the mechanism for obtaining payment for Cheques
- B It moves cash between banks
- C It sets credit levels for banks' business customers
- D It arranges long term loans for bank customers

5. Which of the following are reasons for a bank returning or dishonouring a cheque?

- i) Words and figures differ
 - ii) Cheque less than guaranteed amount
 - iii) Cheque and guarantee card stolen
 - iv) Cheque unsigned
- A (i), (ii), (iii), (iv)
 - B (i), (iii), (iv)
 - C (i), (ii), (iv)
 - D (ii), (iii), (iv)

6. When a business or an individual hands over cash to be paid into their bank account, which of the following documents should be prepared?

- A Cheque
- B Credit card mandate
- C Paying-in slip
- D Remittance advice

7. Alfredo is the Managing Director of a large engineering company. He signs his name on a company cheque for FRW 260,000 in accordance with the bank mandate. The company name appears on the cheque. If the bank dishonours the cheque as the company has insufficient funds in the account, who is liable for the FRW 260,000?


- A The engineering company
- B Alfredo
- C The bank
- D No one

8. Selina receives a cheque from a customer. What term describes Selina's role in this transaction?

- A Payer
- B Drawer
- C Payee
- D Drawee

UNIT 9

CASHBOOK AND BANK RECONCILIATION

 **Key unit competence:** To be able to reconcile cash book and bank statement balances



Introductory activity

Suppose that you are hired as an account clerk at your school. At the end of the month you find that there is disagreement between the cash book balance and the balance on the bank statement.

- What are the reasons do you think are basis of those discrepancies?
- What do you suggest as an answer for those discrepancies to ensure the balance to be reported in financial statement?

9.1: Cash Book and Bank Statement

Activity 9.1



Carry out the research on the difference between cash book and bank statement

9.1.1 Nature and purpose of a cash book

A book in which cash receipts and payments are recorded is known as a cash book. A cash book is a part of ledger as well as a book of original entry. All receipts and payments are recorded in the cash book directly. Any entry made in the cash book is part of double entry. It means if a debit entry is made in the cash book then only corresponding credit entry is to be made in the respective ledger account. Similarly, if a credit entry in the cash book then only debit entry is to be made in the respective ledger account.

We can maintain cash account and bank account in a cash book. A cash account records the receipt and payment on cash, and the bank account records receipts and payments of money by cheque.

Note: Recording transaction in the cash book and types of cash books had been discussed on in the Unit 3.9

9.1.2 Bank statement

Bank statement is sent by a bank to its short- term receivables and payables (customers with bank overdrafts and customers with money in their accounts) itemizing the balance on the account at the beginning of the period, receipts into the account and payments from the account during the period, and the balance at the end of the period. These statements may be produced monthly, weekly or even daily depending on the volume of transactions going through the account.

You should be clear on one point. If a customer has money in their account, **the bank owes them that money**, and the customer is therefore an **account payable** of the bank. This means that if a business has FRW 5,000,000 cash in the bank, it will have a debit balance in its own cash book, but the bank statement, if it reconciles exactly with the cash book, will state that there is a credit balance of FRW 5,000,000 in the bank's payables account. (The banks records are a mirror image of the customers' own records, with debits and credits reversed.)

What does a bank statement look like?

Bank Of Kigali PLC		CONFIDENTIAL		
KN 4 AV, KIGALI		Account ABC CO. NYARUGENGE		SHEET NO 11 (d)
2022	Statement date 31st March 2022 (a)	Account no 40000214578900(b)		
Date ©	Details	FRW Withdrawals	FRW Deposits	FRW Balance
01 March	Balance from sheet no 10(e)			78,758,000(f)
04 March	00000055(g)	21,681,000		
12 March	00000054	15,737,000		
17 March	00000057	2,200,000		
28 March	SanLam insurance DD(i)	8,732,000		
	BRD DD	114,010,000		
	HEC SO(j)	5,469,000		
	Implisco Rwanda11209(h)		46,986,000	
	Interest (l)	932,000		
	Charges (k)	3,000,000		46,017,000 O/D
31 March	Balance to Sheet no 12			46,017,000 O/D

(e) Key **SO** Standing Order **DV** Dividend **CC** Cash&/or Cheques **AC** Automated cash **PY** Payroll
EC Eurocheque **TR** transfer **CP** Card Purchases **DD** Direct Debit **OD** Overdrawn

The following points refer to the circled letters on the bank statement.

Letter	Item	Explanation
(a)	The statement date	This indicates that only transactions which have passed through your account up to this date (and since the last statement date) will be shown on the statement
(b)	Account number	This number is required on the statement, particularly if the bank's customer has more than one account
(c)	Date	This shows the date any transaction cleared into or out of your account. It is not normally the date that you performed the transaction as it takes three or more days for the bank to process a transaction.
(d)	Sheet number	Each bank statement received will have a number. The numbers run in sequential order , this helps to keep them in order and it immediately shows if statement is missing.
(e)	Key	Not all bank statements will have a key to abbreviations they use but it is helpful when one is provided. Note the following Dividends can be paid directly into a bank account if the shareholder has instructed the company in which they hold shares to do so Automated cash is withdrawal from an automated teller machine – unusual for a business. Card purchase is a purchase by debit card, again unusual for a business.
(f)	Balance	Most statements show a balance as at the end of each day's transactions.
(g)	Cheque number	The number is the same as that which appear on the individual cheque. Numbers are necessary to help you to identify items on the statement: you could not do so if the amount of the cheque appeared.
(h)	Paying- in slip numbers	The need for these numbers is the same as for cheques.

(i)	Direct debit payments & receipts	The of the direct debit payment is usually identified, either in words or by an account number
(j)	Standing order payments & receipts	Again, the recipient is identifiable.
(k)	Charges	The charges which the bank levies are based on the number of transactions (cheques, receipts and so on) which have been processed through your account in a given period (usually a quarter).
(l)	Interests	Interest is charged on the amount of an overdrawn balance for the period it is overdrawn. On personal accounts, banks may pay interests to customers who do not go overdrawn.



Application activity 9.1

1. What is a cash book?
2. State the components of bank statements

9.2 Bank reconciliation



Activity 9.2

Discuss the purpose of preparing bank reconciliation statement

9.2.1 The meaning of bank reconciliation statement

Bank reconciliation statement may be defined as a detailed statement reconciling at a given date the cash balance reported by the bank with that shown in the records of a business.

These days almost all businessmen operate bank account. All the transactions in a bank account are recorded in the cash book in the bank column. The bank accounts opened by businessmen are normally current accounts. In this account, the customers of the bank can deposit or withdraw money whenever they like. The relationship between a bank and its customers is one the debtor and the

creditor. If a trader has deposited FRW 20,000,000 into his bank account then the bank is the debtor of the trader and from the bank's points of view, the trader is a creditor.

9.2.2 Importance of Bank Reconciliation

- Bank reconciliation strengthens an organization's internal control system through detection and prevention of fraud. An accountant or cashier who embezzles his/her employer's funds and manipulates the cash book will be discovered if bank transactions (cheques) were involved. It is therefore advisable to receive and make payments by cheque because such transactions are easier to trace in the bank statement than if they were cash.
- Bank reconciliation leads to accuracy in records. This is because the cash book and bank statement are synchronized. A mistake in either the cash book or bank statement will be detected and corrected during bank reconciliation.

9.2.3. Reasons for discrepancy between cashbook and bank statement balances

i. Un-credited Cheques and Deposit in Transit

These are cheques that are deposited or ledger into the bank account at the bank, but take time before being posted to the trader's account by the bank. The cash book will thus show a record of these cheques, which may not appear on the bank statement. Also banks accept cheques for collection whereby customers accounts are credited only when money is actually received from the banks against which cheque were drawn

ii. Un-presented Cheques

These are cheques issued to creditors and immediately credited to the bank account in the cash book but take time before they are actually presented to the bank for payment. The trader's cash book thus reflects the payment, which is not shown by the bank statement.

iii. Standing Orders

These are instructions issued by a trader to the bank to make certain payments on his/her behalf, such as insurance premiums, rent to landlord etc. The bank continually pays according to trader's last instructions without contacting him/her as often.

Such payments appear in the bank statement as debit entries but do not appear in the cash book as the trader has no proof that they have been made, until when in receipt of the statement.

iv. Direct credit/ Direct Remittances

This refers to deposits directly lodged into the customer's bank current account without his/her knowledge. It could comprise dividends received from investments, interest received on fixed bank deposits, or a debtor's payment by credit transfer etc. Such information is shown in the bank statement and not in the trader's book.

v. Dishonoured Cheques

A cheque deposited in the trader's bank account is returned by the bank as unpaid or dishonoured for reasons such as:

- When the funds on the drawers account are not sufficient the cheque will be labelled (IF) insufficient Fund or R/D Refer to the drawer
- Amount in words differing from the amount in figures
- Drawer's signature being different from the specimen signature available at the bank.
- Cheque is presented earlier than that face date (post dated).
- Cheque presented beyond two months of the date of issue (stale cheque)

The bank statement thus shows amounts of dishonoured cheques on the debit side. The cash book does not show the credit entry of dishonoured cheques, as this information will not yet have been communicated to the trader. He only gets informed of the information thereof when he receives the bank statement.

vi. Bank charges

The bank charges its customers for banking services. These are debited straight away to the customer's bank account without having to contact the customer. The customer is ignorant of the bank charges, until when in receipt of the bank statement.

vii. Errors or mistakes

Errors or mistakes made either in posting the cash book or bank statement as shown in the bank statement, may also cause disagreement between the two accounts. For instance, the cash book is debited with a cheque issued to

a creditor, or the bank erroneously debits the trader's account with dividends received by the bank on his/her behalf.



Application activity 9.2

1. Explain the following terms
 - a) Bank reconciliation statement
 - b) Un credited cheques
 - c) Un presented cheques
 - d) Direct remittances
2. What are causes for discrepancy between cash book and bank statement balances
3. Discuss the importance of bank reconciliation

9.3 Preparation of bank reconciliation statement



Activity 9.3

KARANGWA is a sole trader in MUHANGA CITY; he keeps the books of accounts regularly. At the end of January 2022 just after receiving the bank statement, he realized discrepancy between the cash book and bank statement balances. He is asked to carry out the bank reconciliation, but he doesn't have enough skills in preparing that statement. Suppose you are hired as an Accountant, what are procedures will you follow to perform that assignment?

9.3.1 Bank reconciliation procedures

Bank reconciliation statement is prepared at any particular date to reconcile the cash book, and bank balance usually at the end of every month. This is because the cash book is balanced at the end of the month likewise bank statement is issued at the end of the month. When preparing a reconciliation statement we can start with a balance either on the cash book or bank statement.

The following are procedures when preparing bank reconciliation:

- Step 1 - Compare the ending balance on the cash book and bank statement and see if there are equal or not.
- Step 2 – Tick off the items in both cash book and bank statement.
- Step 3 – Up date the cash book from the bank statement
- Step 4 – Balance the cash book bank columns to produce an updated balance
- Step 5 – Identify the remaining un- ticked items from the cash book
- Step 6 – Preparation of the bank reconciliation statement

9.3.2 Method of bank reconciliation

There are three principal methods of preparing a bank reconciliation statement

1. Beginning with the cash book balance, adjusting, updating or correcting the cash book and then preparing a bank reconciliation statement. The ultimate aim of this method is to arrive at or prove the bank statement balance.
2. Beginning with the bank statement balance and working towards proving the cash book balance.
3. Adjusting the cash book balance and also adjusting the bank statement balance. The aim is to show whether the two adjusted balances agree.

Example1.

The following cash book and the bank statement for KBG Ltd for the month of January 2022

Cash book (Bank column)					
2022			2022		
		FRW(000)			FRW(000)
1/1	Bal. b/f	80,000	7/1	MAKUTA	32,000
2/1	John	60,000	8/1	PETER	40,000
10/1	XYZ Ltd	24,000	11/1	OLIVIER	30,000
14/1	TWAGIRA	10,000	17/1	BAHO	14,000
16/1	TABARO	4,000	28/1	JIMMY	6,000
28/1	STELLA	34,000	28/1	HENRIETTE	4,000
30/1	MALTHE	13,000	30/1	MARTIN	2,000
30/1	JOEL	2,000	30/1	MANDA	1,000
			31/1	SIMON	4,000
			31/1	Bal c/f	<u>94,000</u>
		227,000			227,000

Bank statement

2022		Dr	Cr	Balance
		FRW (000)	FRW (000)	FRW(000)
1/1	Balance b/d			80,000
5/1	John		60,000	140,000
8/1	MAKUTA	32,000		102,000
10/1	PETER	40,000		68,000
13/1	OLIVIER	30,000		38,000
14/1	XYZ Ltd		24,000	62,000
16/1	TWAGIRA		10,000	72,000
18/1	BOBO	14,000		58,000
20/1	C.M. Leon		18,000	76,000
25/1	S.O. San Lam	2,000		74,000
26/1	C.M. (George)		16,000	90,000
31/1	Bank charges	200		89,800

C.M. = Credit memo

S.O. = Standing order

A cheque written to JIMMY on 28/1/2022 and one received from TWAGIRA and banked on 16/1/2022 were dishonoured by the bank.

Required: Prepare KBG Ltd bank reconciliation statement for the month ended 31st January 2022

Answer

Method 1: Beginning by adjusting or correcting the cash book and working towards proving balance as per bank statement.

Adjusted (corrected cash book)

	FRW(000)			FRW(000)
Balance b/f	94,000	TWAGIRA (dishonored cheque)		4,000
C.M Leon	18,000	San Lam (S.O)		2,000
C.M George	16,000	Bank charge		200
Jimmy (dishonored cheque)	6,000	Bal. c/f		127,800
	134,000			134,000

BBK Ltd Bank reconciliation statement for the month ended 30/9/2009

	(FRW.000)	(FRW.000)
Balance as per adjusted cash book		127,800
Add: <u>Un-presented cheques</u>		
Henriette	4,000	
Martin	2,000	
Manda	1,000	
Simon	4000	11,000
Less: <u>Un-credited cheques</u>		
Stella	34,000	
Malthe	13,000	
Joel	2,000	49,000
Balance as per bank statement		<u>89,800</u>

Method 2: Beginning with the bank statement balance and working towards proving the balance as per cash book

	(FRW.000)	(FRW.000)	(FRW.000)
Balance as per bank statement			89,800
Add: Direct debits			
San Lam (S.O)		2,000	
Bank charges		<u>200</u>	2,200
Un-credited cheques			
Stella	34,000		
Malthe	13,000		
Joel	<u>2,000</u>	49,000	
<u>Dishonored cheque</u>			
Twagira		4,000	<u>55,200</u>
			145,000
Less: direct credits:			
C.M Leon	18,000		
C.M George	<u>16,000</u>	34,000	
Un-presented cheques:			
Henriette	4,000		
Martin	2,000		
Manda	1,000		
Simon	4000	1,000	
<u>Dishonored cheques</u>			
Jimmy		<u>6,000</u>	<u>51,000</u>
Balance as per cash book			<u>94,000</u>

Method 3: the aim is to obtain agreeing adjusted balances

	(FRW.000)	(FRW.000)
Balance as per cash book		94,000
Add: Direct credits:		
C.M Leon	18,000	
C.M George	<u>16,000</u>	34,000
Jimmy dishonored cheque		<u>6,000</u>
		134,000

Less: direct debits:		
San Lam (S.O)	2,000	
Bank charges	200	
Twagira -dishonored cheque	<u>4,000</u>	6,200
Adjusted cash book balance		<u>127,800</u>
Balance as per bank statement		89,800
Add: un-credited cheques:		
Stella	34,000	
Malthe	13,000	
Joel	<u>2,000</u>	<u>49,000</u>
		138,800
Less: Un-presented cheques:		
Henriette	4,000	
Martin	2,000	
Manda	1,000	
Simon	<u>4000</u>	<u>11,000</u>
Adjusted bank statement balance		<u>127,800</u>

Example 2

Mupenzi's cash book showed a debit balance of FRW 3,000,000 on 31 March 2022. His bank statement showed a credit balance of FRW 2,212,480 on the same date. A careful examination of the two records revealed that the difference was due to the following:

- A cheque for FRW 82,410 issued by Murenzi, another customer at the bank, was wrongly debited by the bank in the Mupenzi's bank account
- The bank had paid FRW 53,390 to Mupenzi's insurance company as per standing order
- John who was Mupenzi's tenant had paid rent FRW 145,000 direct into Mupenzi's bank account
- Cheques for FRW 432,750 deposited by Mupenzi on 29 March were returned unpaid but no entry had been made in the cash book to record the return.

- e) Cheques totaling FRW 1,344,020 issued by Mupenzi to his creditors did not appear on the bank statement. One of these cheques for FRW 100,000 is dated 10 June 2017.
- f) The cashier, in totaling the cash book pages, overstated the debit balance of the cash book by FRW 200,000.
- g) Bank charges amounting to FRW 52,910
- h) Cheques totaling FRW 1,455,080 deposited by Mupenzi on 29 March were credited by the bank on 2 April.

Required: (i) Adjustment of the cashbook balance (ii) A bank reconciliation statement as at 31 March 2009

Answer

a)		Adjusted cash book	
	FRW		FRW
Balance b/d	3,000,000	Bank charges	52,910
Direct credit (John)	145,000	Standing order	53,390
Stale cheque	100,000	Dishonored cheques	432,750
		Error	200,000
		Balance c/d	<u>2,505,950</u>
	<u>3,245,000</u>		<u>3,245,000</u>

Bank reconciliation statement as at 31st March 2022

Method 1: Beginning by adjusted cash book balance and working towards proving balance as per bank statement.

	(FRW)
Balance as per adjusted cash book	2,505,950
Add: Un-presented cheques	1,244,020
Less: Un-credited cheques	(1,455,080)
Error decreasing	(82,410)
Balance as per bank statement	<u>2,212,480</u>

Method 2: Beginning with the bank statement balance and working towards proving the balance as per cash book

	(FRW)	(FRW)	(FRW)
Balance as per bank statement			2,212,480
Add: Direct debits			
Standing order	53,390		
Bank charges	52,910		
Dishonored cheques	432,750		
Error	<u>200,000</u>	739,050	
Un-credited cheques		1,455,080	
Error increasing		<u>82,410</u>	2,276,540
Less: direct credits:			
Direct credit (John)	145,000		
Stale cheque	100,000	245,000	
Un-presented cheques:		<u>1,244,020</u>	<u>(1,489,020)</u>
Balance as per cashbook			3,000,000

Method 3: the aim is to obtain agreeing adjusted balances

	(FRW)	(FRW)	
Balance as per cash book		3,000,000	
Add: direct credits:			
Direct credit (John)	145,000		
Stale cheque	<u>100,000</u>		245,000
Less: direct debits:			
Standing order	53,390		
Bank charges	52,910		
Dishonored cheques	432,750		
Error	<u>200,000</u>		<u>(739,050)</u>
Adjusted cash book balance			2,505,950

Balance as per bank statement	2,212,480
Add: un-credited cheques:	1,455,080
Error increasing	82,410
Less: Un-presented cheques:	<u>(1,244,020)</u>
Adjusted bank statement balance	2,505,950



Application activity 9.3

The following is the cash book (bank columns only) of F King for December 2021/ **12**

2007	Dr	FRW'000	2021	Cr	FRW'000
Dec	6 P Paul	230	Dec	1 Balance b/d	1900
	20 C Hertier	265		10 J Lambert	304
	31 B Bertin	325		19 P Wilson	261
	31 Balance c/d	<u>1,682</u>		29 K Chanita	<u>37</u>
		<u>2,502</u>			<u>2,502</u>

The following is the bank statement:

2021	Dr (FRW'000)	Cr (FRW'000)	Balance (FRW'000)
Dec 1	Balance		1,900 O/D
8	Cheque	230	1,670 O/D
13	J. Lambert	304	1,974 O/D
21	Cheque	265	1,709 O/D
22	P Wilson	261	1,900 O/D
30	Pax: standing order	94	2,064 O/D
31	F Lay: trader's credit	102	1,962 O/D
31	Bank charges	72	2,034 O/D

You are required to:

- Update the cash book to take into account all necessary items into account
- Draw up a bank reconciliation statement as on 31 December 2021



End of unit assessment

The following is the cash book (bank column) of Mr MUGABE for November 2021

Bank account

2021			2021		
		FRW'000			FRW'000
Nov.2	HIGIRO	2,750	Nov.1	Bal. b/d	8,070
Nov. 9	MUZEHE	1,400	Nov. 7	Paul	1,000
Nov. 20	Leon	450	Nov. 10	Jolly	490
Nov. 20	Cassien	720	Nov.15	Straton	630
Nov. 30	Bal. c/d	<u>4,870</u>			
		<u>10,190</u>			<u>10,190</u>

Bank statement 30/11/2021

Date	Details	Debit '000	Credit '000	Balance '000
Nov. 1	Balance b/d			8,070 Dr
Nov. 2	HIGIRO		2,750	5,320 Dr
Nov. 15	Paul	1,500		6,820 Dr
Nov. 20	Leon		450	6,370 Dr
Nov. 24	Jolly	490		6,860 Dr
Nov.28	Standing order	330		7,190 Dr
Nov.30	Traders' credit		600	6,590 Dr
Nov. 30	Bank charges	550		7140 Dr


Note: the cheque issued to Paul was FRW 1,500,000 and not FRW 1,000,000

Prepare:

- The amended cash book
- Bank reconciliation statement

UNIT 10

FINANCIAL STATEMENTS OF SOLE TRADERS

 **Key unit competence:** To be able to prepare financial statements of a sole trader



Introductory activity

AMANI is a sole trader selling purified mineral water, juice, and milk. He has invested money in acquiring the assets, including buildings and motor vehicles, some by cash and others on credit. In his first year of trading, he has enjoyed an increased number of customers. Though AMANI is not sure whether he earned profit or loss comparing business expenses and revenues, he is also not aware of his business's financial position.

Required: What kind of financial reports to be prepared by AMANI that provide the information on his business's performance and financial position?

10.1. Meaning, objectives and qualitative characteristics of financial statements

Activity 10.1



CYUSA, a sole trader in Rwamagana, has been requested by Revenue Authority to report his business financial information, but he is persisting as why? You are required to help him by answering the following questions.

1. What is the objective of financial statements?
2. What are the characteristics of useful financial information?

10.1.1. Meaning of financial statements

Financial statements are a collection of summary level reports about an organization's financial performance, financial position, and cash flows. The main ones are:

- Statement of Profit or Loss (Income statement)
- Statement of financial position (Balance Sheet)
- Statement of Cash flow (Cash flow statement)

10.1.2. Objectives of financial statements

- To provide information about the financial position (Balance sheet)
- To provide information about financial performance (income statement)
- To provide information about changes in financial position of an entity (cash flow statement)
- To determine whether a business has the capacity to pay back its debts.
- To derive whether financial ratios from the statements can indicate the condition of the business.
- To use as the basis for an annual report, which is distributed to investors and the investment community?

10.1.3. Qualitative characteristics of financial statements

The qualitative characteristics of useful financial reporting identify the types of information are likely to be most useful to users in making decisions about the reporting entity on the basis of information in its financial report. The qualitative characteristics apply equally to financial information in general purpose financial reports as well as to financial information provided in other ways.

Fundamental qualitative characteristics

Relevance and faithful representation are the fundamental qualitative characteristics of useful financial information.

Relevance

Relevant financial information is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both. The predictive value and confirmatory value of financial information are interrelated.

Materiality

Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis

of those reports, which provide financial information about a specific reporting entity.

Faithful representation

This fundamental characteristic seeks to maximize the underlying characteristics of completeness, neutrality and freedom from error.

Enhancing qualitative characteristics

Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented.



Application activity 10.1

- i) Define financial statements
- ii) What are the main financial statements?
- iii) List the qualitative characteristics of financial statements
- iv) What are the main objectives of financial statements?

10.2. Statement of profit or loss/ Income statement



Activity 10.2

The following information relates to the financial year ended 2020 in the business of Alice, a sole proprietor in Kigali city:

	FRW
Sales	100,000
Wages	20,000
Purchases	70,000
Discount received	12,000
Discount allowed	11,000

Alice wants to know the business's financial performance.

Required:

- i) Using the skills got from O level entrepreneurship, which financial statement to be used in order to get the business financial performance?
- ii) Which formula used to get the financial performance of a business?

10.2.1 Meaning of Income Statement

Income statement is a financial statement prepared to provide information about financial performance of a business. Many businesses try to distinguish between a gross profit earned on trading, and a net profit. They therefore prepare the statement of profit or loss in two parts.

In the first part (Trading Account) of the statement revenue from selling goods and services is compared with direct costs of acquiring, producing or supplying the goods sold to arrive at a gross profit figure. From this, deductions are made in the second half of the statement (profit and Loss Account) in respect of indirect costs (referred to as expenses in financial accounting) to arrive at a net profit figure.

The statement of profit or loss normally covers a one-year accounting period but this is not always the case; other accounting periods are permissible in certain circumstances.

Elements of statement of profit and Loss are **incomes** and **expenses** and the Source of data is a **Trial balance**.

Heading of income statement is composed by:

- Name of the sole trader
- Name of income statement
- Period of income statement

10.2.2 Format of income statement

There are two formats of preparing the income statement, the Horizontal or T-account format and the Vertical or narrative format

Horizontal format or conventional format

Income statement

Opening stock	XXX	Sales	XXX
Purchases	XXX	Sales returns (<u>XXX</u>)	XXX
Purchases returns	(XXX)	Turnover	XXX
Carriage inwards	XXX	Bal b/d: GROSS PROFIT	XXX
Bal c/d: GROSS PROFIT	<u>XXX</u>	Other revenues	XXX
	XXX		
Operating expenses	XXX		
Bal c/d: NET PROFIT	<u>XXX</u>		

This format is outdated and not preferred.

Vertical format

Income statement

	<i>FRW</i>	<i>FRW</i>	<i>FRW</i>
Sales			XXX
Sales returns			<u>(XXX)</u>
Net sales or turnover			<u>XXX</u>
Opening stock		XXX	
Add: purchases	XXX		
Add: carriage inward	XXX		
Purchases returns	<u>(XXX)</u>		
Net purchases		<u>XXX</u>	
COST OF GOODS AVAILABLE FOR SALES		XXX	
Closing stock		<u>(XXX)</u>	
COST OF SALES		XXX	
Add: wages		XXX	
Add: warehouse expenses		XXX	
COST OF GOODS SOLD			<u>(XXX)</u>
GROSS PROFIT			XXX
Add: Other income:			XXX
Discount received			XXX
Interest received			<u>XXX</u>
Etc			XXX
Total incomes		XXX	
Less miscellaneous expenses:		XXX	
Bad debts		XXX	
Wages and salaries		XXX	

Postage		XXX	
General expenses		XXX	
Rent		XXX	
insurance		XXX	
Stationery		XXX	
Carriage outwards		XXX	
Discount allowed		XXX	
Heating		XXX	
Electricity		XXX	
Publicity		XXX	
Depreciation		<u>XXX</u>	
NET PROFIT			XXX

NOTES:

1. The list of expenses above is not exhaustive.
2. The **net profit** is for the period, and it is transferred to the proprietor's capital account in the statement of financial position which will be discussed in the following contents.
3. **Drawings** are withdrawals of profit and not expenses. They may be cash drawings (when cash is drawn) or stock drawings (when stock is drawn). They must not be included in the statement of profit or Loss. These are shown as a reduction in the capital account figure on the face of the statement of financial position and also a reduction of assets.
4. **Carriage inwards and carriage outwards** are both expenses of the business. Carriage inwards means transport charges regarding the goods purchased and it is added to the purchases to increase the cost of goods sold, while carriage outwards are transport charges regarding the goods sold and are considered as part of the operating expenses.

5. Returns inwards and Returns outwards

Returns inwards refer to sales returns and are deducted from total sales for the period to determine net income from sales, also known as turnover. Returns outwards on the other hand refer to purchases returns, and they are deducted from total purchases for the period to determine net purchases and cost of goods sold. The alternative terms used are “**returns in**” and “**returns out**”

The statement of Profit or loss shows both the gross profit and the net profit for the accounting period.

10.2.3 Meaning of related terms

- **Trading account** is an account usually prepared to ascertain the Gross profit or gross Loss. (This includes all expenses directly incurred in the trading process) at the end of a trading period.
- **Cost of goods sold:** is derived by adding purchases to the opening stock minus closing stock or (cost of goods available for sales- closing stock) i.e. opening stock +purchases – closing stock)
- **Cost of goods available for sale:** is opening stock plus the total purchases for the period. (Opening stock +purchases)
- **Gross profit** is the difference between the value of revenue (sales) **and** the cost of goods sold. It is an excess of selling price of goods over their cost price. It represents the difference between sales revenue and purchase price of goods sold
- **Gross Loss:** If the cost of goods sold exceeds the sales, the difference will be a gross loss. The main items in the trading account are sales, purchases, opening stock and closing stock. A trading account or any other accounts also has a heading which is stated in these forms.
- **Net profit** is calculated as Gross Profit **plus** any other income generated by the business, such as on the sale of non-current assets and **less** all other expenses incurred in running the business.
- **Net profit** may be defined as an excess of gross profit over the expenses of the business incurred to conduct the business transactions. There will be a net loss when gross profit is less than the expenses.
- **Closing stock:** This is the stock at the end of the trading period. This stock is an asset to the business and is shown as a current asset in the balance sheet. Closing stock will be shown as additional information on the trial balance i.e. it will be out of the trial balance items.

10.2.4 Gross profit percentage

Gross profit percentage may be given as percentage of cost price or sale price. If this percentage is given on the cost price and instead of cost price, the sales figure is given then this percentage must be changed accordingly and vice versa. Gross profit as percentage to cost price is known as mark-up and as a percentage to a sale price 'margin'.

Example 1

Calculate Mugisha's Gross profit if the cost of goods sold is FRW 300,000 and a profit mark-up is 20%.

Solution

Gross Profit = FRW 300,000*20%= FRW 60,000

Example 2

Calculate a Gross profit if the sales are FRW 400,000 and a profit margin is 20%.

Solution

Gross profit = FRW 400,000 * 20% = FRW 80,000

102.5. Forms of financial statement

Single step income statement

A single step income statement is one of two commonly used formats for the income statement or profit and loss account. The single step format uses only one subtraction to arrive at net income.

NET INCOME= (REVENUES+GAINS)- (EXPENSES +LOSSES)

An extremely condensed income statement in the single step format would look like this:

MUGISHA	
INCOME STATEMENT FOR THE FIVE MONTHS ENDED MAY 31 ST 2018	
Revenues &Gains	FRW 108,000
Expenses & Losses	FRW <u>90,000</u>
Net Income	FRW 18,000

Multiple step income statement

Multi step Income statement segregates the operating revenues from the non-operating revenues and operating expenses from non-operating expenses, gains and losses.

The difference between single step income statement and multiple step income statement is that multiple step reveals the company's gross profit whereas single step directly calculates the Net Profit. The format given above on vertical format is a multiple step income statement.

Example 3

Mr. Samuel has given you the following balances extracted from his books as at 30th September, 2020

	FRW'000'
Cash on hand	1,200
Cash in bank	11,000
Stock 1/9/2020	21,000
Debtors	8,000
Creditors	10,000
Returns inwards	500
Sales	56,000
Purchases	20,500
Capital	14,900
Salaries	4,000
Water and electricity	600
Postage	200
Drawings	900
Stock 30/9/2020	13,500
Furniture and fittings	7,500
Motor van	35,000
Loan	30,000
Rent received	1,200
Office rent	1,700

Required:

From the above balances, prepare a statement of profit and Loss (or income statement)

ANSWER

Mr Samuel

Statement of profit and Loss for the year ended 30th September 2020

	FRW'000'	FRW'000'
Sales	56,000	
Less: Returns inwards	<u>500</u>	
		55,500
Opening stock	21,000	
Purchases	<u>20,500</u>	41,500
	41,500	
Less: closing stock	<u>13,500</u>	
Cost of goods sold		<u>28,000</u>
GROSS PROFIT		27,500
Rent received		<u>1,200</u>
		28,700
Expenses:		
Salaries		
Water and electricity	4,000	
Postage	600	
Office rent	200	
Total expenses	1,700	<u>6,500</u>
NET PROFIT		<u>22,200</u>

Example 4

On 1st October 2021. Shema Started trading as a snack vendor, selling hot and cold food from a van which she packs by a road side.

He borrowed FRW 2,000,000 from her bank, and the interest cost of the loan was FRW 50,000 per month.

- a) He rented the van at a cost of FRW 800,000 for 3 months. Running expenses for the van averaged FRW 150,000 per month.
- b) He hired a part time helper at a cost of FRW 120,000 per month.
- c) His main business was to sell food to customers who stop their cars by his van, but he also did some special catering arrangements for business customers, supplying food for office parties. Sales to these customers were usually on credit.
- d) For the three months to 31st December 2021, his total sales were:
 - i) Cash sales FRW 6,000,000
 - ii) Credit sales FRW 2,000 (all paid by 31st December 2021)
- e) He purchased food from a local food wholesaler, Best Stores. The cost of purchases in the three months to 31st December 2021 was FRW 4,250,000, and at 31st December she had sold all of it. He still owed FRW 850,000 to Best Stores for unpaid purchases on credit.
- f) He used his own home for his office work. Telephone and postage expenses for the three months to 31 December were FRW 100,000.
- g) During the period he paid himself FRW 250,000 per month.

Required: Prepare a statement of Profit or Loss for the three months 1 October-31 December 2021.

Answer

SHEMA		
STATEMENT OF PROFIT FOR THE PERIOD ENDED 31 ST December 2021		
	FRW'000'	FRW'000'
Revenue FRW (6,000,000 +2,000,000) (e)		8,000
Cost of sales (f)		<u>(4,250)</u>
Gross profit		3,750
Expenses:		
Wages (3 months*FRW 120,000) (c)	360	
Van rental (b)	800	
Van expenses (b)	450	
Telephone and postages (g)	100	
Interest charges (3 months*FRW 50,000) (a)	<u>150</u>	
		<u>(1,860)</u>
Net profit earned in the period		<u>1,890</u>



Application activity 10.2

1. Which of the following statements relating to the statement of profit or loss is false?
 - i) It shows in detail how the profit or loss of a period has been made
 - ii) It shows the value of sales less total expenses as net profit
 - iii) It represents the financial position at a point in time
 - iv) It is one of the key accounting statements of any business.

2. From the details given below, prepare Mugabo's statement of Profit and Loss for the year ended 31/12/2015.

	FRW '000'
Stock 1/1/2015	8,000
Stock 31/12/2015	9,200
Rent	3,500
Salaries	2,000
Insurance	2,800
Purchases	45,000
Sales	60,000
Office expenses	3,000
Rates	1,500
Interest received	2,500

10.3 Effect of errors on the calculation of the profit

Activity 10.3



Examine the following errors and show their effects on net profit:

Furniture purchased for FRW 2,000 had been debited to the purchases account

Goods purchased from Rwanda Group of companies for FRW 2,500 were credited to the account of Rwanda and company

An invoice from Kanimba firm for FRW 7,800 was omitted

Goods sold to Umutoni for FRW 1,750 were entered in the sales daybook or sales book as FRW 1,570.

- i) The salaries and wages account was over added by FRW 350 and the rent received account had been over added by FRW 350.

As you have seen in unit 6, some types of errors will cause an imbalance in the trial balance. The bookkeeper will then know that an error has been made and will look for it and correct it. In this case, the trial balance will balance but the statement of profit or loss may be incorrect. You may be asked to consider how errors, and correction of errors, affect the statement of profit or Loss.

Examination questions frequently require a net profit figure to be corrected. To arrive at the correct net profit figure, the errors are corrected first and then the effect of these corrections on net is determined. These adjustments are added or subtracted from the net profit figure given in the question to find out the adjusted net profit. For this purpose, the following format may be adopted.

Net profit as per question X

ADD :

- 1. X
- 2. X
- 3. X X
- X

DEDUCT :

- 1. X
- 2. X
- 3. X
- X

Adjusted or corrected net profit X

Example 1

NDAMAGE Enterprise makes up its annual accounts to 31st December. Her trial balance at 31st December 2012 showed the shortage on the debit side of FRW 1,050. This difference was posted to a Suspense account.

The following errors were then discovered.

- i) The purchases journal had been under cast by FRW56,300
- ii) The sale of office equipment had been posted to the sales account, FRW13,205.

- iii) Received from Kwizera Florian FRW 66,700, a debtor, was correctly entered in the Cash Book, but had been wrongly posted to the Debtors Ledger as FRW6,600.
- iv) Discount allowed of FRW1,500 had been entered in the cash book, but was not posted in the customer's account.
- v) Machinery was purchased on credit from Ruvubu Factory for FRW250,000 but no entry had been made in the Enterprise's books.

Required:

1. For each error state how the net profit will be affected when the errors are corrected
2. Calculate the corrected net profit if the reported profit was FRW 87,000.

Answer

1. (i) decrease on net profit, (ii) decrease, (iii) no effect, (iv) no effect, (v) no effect

2. Reported profit	87,000
Less: the purchases journal under cast	56,300
Less: sales of office equipment posted in Sales account	<u>13,205</u>
Corrected net profit	<u>17,495</u>

Example 2

The accountant KAZUNGU prepared a trial balance for his business for the month of December 2017 but it failed to balance. The total on the debit side was more than the total on credit side by FRW 33,000. He opened a suspense account for the difference and proceeded to prepare final accounts. He reported a net profit of FRW 1,400,000.

During the month of January 2018 he discovered the following mistakes which had been made in December 2017:

1. The purchases account had been under cast by FRW 2,000
2. Payment of FRW 555,000 by cheque for insurance was properly recorded in the cash book but was posted to insurance account by mistake as FRW 515,000
3. A sales invoice of FRW 300,000 was not recorded in the sales day book and therefore not posted to the ledger

4. The credit side of the sales account was under added by FRW 4,000
5. Motor vehicle repairs costing FRW 50,000 was debited to Motor Vehicle account
6. Payment of FRW 680,000 cash to John a creditor was properly recorded in John's account but was wrongly recorded in cash book as FRW 670,000
7. The bookkeeper had made a mistake by debiting ledger fee of FRW 15,000 to the cash book but properly recorded in the ledger fee account
8. Sale of goods for FRW 600,000 on credit to Mbabazi was properly recorded in the sales account but was wrongly recorded in Uwimbabazi account
9. The bank column of the cash book credit side was over added by FRW 1,000
10. A credit note issued for FRW 800,000 was properly recorded in the customer's account but was wrongly recorded in the other account necessary for completion of double entry as FRW 820,000
11. Discount received of FRW 6,000 was debited to discount allowed account

Required: Statement of corrected net profit

Answer

KAZUNGU
Statement of corrected net profit

	FRW	FRW
Original net profit (Containing errors)		1,400,000
Add: Unrecorded sales		300,000
Under added sales		4,000
Overstated returns inwards		20,000
Discount received recorded as discount allowed		<u>12,000</u>
		1,736,000
Less:		
Purchases under cast		
Understated insurance	2,000	
Repair charge debited to Motor Vehicle account	40,000	92,000
	50,000	1,644,000
Corrected net profit		1,644,000



Application activity 10.3

An accountant of MUYANGO extracts a trial balance which fails to agree by a figure of FRW 2,400,000. He places the difference in Suspense account and then proceeds to prepare draft Trading and Profit and Loss Account for the year ended 31st May 2018 which results in a net profit of FRW 64,000,000. Later he attempts to find the errors which had caused his trial balance to disagree. The following errors are found:

- i) Rent payable under cast by FRW 800,000
- ii) Rates overcast by FRW2,000,000
- iii) Sales overcast by FRW2,800,000
- iv) Cash payment to a creditor entered in the cash book only FRW 1,200,000
- v) Complete omission of drawings by cheque FRW 600,000
- vi) A purchase of FRW 7,500,00 is entered in the books, debit and credit entries as Frw 5,700,000
- vii) Investment income under cast by FRW 400,000

Required: Prepare a statement to show corrected net profit

10.4 Statement of financial position/ Balance sheet



Activity 10.4

NGABO, sole trader at Huye, gives you the following information.

	FRW
Land	4,000,000
Motor vehicle	5,000,000
Machinery	4,000,000
Capital	10,000,000
Long term loan	3,000,000

You are asked to:

1. Show the accounting equation from the given information
2. Which financial statement in which the accounting equation is applied?

A balance sheet is a financial statement which shows the financial position of an organization at a particular date with regards to its assets, liabilities and owner's equity. When a balance sheet balances, it means that the accounting equation has been satisfied.

Heading of balance sheets:

- Name of the sole trader
- Name of balance sheets
- End period of balance sheets

Format of balance sheets:

- Horizontal format
- Vertical format

Elements of balance sheets

- **Assets:** Assets represent the resources owned by the business. These are resources controlled by the entity as a result of past events. Assets are classified into current and non-current assets.
 - **Current assets:** Current assets are the assets acquired by a firm and stay in the firm for a short period of time, usually less than one year. The current assets are:
 - Cash and cash equivalent (bank, petty cash)
 - Marketable securities/short term securities
 - Account receivables
 - Bills receivable
 - Inventory (stock of goods, stock of raw materials and supplies, stock of work in progress, stock of finished goods and semi-finished goods)
 - Prepaid expenses
 - Accrued income
 - **Fixed assets/ Non-current assets**
 - Investment
 - Tangible assets: They are those assets which have physical existence and which are in use in an enterprise for a period of one year and above. They are mainly: premises, land, buildings, plant and machinery, equipment, furniture, fixture and fittings, motor vehicle, long term securities in portfolio etc.

- Intangible assets: intangible fixed assets are assets which do not have physical existence. They are mainly: leasehold, patent, Goodwill, Trade mark, organization cost at creation of the company, copyright and license.
- **Liabilities:** Present obligations of an entity as a result of past event. Liabilities are classified into current and non-current liabilities.
 - **Current liability:** These are obligations of payments maturing in less than one financial year. They are:
 - Note payable
 - Creditors
 - Overdraft
 - Tax payable
 - Unearned revenues
 - Prepaid income
 - Accrued expenses
 - **Non-current liability:** they are obligations of payments maturing in more than one financial year. They are: long term bank loans, bonds (debenture) loans.
 - **Equity**

Equity is the net amount of funds invested in a business by its owners, plus any retained earnings (Net profit):

Owner's equity = capital plus net profit minus drawings

Accounting equation:

Assets = Liabilities + Owner's Equity

OR

Owner's equity = capital + Net profit - Drawings.

Importance of a balance

- a) The balance sheet helps to know the three origins of economic resources used by a firm:
 - Contribution of shareholders or owners
 - Long, medium and short term liabilities
 - Internal financing (retained earnings and reserves)

Sources of capital used by a business are:

- Personal resources
- **Borrowing from friends or banks**
- **Trade credits**
- **Bank** overdraft

b) The balance sheet helps to know the use of economic resources

The uses are:

- Fixed assets (Fixed capital)
- Current assets (stocks, receivables, cash)

Structural equilibrium of the enterprise

The structural equilibrium is based on the following general principles:

1. Owner's equity should be greater than liabilities.
2. Capital employed (owner's equity plus long term liabilities) should cover the fixed assets and part of current liabilities.
3. Current liabilities should be invested only into current assets and basically in cash and receivables so to be easily reimbursed.

FORMAT

Balance sheet as at.....

Fixed assets:		
Land	XX	
Plant and machinery	XX	
Motor vehicle	XX	
Furniture	XX	
Goodwill	XX	
Patent right	XX	
Etc	XX	
	<u>XX</u>	
Current assets:		XXX
Cash at bank	XX	
Cash in hand	XX	
Stock	XX	
Prepaid expenses	XX	
Accrued incomes	XX	
Etc	XX	
	-	
Total assets	<u>XXX</u>	
	<u>XXX</u>	
Owner's equity:		
Capital	XX	
Net profit	XX	
Drawings	<u>(XX)</u>	
Owner's equity		XXX
Liabilities:		
Current liabilities	XX	
Long term liabilities	<u>XX</u>	
Total liabilities	<u>XXX</u>	
	<u>XXX</u>	

OR

FORMAT OF BALANCE SHEET

Fixed assets.....	XX
Current assets.....	XX
Current liabilities.....	(XX)
Working capital.....	(XX)
CAPITAL EMPLOYED.....	<u>XXX</u>
Financed by:	
Owner's equity.....	XX
Long term liability.....	XX
CAPITAL EMPLOYED	<u>XXX</u>

Example 1

Mr. Samuel has given you the following balances extracted from his books as at 30th September,2020

	FRW'000'
Cash on hand	1,200
Cash in bank	11,000
Stock 1/9/2020	21,000
Debtors	8,000
Creditors	10,000
Returns inwards	500
Sales	56,000
Purchases	20,500
Capital	14,900
Salaries	4,000
Water and electricity	600
Postage	200
Drawings	900
Stock 30/9/2020	13,500
Furniture and fittings	7,500
Motor van	35,000
Loan	30,000
Rent received	1,200
Office rent	1,700
Net profit	22,200

You are required to prepare the statement of financial position as at 30th September 2020

Solution

Mr Samuel

Statement of financial position as at 30th September 2020

	FRW"000"	FRW"000"
Fixed assets:		
Motor van	35,000	
Furniture and fittings	<u>7,500</u>	
		42,500
Current assets:		
Stock	13,500	
Debtors	8,000	
Cash on hand	1,200	
Cash in bank	<u>11,000</u>	
		<u>33,700</u>
Total assets		<u>76,200</u>
Financed by:		
Capital		14,900
Net profit		22,200
Less: Drawings		<u>900</u>
Owner's equity		36,200
Loan		30,000
Current liabilities:		
Sundry creditors		10,000
		<u>76,200</u>

Or

Mr Samuel

Statement of financial position as at 30th September 2020

	FRW"000"	FRW"000"
Fixed assets:		
Motor van	35,000	
Furniture and fittings	<u>7,500</u>	
		42,500
Current assets:		
Stock	13,500	
Debtors	8,000	
Cash on hand	1,200	
Cash in bank	<u>11,000</u>	
	33,700	
Current liabilities:		
Sundry creditors	<u>(10,000)</u>	
WORKING CAPITAL		<u>23,700</u>
CAPITAL EMPLOYED		<u>66,200</u>
Financed by:		
Capital		14,900
Net profit		22,200
Less: Drawings		<u>900</u>
Owner's equity		36,200
Loan		<u>30,000</u>
CAPITAL EMPLOYED		<u>66,200</u>

EXAMPLE 2

The following monthly Trial balance was extracted from the books of Ben on 31st May, 2019:

	Dr	Cr
	FRW "000"	FRW "000"
Capital		14,800
Drawings	6,000	
Freehold Property	15,000	
Furniture	2,800	
Stock (31 st May)	6,200	
Office expenses	900	
Bad debts	400	
Salaries	500	
Discounts allowed	200	
Discounts received		100
Gross profit		17,500
Bank overdraft		1,600
Cash on hand	2,800	
Debtors	5,000	
Creditors		7,000
Travelling expenses	1,200	
	41,000	41,000

Required:

- Statement of Profit and Loss for the period ended 31st May 2019
- Statement of financial position as at 31st May 2019

ANSWER

Ben

Statement of profit and loss for the period ended 31st May 2019

	FRW '000'	FRW '000'
Gross profit		17,500
Discounts received		<u>100</u>
		17,600
Expenses:		
Office expenses		
Bad debts	900	
Salaries	400	
Discounts allowed	500	
Travelling expenses	200	
	1,200	<u>(3,200)</u>
Net profit		14,400

Ben

Statement of financial position as at 31st May, 2019

	FRW '000'	FRW '000'
Fixed assets:		
Freehold property	15,000	
Furniture	2,800	
		17,800
Current assets:		
Closing Stock	6,200	
Cash on hand	2,800	
Debtors	5,000	
		<u>14,000</u>
		<u>31,800</u>
Financed by		
Capital	14,800	
Net profit	14,400	
Drawings	<u>(6,000)</u>	23,200
Liabilities:		
Bank overdraft		1,600
		<u>7,000</u>
Creditors		<u>31,800</u>



Application activity 10.4

- 1) Which of the following statements relating to how a five-year bank loan is shown in the statement of financial position is true:
 - i) It should be shown as a non-current asset
 - ii) It should be shown as a non-current liability
 - iii) It should be split into a current liability and non-current liability
 - iv) It should be shown as a current liability
- 2) Which of the following statements correctly describes the contents of the statement of financial position?
 - i) A list of ledger balances shown in debit and credit columns
 - ii) A list of all the assets owned and all the liabilities owed by a business
 - iii) A record of income generated and expenditure incurred over a given period
 - iv) A record of the amount of cash generated and used by a company in a given period.
- 3) From the following information, prepare a statement of financial position

	Dr	DR
	FRW'000'	FRW'000'
Cash in hand	10,800	
Cash at bank	38,790	
Petty cash in hand	1,350	
Motor vehicles	270,000	
Furniture	90,000	
Office equipment	67,500	
Sundry debtors/creditors	147,150	119,340
Drawings	22,500	
Capital		464,040
Net profit		166,860

10.5 Effect of errors on the balance sheet

Activity 10.5



After extracting the trial balance and financial statements of MUHIRE, an investigation revealed the following errors:

1. Debtors account over casted by FRW 30,000
2. Rent received debited in discount allowed FRW 40,000
3. Purchases of machinery completely omitted
4. Cash received from a debtor FRW 215,000 recorded in both accounts as FRW 151,000

REQUIRED: Show the effect of each error on the balance sheet

When correcting errors, you may be asked to consider how errors, and correction of errors, affect the statement of financial position. Examination questions frequently require a balance sheet to be corrected. To arrive at the correct balance sheet, the errors are corrected first and then the effect of these corrections on balance sheet is determined. These adjustments are used to correct the balance sheet.

Example

Set out below is the draft Balance Sheet of KAZUNGU as at 31st March 2020

	FRW '000'	FRW'000'
Capital account:		
Balance as at 1/4/2019	18,000	
Add: Net profit for 2019/2020	6,000	
Drawings	<u>(4,000)</u>	
CAPITAL EMPLOYED		20,000
Represented by:		
Fixed assets at cost in 2019	20,400	
Depreciation at cost in 2020	<u>(15,300)</u>	5,100
Current assets:		
Stock	10,360	
Debtors	4,050	
Bank	<u>5,820</u>	
	20,230	

Current liabilities:	5,200	
Creditors	<u>130</u>	
Suspense account	<u>5,330</u>	
Net current assets/ working capital		<u>14,900</u>
TOTAL NET ASSETS/CAPITAL EMPLOYED		<u><u>20,000</u></u>

After correcting the errors that caused the suspense account to take place and preparing a statement of corrected net profit, the following results was obtained:

Corrected net profit	6,375
Debtors' account	3,960
Fixed assets cost	20,600
Depreciation on fixed assets	15,300
Stock	10,490

Required:

Corrected/final balance sheet

Answer

Final balance sheet of KAZUNGU as at 31st March 2020

	FRW '000'	FRW'000'
Capital account:		
Balance as at 1/4/2019	18,000	
Add: Net profit for 2019/2020	6,375	
Drawings	<u>(4,000)</u>	
CAPITAL EMPLOYED		<u>20,375</u>
Represented by:		
Fixed assets at cost in 2019	20,600	
Depreciation at cost in 2020	<u>(15,300)</u>	
Current assets:		5,300
Stock	10,490	
Debtors	3,960	
Bank	<u>5,820</u>	
	20,275	
Current liabilities:		
Creditors	<u>5,200</u>	
Net current assets/ working capital		<u>15,075</u>
TOTAL NET ASSETS/CAPITAL EMPLOYED		<u><u>20,375</u></u>



Application activity 10.5

Below are particulars regarding Odile' final accounts:

The net profit per the accounts is found to be FRW 154,000. The Balance Sheet when drawn up appeared to be as follows:

Odile
Draft balance as at 31st/12/2021

	FRW
Capital	1,000,000
Net profit	154,000
Drawings	<u>(72,000)</u>
Owner's equity	1,082,000
Current liabilities:	
Creditors	109,000
Suspense account	<u>9,000</u>
	<u>1,200,000</u>
Fixed assets:	
Plant and machinery (cost)	1,010,000
Depreciation	<u>(60,000)</u>
	950,000
Current assets:	
Stock	170,000
Debtors	50,000
Cash	<u>30,000</u>
	<u>250,000</u>
	1,200,000

The following errors were subsequently detected and corrected:

- a) cash sales entry entered in cash book only FRW 6,000
- b) Drawings (cash) completely omitted from books FRW 1,000
- c) Rent account under cast FRW 2,000
- d) Creditor BARASA paid, but entry in his ledger account only FRW 5,000

Required:

Draw up statement of adjusted net profit and revised balance sheet at 31st December 2021.

10.6 Statement of cash flow

Activity 10.6



UWERA is a sole trader operating her business in Rubavu District. The business buys and sells fish. She wants to know about her business's movement in cash and she gives you the following information related to inflows and outflows of cash:

- | | |
|---|--------|
| 1. Cash sales | 70,000 |
| 2. Receipt from debtors | 30,000 |
| 3. Cash paid to creditors | 35,000 |
| 4. Wages paid | 10,000 |
| 5. Rent received | 15,000 |
| 6. Receipt from sale of a motor vehicle | |

You are required to:

- Give the name of statement in which the movement of cash is shown
- Which formula to be used to get the movement of cash

10.6.1 The meaning of statement cash flow and related terms

The term **cash** is used to mean fund or cash on hand and demand deposit.

Cash equivalent are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalent.

Cash and cash equivalent: These are items which are not held for investment or other long term purposes, but rather to meet short term cash commitments. An investment's maturity date should normally be three months from its acquisition date.

A cash flow statement is a financial statement that shows us the exact source (inflows) of the business fund obtained during a period and the use to which the business funds are applied (outflows).

Statements of cash flows are a useful addition to the financial statements of a company because accounting profit is not the only indicator of performance. They concentrate on the sources and uses of cash and are a useful indicator of a company's **liquidity and solvency**.

It has been argued that “profit” does not always give a useful or meaningful picture of a company's operations. Readers of a company's financial statements might even be misled by a **reported profit figure**.

Statements of cash flows are frequently given as an additional statement, supplementing the statement of financial position, statement of profit or loss and related notes.

Statement of cash flows indicates the changes that took place in the cash balances between two balance sheet dates. It provides historical information about cash and cash equivalents, classifying cash flow from operating, investing and financing activities.

The cash flow statements presented by companies contain information on three parts:

Cash from operating activities

Cash flow from financing activities

Cash from investing activities

The manner of presentation of cash flows from operating, investing and financing activities depends on the nature of the enterprise. By classifying cash flows between different activities in this way, users can see the impact on cash and cash equivalents of each one, and their relationship with each other.

10.6.2 Benefits statement of cash flow

1. Useful for short term planning: it will enable the business to ensure cash is available to meet its financial obligations.
2. Helps in efficient cash management: projected cash flow statement will help on planning and coordinating sources and application of cash.
3. Helps in internal finance management
4. Disclose the movement of cash showing the increase or decrease in cash and hence explaining the decreases or increases of cash
5. Discloses success or failure of cash planning comparison between the projected cash flow statement and the actual cash flow statement will indicate success or failure.

6. Statement of cash flow enhance comparability: as they are not affected by differing accounting policies used for the same type of transactions or events.

10.6.3 Distinguish among operating, investing, and financing activities.

The statement of cash flow is portioned into three segments, namely: cash flow resulting from operating activities, cash flow resulting from investing activities, and cash flow resulting from financing activities.

Operating activities

Operating activities include the production, sales and delivery of the company's product as well as collecting payment from its customers. This could include purchasing raw materials, building inventory, advertising, and shipping the product. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Most of these components will be those items which determine the net profit or loss of the enterprise.

Operating cash flows include (Examples):

- Receipts from the sale of goods or services
- Receipts for the sale of loans, debt or equity instruments in a trading portfolio
- Interest received on loans
- Dividends received on equity securities
- Payments to suppliers for goods and services
- Payments to employees or on behalf of employees
- Interest payments

Investing activities

The cash flows classified under this heading show the extent of new investment in assets which will generate future profit and cash flows.

The standard gives the following examples of cash flows arising from investing activities:

- Purchases or sale of fixed asset (assets can be land, building, equipment, marketable securities, etc)
- Cash payments to acquire shares or loan notes of other entity
- Cash receipts from sales of shares or loan notes of other entities
- Cash advances and loans made to other parties

- Cash receipts from the payment of advances loans and loans made to other parties
- Payments related to mergers and acquisitions

Financing activities

Financing activities include the inflow of cash from investors such as banks and shareholders, as well as the outflow of cash to shareholders as dividends as the company generates income. This is an indicator of **likely future interest and dividend payments**. Other activities which impact the long term liabilities and equity of the company are also listed in the financing activities section of the cash flow statement.

The standard gives the following examples of cash flows which might arise under these headings:

- Proceeds from issuing loans, bonds, mortgages and other short term or long term borrowings
- Payments of dividends
- Payments to owners to acquire or redeem the entity's share of company shares
- Repayment of debt principal, including capital leases
- For non-profit organizations, receipts of donor-restricted cash that is limited to long term purposes.
- Interest payments can also be considered under this activity if not considered under operating activities – However, interest payments of financial institutions should always be classified under operating activities

Items under the financing activities section include:

- Dividends paid
- Sale or repurchase of the company's stock
- Net borrowings
- Payment of dividend tax

10.6.4 Net cash position

This is a difference between the cash inflows and cash outflows. That is the cash at the beginning plus total cash inflows less total cash outflows. When it is with a positive result it is called a **SUPLUS** whereas a negative result is a **DEFICIT**.

How to deal with surplus

Positive cash flow indicates that a company has more money flowing into the business than out of it over a specified period. This is an ideal situation to be in because having an excess of cash allows the company to:

- Expand business activities
- Settle debt payments
- Reinvest in itself and its shareholders
- Acquire new fixed assets
- Increase credit sales and decrease cash sales
- Increase cash purchases and decrease credit purchases

Positive cash flow does not necessarily translate to profit, however. Your business can be profitable without being cash flow-positive, and you can have positive cash flow without actually making a profit.

How to deal with deficit

- Increase cash sales and decrease credit sales
- Increase credit purchases and decrease cash purchases

Net cash flows

It indicates whether a business has enough cash to cover the expected cash payment (surplus) it means cash inflows are greater than cash outflows or not, it means cash outflows are greater than cash inflows.

10.6.5 Components of cash and cash equivalent

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments.

10.6.6 Formats of cash flow statement

The standard offers a choice of method for this part of statement of cash flows.

Direct method: Discloses major classes of gross cash receipts and gross cash payments.

Indirect method: net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing activities.

Direct method discloses information not available elsewhere in the financial statement, which could be of use in estimating future cash flows. However, the indirect method is simpler, more widely used and more likely to be examined.

Direct method

FORMAT
Cash flow statement as at.....

Inflows:		
Sales	XX	
Commission received	XX	
Rent received	XX	
Sales of fixed assets	XX	
Etc	<u>XX</u>	
Total inflows		XXX
Outflows:		
Purchases	XX	
Rent paid	XX	
Purchase of fixed assets	XX	
Etc	<u>XX</u>	
Total outflows	<u>XXX</u>	
NET CASH FLOWS		XXX

NOTE: This format does not to separate operating cash flow, investing cash flows and financing cash flows.

OR
Cash flow statement as at.....

Cash flow from operating activities:		
Cash received from customer	xxx	
Cash paid to suppliers	(xxx)	
Cash paid to employees	(xxx)	
Cash paid to another expense	(xxx)	
Receipt from sale of goods/ services	xxx	
Receipt from sale of loan, debt or equity instrument in trading post folio	xxx	
Interest received on loan	xxx	
Interest paid on loan	(xxx)	
Dividends received	xxx	
Dividends paid	(xxx)	
Net Cash flow from operating activities		xxx
Cash flow from investing activities:		
Purchases of fixed assets	(xxx)	
Sales of fixed assets	xxx	
Loan to suppliers or customers	(xxx)	
Loan from suppliers' or customers	xxx	
Payment related to mergers and acquisition	(xxx)	
Net cash flow from investing activities		XXX
Cash flow from financing activities:		
Payment of dividends	(xxx)	
Net borrowing	xxx	
Sales of shares	xxx	
Purchase of shares	xxx	
Sales of company's stock (stock exchange)	xxx	
Purchases of company's stock	xxx	
Net cash flow from financing activities		XXX
Net increase/ decrease in cash and cash equivalent		XXX
Add: cash and cash equivalent at the beginning		XXX
CASH AND CASH EQUIVALENT AT THE END/ NET CASH POSITION		XXX

EXAMPLE 1

From the following information, prepare cash flow statement (Direct method) as at Dec 31st 2012

	FRW'000'
Opening cash balance (1 st Jan 2012)	500
Cash received from customers	9,250
Cash from sales of buildings	970
Issue of shares	1,200
Cash paid to suppliers	4,320
Cash paid to employees	1,350
Payment of loan	700
Cash paid to another expenses	600
Tax paid	100
Dividend paid	15

SOLUTION

CASH FLOW STATEMENT (DIRECT METHOD)

	FRW '000'	FRW'000'
<u>Cash flow from operating activities</u>		
Cash received from customers	9,250	
Cash paid to suppliers	(4,320)	
Cash paid to employees	(1,350)	
Cash paid to another expense	(600)	
Dividend paid	(150)	
Tax paid	<u>(100)</u>	
Net Cash flow from operating activities		2,730
<u>Cash flow from investing activities</u>		
Cash from sales of building	<u>970</u>	
Net Cash flow from investing activities		970
<u>Cash flow from financing activities</u>		
Payment of loan	(700)	
Issued of shares	<u>1,200</u>	
Net cash flow from financing activities		<u>500</u>
Net increase in cash and cash equivalent		4,200
Cash and cash equivalent at the beginning		<u>500</u>
CASH AND CASH EQUIVALENT AT THE END (NET CASH POSITION)		<u>4,700</u>

Example 2

Mugabo had the following information in 2014:

	FRW '000'
Issue of shares	304,000
Share premium paid	28,400
Payment to creditors	107,380
Acquisition of Plant and machinery	164,000
Disposal of motor vehicles	19,000
Receipts from debtors	84,300
Cash sales	102,000
Cash purchases	55,000

Required: prepare a cash flow statement (Direct method)

Solution

Mugabo Cash flow statement

	FRW '000'	FRW '000'
Cash flow from operating activities:		
Payment to creditors	(107,380)	
Receipts from debtors	84,300	
Cash sales	102,000	
Cash purchases	<u>(55,000)</u>	
Net cash flow from operating activities		23,920
Cash flow from investing activities:		
Acquisition of Plant and machinery	164,000	
Disposal of motor vehicles	(19,000)	
Net cash flow from investing activities		145,000
Cash flow from financing activities:		
Share premium paid		<u>28,400</u>
		<u>197,320</u>



Application activity 10.6

1. Define cash and cash equivalent.
2. Which of the following headings is not classification of cash flow?
 - a) Operating
 - b) Investing
 - c) Administration
 - d) Financing
3. Umuhoza had the following transactions during the year.
 - a) Cash received from customers 32,900
 - b) Cash paid to suppliers 17,950,000
 - c) Cash paid to employees 11,250
 - d) Interest paid 2,100

From the following information, calculate the cash flow from operating activities.

4. Use the following data to construct a statement of cash flows using the direct method.

	2000 FRW	1999 FRW
Cash	4,000	14,000
Accounts receivable	25,000	32,500
Prepaid insurance	5,000	7,000
Inventory	37,000	34,000
Fixed assets	316,000	270,000
Accumulated depreciation	(45,000)	(30,000)
Total assets	<u>342,000</u>	<u>327,500</u>
Accounts payable	18,000	16,000
Wages payable	4,000	7,000
Notes payable	173,000	160,000
Capital stock	88,000	84,000
Retained earnings	<u>59,000</u>	<u>60,500</u>
Total liabilities & Equity	<u>342,000</u>	<u>327,500</u>
	2000	
Sales	200,000	
Cost of goods sold	(123,000)	
Depreciation expense	(15,000)	
Insurance expense	(11,000)	
Wage expense	<u>(50,000)</u>	
Net Income	<u>1,000</u>	

During 2000 declared and paid dividends of FRW 2,500

During 2000, ABC paid FRW 46,000 in cash to acquire new fixed assets. The account payable was used only for inventory. No debt was retired during 2000.

10.7 Accounting records for incomplete information

Activity 10.7



Maurice has a small business buying and selling energy drinks. This business does not write its accounts in double entry form due to lack of accounting skills. Besides, given the size of his business, it is not mandatory for him to keep the books of accounts. Maurice records its cash transaction (not necessarily in a professionally written cash book) and simply lists its debtors and creditors. Only single records are made, important records for conformity to double entry are omitted and therefore incomplete. Figures for credit sales, credit purchases, opening capital etc. are missing.

From the above scenario, answer the following questions:

1. How Maurice Ltd records are called?
2. Is this book-keeping suitable? Justify your answer.

10.7.1 Meaning of accounting for incomplete record or single entry accounting

Single entry accounting may be defined as a system of book keeping in which the dual aspect of transactions is ignored and in which personal accounts only are maintained. It means any system which is single entry system. In the questions based on incomplete records, some information is provided and some missing information is to be found.

Obviously this book-keeping system is unsuitable. It is impossible to extract any trial balance. Financial statements cannot therefore be prepared from information supplied under single entry and incomplete records because some key figures for financial statements preparation are missing and the trial balance cannot be prepared. No set of single rules can be given as short cut to the understanding of the principles involved. These figures are obtained by applying the basic principles of the double entry.

There are two main kinds of the questions based on incomplete records:

- a) Those requiring a computation of profit based on increase in net assets
- b) Those requiring the production of the final accounts from a cash book

The following steps are followed when attempting to re-organize and prepare final accounts/financial statements from single entry and incomplete records.

Step 1

Calculation of the opening capital

In many cases, the sole trader may not know with how much capital he/she started business. The opening capital can be determined by preparing the statement of affairs. A statement of affairs is simply an opening balance sheet.

Step 2

Re-writing the cash book

Sometimes it may be necessary to re-write the cash book professionally in a columnar form applying double entry system. This especially necessary where the closing cash/bank balances are not provided. Re-writing the cash book may also reveal 'hidden' drawings etc. it is also necessary to complete the double entry for all items entered into the cash book.

Step 3

Calculating credit sales and credit purchases

Since in single entry, debtors and creditors are simply listed, credit sales and credit purchases cannot easily be ascertained. There are no purchases or sales A/Cs maintained in a double entry fashion. These key figures can be determined by preparing control accounts. Debtors control account for credit sales and creditors control accounts for credit purchases. In some instances, credit sales and credit purchases could be computed from accounting ratios (mark up and margin).

Example 1

From the following information, calculate credit sales for James for the year ended 31/12/2016.

- 1/1/2016 Debtors' balance FRW 10,000,000
- 31/12/2016 debtors' balance FRW 15,000,000
- Cash received from debtors during the year FRW 12,000,000

Debit	Debtors control account		Credit
	FRW'000'		FRW'000'
Bal b/d	10,000,000	Bal b/d	12,000,000
Credit sales	<u>17,000,000</u>	Credit purchases	<u>15,000,000</u>
	<u>27,000,000</u>		<u>27,000,000</u>

Example 2

From the following information, calculate James's credit purchases for the financial year ended 31/12/2016

- 1/1/2016
- 31/12/2016
- Creditors balance FRW 14,000,000 FRW 10,000,000
- Cash payment to creditors during the year amounted to FRW 20,000,000

Debit	Creditors' control account		Credit
	FRW		FRW'000'
Cash	20,000,000	Bal b/d	14,000'000
Bal b/d	<u>17,000,000</u>	Credit purchases	<u>15,000,000</u>
	<u>30,000,000</u>		<u>30,000,000</u>

Step 4

Adjusting some expense accounts

Some expense accounts may require to be adjusted. This is because in these accounts information is scattered and disorganized. It may occur that in the same case expense account there were prepayments and/ or accruals and cash payments during the year. This scattered information needs to be brought together so that the figures to be posted to the profit and loss account are determined. This step will require opening T Account.

Example 3

Calculate the rent figure to be taken to the P&L A/C from the following information.

	1/1/2026'FRW	31/12/2016 'FRW'
Prepaid rent	300,000	350,000
Rent paid by cheque during the year was 500,000		

Creditors' control account

	FRW		FRW'000'
Bal b/f	300,000	P&L	450,000
Bank	<u>500,000</u>	Bal c/f	<u>350,000</u>
	<u>800,000</u>		<u>800,000</u>

Step 5

Preparation of the trial balance

Previously it was impossible to prepare the trial balance when the entries were single form and some key figures were missing. Having transformed single entry records into double entry, all the ledger accounts created for completion of double entry and cash book are balanced off or closed and together with the previously missing figures for credit sales, credit purchases, opening capital etc, a trial balance can be prepared.

Step 6

Preparation of financial statements

Once the trial balance has agreed, final accounts/financial statements can be prepared. The financial statements that are prepared by sole traders are income statements and balance sheet.

NOTE

In examinations some of the above steps may be omitted especially step V above.

Computing of profit

The net assets basis uses the principles of fundamental accounting equation to build up a set of accounts and to calculate the profit figure. The accounting equation is:

Profit = Increase in assets + drawings – Additional Capital – Increase in other liabilities.

The net worth of a business means the net value of assets which belongs to the proprietor. Any increase in capital represents the increase in net value of assets. If there are no drawings and no additional capital is introduced by the proprietor, then this increase is due to the net profit earned during particular year.

Drawings reduce the value of assets so there are added into assets to find actual profit similarly, an additional capital introduced by the proprietor results in the increase in assets but this has not come about as a part of profit thus it is deducted to arrive at the figure of true profit. Any increase in outside liabilities like bank loan is also deducted

Example 4

The records of UWERA provide the following information for the year ending 31st December 2015.

Capital January FRW 5,600,000

Capital 31st December FRW 8,500,000

Drawings FRW 2,500,000

New capital introduced by UWERA FRW 1,500,000

Calculate UWERA's net profit on the basis of these figures.

$$\text{Profit} = \text{FRW } 2,900 + 2,500 - 1,500 = \text{FRW } 3,900$$

Note: Increase in assets is the increase in capital from 1st January to 31st December 2015.

10.7.2 Final accounts from incomplete records

To prepare the final accounts from incomplete records, the following steps are taken:

- a) Statement of affairs
- b) Reconstruction of accounts

Statement of affairs

In order to find out the opening capital, a statement of affairs is prepared. Total assets and total liabilities are taken into consideration and the difference between these two is taken as capital at the start of accounting period.

Example 5

CYUBAHIRO does not keep proper records of his business transactions but he gives the following information as at 1st January 2016.

	FRW'000'
Balance at Bank	550
Debtors	2,880
Creditors	1,970
Motor vehicle	3,500
Accrued expenses	150
prepayments	90

Required: Prepare the statement of affairs to find his capital as at 1st January 2016.

Answer

STATEMENT OF AFFAIRS AS AT 1ST January 2016

	FRW'000'	FRW '000'
ASSETS:		
Balance at bank	550	
Debtors	2,880	
Motor vehicles	3,500	
Prepayments	<u>90</u>	
		7,020
Liabilities:		
Creditors	1,970	
Accrued expenses	<u>150</u>	
		<u>2,120</u>
Capital as at 1 st January 2016		<u><u>4,900</u></u>

Reconstruction of accounts

From the given information, the missing figures are obtained by reconstructing the control accounts. These accounts are reconstructed by applying the principles of double entry to the available information. Normally, creditors' accounts are prepared to find out the figures of purchases and sales and those are prepared in step IV. The cash or bank account is constructed to find out the balance at bank. Similarly, nominal accounts can be constructed as required.

An important aspect of these accounts is to build up the whole of the answer on simultaneous basis rather than completing one account at a time.

Illustration 6

James is a sole trader and does not maintain a full set of accounting records

The following information regarding his cash and bank transactions was obtained for the year ended on 31st/12/2017.

	Cash FRW '000'	Bank FRW '000'
Receipts		
Cash sales	10,000	30,000
Receipts from debtors	5,000	8,000
Bank loan	-	20,000
Disbursements (payments)		
Cash purchases	2,000	7,000
Payments to trade creditors	6,000	15,000
Electricity	100	200
Rent	500	1,500
Insurance	-	3,000
Drawings	600	1,000

The following information is also relevant

	1/1/2017 FRW'000'	31/12/2017 FRW '000'
Vehicles, cost	20,000	-
Stock	5,000	3,000
Trade debtors	10,000	15,000
Trade creditors	4,000	7,000
Accrued rent	400	200
Prepaid insurance	600	800
Cash	8,000	
Bank	12,000	

The bank loan was obtained on 31/6/2017 and it is at interest rate of 20%p.a. interest for the period accrued.

Vehicle is to be depreciated by 20%p.a. on cost.

Required:

- i) Determine James' opening capital on 1/1/2017
- ii) Write up a cash book
- iii) Prepare a set of final accounts that can be prepared from the above information for the year ended on 31st December 2017.

Answer

**James
Statement of Affairs as at 1/1/ 2017**

	FRW'000'	FRW'000'	FRW'000'
Fixed assets:			
Vehicle, cost			20,000
Current assets:			
Stock		5,000	
Trade debtors		10,000	
Prepaid insurance		600	
Bank		12,000	
Cash		<u>8,000</u>	
		35,600	
Less: current liabilities			
Trade creditors			
Accrued rent		4,400	
Working capital (net Current assets)	4,000		<u>31,200</u>
	400		<u>51,200</u>
Net total assets/ capital employed			<u>51,200</u>
Financed by:			<u>51,200</u>
Opening Capital 1/1/2017			<u>51,200</u>
Capital employed			

James
Cash book

Particulars	Ref	Cash	Bank	Particulars	Ref	Cash	Bank
		FRW '000'	FRW'000'			FRW'000'	FRW'000'
Bal b/d		8,000	12,000	Cash purchases		2,000	7,000
Cash sales		10,000	30,000	Payments to creditors		6,000	15,000
Receipts from debtors		5,000	8,000	Electricity		100	200
				Rent		500	1,500
Bank loan			20,000	Insurance			3,000
				Drawings		600	1,000
				Bal C/d		<u>13,800</u>	<u>42,300</u>
		<u>23,000</u>	<u>70,000</u>			<u>23,000</u>	<u>70,000</u>

Debit	Debtors' control account		Credit
	FRW'000'		FRW'000'
Bal b/d	10,000	Cash	5,000
Credit sales	18,000	Bank	8,000
		Bal c/d	<u>15,000</u>
	<u>28,000</u>		<u>28,000</u>

Debit	Creditors' control account		Credit
	FRW'000'		FRW'000'
Cash	6,000	Bal b/d	4,000
Bank	15,000	Credit purchases	24,000
Bal c/d	<u>7,000</u>		
	<u>28,000</u>		<u>28,000</u>

Debit	Sales account		Credit
	FRW'000'		FRW'000'
Trading a/c	58,000	Cash	10,000
		Bank	30,000
		Debtors' control a/c	<u>18,000</u>
	<u>58,000</u>	Bal c/d	<u>58,000</u>

Debit	Purchases' account		Credit
	FRW'000'		FRW'000'
Cash	2,000	P&L	33,000
Bank	7,000		
Creditors' Control	<u>24,000</u>		
	<u>33,000</u>		<u>33,000</u>

Debit	Electricity account		Credit
	FRW'000'		FRW'000'
Cash	100	P&L A/C	300
Bank	<u>200</u>		
	<u>300</u>		<u>300</u>

Debit	Rent account		Credit
	FRW'000'		FRW'000'
Cash	500	Bal b/d Accrued	400
Bank	1,500	P&L A/C	1,800
Bal c/d (Accrued)	<u>200</u>		
	<u>2,200</u>		<u>2,200</u>

Debit	Insurance account		Credit
	FRW'000'		FRW'000'
Bal b/d	600	P&L A/C	2,800
Bank	3,000	Bal c/d (prepaid)	800
	<u>3,600</u>		<u>3,600</u>

Debit	Drawings account		Credit
	FRW'000'		FRW'000'
Cash	600	Balance sheet	1,600
Bank	<u>1,000</u>		
	<u>1,600</u>		1,600

Debit	Loan interest account		Credit
	FRW'000'		FRW'000'
Interest payable	<u>2,000</u>	P&L A/C	<u>2,000</u>
	<u>2,000</u>		<u>2,000</u>

Debit	Loan interest payable account		Credit
	FRW'000'		FRW'000'
	<u>2,000</u>	Interest	<u>2,000</u>
Bal c/d	<u>2,000</u>		<u>2,000</u>

James
Statement of Profit or Loss for the year ended 31st/7/2017

	FRW '000'	FRW'000'
Sales		58,000
Cost of goods sold:		
Opening stock	5,000	
Add: Purchases	33,000	
Closing stock	<u>(3,000)</u>	
Cost of goods sold		<u>(35,000)</u>
GROSS PROFIT		23,000
Operating expenses:		
Electricity	300	
Rent	1,800	
Insurance	2,800	
Loan interest	2,000	
Depreciation on Vehicle	<u>4,000</u>	
		<u>(10,900)</u>
NET PROFIT		<u>12,100</u>

James
Balance sheet as at 31.12.2017

	FRW '000'	FRW'000'	FRW'000'
FIXED ASSETS:		20,000	
Vehicle		(4,000)	
Acc. Depreciation			16,000
CURRENT ASSETS:		3,000	
Stock		15,000	
Trade debtors		800	
Prepaid insurance		42,300	
Bank		<u>13,800</u>	
Cash		74,900	

CURRENT LIABILITIES:			
Trade creditors			
Accrued rent			
Interest payable (accrued interest)			<u>65,700</u>
Net current assets (W.C.)		<u>9,200</u>	
NET TOTAL ASSETS/ CAPITAL EMPLOYED			<u>81,700</u>
FINANCED BY:			
Opening capital 1/1/2017			51,200
Add: Net profit	7,000		12,100
Drawings	200		<u>(1,600)</u>
Owner's equity	<u>2,000</u>		61,700
LONG TERM LIABILITIES:			<u>20,000</u>
Bank loan			<u>81,700</u>
CAPITAL EMPLOYED			



Application activity 10.7

- When Ossie completed his extended trial balance the totals were:

Statement of profit or Loss columns

Debit	Credit
FRW '000'	FRW'000'
129,685	136,894

Statement of financial position columns

Debit	Credit
FRW '000'	FRW'000'
149,212	142,003

What is Ossie's profit or Loss for the period?

- A A loss of FRW 7,209,000
 - B A loss of FRW 12,318,000
 - C A profit of FRW 7,209,000
 - D A profit of FRW 12,318,000
2. In the last 12 months, Joanna's capital balance increased by FRW 6,798,000. In the year her drawings totaled FRW 14,600,000 and she introduced additional capital of FRW 2,900,000.

What is Joana's net profit or loss for the year?

- a) FRW 4,902,000 loss
- b) FRW 18,498,000 loss
- c) FRW 4,902,000 profit
- d) FRW 18,498,000 profit

Skills Lab

1. Referring to AKEZA ledger accounts (Unit 4.5), prepare a trial balance and a balance sheet.

AKEZA trial balance for

Particulars	debit	Credit
Cash	6,700,000	
Bank	1,500,000	
Land	2,500,000	
Office equipment	2,000,000	
Motor vehicle	15,000,000	
Drawings	800,000	
Capital		20,000,000
Equipment suppliers Ltd		500,000
Loan		8,000,000
Total	28,500,000	28,500,000

2. Referring to the end unit assessment (Unit 5, question 3), prepare AKANYANA Ltd Statement of Profit or Loss and a Statement of financial position.

AKANYANA Ltd's trial balance

Particulars	Debit	Credit
▪ purchases	860,000	
▪ debtors	910,000	
▪ rent	160,000	
▪ electricity	150,000	
▪ bank	3,930,000	
▪ cash	690,000	
▪ returns inwards	140,000	
▪ salaries	310,000	
▪ creditors		350,000
▪ sales		6,700,000
▪ returns outwards		100,000
Total	7,150,000	7,150,000



End of unit assessment

1. Clement's trial balance includes balances for: insurance, trade payables, trade receivables.

Which of the following statement is correct?

- Insurance is a current asset, trade payables is an expense, trade receivables is a current liability
- Insurance is an expense, trade payables is a current liability, trade receivables is a current asset
- Insurance is an expense, trade payables is a current asset, trade receivables is a current liability
- Insurance is a current liability, trade payable is an expense, trade receivables is a current asset.

2. At 31st October 2016 Jane owed her suppliers FRW 13,856,000. During the year to 31st October 2017 she owed FRW 11,552,000.

What was the value of Jane's credit purchases for the year to 31 October 2017?

- a) FRW 70,478,000
 - b) FRW 93,582,000
 - c) FRW 98,190,000
 - d) FRW 121,294,000
3. At 30 November 2013, John's bank current account was overdrawn. He also had a bank loan on which monthly capital repayments were due to commence in February 2015.

How should these balances be reported on his statement of financial position at 30 November 2013?

Bank current account

Bank loan

- a) Current liability Current liability
 - b) Non-current liability Current liability
 - c) Current asset Non-current asset
 - d) Current liability Non-current liability
4. Items that appear in the financial records of a business include: employees' salaries and cash held in the bank

Where should these items ultimately appear in the financial statements?

- a) Both items should appear in the statement of profit or loss
- b) Item (i) in the statement of financial position and item (ii) in the statement of profit or Loss
- c) Both items should appear in the statement of financial position
- d) Item (i) in the statement of profit or loss and item (ii) in the statement of financial position

5. From the following particulars relating to Silas, a sole trader, you are required to prepare his statement of profit or Loss for the year ending 30th June, 2020 and a Balance sheet as on that date.

Trial balance as at 30th June 2020

	DR FRW	CR FRW
Capital		30,000
Motor vehicle	21,000	
Cash in hand	2,500	
Cash at bank	2,400	
Stock at start	5,000	
Purchases	35,000	
Sales		38,000
Salaries and wages	3,500	
Electricity	500	
Postage and telephone	600	
Rent	1,000	
Sundry debtors	7,000	
Sundry creditors		<u>10,500</u>
	<u>18,500</u>	<u>18,500</u>

Stock at 30st June 2020 was valued at FRW 6,000

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