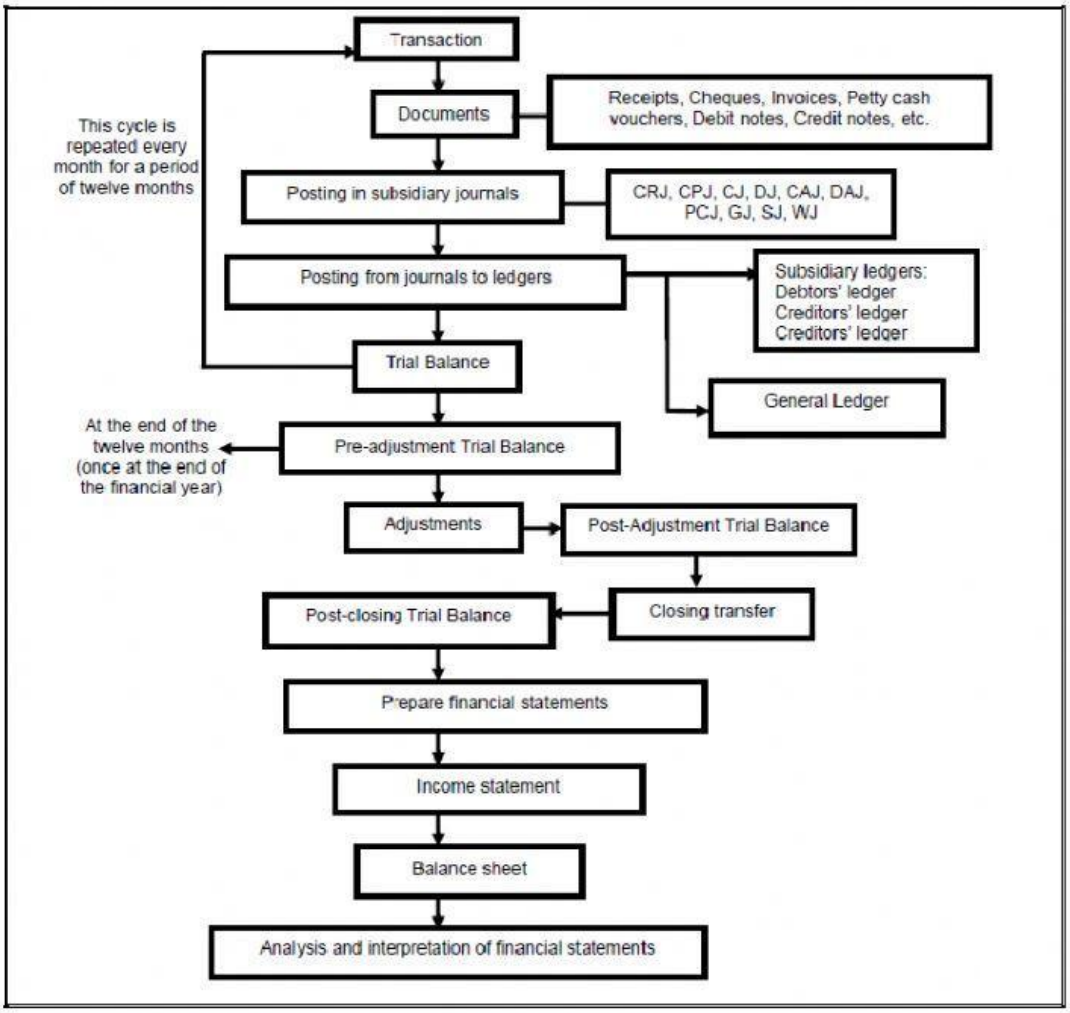
Name

2 Bookkeeping of a sole trader

2.1 The Accounting cycle

The accounting cycle starts with entering data in the source documents and ends with the preparation of Financial statements at the end of the relevant financial period.



The accounting cycle should always be taken into account. The first five steps, namely, the transactions that take place up to preparing a Trial balance will be discussed in this unit. These steps take place every month. At the end of the financial period, Financial statements need to be compiled. This will be discussed later this year.
Let us look at the first five steps.

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Step 1 Transactions

No matter what type of enterprise is started, everything that happens in a business must be recorded. All activities involving monetary value that take place between the business and other enterprises, must at some point be recorded in the books of the enterprise. These activities are known as transactions.

Step 2 Documents

Proof must be given that these transactions have already taken place. The evidence of these transactions is known as source documents. Examples of source documents include receipts, cheques, deposit slips, bank statements, invoices, debit notes and credit notes. The information on these documents must be recorded in the books of the business.

Step 3 Subsidiary books (Journals)

Many recurring transactions take place on a regular basis and therefore businesses use journals to group similar transactions together. A journal is also known as the book of first entry because a journal is the first place a transaction will be recorded in from a source document.

From the different documents, it will be recorded in the following journals:

- Cash Receipts Journal

All the money received will be entered in the Cash Receipts Journal.
Examples: Cash sales of merchandise, rent income, capital contribution by the owner and payments received from debtors.

- Cash Payments Journal

All money paid out by the business per cheque is recorded in the Cash Payments Journal.
Examples: salaries and wages to employees, water and electricity, stationery, payments to creditors, trading licence, bank costs.

- Debtors Journal

To increase your turnover, a business can decide to sell goods on credit. All credit sales will be entered in the Debtors' Journal. An original invoice will be issued to the debtors and the duplicate invoice will be used to enter the transactions in the Debtors Journal.

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Before credit can be granted to a client, the business must ensure that the client is creditworthy. A client is creditworthy when it is likely that he can pay his debt. The credit limit should be set, in other words, the maximum must be determined for which the client may purchase on credit.

For each person who buys on credit from the business, an account is opened. At the end of the month, after all transactions have been posted, a schedule of debtors should be prepared. A schedule shows all the balances owed to the business by debtors at the end of the month. This total should correspond with the balance of the Debtors' control account at the end of the month in the General Ledger

- Debtors' Allowances Journal

When goods are sold on credit, the buyer can decide to return the goods or demand an Allowances on the amount owed. The business must investigate the reason why the goods were returned or why an Allowance is demanded. When Allowances is demanded, goods are not returned to the business. This means that the cost price of the goods sold is not affected (Leave the Cost of sales column open).
All duplicates of credit notes are used to make entries in the Debtors' Allowances Journal.

- Creditors Journal

There might be a need in the business to keep cash in the bank in order to receive interest, and to make credit purchases. If a business wants to make purchases on credit, it must decide on suppliers who ask the best prices and offer the best credit period.

If the business buys on credit, it will receive the original invoice together with the purchase. As different suppliers are used, the invoices will have different numbers. This implies that the invoices should be re-numbered so that the credit purchases can be numbered in number sequence in the business's books. Re-numbering is done according to the dates of the invoices. The original invoices will be used to enter the transactions in the Creditors' Journal.

For each credit provider where the business buys on credit, an account is opened. At the end of the month, after all transactions have been posted, a schedule of creditors should be prepared. A schedule shows all the balances that the business owed to creditors at the end of the month. This total should correspond with the Creditors' control account at the end of the month in the General Ledger.

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- Creditors' Allowances Journal

If trading stock, assets and consumable stores are bought on credit, they can be returned to the trader. Reasons may include:

a The wrong trading stock was delivered.

b The trader did not give trade discount on the invoice.

Example: When trading stock is returned or discount is demanded, a debit note is issued to the trader. The original debit note is sent to the trader and the duplicate debit note (source document) is used to record the transaction in the Creditors' Allowances Journal. The trader will send a credit note to the business in recognition of reception of the debit note and that the business' account will be altered accordingly.

- Petty Cash Journal

The Petty Cash Journal is used to make small cash payments. Each payment that occurs is written down on a petty cash voucher (source document) and authorised by the petty cash cashier and a senior manager of the business. Where possible, all external source documents should be attached to the petty cash voucher.

- General Journal

All other transactions that are not recorded in the above mentioned journals will be entered in the General Journal.

Step 4 Ledgers

The summarised information in each journal is entered in the relevant ledger accounts. For each debtor a debtor' ledger account needs to be opened and for each creditor a creditors' ledger account needs to be opened.

Step 5 Trial balance

A Trial balance is a list of entries made on the debit and credit sides of the ledger accounts. A Trial balance is prepared at the end of each month.

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2.2 Inventory systems

There are two ways in which a business can keep record of the inventory in the business, namely the continuous inventory system or the periodic inventory system. Which system should be chosen and which system is the better?

The system used depends on the nature of the business, the type of goods sold and the level of computerisation in the business. A continuous inventory system allows a business to keep record of the stock levels of the various items sold by the business. This method is especially suited for a business that sells goods that are easily identifiable and measurable or of which the value could easily be determined. The use of scanners or bar codes makes it much easier for these businesses to calculate inventory. If a business sells goods that are not easily identifiable or measurable, or of which the value cannot be easily determined (e.g. a cafe), it should use the periodic inventory system. In grade 10 you have to know the continuous inventory system and in grade 11 the periodic inventory system.

2.3 Subsidiary books/ journals

2.3.1 Cash Receipts Journal

Explanation of Cash Receipts Journal:

(This explanation must be studied together with the example on the next page)

1. Name of the subsidiary journal, name of the business and the month in which the journal was prepared.
2. Folio reference number of the Cash Receipts Journal.
3. The relevant source document number.
4. The specific day of the relevant month (heading May 2010).
5. This column shows the source of the relevant receipt.
6. For each debtor there needs to be a separate account in the Debtors' Ledger. A folio number will be used to indicate the account the amount will be posted to in the Debtors' Ledger.
7. The analysis column shows the breakdown of the individual amounts received as a separate receipt.
8. The bank column shows the total amount received for the day. This amount will be deposited into the business's bank account.
9. This column contains the selling price of trading stock sold for cash.
10. This is a non-cash item but is included in the Cash Receipts Journal to allow for the regular updating of the trading stock account.

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11 Total amount which the debtors account will be credited (decreases). This amount will be the amount received from the debtor plus discount allowed.

12 This is a non-cash item but is included in the Cash Receipts Journal to see the discount allowed to debtors.

13 If there is no specific column for a transaction the sundry account column is used for the transaction.

14 The amount received.

15 The folio number will be used to indicate the account the amount will be posted to in the General Ledger.

16 The account in the General Ledger

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Calculating selling price and cost of sales

Example 1

If a business sells goods for R24 000 and the profit margin is 50%, determine the cost price.

A formula is always used. Always set the cost price equal to 100%.

Cost price + profit margin = selling price

CP + P = SP

100% + 50% = 150%

Golden rule: The amount you are looking for is always on top (the numerator of the fraction).

In this example we want to determine the cost price. This price (cost price) is on top – the price that is known goes at the bottom, multiplied by the amount.

$$\frac{CP\%}{SP\%} \times \frac{Amount}{1}$$

$$\frac{100\%}{150\%} \times \frac{R24\,000}{1}$$

= R16 000 is the cost price (purchased price)

Example 2

If a business purchases goods for R30 000 and the profit margin is 25%, calculate the selling price.

Use the formula:

CP + P =SP

100 + 25 = 125

Golden rule: The amount you are looking for goes on top.

$$\frac{125}{100} \times \frac{R30\,000}{1}$$

=R37 500 is the selling price

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If a business sells goods for R60 000 and the cost price is R40 000, calculate the profit margin.

To determine the percentage, the selling price percentage should be determined as we know that the cost price percentage is 100%. To get a percentage, multiply by 100.

$$\frac{R60\,000}{R40\,000} \times \frac{100}{1}$$

= 150% (selling price percentage)

To determine the profit margin = 150% - 100% = 50%

Activity4 (Calculation of selling price, profit margin and cost price)			
Complete the table below by calculating the correct amounts/percentages. Each calculation is independent and does not follow on the previous one.			
No.	Selling price	Profit margin	Purchase price (cost)
1	R20 800	100%	R?
2	R80 000	?	R50 000
3	R?	33⅓%	R12 000
4	R45 000	60%	R?
5	R9 600	?	R8 000
6	R?	66⅔%	R150 000

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