

# **INTRODUCTORY FINANCIAL ACCOUNTING**

## **Topics to be covered:**

**Nature and purpose of accounting**

**Recording of data in the accounting records**

**Functions of the general ledger**

**Preparation of simple financial statements**

**Recording cash transactions**

## **1.0 EXPLAIN THE NATURE OF ACCOUNTING SYSTEMS**

### **1.1 Explain accounting and its purpose**

Accounting is the process of recording, classifying, summarizing, reporting, analyzing and interpreting information about the economic activities about an organization. This information is used by decision makers during the stewardship of their organisation.

The purpose of accounting is to provide financial information to the major stakeholders for decision making. The main decision makers are:

- Managers
- Directors
- Investors
- Suppliers
- Government agencies
- Employees

Financial information is usually provided in the form of reports which are:

- Income Statement (Income and Expenditure Account if it's nonprofit making organisation)
- Balance Sheet
- Cash Flow Statement

### 1.1.1 Definitions or explanations

**Income statement** is a statement that shows the financial performance of an organisation during a given period. It compares revenue earned during the period against the expenses incurred in earning the stated income.

- **Revenue** will be the monetary value of goods and services that has been delivered to the customers.
- **Expense** will be the monetary value of resources that have consumed in the delivery of goods and services.

**Balance Sheet** is a statement that shows the financial position of an organisation at a specific date. It shows the assets, capital and liabilities of an organisation.

- **Assets** are resources owned by an organisation. Assets can be divided into two categories which are **fixed assets** and **current assets**
- **Capital** is resources introduced into the business by the owners. For non –profit making organisation it will be contribution that has been made by the membership.
- **Liabilities** are resources owed by an organisation to other parties. Liabilities may be divided into two categories that are **long – term - liabilities** and **current liabilities**.

**Cash Flow Statement** is a statement that shows the cash movement. That is shows where the money of the organisation came from and where it went to.

Accounting is mainly divided into two branches which are;

- Financial Accounting
- Management Accounting
  
- **Financial Accounting** is mainly concerned with providing information to internal and external consumers through financial statements that have been explained earlier.
  
- **Management Accounting** is mainly concerned with providing information to management for planning and control. This wills reports such as budgets, performance and activity reports.

#### Activity 1

1. *Briefly explain accounting and its purpose.*
  
2. *What are the three financial statements that are produced from the accounting activities? Briefly explain each one of them.*
  
3. *Explain the following terms: asset, capital, liabilities, revenue and expense.*

## **2.0 DATA COLLECTION AND RECORDING IN THE ACCOUNTING RECORDS**

Production of financial information through financial statements is based on systematic and routine based activities. Financial data is based on economic activities of an organisation which is recorded according to the accounting requirements. Recording of data is based on the **accounting equation**.

### **2.1 ACCOUNTING EQUATION**

**Assets = Capital + Liabilities**

The three terms of the accounting equation have already been explained earlier. As organisations continue with their daily operational activities, those activities would always be classified under any of the items of the accounting equation. In recording the activities or collection of financial data organisation, it must be insured that the accounting equation continue to balance.

Data recorded should have documentary evidence. This means that the source which data was extracted from should be tangible.

**Example:**

B. Thabiso is setting up a new business. In starting a new business, he contributed a total cash of P150 000 into the business.

**AEQ 1.**

**ASSETS = CAPITAL + LIABILITIES**

**Cash**

P150 000 = P150 000 + 0

The accounting equation status is maintained because the cash that has been contributed into the business becomes the asset of an organisation and also the capital.

**AEQ 2.**

Thabiso bought building for P75 000, furniture for P20 000 and motor van for P40 000.

**ASSETS = CAPITAL + LIABILITIES**

**Cash Building Furniture Motor van**

P15 000 P75 000 P20 000 P40 000 = P150 000 + 0



|                       |               |                        |
|-----------------------|---------------|------------------------|
| Building              | 75 000        |                        |
| Furniture             | <u>20 000</u> | P135 000               |
| <b>Current Assets</b> |               |                        |
| Cash                  | <u>65 000</u> | <u>65 000</u>          |
|                       |               | <b><u>P200 000</u></b> |
| <b>Financed by:</b>   |               |                        |
| Capital               |               | P150 000               |
| Liabilities           |               | <u>50 000</u>          |
|                       |               | <b><u>P200 000</u></b> |

The balance sheet as reflected above indicates the type of assets the organisation owns and how those assets have been financed.

## ACTIVITY 2

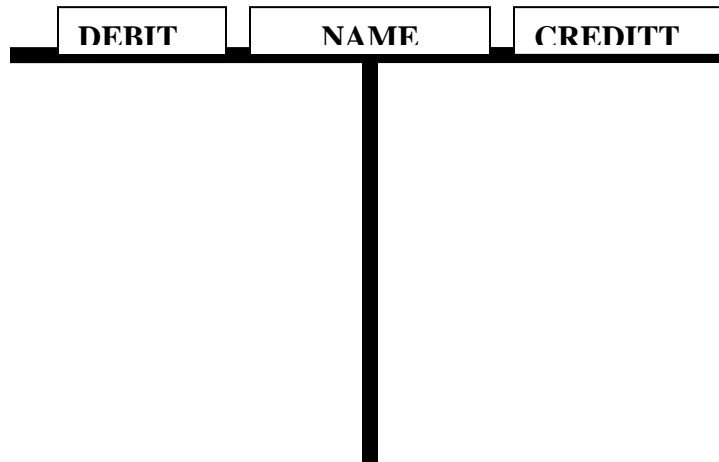
From the following information, you are required to complete the accounting equation and the balance sheet.

Thabo Kalake is starting a business. Before actually starting to sell anything, he bought fixtures for P2 000, a motor vehicle for P5 000, and stock of goods for P3 500. Although he has paid in full for the fixtures and the motor vehicle, he still owes P1 400 for some of the goods. J. Preston lent him P3 000. Kalake, after the above, has P2 800 in the business bank account and P100 cash in hand.

## 2.2 RECORDING DATA

Data is collected in the records using an account system that is each activity has its unique record. This record is called an **account**.

**An account is a detailed history of an item.** It is usually structured in a T format. It has the left hand side and right hand side. The **left hand side** is called a **debit** and **right hand side** is called a **credit**.



The challenge will be when to enter the transaction on the debit side or on the credit side. However there are basic principles that would normally assist on how to decide.

**Basic principles:**

**Assets are:**

- Increased by debit entry
- Decreased by credit entry

**Liabilities are:**

- Increased by credit entry
- Decreased by debit entry

**Capital is:**

- Increased by credit entry
- Decreased by debit entry

**Revenue is**

- Increased by credit entry
- Decreased by debit entry

**Expenses are:**

- Increased by debit entry
- Decreased by credit entry

*Activity 3*

State which account will be a debited and will be credited.

- a. Started business with P6 000 and paid it into bank account  
DR.....CR.....
- b. Paid rent for a month of P100 by cheque  
DR.....CR.....
- c. Purchased fittings for P1 200 cheque  
DR.....CR.....
- d. Paid for refrigerators P700 by cheque  
DR.....CR.....
- e. Purchased motor van P2 000 paid by cheque  
DR.....CR.....
- f. Paid for motor insurance P55 by cheque  
DR.....CR.....
- g. Borrowed P2000 cash from the bank  
DR.....CR.....
- h. Cash sales DR.....CR.....
- i. Banked P600.DR.....CR.....

### 2.3 Double Entry System

As noted in the above activity that every transaction would affect two accounts. This is called the **double entry system** which is meant to maintain the accounting equation. In any bookkeeping entries, the double entry system should be observed at all times.

## **3.0 PERFORM THE ACCOUNTING FUNCTIONS FOR GENERAL LEDGER TRANSACTIONS**

### **3.1 Books of Accounts**

There are two main books in the accounting system these are:

- General Journal
- General Ledger

**General journal** is the original book of entry. Information recorded on this book is usually extracted from the source documents such as invoices, receipts, contracts agreements and many other relevant documents. It would usually show the account to be debited and credited and short description on the transaction. Information on this book will be posted to the ledger.

### General Journal format

| DATE | ACCOUNT<br>/NARRATION | DR | CR |
|------|-----------------------|----|----|
|      |                       |    |    |

### Example:

On the 7<sup>th</sup> July 2005 Kagiso started business with P4 000 which deposited into the bank.

| DATE        | ACCOUNT<br>/NARRATION | DR     | CR |
|-------------|-----------------------|--------|----|
| 7 July 2005 | Bank                  | P4 000 |    |

|  |  |  |        |
|--|--|--|--------|
|  | <p>Capital</p> <p>Being money introduced into the business by the owner.</p> |  | P4 000 |
|--|--|--|--------|

**General ledger** is the main book of accounts. This is the book where all the accounts are kept. Each account maintained in this book will contain specifically information that relates to that particular item alone. Information will generally be from the journal.

**Example:**

**BANK**

| DATE     | DETAILS | FOLIO | AMOUNT | DATE | DETAILS | FOLIO | AMOUNT |
|----------|---------|-------|--------|------|---------|-------|--------|
| 07/07/05 | Capital | GJ 1  | P4 000 |      |         |       |        |

**CAPITAL**

| DATE | DETAILS | FOLIO | AMOUNT | DATE     | DETAILS | FOLIO | AMOUNT |
|------|---------|-------|--------|----------|---------|-------|--------|
|      |         |       |        | 07/07/05 | Bank    | GJ 1  | P4 000 |

**3.2 BALANCING OF ACCOUNTS**

Balancing of accounts means adding the entries on both sides of the account in order to determine the outstanding amount of each item.

| DR       |         |       |                      | BANK |         | CR    |                      |
|----------|---------|-------|----------------------|------|---------|-------|----------------------|
| DATE     | DETAILS | FOLIO | AMOUNT               | DATE | DETAILS | FOLIO | AMOUNT               |
| 07/07/05 | Capital | GJ 1  | <u>P4 000</u>        |      | Balance | c/f   | <u>P4 000</u>        |
|          |         |       | <b><u>P4 000</u></b> |      |         |       | <b><u>P4 000</u></b> |
|          | Balance | b/f   | P4 000               |      |         |       |                      |

| DR   |         |       |                      | CAPITAL  |         | CR    |                      |
|------|---------|-------|----------------------|----------|---------|-------|----------------------|
| DATE | DETAILS | FOLIO | AMOUNT               | DATE     | DETAILS | FOLIO | AMOUNT               |
|      | Balance | c/f   | <u>P4 000</u>        | 07/07/05 | Bank    | GJ 1  | <u>P4 000</u>        |
|      |         |       | <b><u>P4 000</u></b> |          |         |       | <b><u>P4 000</u></b> |
|      |         |       |                      |          | Balance | b/f   | P4 000               |

The balance brought forward (b/f) under each account indicates the amount that would still be outstanding that is it could be:

- The amount or value of a property owned if it is an asset.
- Total amount or value of resources introduced/contributed into the business by the owners if it is capital.
- Total value of resources owed to other parties if it is a liability.
- Total monetary value of resources consumed if it is an expense.
- Total amount of income earned if it is revenue.

### 3.3 EXTRACTING THE TRIAL BALANCE

After balancing all the accounts, it will be necessary to check if the double entry system has been observed or no errors have been committed. This is achieved by extracting the trial balance. This is done by listing all the balances that have been brought forward (b/f) under each account. The balances are listed as they appear that is DR or CR. The total of

the debit balances should equal the total of the credit balances. If the totals are not equal, this would mean that there is an error somewhere in the accounts.

Simple trial balance from the above two accounts will appear as below.

**Trial balance as at 7 July 2005**

| <b>Account Name</b> | <b>DR</b>    | <b>CR</b>    |
|---------------------|--------------|--------------|
| Bank                | P4 000       |              |
| Capital             |              | P4 000       |
| <b>Total</b>        | <b>4 000</b> | <b>4 000</b> |

**4.0 PREPARE SIMPLE FINANCIAL STATEMENTS**

Financial statements that would normally be prepared for non profit making organization will be **Income and Expenditure account** and the **balance sheet**. However, some organizations may engage in some revenue generating activities such as catering activities. In such cases, the organization may have to prepare an **income statement** as trading activity to determine if it is profitable enough.

***EXHIBIT***

**Income and Expenditure Account for the period ending 30 September 2005**

**Income**

Subscriptions P4 000

|                          |              |                      |
|--------------------------|--------------|----------------------|
| Donations                | 30 000       |                      |
| Sponsored walk           | <u>2 000</u> | <u>P36 000</u>       |
| <b>Expenditure</b>       |              |                      |
| Stationery               | 200          |                      |
| Motor expenses           | 500          |                      |
| Donations                | 1500         |                      |
| Wages and salaries       | <u>1000</u>  | <u>(32 000)</u>      |
| <b>Surplus/(Deficit)</b> |              | <b><u>P4 000</u></b> |

#### ACTIVITY 4

- a) Write up the appropriate ledger accounts for the following entries which relate to the business of Sam Barker who owns a do-it-yourself store.
1. Opening balance at bank P5, 321.
  2. Sold goods to J. Green for P65, allowed one month to pay.
  3. Purchased goods from the Timber Supply Co. Ltd for P974 on usual trade terms (net monthly).
  4. Drew cash from bank P142 for wages.
  5. Sold goods for cash P74.
  6. Returned some goods to Timber Supply Co. Ltd as poor quality valued at P38.

7. Sold goods on credit to Ace Hotel Co. Ltd P350.
  8. j. Green paid P25 on account
  9. Sold goods for cash P214.
  10. Paid cheque for repairs to shop P27.
  11. Sold goods for cash P118.
  12. Banked P250 cash.
  13. Paid cheque P2,000 for sawing equipment
  14. Sold goods to SBS (Decorators) Ltd P110 on credit terms.
  15. Paid delivery expenses on goods to SBS (Decorators) Ltd cash P14.
  16. Drew cash from bank P158 for wages.
- b) After completing the entries, bring down the balances on all the accounts and draw up a trial balance. For this purpose, you are informed that the opening balance of assets amounted to P4, 792. There were no outstanding liabilities at the beginning of the period.
- c) How much capital did Sam Barker have at the commencement of this period?
- d) How much does the business owe at the end of this period?
- e) How much is owed to the owed to the business at the end of the period?

## **5.0 PERFORM THE ACCOUNTING FUNCTIONS FOR CASH TRANSACTIONS**

### **5.1 What are cash transactions?**

Cash transactions are those organization's financial activities that relate to cash or bank involvement. Cash is classified as a readily consumable commodity which means it requires high level of security. To provide high level security, it is therefore necessary to have a separate book of accounts that would record all the cash activities undertaken by an organization.

The necessary book for recording cash transactions is the **cash book**. The cash book will generally take the role of both the general journal and general ledger.

**Cash Book Format**

| DEBIT |         |       | CASH BOOK |      |      |         | CREDIT |      |      |
|-------|---------|-------|-----------|------|------|---------|--------|------|------|
| Date  | Details | Folio | Cash      | Bank | Date | Details | Folio  | Cash | Bank |
|       |         |       |           |      |      |         |        |      |      |

This cash book format displayed above is actually the combination of the cash account and bank account as one would find them in the general ledger.

**Exhibit**

| DEBIT |         |       | CASH BOOK |      |      |         | CREDIT |      |      |
|-------|---------|-------|-----------|------|------|---------|--------|------|------|
| Date  | Details | Folio | Cash      | Bank | Date | Details | Folio  | Cash | Bank |
|       |         |       |           |      |      |         |        |      |      |

|       |           |     |            |              |       |         |     |            |              |
|-------|-----------|-----|------------|--------------|-------|---------|-----|------------|--------------|
| Aug 1 | Balance   | b/f | 200        | 5 000        | Aug 5 | Rent    |     |            | P1000        |
| 7     | Donations |     |            | 40000        | 7     | Petrol  |     | P50        |              |
|       |           |     |            |              | 15    | Wages   |     |            | 3 000        |
|       |           |     |            |              |       | balance | c/f | <u>150</u> | <u>42000</u> |
|       |           |     | <u>200</u> | <u>45000</u> |       |         |     | <u>200</u> | <u>45000</u> |
|       | Balance   | b/f | 150        | 42000        |       |         |     |            |              |

## 5.2 Bank Reconciliation Statement

Bank reconciliation statement is a report that reflects the causes of the difference between the cash book bank balance and bank statement bank balance. It is prepared as part of the internal control system over cash in the bank.

The process will be:

- Identify those transactions that appear in both the cash book and the bank statement. This will isolate those that do not appear in both documents.
- Update the cash book with those items that appear in the bank statement but not in the cash book which are not in error.
- Prepare the bank reconciliation statement.

### Exhibit:

#### Bank Reconciliation Statement as at 30 September 2005

Balance as per updated cash book

P15 000

|  |            |                |
|--|------------|----------------|
| Add : unpresented cheques                  |            |                |
| Cheques # 10081                            | P1300      |                |
| 10083                                      | <u>750</u> | <u>2 050</u>   |
|  |            | 17 050         |
| Deduct : deposits not yet credited by bank |            |                |
|  |            | <u>(1 020)</u> |
| Balance as per bank statement              |            |                |
|  |            | <u>P16 030</u> |

### Activity 5

Gabane Boipelego project is a community based project which has been established by members of the village. The purpose of the project is to provide service or assistance to the various disadvantaged or challenged members of the village. It raises funds from various activities and requests from other philanthropist organisations and government.

During the month of May 2005, it embarked on the following economic activities.

- May 02: Cash book showed a bank balance P15 000 and cash in the till was P500.00.
- 04: Received donations of P50 000 from international organisation which they immediately paid into the bank.
- 05: Bought computer for office use for P6 000.00.
- 06: Bought goods worth P10 000.00 paying by cheque and donated them to the various disadvantaged members of the community
- 07: Bought stationery for office P50.00 cash
- 10: Paid for petrol P200.00 cash
- 13: Paid Printers Botswana P150.00 for printing dinner fund raising tickets.
- 18: Bought clothes and other material P5 000.00 paying by cheque to be donated to the orphans and elderly.
- 20: Bought grocery for the dinner fund raising activity for P400.00.
- 22: Paid P200.00 for the dinner dance venue.

- 23: Received P1500.00 for the sale of dinner dance tickets.
- 25: Paid monthly rental of P2 000.00 for their offices.
- 27: Paid wages and salaries of P6 000.00 then three employees.
- 30: Paid water P50.00 cash and P100.00 for electricity.

You have been engaged as an accounts officer of the Gabane Boipelego project. As an accounts officer you are required to:

- i) Record the above transaction in the cash book.
- ii) Prepare a small profit and loss account which indicates whether the dinner dance made any profit.
- iii) A report to the donors that reflects how the P50 000.00 that was received earlier in the month was used. The funds donated are intended to fund assistance to the needy and operating expenses.
- iv) Consolidated profit and loss account and balance sheet for the project.