



Economics and Management Sciences: EMSC4

LESSON 16

Unit Standard: 13999

TOPIC: EXPLAIN THE CYCLE OF RECORDING TRANSACTIONS AND RELEVANT TERMINOLOGY

NB: At the end of this lesson you must be able to:

- 1. Explain accounting transactions**
- 2. Explain accounting terminology (Assets, Liabilities, Owners Equity, Income, Expenditure, Receipts, Payments, and Profit etc.)**
- 3. Explain and demonstrate the cycle of recording transactions. (Subsidiary Journals, Léger accounts, Trial Balances, Final Accounts)**

1. ACCOUNTING TRANSACTIONS ARE EXPLAINED

- Accounting-is the recording of transactions, calculation of profit and losses, and communication of results.
- Transaction-is a business event having a monetary impact on the financial records of a business/buying of goods and services. Transactions are recorded in the accounting records of a business in a particular accounting period (12 months).An example is sale in cash or credit to a customer.

2. ACCOUNTING TERMINOLOGY IS EXPLAINED

- Assets-are something the business OWNS and it is either in cash or can be sold. It consists of Noncurrent and current assets.
- Non-Current assets-are valuables (Assets) kept for a long period of time that is more than a year. These assets are divided into tangible/Fixed assets and financial assets.



- Tangible assets-are physical assets (can be touched), kept and used to run the business for example, Land and buildings, Vehicles, Equipment, Tools, Machinery etc.
- Financial assets-are investments in financial institutions for example fixed deposits.
- Current assets- are assets that are cash or can be changed into cash quickly for example inventories/trading stock, Trade and other receivables (Debtors, Prepaid expenses and Accrued income), Cash and cash equivalents (Bank, Petty cash, Cash float, Savings account).
- Liabilities-are money owed to other businesses. They are divided into Noncurrent and Current liabilities.
- Non-current liabilities are debts that will **not** be repaid within the next twelve months for example mortgage loan.
- Current liabilities-are debts that **will be** repaid within the next twelve months. For example:
- Trade and other payables-creditors, accrued expenses etc.

BANK OVERDRAFT-THE ABILITY TO DRAW MORE MONEY IN A BANK ACCOUNT THAN YOU HAVE.

- Expense- are the cost of running a business for example electricity, water, rates and taxes, wages, salaries etc.
- Income/Gain-is the income earned after selling goods and services.
- Owners' equity-is the value/worth of the business/what is due to the owner(s).For example an owner contributes (invest) capital (money or fixed assets) to the business, and in turn the business has borrowed the money (capital) and it will pay it back one day and the owner is entitled to earn profit after drawings have been settled.
- Receipt-money that the business receives after a transaction for example selling a good or service cash or on credit.
- Payments-money taken out of the business to pay for something for example buying stationery.



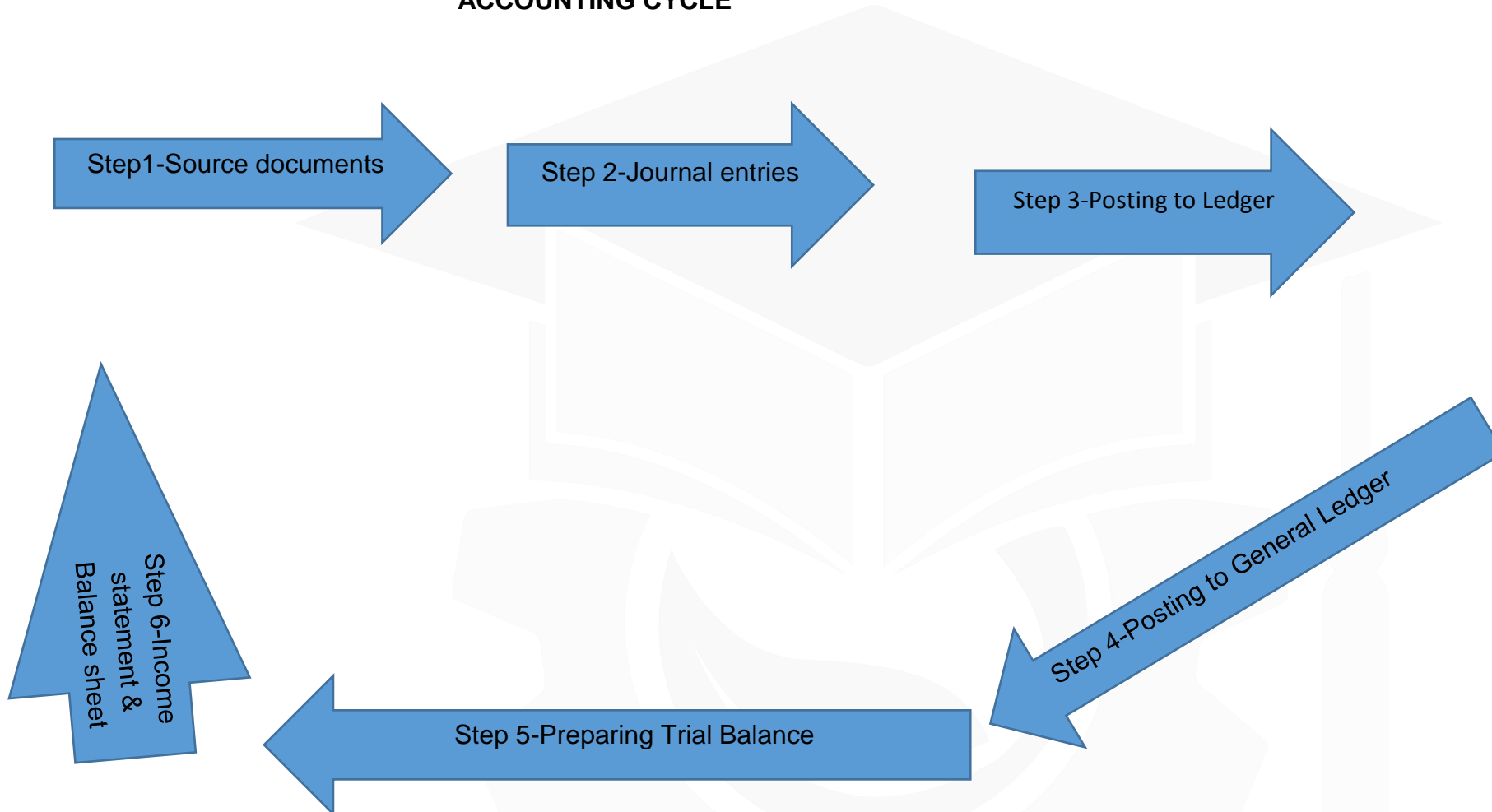
- Accounting equation-assets must be equal to equity and liabilities





3. THE CYCLE OF RECORDING TRANSACTIONS

ACCOUNTING CYCLE





- Source documents- are used to record the transaction in the subsidiary books (books of prime entry). All transactions must have a source document.
- Subsidiary journals-is where daily transactions are recorded for example Cash receipts, Cash payments, Creditors, Debtors etc.
- Ledger accounts- has an account (page) for each asset, liability, expense and gains which summarises the daily transactions entered in the journals .That is, after closing off subsidiary journals at the end of every months ledger accounts are prepared.
- Trial balance-takes all the closing accounts balances from the general ledger and put them according to assets, equity and liabilities in a manner that the credit side will equal the debit side. The trial balance is divided into nominal account section (trading section) and balance sheet section (assets, equity and liabilities).
- Income statement/Statement of comprehensive income-records transactions from the trial balance that belongs to the operation of the business (nominal income section) to determine profit or loss.
- Balance sheet-shows how assets, equity and liabilities were employed and it is derived from the balance sheet section of the trial balance.
- The basic rules of accounting -Assets and expenses have a debit (left side of ledger account) and equity and liabilities have a credit balance (right side of a ledger account).
- A transaction must be debited and credited (double entry) this happens when for example the owner deposit R10 00 as capital to his business, a capital account will be credited by R10 000 meaning it is an investment to the business, and it is an equity, and the bank account of the business will be debited, this is an asset in the form of money that the business has received.
- Assets increase on the debit side and decrease on the credit side, we are continuing with the above example, the business has received R10 00 cash (asset) it will be recorded on the debit side (left side) this indicates that the business has now R10 000 cash and because it is treated as an asset it is debited.
- Equity and liabilities increase on the credit side and decrease on the debit side, still on the example above, the owner has contributed R10 000 as capital, we are going to credit (right side) the capital account this indicates that equity has increased by R10 000.



This is further illustrated below using the ALEGO box:

	Debit	Credit
A(assets)	+ (increase)	-(decrease)
L(liabilities)	- (decrease)	+ (increase)
E(expenses)	+ (increase)	- (decrease)
G(gains/income)	- (decrease)	+ (increase)
O(owners' equity)	Drawings (decrease)	Capital (increase)

ILLUSTRATIVE EXAMPLE OF ACCOUNTING EQUATION (A = E + L)

Transactions

1. The owner B. Nkosi' deposited R60 000 in the current account of the business as his capital contribution.
2. Paid Sparo properties R2 000 by cheque for rent of the building.
3. Purchased a motor vehicle from Hatfield VW on credit for R40 000.
4. Sold goods for cash R10 000 (cost price R6 000).
5. Mr Nkosi paid his personal phone account of R450 with a business cheque.



Required: record transactions in the answer book as follows: document no, source document type, account to be credited, account to be debited, the effect on the accounting equation and the brief explanation.

No.	Source document	Account to be debited	Account to be credited	Assets	Explanation	Equity (owners)	Explanation	Liabilities	Explanation
1	Receipt	Bank	Capital	+R60 000	Bank increases	+R60 000	Capital contribution		
2	Cheque counterfoil	Rent paid/expense	Bank	-R2 000	Bank decreases	-R2 000	Rent expenses		
3	Invoice	Vehicle	Creditors	+R40 000	Vehicles increased	-		+R40 000	Creditors increased
4	Cash register roll	Cost of sales	Trading stock	-R6 000	Stock decreased	-R6 000	Cost of sales	-	
4	Cash register roll	Bank	Sales	+R10 000	Bank increase	+R10 000	Sales		
5	Receipt	Drawings	Bank	-R450	Bank decreases	-R450	Drawings		
			Total	R101 550	=	R61 550	+	R40 000	



Total for Assets =R101 550 Equity and liabilities =R101 550 (R61 550 + R40 000)

Activity 1

Study the trial balance below and answer the questions that follows.

THANDA-BANTU TRADERS TRIAL BALANCE ON THE 31 DECEMBER 2012

	DEBITS	CREDITS
BALANCE SHEET ACCOUNTS SECTION		
CAPITAL		250 000
DRAWINGS	12 000	
LAND AND BUILDING	75 000	
EQUIPMENTS	65 000	
VEHICLES	92 000	
TRADING STOCK	35 000	
DEBTORS	16 000	
BANK	10 000	
CREDITORS		30 000



NOMINAL ACCOUNTS SECTION		
SALES		100 000
COST OF SALES	45 000	
RENT INCOME		12 000
COMMISSION INCOME		7 000
SALARIES AND WAGES	30 000	
STATIONARY	2 000	
TELEPHONE	6 000	
RENT EXPENSE	11 000	
TOTALS	399 000	399 000

- 1.1. Identify any three (3) amounts that are on the debit side under the balance sheet section. (3)
- 1.2. How much capital was contributed in the above trial balance? (1)
- 1.3. Name two accounts that are classified as owners' equity. (2)
- 1.4. Identify two (2) expenses. (2)



1. The owner deposited R50 00 directly into the bank account of the business as his capital contribution.
2. Bought trading stock to the value of R35 00 and paid by cheque. Received R30 000 loan from African bank.
3. Paid R2000 rent to City property for rental of business premises for May.
4. Sold goods on credit to the value of R700 to Sello Traders.
5. Paid R10 000 to African bank as part payment of a loan that was made at the beginning of the financial year.
6. Bought stationery from BB stationers and paid R600 cash.
7. Sold goods for R1200 (cash) and the cost of sales was R700.
8. Received R700 from a debtor MR Bopape in settlement of his account.
9. The owner took stock to the value of R3000 for personal use.
10. Bought a new cash register roll and paid R2000 cash.